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Treasury Issues Interim Final Rule on TARP Standards for Compensation and Corporate Governance

On June 10 the US Department of the Treasury issued an interim final rule on Troubled Asset Relief Program (TARP) standards for compensation and corporate governance (the Rule). The Rule became effective immediately upon its publication in the [Federal Register](#) on June 15. Nonetheless, Treasury is inviting public comment for a 60-day period and will consider comments in developing a final rule.

Financial institutions that have received assistance from Treasury under the TARP should, in light of the Rule, review carefully the current compensation arrangements, not only for senior executive officers (SEOs) but also for other employees, and start preparing plans to implement specific requirements under the Rule.

Background

The Emergency Economic Stability Act of 2008 (EESA), as amended by the American Recovery and Reinvestment Act of 2009 (ARRA) in February this year, provides that certain entities that receive financial assistance from Treasury under the TARP are subject to specified executive compensation and corporate governance standards to be established by the Secretary of the Treasury. The Rule implements ARRA provisions and consolidates all of the executive-compensation-related provisions that are specifically directed at TARP recipients into a single rule, superseding all prior rules and guidance. In addition, pursuant to the discretion granted to the Secretary of the Treasury under ARRA, the Rule adopts additional standards for compensation and corporate governance.

Clarification of Standards Requirements

The following table illustrates how the Rule promulgates the standards under ARRA (for discussion of the standards adopted by ARRA, please see our February Alert "[Economic Stimulus Act Imposes New Executive Compensation and Corporate Governance](#)

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Comparison of the ARRA and Interim Final Rules

We have prepared a table on how the ARRA and Interim Final Rules compare in regards to the prohibition of golden parachute payments, limitations on bonus payments to CEOs and highly compensated employees, and risk analysis compensation. [The table is now available as a PDF.](#)

Additional Compensation and Governance Standards

In addition to setting forth standards provided under ARRA, the Rule includes the following additional compensation and governance standards, which were not included in ARRA:

- a. **Prohibition of Tax Gross-Ups** – The Rule prohibits the payment to CEOs and the 20 next most highly compensated employees of a tax "gross-up," or a payment to cover taxes due on compensation such as golden parachutes and perquisites. Such prohibited gross-up payment includes a right to a payment of a gross-up at a future date. No grandfathering exception applies. However, a payment under a "tax equalization agreement," which provides payments intended to compensate an employee for some or all of the excess of the taxes actually imposed by a foreign jurisdiction on the compensation paid by a TARP recipient to the employee, is excluded from the prohibition.
- b. **Disclosure of Perks Over US\$25,000** – Within 120 days of the completion of its fiscal year, each TARP recipient is required to disclose to Treasury, and its primary regulatory agency, the type and amount of perquisites provided to any employee who is subject to the bonus restrictions under ARRA with total value exceeding US\$25,000.
- c. **Disclosure About Compensation Consultants** – Within 120 days of the completion of its fiscal year, a TARP recipient is required to disclose to Treasury and its primary federal regulator whether the TARP recipient, its board of directors, or its compensation committee has engaged a compensation consultant and to describe, in narrative form, all types of services the compensation consultant, or any of its affiliates, has provided.

Appointment of a Special Master

The Rule established the Office of the Special Master for TARP Executive Compensation and appointed Kenneth Feinberg as the Special Master for TARP Executive Compensation. The Special Master will review payments and compensation plans for the executives and the 100 most highly compensated employees of TARP recipients that have received exceptional assistance. Such recipients currently include AIG, Citigroup, Bank of America, Chrysler, GM, GMAC and

Chrysler Financial. The Special Master has broad powers to disapprove compensation arrangements and require the TARP recipient to restructure the arrangements.

In addition, a TARP recipient other than those receiving exceptional assistance or an employee of such a TARP recipient may request an advisory opinion from the Special Master as to whether a compensation structure is inconsistent with the purposes of EESA or TARP or otherwise contrary to the public interest.

Proposed Legislation

Simultaneously with the release of the Rule, Treasury proposed new legislation to (i) provide compensation committees with new independence and (ii) ensure investors have a "say on pay."

Action Items

We recommend that financial institutions that have received TARP financial assistance promptly do the following:

- Understand the Rule and its application to the specific circumstances of the institution;
- Make use of the exemptions from compensation restrictions, for those executives whose situations might fit within the exemption but who are actually receiving benefits more generally or through other means (for instance, make use of applicable commissions and tax equalization agreements where possible);
- Update the mission statement and agendas for the Compensation Committee, which now must generally evaluate compensation plans in light of risk to the institution from such plans and which will need to provide narrative disclosures for 10-K annual reports, and make sure that the Compensation Committee makes the periodic analyses required of it.

The contents of this update are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations. Counsel should be consulted for legal planning and advice.

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