ARNOLD & PORTER LLP

ADVISORY

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TREASURY ANNOUNCES NEW INTERIM FINAL RULE IMPLEMENTING COMPENSATION AND CORPORATE GOVERNANCE STANDARDS UNDER EESA

On June 10, 2009, the US Department of the Treasury (Treasury) released an interim final rule (June Rule) providing much-anticipated guidance on the executive compensation and corporate governance provisions of the Emergency Economic Stabilization Act of 2008 (EESA) that apply to entities that receive financial assistance under the Troubled Asset Relief Program (TARP). Originally enacted in October 2008, the executive compensation and corporate governance provisions of EESA were amended by the American Recovery and Reinvestment Act of 2009 (ARRA) in February 2009. The June Rule supersedes all prior Treasury guidance on executive compensation under TARP and applies to any entity that has received or will receive financial assistance under TARP (TARP Recipient). The June Rule became effective on June 15, 2009, upon its publication in the Federal Register. Key aspects of the June Rule are discussed in this advisory.

PROHIBITION ON BONUSES, INCENTIVE COMPENSATION, AND RETENTION AWARDS

- **ARRA Prohibition on Bonus Payments; Restricted Stock and Grandfathered Agreement Exceptions.** ARRA prohibits a TARP Recipient from paying or accruing any bonus, incentive compensation, or retention award (collectively, referred to in the June Rule as Bonus Payments) to (or for) up to 25 of the TARP Recipient's senior executive officers (SEOs) and most highly compensated employees (MHCEs). The number of SEOs and/or MHCEs subject to this restriction ranges from one to 25 depending upon the amount of financial assistance the TARP Recipient has received. Under ARRA, grants of "long-term restricted stock," as well as payments required to be paid pursuant to employment contracts executed on or before February 11, 2009 (Grandfathered Agreements), are excepted from the prohibition on Bonus Payments. The Bonus Payment prohibition applies for the period during which the TARP Recipient has an outstanding obligation to the federal government under TARP (disregarding obligations in the form of warrants to purchase common stock held by Treasury) (TARP Period).

- **Definitions of Bonus, Incentive Compensation, and Retention Awards.** The June Rule provides guidance as to the scope of the terms bonus, incentive compensation, and retention award under ARRA, including the following:

Brussels
+32 (0)2 290 7800

Denver
+1 303.863.1000

London
+44 (0)20 7786 6100

Los Angeles
+1 213.243.4000

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+1 212.715.1000

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+1 703.720.7000

San Francisco
+1 415.356.3000

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— The term bonus does not include commission payments for sales and investment management services that meet certain requirements.

— The term incentive compensation plan includes any plan providing stock options or other equity-based compensation.

— The term retention award includes payments that are contingent on the completion of a period of service or a specific activity, provided that the award is not based on the performance of the employee or the TARP Recipient.

- **Long-Term Restricted Stock Exception.** As indicated above, under ARRA, long-term restricted stock is excluded from the prohibition on Bonus Payments. The June Rule defines long-term restricted stock as restricted stock or restricted stock units (RSUs) that meet the following requirements: (i) the award is forfeited if the employee terminates employment within two years following the date of grant (other than due to death, disability, or a change in control); (ii) the award does not become transferable earlier than pursuant to a schedule under which 25% of the award becomes transferable at the same time that 25% of the financial assistance is repaid to the government; and (iii) the value of the award does not exceed one-third of the employee's total annual compensation. The June Rule permits a TARP Recipient to accelerate transferability to allow an employee to pay applicable taxes associated with vesting of restricted stock. It also provides guidance as to how to calculate the value of awards and an employee's annual compensation for this purpose.

- **Grandfathered Bonus Payments.** The June Rule clarifies that Grandfathered Bonus Payments include any Bonus Payment required to be paid under an employment or other compensation contract executed on or before February 11, 2009 if the employee had a legally binding right to the payment on or prior to such date. The June Rule provides that such contracts can be amended without loss of grandfathered status, provided that the amendment does not materially enhance the grandfathered Bonus Payment.

CLAWBACKS

- **Scope of Clawback.** Under ARRA, a TARP Recipient is required to ensure that any Bonus Payment that is paid or accrued during the TARP Period to (or for) an SEO or one of the next 20 MHCEs is subject to clawback by the TARP Recipient if the payments or accruals were based on financial statements or performance metrics later found to be materially inaccurate. The June Rule provides that whether a financial statement or performance metric is materially inaccurate generally depends on all of the relevant facts and circumstances. A financial statement or performance metric criteria is treated as materially inaccurate, however, for any employee who knowingly provided inaccurate information or knowingly failed to timely correct inaccurate information.

- **Exercise of Clawback.** The TARP Recipient must exercise its clawback rights, except to the extent it is unreasonable to do so (such as, for example, if the expense of enforcing the rights would exceed the amount recovered).

IDENTIFYING TARP RECIPIENTS, SEOS, AND MHCES

- **Identifying TARP Recipients.** Under previously issued TARP guidance, TARP executive compensation restrictions applied to the TARP Recipient, as well as any entity related to the TARP Recipient through an 80% or greater ownership link. Under the June Rule, the TARP restrictions apply to any entity related to the TARP Recipient through a 50% or greater ownership link, as well as any entity that is created solely to avoid the application of the TARP restrictions.

- **Identifying SEOs and MHCEs.** For a TARP Recipient that is a public company, the TARP Recipient's SEOs are its top five "named executive officers" as determined pursuant to relevant federal securities laws (using annual compensation for the last completed fiscal year). The June Rule provides that a TARP Recipient's MHCEs are identified based on compensation for the last completed fiscal year. Private companies are required to use analogous rules.

COMPENSATION RISK REVIEW; KEY CORPORATE GOVERNANCE REQUIREMENTS

- **Compensation Risk Assessment—Duties of the Compensation Committee.** Under the June Rule, the Compensation Committee of a TARP Recipient must meet at least every six months with senior risk officers to discuss and evaluate the risks posed to the TARP Recipient by its SEO compensation plans and other employee compensation plans. The Compensation Committee must identify and limit any features in the compensation plans that pose risks to the TARP Recipient, including any features that could encourage behavior focused on short-term results rather than long-term value creation. In addition, the Compensation Committee is required to discuss, evaluate, and eliminate features in any employee compensation plan that could encourage the manipulation of reported earnings of the TARP Recipient. The Compensation Committee also must provide a certification that it has conducted the required risk analysis and include in its annual Compensation Committee Report a narrative describing, among other things, how the SEO compensation plans and other employee compensation plans do not encourage the SEOs and the employees to take excessive risks. A privately-held company is required to provide the certification and narrative to Treasury and its primary regulator.

- **Permit a "Say on Pay" Vote.** Any proxy, consent, or authorization for an annual or other meeting of the shareholders of a TARP Recipient that occurs during the TARP Period must permit a separate non-binding shareholder vote to approve the compensation of certain executives. ARRA instructed the Securities and Exchange Commission (SEC) to promulgate any necessary rules relating to this requirement.

- **Disclosures Regarding Compensation Consultants.** A TARP Recipient is required to annually disclose to its primary regulator and Treasury whether the TARP Recipient, its board of directors, or its compensation committee has engaged a compensation consultant and the types of services the compensation consultant or any of its affiliates has provided during the past three years, including any "benchmarking" or comparisons used to identify percentile levels of compensation. The disclosure requirement applies if any part of the relevant fiscal year occurs during the TARP Period.

- **Establish a Luxury Expenditures Policy.** Under ARRA, the board of directors of a TARP Recipient must adopt an excessive or luxury expenditures policy. The June Rule further requires that the TARP Recipient file the policy with Treasury and post it on the TARP Recipient's website, if applicable. Among other things, the policy must identify the types and categories of expenses prohibited or requiring prior approval and establish approval procedures for expenses requiring prior approval.

NEW RULES RELATING TO GOLDEN PARACHUTE PAYMENTS, GROSS-UPS, AND PERQUISITES

- **Expanded Definition of Golden Parachute Payment.** Under ARRA, a TARP Recipient may not make a golden parachute payment to an SEO or any of the next five MHCEs during the TARP Period. As under ARRA, the June Rule defines a golden parachute payment as a payment for departure from a TARP Recipient for any reason other than a payment for services performed or benefits accrued. The June Rule expands the definition to include payments made upon the occurrence of a change in control without regard to whether the employee terminates employment (single trigger payments).

- **Prohibition on Tax Gross-Up Payments.** Under the June Rule, TARP Recipients are prohibited from providing tax gross-ups (defined to include any reimbursement of taxes owed with respect to any compensation other than under a tax equalization agreement) to any of the SEOs and the next 20 MHCEs during the TARP Period. The prohibition also applies to gross-up payments that are earned during the TARP Period and payable at a later date.

- **Required Disclosure of Perquisites Over $25,000.** The June Rule provides that during the TARP Period, TARP Recipients must annually disclose to its primary federal regulator and Treasury any perquisites whose total value exceeds $25,000 for any employee who is subject to the prohibition on Bonus Payments. The TARP Recipient also must disclose the justification for providing the perquisites.

CEO AND CFO CERTIFICATION REQUIREMENTS

- **Required CEO and CFO Certification.** Pursuant to the June Rule, the CEO and the CFO of a TARP Recipient must provide an annual certification within 90 days of the completion of each fiscal year any part of which falls in the TARP Period covering a range of items, including compliance with the restrictions on Bonus Payments, golden parachutes, and tax gross-ups.

- **Disclosure of Required Certifications.** A public company TARP Recipient must provide the CEO and CFO certifications to Treasury and include the certifications as an exhibit to the TARP Recipient's annual report on Form 10-K. Private company TARP Recipients must provide the relevant disclosures and certifications to their primary regulatory agency and to Treasury.

THE ROLE OF THE SPECIAL MASTER

- **Interpret EESA and the June Rule; Provide Advisory Opinions.** Pursuant to the June Rule, Treasury established the Office of the Special Master (Special Master) for TARP Executive Compensation. The Special Master has the authority to interpret the executive compensation provisions of EESA, the June Rule, and other applicable guidance, and to provide TARP Recipients with opinions, as requested or otherwise as appropriate, regarding payments to or compensation structures for their employees.

- **Approve Compensation Paid by TARP Recipients Receiving Exceptional Financial Assistance.** With respect to a TARP Recipient receiving exceptional financial assistance, the Special Master must review and approve the compensation structure for (i) SEOs and MHCEs subject to the Bonus Payment restrictions and (ii) any employee who is either an executive officer (as defined in the federal securities laws) or one of the 100 MHCEs not subject to the Bonus Payment restrictions. Under an exception, no Special Master review is necessary with respect to an employee if the employee's annual compensation both complies with the restrictions on Bonus Payments and does not exceed $500,000 (excluding the value of any permissible long-term restricted stock).

- **Examine Compensation Paid Prior to February 17, 2009.** Treasury has delegated to the Special Master the authority to review all compensation paid before February 17, 2009 to employees of TARP Recipients to determine if they conflict with the purpose of EESA, or are otherwise contrary to the public interest.

APPLICABILITY TO TARP RECIPIENTS WHO HAVE NEVER HAD AN OUTSTANDING OBLIGATION TO TREASURY

- The restrictions contained in the June Rule apply on a substantially more limited basis (generally consisting of certain of the risk assessment provisions and the luxury expenditures policy) to TARP Recipients who have never had an obligation to Treasury. A TARP Recipient is generally treated as having an obligation to Treasury if it is required to repay financial assistance received from Treasury through the repayment of a debt obligation or the redemption or repurchase of an equity security, excluding warrants to purchase stock of the TARP Recipient.

We hope that you find this brief summary helpful. If you would like more information or assistance in addressing the issues raised in this advisory, please feel free to contact:

Edward E. Bintz
+1 202.942.5045
Edward.Bintz@aporter.com

Douglas S. Pelley
+1 202.942.5423
Douglas.Pelley@aporter.com

Christopher L. Allen
+1 202.942.6384
Christopher.Allen@aporter.com

Melissa L. Grubbs
+1 202.942.5058
Melissa.Grubbs@aporter.com

Eunice Y. Kang
+1 212.715.1043
Eunice.Kang@aporter.com