

Limits on Executive Compensation

Summary of Title VII, Section 7001 (American Recovery and Reinvestment Act of 2009)

On February 17, 2009 President Obama signed the American Recovery and Reinvestment Act of 2009 (ARRA of 2009). This act is more commonly known as the Stimulus package or the Stimulus bill. The main purpose of the act is to stabilize the US economy with a large injection of federal funds. However, the ARRA of 2009, does also address issues with the “Trouble Asset Relief Program” (TARP) enacted in fall 2008 which was part of the Emergency Economic Stabilization Act (EESA). The media more commonly refers to TARP as the Banking Industry Bailout.

The main focus of this writing is to summarize Title VII of the ARRA of 2009 called “Limits on Executive Compensation.” This title specifically focuses on requirements and/or restrictions put on banks that have or will receive TARP assistance from the US Treasury. Section 7001 of ARRA of 2009 amends Section 111 of the Emergency Economic Stabilization Act of 2008. Please note that the amount of TARP assistance taken by an institution will determine which officers and employees are covered by this section (see Table 1). The most important requirements and/or restrictions are listed below:

- “Prohibition on paying or accruing any bonus, retention award or incentive compensation to senior executive officers”
- “Prohibition on making any golden parachute payment to a senior executive officer or any of the next 5 most highly paid employees”
- Provision for “Clawback Rights” “on any bonus, retention award or incentive compensation paid to a senior executive officer and any of the next 20 most highly compensated employees based on statements of earnings, revenues, gains or other criteria that are later found to be materially inaccurate”.

- Annual Limit of \$500,000 of deductible compensation for some senior executives as applicable to section 162(m)(5) of Internal Revenue Code of 1986
- Requirement for both “the Chief Executive Officer and the Chief Financial Officer to provide written certification of compliance to the rules of this section.”
 - Publicly Traded companies must provide certifications to the Security and Exchange Commission with other required filings
 - Private companies must provided certifications to the Treasury Secretary
- Requirement to “establish a Board Compensation Committee comprised entirely of independent directors for purpose of reviewing employee’s compensation plans.” “The compensation committee shall meet at least semi-annually.” Non-SEC registrants that have received \$25 million or under of TARP assistance can have their full board of directors carry out the duties of a compensation committee.
- Requirement to have a company policy regarding excessive or luxury expenditures as determined by the Treasury Secretary which may include:
 - Entertainment or events
 - Office and facility renovations
 - Aviation or other transportation services
 - Other activities or events that are not reasonable expenditures for staff development
- Provision for what is being called “Say on Pay”. Which is a requirement to ‘permit a separate shareholders vote to approve the compensation of executives.’ However this vote is non-binding.
- Provision that states “the Treasury Secretary shall review bonuses, retention awards and other compensation paid to senior executive officers and the next 20 most highly compensated employees prior to the enactment of the ARRA of 2009.”

Exceptions to the Prohibitions on Bonuses

There are two notable exceptions on the prohibition of bonuses in section 7001:

- Prohibition on bonuses does not include payment of long-term restricted stock, provided that such long-term restricted stock:
 - Does not fully vest during TARP assistance period
 - The value is not greater than one third (1/3) of the total amount of officers and/or employees annual compensation
 - Is subject to other terms and conditions determined by Treasury Secretary to be in the public's best interest.
- Prohibition on bonuses does not include payments required to be paid pursuant to a written employment contract executed on or before February 11, 2009

Table 1 – Covered Employees by Amount of TARP Assistance

| TARP Assistance | Covered Executives / Employees |
|--|--|
| Less than \$25 Million | Most Highly Compensated Employee |
| At Least \$25 Million but less than \$250 Million | 5 Most Highly Compensated Employees |
| At Least \$250 Million but less than \$500 Million | Senior Executive Officers & At Least the Next 10 Most Highly Compensated Employees |
| Over \$500 Million | Senior Executive Officers & At Least the Next 20 Most Highly Compensated Employees |

The American Recovery and Reinvestment Act of 2009 has clearly introduced new challenges to the issues of Executive Compensation and Corporate Governance. At this time, these requirements and restrictions only apply to companies who currently have or will have outstanding obligations of TARP assistance. Title VII, section 7001 of the ARRA of 2009 leaves certain issues open to the determination of the Treasury Secretary. Therefore we anticipate there will be updates over the next year.

Total Compensation Solutions is available to review any compensation issues regarding TARP compensation rules or any other compensation issues. Call Tom Bailey at 914-730-7300 or go to www.Total-comp.com