

President Obama Announces New Restrictions on Executive Compensation for Financial Institutions Receiving Government Assistance

February 5, 2009

On February 4, the White House and the U.S. Department of Treasury (the Treasury Department) issued a press release announcing new guidelines on executive pay for financial institutions receiving government assistance under the Troubled Assets Relief Program. The press release is available online at <http://www.ustreas.gov/press/releases/tg15.htm>. We expect that in the coming weeks additional guidance regarding the application and scope of the guidelines will be issued, and that guidance will have a material effect on how the guidelines are interpreted and administered.

I. Restrictions on Executive Compensation

Except for the certification requirements discussed below (which apply to all institutions that have previously received government assistance or do so prospectively), the guidelines on executive compensation distinguish between institutions receiving “exceptional assistance” from the government and institutions participating in any new generally available capital access program. Institutions categorized as receiving “exceptional assistance” negotiate bank-specific agreements with the Treasury Department.

The Treasury Department indicated in the press release that these new executive compensation standards will not apply retroactively to existing investments or to previously announced generally available capital access programs, such as the Capital Purchase Program. Therefore, these investments and programs will continue to be governed by existing requirements and guidance on executive compensation, with the additional overlay of the certification requirements.

A. Institutions Receiving “Exceptional Assistance”

- ***\$500,000 Total Annual Compensation Limit plus Restricted Stock.*** The total amount of compensation for each senior executive (i.e., CEO, CFO, and the next three most highly compensated officers) will be limited to \$500,000, although additional compensation beyond \$500,000 can be awarded in the form of restricted stock awards (or other similar long-term incentive arrangements). The restricted stock cannot vest until the government has been repaid in full or until a specified period to be determined based on various factors (e.g., the degree to which the institution has satisfied its repayment obligations, protected taxpayer interests, or met lending and stability standards). The ongoing (and seemingly unlimited) ability to grant

restricted stock and other qualifying incentives (which may include options and stock appreciation rights) as components in a compensation package is an important aspect of this new regime, and offers significant planning opportunities for institutions.

- **“Say on Pay” Shareholder Resolution.** The senior executive compensation structure and the rationale for how compensation is tied to sound risk management will be required to be submitted to a nonbinding shareholder resolution.
- **Mechanism to “Clawback” Bonuses.** Mechanisms will be required to “clawback” bonuses and incentive compensation from the top 25 senior executives if an executive is found to have knowingly engaged in providing inaccurate information relating to financial statements or performance metrics used to calculate his or her own incentive pay.
- **Prohibition on “Golden Parachute” Payments.** The top 10 senior executives will be prohibited from receiving any “golden parachute” payments upon severance from employment. In addition, and at a minimum, the next 25 executives are prohibited from receiving any “golden parachute” payment upon severance from employment greater than one year’s compensation. It is unclear the extent to which various termination payments will be subject to this prohibition.
- **Company Policy Relating to Luxury Expenditures.** The boards of directors of institutions will be required to adopt a companywide policy on luxury expenditures, such as aviation services, office and facility renovations, entertainment and holiday parties, and conferences and events. CEOs will have to certify expenditures that could be viewed as luxury items, and expenditure policies will have to be posted on each institution’s website.

B. Institutions Participating in Future Generally Available Capital Access Programs

- **Future Guidance Will Be Issued.** The Treasury Department stated in the press release that it intends to issue proposed guidance subject to public comment on executive compensation requirements relating to future generally available capital access programs.
- **Mechanism to “Clawback” Bonuses and Company Policy Relating to Luxury Expenditures.** Some of the proposed requirements listed are similar to those discussed above for institutions receiving “exceptional assistance,” including requiring a mechanism to “clawback” bonuses and adopting a policy relating to luxury expenditures.
- **“Golden Parachute” Payments Limits.** One difference from the “exceptional assistance” rules is that only the top five senior executives for institutions participating in future generally available capital access programs will be prohibited from receiving any “golden parachute payments” upon severance from employment greater than one year’s compensation.
- **Waiver of \$500,000 plus Restricted Stock Rule.** In addition, institutions participating in future generally available capital access programs will be allowed to waive the \$500,000 total annual compensation plus restricted stock rule by disclosing their compensation, and if requested, submitting a nonbinding “say on pay” shareholder resolution. These institutions will be required to provide an explanation of how the compensation arrangements of its senior executives and other employees do not encourage excessive and unnecessary risk-taking.

II. Compliance and Certification by CEO and Compensation Committees

The CEO of any institution that has previously received government assistance or does so prospectively will be required to certify on an annual basis that the institution has strictly complied with statutory, Treasury Department, and contractual executive compensation restrictions. In addition, the compensation committee of each institution will be required to provide an explanation of how its senior executive compensation arrangements do not encourage excessive and unnecessary risk-taking.

III. Long-Term Executive Pay Reform

The Treasury Department indicated in the press release that it believes now is the right time to examine how companywide compensation strategies at institutions may have encouraged the excessive risk-taking that contributed to current market events, and to begin developing model compensation policies for the future. The steps specified to develop such policies include the following:

- **Compensation Committee Review and Disclosure.** Require the compensation committee of each public financial institutions (irrespective of whether it is receiving government assistance) to review and disclose executive and certain employee compensation arrangements, and to explain how these compensation arrangements and strategies are consistent with promoting sound risk-management and long-term value creation for its institution and its shareholder.
- **Compensation That Encourages a Long-Term Perspective.** Require top executives to receive compensation that is structured to encourage a long-term perspective on creating economic value for their shareholders and the economy. One idea specifically mentioned in the press release is to require top executives at financial institutions to meet time-based vesting conditions for stock awards to encourage a more long-term focus on the economic interests of the institutions.
- **“Say on Pay” Shareholder Resolution.** Require each institution (irrespective of whether it is receiving government assistance) to submit to its shareholders a nonbinding resolution on the levels of executive compensation and how the structure of compensation incentives help promote risk management and long-term value creation for the institution and the economy.
- **Conference on Long-Term Executive Pay Reform.** The Secretary of the Treasury will host a conference with shareholder advocates, major public pension and institutional investor leaders, policymakers, executives, academics, and others on financial institution executive pay reform and will seek testimony, comment, and white papers on model executive pay initiatives to establish best practices and guidelines on executive compensation arrangements for financial institutions.

For additional information about the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

Chicago

Brian D. Hector

312.324.1160

bhector@morganlewis.com

Louis L. Joseph

312.324.1726

louis.joseph@morganlewis.com

Dallas

Riva T. Johnson	214.466.4107	riva.johnson@morganlewis.com
Heath Miller	214.466.4118	hmillier@morganlewis.com
Erin Turley	214.466.4108	eturley@morganlewis.com

New York

Craig A. Bitman	212.309.7190	cbitman@morganlewis.com
Gary S. Rothstein	212.309.6360	grothstein@morganlewis.com
Andrew J. Schaffran	212.309.6380	dschaffran@morganlewis.com
Samuel S. Shaulson	212.309.6718	sshaulson@morganlewis.com

Palo Alto

S. James DiBernardo	650.843.7560	jdibernardo@morganlewis.com
Zaitun Poonja	650.843.7540	zpoonja@morganlewis.com

Philadelphia

Robert L. Abramowitz	215.963.4811	rabramowitz@morganlewis.com
I. Lee Falk	215.963.5616	ilfalk@morganlewis.com
Amy Pocino Kelly	215.963.5042	akelly@morganlewis.com
Robert J. Lichtenstein	215.963.5726	rlichtenstein@morganlewis.com
Vivian S. McCardell	215.963.5810	vmccardell@morganlewis.com
Joseph E. Ronan	215.963.5793	jronan@morganlewis.com
Steven D. Spencer	215.963.5714	sspencer@morganlewis.com
Mims Maynard Zabriskie	215.963.5036	mzabriskie@morganlewis.com
David B. Zelikoff	215.963.5360	dzelikoff@morganlewis.com

Pittsburgh

John G. Ferreira	412.560.3350	jferreira@morganlewis.com
R. Randall Tracht	412.560.3352	rtracht@morganlewis.com

Washington, D.C.

Althea R. Day	202.739.5366	aday@morganlewis.com
Benjamin I. Delancy	202.739.5608	bdelancy@morganlewis.com
David R. Fuller	202.739.5990	dfuller@morganlewis.com
Mary B. (Handy) Hevener	202.739.5982	mhevener@morganlewis.com
Daniel L. Hogans	202.739.5510	dhogans@morganlewis.com
Dean R. Morley	202.739.5989	dmorley@morganlewis.com
Gregory L. Needles	202.739.5448	gneedles@morganlewis.com

IRS Circular 230 Disclosure

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. For information about why we are required to include this legend in emails, please see <http://www.morganlewis.com/circular230>.

About Morgan, Lewis & Bockius LLP

Morgan Lewis is an international law firm with more than 1,500 lawyers in 22 offices located in Beijing, Boston, Brussels, Chicago, Dallas, Frankfurt, Harrisburg, Houston, Irvine, London, Los Angeles, Miami, Minneapolis, New York, Palo Alto, Paris, Philadelphia, Pittsburgh, Princeton, San Francisco, Tokyo, and Washington, D.C. For more information about Morgan Lewis, please visit www.morganlewis.com.

This LawFlash is provided as a general informational service to clients and friends of Morgan, Lewis & Bockius LLP. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship. These materials may be considered **Attorney Advertising** in some states.
Please note that the prior results discussed in the material do not guarantee similar outcomes.

© 2009 Morgan, Lewis & Bockius LLP. All Rights Reserved.

