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Treasury Announces Executive Compensation Rules Under the Emergency Economic Stabilization Act

The U.S. Treasury Department announced today how the executive compensation and corporate governance standards will apply to participants in three programs under the Emergency Economic Stabilization Act of 2008 (the "Act"). The standards generally apply to the chief executive officer, chief financial officer, and the next three most highly compensated executive officers (each a "senior executive"). For a copy of the Treasury announcement, [click here](#).

A. Troubled Asset Auction Program

Limitation on New Parachute Agreements. As proscribed by the Act, any financial institution that sells more than \$300 million of troubled assets to the Treasury via an auction will be prohibited from entering into new executive employment contracts that include golden parachutes for the term of the program. This term will be reflected in Treasury Notice 2008-TAAP. *[Note that a prohibited parachute payment is generally one that exceeds one times the executive's five year W-2 compensation but only if total parachute payments exceed three times that average.]*

Limitations on Executive Compensation Deduction/Broader Application of Parachute Excise Tax. In addition, under the Act:

(1) the financial institution may not take a tax deduction for executive compensation in excess of \$500,000 for each senior executive,

(2) the financial institution may not deduct certain golden parachute payments to its senior executives, and

(3) a 20 percent excise tax will be imposed on the senior executive receiving a parachute payment. These tax rules will be reflected in I.R.S. Notice 2008-94. *[Note that the loss of the deduction for compensation in excess of \$500,000 includes performance based compensation, which is otherwise excluded from the \$1 million deduction ceiling applicable to public company senior executive compensation.]*

B. Capital Purchase Program

New Bank Equity Purchases to Strengthen Capital Structures to Facilitate Lending in the Capital Markets. The Treasury is issuing guidance for a new Capital Purchase Program that will provide equity capital under standardized terms directly. As a condition to participating, a financial institution will become subject to more stringent executive compensation rules while the Treasury holds the equity.

A participating financial institution must meet certain executive compensation standards, including:

(1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution, as required by the Act;

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(2) requiring a clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate, as required by the Act;

(3) prohibiting making any golden parachute payment to a senior executive; and

(4) agreeing not to take a tax deduction for executive compensation in excess of \$500,000 for each senior executive. *[Note this provision is not required by the Act for direct purchases of troubled assets.]*

Treasury Issues Term Sheet for Senior Preferred Equity. The Treasury also released today a term sheet for the Senior Preferred Stock to be issued under this program that addresses the foregoing Executive Compensation terms. The term sheet provides that as a condition to the closing of the investment, the issuing qualifying financial institution (“QFI”) and its senior executive officers covered by the Act are required to “modify or terminate all benefit plans, arrangements and agreements (including golden parachute agreements) to the extent necessary to be in compliance with, and following the closing.” For so long as the Treasury holds any equity or debt securities of the QFI, the QFI also must agree to be bound by the executive compensation and corporate governance requirements of the Act and any guidance or regulations issued thereunder on or prior to the date of the investment to carry out its provisions. As an additional condition to closing, the QFI and its senior executive officers covered by the Act must grant a waiver to the Treasury releasing it from any claims that the QFI and such senior executive officers may otherwise have as a result of the issuance of any regulations that modify the terms of benefits plans, arrangements and agreements to eliminate any provisions that would not be in compliance with the executive compensation and corporate governance requirements the Act and any guidance or regulations on or prior to the date of the investment to carry out its provisions.

For a complete copy of the term sheet, [click here](#).

C. Programs for Systemically Significant Failing Institutions

A third, new program is under development to provide direct assistance to certain failing firms on a case-by-case basis. Executive compensation standards will apply, as reflected in Treasury Notice 2008-PSSF. These standards are similar in all respects to the Capital Purchase Programs executive compensation standards described above, except that golden parachutes will be defined more strictly to prohibit any payments to departing senior executives.

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