

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

On June 10, 2009, the U.S. Department of the Treasury (the “Treasury”) released an Interim Final Rule on TARP Standards for Compensation and Corporate Governance (the “Interim Final Rule”).¹ The Interim Final Rule provides guidance on the executive compensation and corporate governance provisions of the Emergency Economic Stabilization Act of 2008 (“EESA”)² and the American Recovery and Reinvestment Act of 2009 (“ARRA”) that apply to entities that receive financial assistance under the Troubled Asset Relief Program (“TARP”).^{3,4} A summary overview of the Interim Final Rule is provided below.

Effective Date and Comment Period

The Interim Final Rule is generally effective as of June 15, 2009. Public comments may be submitted during the 60-day period following the effective date and the Treasury will consider comments received during such period in connection with development of a final rule.

Executive Compensation Limits

Limitation on Bonus Payments to Senior Executive Officers and Highly Compensated Employees (Section 30.10 (Q-10))

The Interim Final Rule provides that, in order to comply with Section 111(b)(3)(D) of EESA, a TARP recipient must prohibit the payment or accrual of any bonus payment (other than certain specified exceptions as noted below) during the TARP period to or by the following specified employees:

- (i) The most highly compensated employee of any TARP recipient receiving less than \$25,000,000 in financial assistance;
- (ii) At least the five most highly compensated employees of any TARP recipient receiving \$25,000,000 but less than \$250,000,000 in financial assistance;
- (iii) The senior executive officers and at least the ten next most highly compensated employees of any TARP recipient receiving \$250,000,000 but less than \$500,000,000 in financial assistance; and

¹ Interim Final Rule available at <http://www.treas.gov/press/releases/reports/ec%20if%20f%20web%206.9.09tg164.pdf>. Related press release dated June 10, 2009 (the “Press Release”) available at <http://www.treas.gov/press/releases/tg165.htm>.

² 12 U.S.C. §5221.

³ EESA, signed into law by President Bush on October 3, 2008, *inter alia*, authorized the Secretary of the Treasury to establish the Troubled Asset Relief Program and Section 111 of EESA contained executive compensation and corporate governance provisions applicable to entities that receive financial assistance under the TARP. On February 17, 2009, President Obama signed into law ARRA which, *inter alia*, amended Section 111 of EESA and thereby strengthened and increased requirements related to executive compensation and corporate governance applicable to such entities. EESA is summarized in our memorandum “The Emergency Economic Stabilization Act of 2008: an Overview,” dated October 13, 2008, available at <http://www.cahill.com/news/memoranda/000116>. ARRA is summarized in our memorandum “The American Recovery and Reinvestment Act of 2009: Executive Compensation and Corporate Governance Provisions,” dated February 25, 2009, available at <http://www.cahill.com/news/memoranda/000152>.

⁴ The Interim Final Rule revises in its entirety 31 CFR Part 30, which comprises the Treasury’s regulations implementing Section 111 of EESA.

- (iv) The senior executive officers and at least the twenty next most highly compensated employees of any TARP recipient receiving \$500,000,000 or more in financial assistance.

The Interim Final Rule specifies the following two exceptions to the above prohibition on bonus payment or accrual:

- Long-term restricted stock. TARP recipients may award long-term restricted stock⁵ to employees in the specified categories, provided that the value of this grant may not exceed one third of each such employee's annual compensation as determined for that fiscal year.
- Legally binding right under valid employment contracts. TARP recipients may generally pay bonus payments required to be paid under a valid employment contract executed on or before February 11, 2009 so long as it has not been subsequently amended to increase the amount payable, accelerate any vesting conditions, or otherwise materially enhance benefits.

The bonus payment limitations under the Interim Final Rule do not apply to bonuses, retention awards, and incentive compensation paid or accrued by TARP recipients or their employees prior to June 15, 2009.

Definition of "TARP period"

The Interim Final Rule defines "TARP period" as "the period beginning with the TARP recipient's receipt of any financial assistance and ending on the last date upon which any obligation arising from financial assistance remains outstanding (disregarding any warrants to purchase common stock of the TARP recipient that the Treasury may hold)."

Definition of "TARP recipient"

The Interim Final Rule defines the term "TARP recipient" as:

- (i) "(i) Any entity that has received or holds a commitment to receive financial assistance; and
- (ii) Any entity that would be treated as the same employer as an entity receiving financial assistance based on the rules in sections 414(b) and 414(c) of the Internal Revenue Code (26 U.S.C. 414(b) or (c)), but modified by substituting "50%" for "80%" in each place it appears in section 414(b) or 414(c) and the accompanying regulations."⁶

⁵ "Long-term restricted stock" is defined as restricted stock or restricted stock units that include the following features: (i) the restricted stock or restricted stock units are issued with respect to common stock of the TARP recipient, (ii) the restricted stock or restricted stock units may not become transferable (as defined in 26 CFR 1.83-3(d)), or payable as applied to a restricted stock unit, at any time earlier than permitted under a schedule specified in the Interim Final Rule tied to repayment of the financial assistance (except (x) as necessary to reflect a merger or acquisition of the TARP recipient or (y) in the case of restricted stock for which the employee does not make an election under Section 83(b) of the Internal Revenue Code (26 U.S.C. 83(b)), at any time beginning with the date upon which such restricted stock becomes substantially vested (as defined in 26 CFR 1.83-3(b)) and ending on December 31 of the calendar year including that date, a portion of such restricted stock may be made transferable as may reasonably be required to pay the Federal, State, local, or foreign taxes that are anticipated to apply to the income recognized due to this vesting) and (iii) the employee must be required to forfeit the restricted stock or restricted stock unit if the employee does not continue performing substantial services for the TARP recipient for at least two years from the date of grant, other than due to the employee's death or disability, or a change in control event (as defined in 26 CFR 1.280G-1, Q&A-27 through Q&A-29 or as defined in 26 CFR 1.409A-3(i)(5)(i)) with respect to the TARP recipient before the second anniversary of the date of grant.

⁶ This change reduces from 80% to 50% the stock ownership threshold which causes companies to be treated as a "controlled group" and hence as a single employer for purposes of applying the restrictions imposed by the Interim Final Rule.

Also included in the definition of “TARP recipient” is any entity related to a TARP recipient described in clause (i) above to the extent that the primary purpose for the creation or utilization of such entity is to avoid or evade any or all of the requirements of Section 111 of EESA or the Interim Final Rule.

Definition of “financial assistance”

The Interim Final Rule defines “financial assistance” as “any funds or fund commitment provided through the purchase of troubled assets under the authority granted to Treasury under section 101 of EESA or the insurance of troubled assets under the authority granted to Treasury under section 102 of EESA, provided that the term “financial assistance” does not include any loan modification under sections 101 and 109 of EESA. A change in the form of previously received financial assistance, such as a conversion of convertible preferred stock to common stock, is not treated as new or additional financial assistance.”

The Interim Final Rule specifies that “financial assistance” includes, *inter alia*, the sale of preferred stock by financial institutions to the Treasury through the Capital Purchase Program.

“Financial assistance”, *inter alia*, (i) does not include posting of collateral to and receipt of loans from the Federal Reserve Term Asset-Backed Securities Loan Facility, or TALF, (ii) does not generally include participating as an investor in the Public Private Investment Program and (iii) does not include the commitment by Treasury (through its financial agent) to pay incentive payments and credit enhancements in exchange for the issuance of a financial instrument to the Treasury’s financial agent by a servicer of mortgage loans or mortgaged-backed securities who commits to modify mortgages it is servicing consistent with guidelines established by the Treasury under the Home Affordable Modification Program.

Definition of “obligation”

The Interim Final Rule defines “obligation” as “a requirement for, or an ability of, a TARP recipient to repay financial assistance received from Treasury, as provided in the terms of the applicable financial instrument and related agreements, through the repayment of a debt obligation or the redemption or repurchase of an equity security, but not including warrants to purchase common stock of the TARP recipient.”

Definition of “senior executive officer” and “most highly compensated employee”

The Interim Final Rule defines “senior executive officer” (“SEO”) as a “named executive officer” as that term is determined pursuant to Item 402(a) of Regulation S-K under the federal securities laws, resulting in the principal executive officer, the principal financial officer and the three other most highly compensated executive officers of a TARP recipient being considered its SEOs. The identification of the three other most highly compensated executive officers is based on their annual compensation for the last completed fiscal year of the TARP recipient, and their annual compensation for this purpose is as determined pursuant to Item 402(a) of Regulation S-K (generally the amount required to be shown in the summary compensation table of the TARP recipient’s proxy statement). The most highly compensated employees (other than the SEOs) are also determined according to their annual compensation for the last completed fiscal year as determined pursuant to Item 402(a) of Regulation S-K. An employee need not be an executive officer in order to be considered one of the most highly compensated employees. In addition, the most highly compensated employees will not include a former employee who is not employed by the TARP recipient on the first day of the fiscal year for which the determination is being made unless the employee is reasonably anticipated to return to employment with the TARP recipient during the fiscal year.

Section 30.10 (Q-10) contains an anti-abuse rule, aimed at addressing circumstances in which a bonus that was not permitted to accrue during the year an employee was covered by the bonus limitation is paid to the employee in the subsequent year when the employee is not covered by the bonus limitation, but is designated as some other form of payment such as a salary increase or a stock option grant. In such a case, the payment in the subsequent year may be recharacterized as a payment of the bonus that was not permitted to accrue in the previous year.

Definition of “bonus payment”

The Interim Final Rule specifies that the term “bonus payment”, unless otherwise noted, includes a payment that is, or is in the nature of, a bonus, incentive compensation, or retention award. The Interim Final Rule further specifies that “a bonus payment may include the forgiveness of a loan or other amount that otherwise may be required to be paid by the employee to the employer.”

Definition of “bonus”

The Interim Final Rule defines the term “bonus” as “any payment in addition to any amount payable to an employee for services performed by the employee at a regular hourly, daily, weekly, monthly, or similar periodic rate. Such term generally does not include payments to or on behalf of an employee as contributions to any qualified retirement plan (as defined in section 4974(c) of the Internal Revenue Code),⁷ benefits under a broad-based benefit plan, bona fide overtime pay, or bona fide and routine expense reimbursements. In addition, provided that the rate of commission is pre-established and reasonable, and is applied consistently to the sale of substantially similar goods or services, commission compensation will generally not be treated as a bonus. For this purpose, a bonus may include a contribution to, or other increase in benefits under, a nonqualified deferred compensation plan, regardless of when the actual payment will be made under the plan. A bonus may also qualify as a retention award or as incentive compensation.”

The exception for “commission compensation” is only applicable to compensation or portions of compensation earned by an employee consistent with a program in existence for that type of employee as of February 17, 2009. Additionally, the Interim Final Rule specifies other requirements that may be applicable in order to qualify for this exception.

Prohibition on Golden Parachute Payments (Section 30.9 (Q-9))

The Interim Final Rule provides that, in order to comply with Section 111(b)(3)(C) of EESA, a TARP recipient must prohibit any golden parachute payment to a CEO and any of the next five most highly compensated employees during the TARP period. A golden parachute payment is treated as paid at the time of departure and is equal to the aggregate present value of all payments made for a departure. Thus, a golden parachute payment during the TARP period may include a right to amounts actually payable after the TARP period.

Definition of “golden parachute payment”

The Interim Final Rule defines “golden parachute payment” as “any payment for the departure from a TARP recipient for any reason, or any payment due to a change in control⁸ of the TARP recipient or any entity that is included in a group of entities treated as one TARP recipient, except for payments for services performed or benefits accrued.” The Interim Final Rule further specifies that acceleration of vesting due to the departure or the change in control event, as applicable, will be considered to be a golden parachute payment.

Requirement for “Clawback” Provision and Exercise Thereof (Section 30.8 (Q-8))

The Interim Final Rule provides that, in order to comply with Section 111(b)(3)(B) of EESA, a TARP recipient must ensure that any bonus payment made to a CEO or the next twenty most highly compensated employees during the TARP period is subject to a provision for recovery or “clawback” by the TARP recipient if the bonus payment was based on materially inaccurate financial statements (which includes, but is not limited to, statements of earnings, revenues, or gains) or any other materially inaccurate performance metric criteria.

⁷ 26 U.S.C. §4974(c).

⁸ For the purposes of the Interim Final Rule, a “change in control” includes any event that would qualify as a change in control event as defined in 26 CFR 1.280G-1, Q&A-27 through Q&A-29 or as a change in control event as defined in 26 CFR §1.409A-3(i)(5)(i).

Furthermore, the Interim Final Rule requires that TARP recipients must exercise their clawback rights except to the extent they demonstrate that it is unreasonable to do so, such as, for example, if the expense of enforcing the rights would exceed the amount recovered.

Establishment of Office of the Special Master for TARP Executive Compensation (Section 30.16 (Q-16))

The Interim Final Rule establishes an Office of the Special Master for TARP Executive Compensation (Special Master). The Special Master will be appointed by, and serve at the pleasure of, the Secretary of the Treasury (the “Secretary”).⁹ The Secretary may remove the Special Master without notice, without cause, and before the naming of any successor Special Master.

The Special Master has the authority to:

- (1) interpret the application of the restrictions on executive compensation and corporate governance requirements for TARP recipient employees under EESA, the Interim Final Rule, and any other applicable guidance, to specific facts and circumstances;
- (2) administer Section 111(f) of EESA, which requires the Secretary to review bonuses, retention awards, and other compensation paid before February 17, 2009 to employees of each entity receiving TARP assistance, to determine whether any such payments were inconsistent with the purposes of Section 111 of EESA or the TARP, or otherwise contrary to the public interest, and which further requires that, if the Secretary makes such a determination, the Secretary seek to negotiate with the TARP recipient and the employee for appropriate reimbursements to the Federal Government with respect to compensation or bonuses;
- (3) approve compensation payments to, and compensation structures for, certain employees of TARP recipients receiving exceptional financial assistance (see below for explanation of this authority);
- (4) provide opinions, as requested or otherwise as appropriate, regarding payments to, or compensation structures for, other employees of TARP recipients; and
- (5) perform such other duties as the Secretary may delegate from time to time to the Special Master relating to executive compensation issues under the TARP, including the specific application of any terms or conditions in a contract between the Treasury and a TARP recipient.

Special Master Review of Compensation at TARP Recipients Receiving “Exceptional Financial Assistance” (Section 30.11 (Q-11))

The Interim Final Rule requires TARP recipients receiving exceptional financial assistance to submit to the Special Master for approval the compensation payments and compensation structures of the CEO and most highly compensated employees subject to the bonus payment limitation, and the compensation structures of all other executive officers and the 100 most highly compensated employees. However, if a TARP recipient limits the annual compensation for any executive who is not a CEO or a most highly compensated employee subject to the bonus limitation provision to \$500,000, with any additional compensation in long-term restricted stock, the compensation structure is not required to be submitted for approval.¹⁰

⁹ The Secretary has appointed Kenneth R. Feinberg as the initial Special Master for TARP Executive Compensation. Mr. Feinberg has served in a similar capacity in other high visibility situations and is perhaps best known to the public for his oversight of the September 11th Victim Compensation Fund.

¹⁰ There is also a related certification requirement. Section 30.15 (Q-15) of the Interim Final Rule specifies that compliance with Section 111(b)(4) of EESA requires the principal executive officer (“PEO”) and the principal financial

The Interim Final Rule contains a list of principles which the Special Master must apply¹¹ in reviewing a compensation structure or a compensation payment to determine whether it is inconsistent with the purposes of Section 111 of EESA or TARP or is otherwise contrary to the public interest. The enumerated principles are as follows:

- (i) Risk. The compensation structure should avoid incentives to take unnecessary or excessive risks that could threaten the value of the TARP recipient, including incentives that reward employees for short-term or temporary increases in value, performance, or similar measure that may not ultimately be reflected by an increase in the long-term value of the TARP recipient. Accordingly, incentive payments or similar rewards should be structured to be paid over a time horizon that takes into account the risk horizon so that the payment or reward reflects whether the employee's performance over the particular service period has actually contributed to the long-term value of the TARP recipient.
- (ii) Taxpayer return. The compensation structure, and amount payable where applicable, should reflect the need for the TARP recipient to remain a competitive enterprise, to retain and recruit talented employees who will contribute to the TARP recipient's future success, and ultimately to be able to repay TARP obligations.
- (iii) Appropriate allocation. The compensation structure should appropriately allocate the components of compensation such as salary, short-term and long-term incentives, as well as the extent to which compensation is provided in cash, equity or other types of compensation such as executive pensions, other benefits, or perquisites, based on the specific role of the employee and other relevant circumstances, including the nature and amount of current compensation, deferred compensation, or other compensation and benefits previously paid or awarded. The appropriate allocation may be different for different positions and for different employees, but generally, in the case of an executive or other senior level position a significant portion of the overall compensation should be long-term compensation that aligns the interest of the employee with the interests of shareholders and taxpayers.
- (iv) Performance-based compensation. An appropriate portion of the compensation should be performance-based over a relevant performance period. Performance-based compensation should be determined through tailored metrics that encompass individual performance and/or the performance of the TARP recipient or a relevant business unit taking into consideration specific business objectives. Performance metrics may relate to employee compliance with relevant corporate policies. In addition, the likelihood of meeting the performance metrics should not be so great that the arrangement fails to provide an adequate incentive for the employee to perform, and performance metrics should be measurable, enforceable, and actually enforced if not met.

officer ("PFO") of any TARP recipient receiving exceptional financial assistance to certify (within ninety days of the completion of each fiscal year any part of which is a TARP period) that the TARP recipient has either limited annual compensation to \$500,000 (excluding grants of long-term restricted stock but including certain pension benefits and deferred compensation accruals otherwise excluded from annual compensation) for any executive officer or one of the 100 most highly compensated employees who is not subject to the bonus payment limitations and has or will pay any additional compensation in the form of long-term restricted stock, or to the extent not so limited the TARP recipient has had the compensation structure of those employees approved by the Office of the Special Master for TARP Executive Compensation.

¹¹ The Special Master has discretion to determine the appropriate weight or relevance of a particular principle depending on the facts and circumstances surrounding the compensation structure or payment under consideration, such as whether a payment occurred in the past or is proposed for the future, the role of the employee within the TARP recipient, the situation of the TARP recipient within the marketplace and the amount and type of financial assistance provided.

The appropriate allocation and the appropriate performance metrics may be different for different positions and for different employees, but generally a significant portion of total compensation should be performance-based compensation, and generally that portion should be greater for positions that exercise higher levels of responsibility.

- (v) Comparable structures and payments. The compensation structure, and amount payable where applicable, should be consistent with, and not excessive taking into account, compensation structures and amounts for persons in similar positions or roles at similar entities that are similarly situated, including, as applicable, entities competing in the same markets and similarly situated entities that are financially distressed or that are contemplating or undergoing reorganization.
- (vi) Employee contribution to TARP recipient value. The compensation structure, and amount payable where applicable, should reflect the current or prospective contributions of an employee to the value of the TARP recipient, taking into account multiple factors such as revenue production, specific expertise, compliance with company policy and regulation (including risk management), and corporate leadership, as well as the role the employee may have had with respect to any change in the financial health or competitive position of the TARP recipient.

Definition of “exceptional financial assistance”

The Interim Final Rule defines “exceptional financial assistance” as “any financial assistance provided under the Programs for Systemically Significant Failing Institutions, the Targeted Investment Program, the Automotive Industry Financing Program, and any new program designated by the Secretary as providing exceptional financial assistance.”¹²

Implementation and Expansion of ARRA Provisions

Compensation Committees (Sections 30.4 (Q-4) and 30.7 (Q-7))

To comply with the standards established under Sections 111(b)(3)(A), 111(b)(3)(E), 111(b)(3)(F) and 111(c) of EESA, a TARP recipient must establish a compensation committee by the later of ninety days after the closing date of the agreement between the TARP recipient and the Treasury or September 14, 2009, and maintain a compensation committee during the remainder of the TARP period.

The compensation committee must:

- (1) Discuss, evaluate, and review at least every six months with the TARP recipient’s senior risk officers the CEO compensation plans to ensure that the CEO compensation plans do not encourage CEOs to take unnecessary and excessive risks that threaten the value of the TARP recipient;
- (2) Discuss, evaluate, and review with senior risk officers at least every six months employee compensation plans in light of the risks posed to the TARP recipient by such plans and how to limit such risks;
- (3) Discuss, evaluate, and review at least every six months the employee compensation plans of the TARP recipient to ensure that these plans do not encourage the manipulation of reported earnings of the TARP recipient to enhance the compensation of any of the TARP recipient’s employees;

¹² The Press Release specifies that as of June 10, 2009, companies receiving exceptional financial assistance include AIG, Citigroup, Bank of America, Chrysler, Chrysler Financial, GM and GMAC.

- (4) At least once per TARP recipient fiscal year, provide a narrative description of how the SEO compensation plans do not encourage the SEOs to take unnecessary and excessive risks that threaten the value of the TARP recipient, including how these SEO compensation plans do not encourage behavior focused on short-term results rather than long-term value creation, the risks posed by employee compensation plans and how these risks were limited, including how these employee compensation plans do not encourage behavior focused on short-term results rather than long-term value creation, and how the TARP recipient has ensured that the employee compensation plans do not encourage the manipulation of reported earnings of the TARP recipient to enhance the compensation of any of the TARP recipient's employees; and
- (5) Certify the completion of the reviews of the SEO compensation plans and employee compensation plans required under (1), (2), and (3) above.¹³

Luxury Expenditure Policies (Section 30.12 (Q-12))

The Interim Final Rule requires that the board of directors of any TARP recipient adopt an excessive or luxury expenditures policy, provide this policy to the Treasury and its primary regulatory agency, and post the text of this policy on its Internet website, if the TARP recipient maintains a company website, before the later of ninety days after the closing date of the agreement between the Treasury and the TARP recipient or September 14, 2009. After adoption of the policy, the TARP recipient must maintain the policy during the remaining TARP period (if the TARP recipient has an obligation), or through the last day of the TARP recipient's fiscal year including the date on which the authorities provided under Sections 101 and 102 of EESA terminate (if the TARP recipient has never had an obligation).

Section 30.1 (Q-1) of the Interim Final Rule defines an excessive or luxury expenditures policy to require the inclusion of standards to ensure appropriate review and approval of potentially excessive and luxury expenditures. The policy must (1) identify the types and categories of expenses prohibited or requiring prior approval; (2) adopt approval procedures for those expenses requiring prior approval; (3) mandate PEO and PFO certification of the prior approval of any expenditures requiring the prior approval of any SEO, other similar executive officers, or the board of directors; (4) mandate prompt internal reporting of any violation of this policy; and (5) mandate accountability for adherence to this policy. The Interim Final Rule requires that the board of directors of each TARP recipient determine what are excessive and luxury expenditures and establish a set of requirements specific to the TARP recipient under this policy.¹⁴

Definition of "excessive or luxury expenditures"

The term "excessive or luxury expenditures" is defined as "excessive expenditures on any of the following to the extent such expenditures are not reasonable expenditures for staff development, reasonable

¹³ Section 30.7 (Q-7) of the Interim Final Rule also provides that TARP recipients with securities registered with the SEC pursuant to the federal securities laws must provide these disclosures and certifications in the Compensation Committee Report required pursuant to Item 407 of Regulation S-K under the federal securities laws (17 CFR §229.407) and to the Treasury. Section 30.7 (Q-7) of the Interim Final Rule requires that TARP recipients that are smaller reporting companies or do not have securities registered with the SEC pursuant to the federal securities laws provide the disclosures and certifications to their primary regulatory agency and to the Treasury. A "smaller reporting company" is generally defined as a company having a public equity float of less than \$75 million, or if its public equity float is zero, has annual revenues of less than \$50 million. Rule 12b-2 under the Securities Exchange Act of 1934, as amended.

¹⁴ This is similar to the method by which public companies adopted a code of ethics under Section 406 of The Sarbanes-Oxley Act of 2002. Under the federal securities regulations promulgated under Section 406, the SEC presented a general framework for a code of ethics, but the public company itself was required to adopt standards specific to the company using the general framework as a guide.

performance incentives, or other similar reasonable measures conducted in the normal course of the TARP recipient's business operations:

- (1) Entertainment or events;
- (2) Office and facility renovations;
- (3) Aviation or other transportation services; and
- (4) Other similar items, activities, or events for which the TARP recipient may reasonably anticipate incurring expenses, or reimbursing an employee for incurring expenses.

“Say on Pay” Vote (Section 30.13 (Q-13))

Pursuant to Section 111(e) of EESA, any proxy or consent or authorization for an annual or other meeting of the shareholders of any TARP recipient that occurs during the TARP period must permit a separate shareholder vote to approve the compensation of executives, as disclosed pursuant to the federal securities laws (including the compensation discussion and analysis, the compensation tables, and any related material). Section 111(e) of EESA also authorizes the SEC to promulgate any necessary final rules or regulations relating to this requirement by not later than February 17, 2010.

The Interim Final Rule requires TARP recipients to comply with any SEC guidance, rules, or regulations promulgated with respect to Section 111(e) of EESA.

Additional Compensation and Governance Standards

In addition to providing new guidance on EESA and ARRA provisions explicitly required by Congress, the Interim Final Rule also includes additional requirements to further protect shareholder value and enhance transparency at TARP firms.

Prohibition on Tax Gross-Ups (Section 30.11 (Q-11))

The Interim Final Rule prohibits TARP recipients from providing tax gross-ups or other reimbursements for the payment of taxes to any of the CEOs and next twenty most highly compensated employees relating to severance payments, perquisites, or any other form of compensation.

Definition of “gross-up”

The term “gross-up” means any reimbursement of taxes owed with respect to any compensation, provided that a gross-up does not include a payment under a tax equalization agreement.¹⁵

Disclosure of Perks (Section 30.11 (Q-11))

The Interim Final Rule requires TARP recipients to disclose annually during the TARP period any perquisite whose total value for the TARP recipient's fiscal year exceeds \$25,000 for each of the CEOs and most

¹⁵ A “tax equalization agreement” is defined as “an agreement, method, program, or other arrangement that 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 the TARP recipient to the employee over the taxes that would be imposed if the compensation were subject solely to U.S. federal, state, and local income tax, or some or all of the excess of the U.S. federal, state, and local income tax actually imposed on the compensation paid by the TARP recipient to the employee over the taxes that would be imposed if the compensation were subject solely to taxes in the applicable foreign jurisdiction, provided that the payment made under such agreement, method, program, or other arrangement may not exceed such excess and the amount necessary to compensate for the additional taxes on the amount paid under the agreement, method, program, or other arrangement.”

highly compensated employees that are subject to the prohibition on payment or accrual of any bonus payment. TARP recipients must provide a narrative description of the amount and nature of these perquisites, the recipient of these perquisites, and a justification for offering these perquisites (including a justification for offering the perquisite, and not only for offering the perquisite with a value that exceeds \$25,000). Such disclosure must be provided within 120 days of the completion of a fiscal year any part of which is a TARP period.

Definition of “perquisite”

The Interim Final Rule defines a “perquisite” as a “‘perquisite or other personal benefit’ the amount of which is required to be included in the amount reported under Item 402(c)(2)(ix)(A) of Regulation S-K under the federal securities laws,¹⁶ modified to also include any such perquisite or other personal benefit provided to a most highly compensated employee subject to Section 30.11 (Q-11) of the Interim Final Rule.

Disclosure of Compensation Consultants (Section 30.11 (Q-11))

The compensation committee of each TARP recipient must provide annually a narrative description of whether the TARP recipient, the board of directors of the TARP recipient, or the compensation committee has engaged a compensation consultant; and all types of services, including non-compensation related services, the compensation consultant or any of its affiliates has provided to the TARP recipient, the board, or the compensation committee during the past three years, including any “benchmarking” or comparisons employed to identify certain percentile levels of compensation (for example, entities used for benchmarking and a justification for using these entities and the lowest percentile level proposed for compensation). Such disclosure must be provided within 120 days of the completion of a fiscal year any part of which is a TARP period.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Glenn Waldrip at 212.701.3110 or gwaldrip@cahill.com; Michael Macris at 212.701.3409 or mmacris@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; or Mike Wenzel at 212.701.3527 or mwenzel@cahill.com.

¹⁶ Column (i) of the Summary Compensation Table (All Other Compensation). See, Regulation S-K, Item 402(c)(2)(ix)(A).