T O O U R F R I E N D S A N D C L I E N T S

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Executive Compensation Provisions in the Emergency Economic Stabilization Act of 2008

The Emergency Economic Stabilization Act of 2008 (the "Act") imposes new executive compensation and tax requirements on any financial institution that participates in the "troubled asset relief program" ("TARP"). A financial institution generally becomes subject to the Act when the Secretary of the Treasury (the "Secretary") purchases troubled assets from the financial institution. The Act imposes standards on these institutions for executive compensation and corporate governance and amends the deductibility limits and the golden parachute provisions under the Internal Revenue Code of 1986, as amended (the "Code"). The standards that the Act imposes differ based on whether the Secretary has purchased the troubled assets from a financial institution through direct purchases or through auction purchases. Direct purchases occur when the Secretary purchases troubled assets from an individual financial institution without a bidding process and market prices are unavailable and, as a result of that transaction, the Secretary receives a meaningful debt or equity position in the financial institution. Auction purchases occur when the Secretary purchases troubled assets of a financial institution through auctions and the purchases of the troubled assets exceed $300,000,000 in the aggregate.

Direct Purchases

The Act provides that if the Secretary receives a meaningful debt or equity position in a financial institution as the result of a direct purchase of troubled assets where there is no bidding process or market prices are unavailable, then the financial institution must meet appropriate standards for executive compensation and corporate governance for the duration of the period the Secretary holds such a debt or equity position. The Act promulgates three very general standards applicable to "senior executive officers," defined as any of the top five executives of a public

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company whose compensation is required to be disclosed under the Securities Exchange Act of 1934 or, for a non-public company, their relevant counterparts. These standards apply for the duration the Secretary holds an equity or debt position in the financial institution.

Limits on Certain Compensation

First, limits must be placed on compensation to prevent incentivizing senior executive officers taking unnecessary and excessive risks that threaten the value of the financial institution. The extent of these proposed limits or how risk should be quantified for purposes of this standard is unknown and presumably will be detailed in future guidance.

Clawbacks Upon Financial Restatements

Second, clawback provisions are to be adopted that provide for the recovery by the financial institution of any bonus or incentive compensation paid to a senior executive officer if the financial criteria it was based on are later proven to be materially inaccurate. Although lacking details, this standard, on its face, contrasts with a similar provision in Sarbanes-Oxley that is limited only to CEOs and CFOs, and applies only if an issuer is required to prepare an accounting restatement because of material noncompliance and the material noncompliance was the result of misconduct. Most importantly, the Sarbanes-Oxley provision does not give the institution a private right of action to enforce the clawback provision.

Golden Parachutes

Third, the financial institution is prohibited from making any golden parachute payments to senior executive officers. The term “golden parachute payment” is not defined in the Act. Presumably, however, it refers to nondeductible payments by corporations that are subject to the 20% excise tax under the existing golden parachute provisions of the Code (Sections 280G and 4999). Those existing provisions generally apply to the amount of any executive benefits that exceed three times the executive’s base amount and that are triggered by reason of a change in ownership or control.

Auction Purchases

If the Secretary purchases troubled assets from a financial institution through auctions which exceed in the aggregate $300,000,000 (including direct purchases), then the financial institution is subject to different requirements than if the assets were purchased directly. As described below, these requirements are largely implemented through amendments of the Code sections that deal with golden parachutes and the deduction of compensation to certain covered executives.

Code Amendment – New Definitions

For purposes of the provisions described below, "covered executives" include (1) any CEO and CFO during any applicable portion of an "applicable taxable year," and (2) the three highest compensated officers for the taxable year who are employed during the applicable portion of an applicable taxable year. Moreover, any employee treated as a covered executive with respect to an applicable employer for any applicable taxable year will continue to be treated as a covered employee for all subsequent applicable taxable years. "Applicable employers" are defined as those institutions participating in TARP, where the aggregate amount of assets acquired by the Secretary for all taxable years exceeds $300,000,000 and such troubled assets were not sold exclusively through direct purchase. "Applicable taxable years" are defined as any taxable year for which such provisions are in effect.

Amendments to Deduction Limitations

The Act amends the current Code provision that limits the deductibility of compensation exceeding $1,000,000 to certain covered employees (Section 162(m)). Under existing law, this deduction limitation is generally applied to compensation paid or accrued by publicly-held corporations with respect to their chief officers, with an important exception for compensation that is performance-based. Under the Act, for applicable employers (regardless of whether they are publicly-held corporations), no deduction can be taken for compensation that exceeds $500,000 received by a covered executive in an applicable taxable year. Any deferred compensation that

is remuneration for service performed during an applicable taxable year will also be subject to such deduction limits. Most importantly, the performance-based compensation exception referred to above will not apply.

Amendments to Golden Parachute Provisions

The Act amends the Code's existing provisions on golden parachutes. As a result, under the golden parachute rules, certain payments will be nondeductible and the recipients will be subject to the 20% excise tax if covered executives of applicable employers are severed from employment due to an involuntary termination by the employer or in connection with any bankruptcy, liquidation or receivership (whether or not upon a change in control). Furthermore, certain provisions, such as the exemptions from the golden parachute rules for reasonable compensation and small business corporations, will not apply in such a situation.

Prohibition on New Golden Parachute Arrangements

Finally, applicable employers also may not enter into new employment contracts with senior executive officers to the extent that such contracts provide for a golden parachute in the event of an involuntary termination, bankruptcy filing, insolvency or receivership. This prohibition applies only to arrangements entered into during the period in which TARP is in effect. The Secretary must issue additional guidance on this topic within two months of the enactment of the Act.

Expiration of TARP

The relief program expires December 31, 2009, unless the Secretary's authority is extended by Congress. If such an extension is granted, it cannot expire later than two years after the enactment of the Act.

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Authors and Contributors:

New York

Laraine S. Rothenberg	+1.212.859.8745
Amy L. Blackman	+1.212.859.8620
Mindy P. Meyers	+1.212.859.8718
Todd McCafferty	+1.212.859.8546

New York

Donald P. Carleen	+1.212.859.8202
Jeffrey Ross	+1.212.859.8678