



PENSION & BENEFITS



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EXECUTIVE COMPENSATION

The American Recovery and Reinvestment Act of 2009 broadens the limitations on executive compensation and amends certain provisions of the Emergency Economic Stabilization Act of 2008. Author Greta Cowart discusses the new standards adopted in the stimulus bill, enacted Feb. 17, 2009.

Executive Compensation Restrictions Are Broadened in the Recovery Act

By GRETA E. COWART

The executive compensation restrictions in the American Recovery and Reinvestment Act of 2009 (the Recovery Act) amend some of the executive compensation provisions in the Emergency Economic Stabilization Act of 2008 (EESA), but retain the limitations on deductions for compensation paid to the chief executive officer, the chief financial officer, and the next three most highly compensated individuals of the company to \$500,000 per year when the company has sold assets to the federal government under the Troubled Asset Relief Program (TARP), but not through the direct purchase program.

The Recovery Act applies to not only future recipients of TARP funds, but also to past recipients of TARP funds for any period during which financial assistance provided under the TARP remains outstanding, excluding periods during which the Federal Government only holds warrants to purchase common stock of the TARP recipient.¹

Application of Restrictions Broadens from Original TARP Restrictions. The Recovery Act restrictions on executive compensation can apply to different groups of executives. The restrictions generally apply to “Senior Executive Officers.” The “Senior Executive Officers” are the top five most highly paid executives of a public company whose compensation is required to be disclosed pursuant to the Securities Exchange Act of 1934 and nonpublic company counterparts.² Some of the restrictions also apply to the next 10 or 20 most highly compensated employees depending on the amount of assis-

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¹ § 111(a)(5) of EESA as amended by § 7001 of the Recovery Act.

² § 111(a)(1) of EESA as amended by § 7001 of the Recovery Act.

tance the entity received from the federal government.³ The various restrictions and to whom each of the restrictions applies depends on the level of TARP assistance. The following restrictions apply to all levels— from less than \$25 million to \$500 million or more:

- Each TARP recipient is subject to corporate governance and executive compensation standards established by the Securities and Exchange Commission while TARP monies are outstanding.

- Compensation restrictions under I.R.C. § 162(m)(5) (\$500,000 limit) apply to the CEO, CFO, and the top three most highly compensated other officers.

- Incentive compensation is prohibited for Senior Executive Officers who take unnecessary and excessive risks that threaten the value of such recipient.

- Clawback provisions are required to recover any bonus, retention award, or incentive compensation paid to a Senior Executive Officer and any of the next 20 most highly compensated employees based on statements of earnings, revenues, gains, or other criteria that are later found to be materially inaccurate.

- No golden parachute payments are permitted (defined as any payment made to a Senior Executive Officer for a departure from a company for any reason, other than for services performed).

- Any compensation plan that would encourage manipulation of the reported earnings of the TARP recipient to enhance the compensation of any of its employees is prohibited.

- Each TARP recipient must establish a Board Compensation Committee that is comprised entirely of inde-

pendent directors to review employee compensation plans and it must meet at least semi-annually for SEC registrants.⁴ It must discuss and evaluate compensation plans in light of any risk posed to the entity.

- Each TARP recipient must establish a company-wide policy regarding excessive or luxury expenditures identified by the Secretary, including: entertainment or events, office and facility renovations, aviation or other transportation services, or other activities or events that are not reasonable expenditures for staff development, reasonable performance incentives or other similar measures conducted in the normal course of business.

The following restriction applies on a graduated scale, depending on the level of TARP assistance:

- Recipients are prohibited from paying or accruing any bonus, retention award, or incentive compensation during any period in which any financial obligation (other than a warrant to purchase common stock) is outstanding. However, this restriction does not prohibit the payment of long-term restricted stock provided such long-term restricted stock does not fully vest during the period during which any obligation from TARP financial assistance is outstanding. Provided further that the restricted stock has a value that is not greater than one-third of the total annual compensation of the employee receiving the award, and provided it is subject to other terms and conditions required by the SEC⁵—

⁴ See chart below for non-SEC registrants.

⁵ The restriction on bonus payments does not apply to any bonus payment required to be paid pursuant to a written employment contract executed on or before Feb. 11, 2009, as such valid employment contracts are determined by the Secretary or the designee of the Secretary.

³ § 111(b)(3)(ii) of EESA as amended by § 7001 of the Recovery Act.

Bonus Prohibition: Level of TARP Assistance

Less than \$25,000,000	\$25,000,000 to \$249,999,999.99	\$250,000,000 to \$499,999,999.99	\$500,000,000 or more
Applies only to the most highly compensated employees of the financial institution.	Applies to at least the 5 most highly compensated employees or such higher number as the Secretary may determine.	Applies to the 5 Senior Executive Officers and at least the 10 next most highly compensated employees, or such higher number as the Secretary may determine.	Applies to the 5 Senior Executive Officers and at least the 20 next most highly compensated employees, or such higher number as the Secretary may determine.

For non-SEC registrants, the compensation committee requirement above applies as follows:

Compensation Committee Requirements

Less than \$25,000,000	\$25,000,000 to \$249,999,999.99	\$250,000,000 to \$499,999,999.99	\$500,000,000 or more

Compensation Committee Requirements – Continued

<p>The compensation committee functions must be fulfilled by the full board of directors.* *§ 111(c)(1) & (3) of EESA as amended by § 7001 of the Recovery Act.</p>	<p>A compensation committee must be established in the same manner as for SEC registrant above.* *§ 111(c)(1) of EESA as amended by § 7001 of the Recovery Act.</p>	<p>A compensation committee must be established in the same manner as for SEC registrant above.* *<i>Id.</i></p>	<p>A compensation committee must be established in the same manner as for SEC registrant above.* *<i>Id.</i></p>
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Say on Pay. In addition to the restrictions outlined above, the statute adds a nonbinding shareholder approval of executive compensation to any proxy or consent or authorization for an annual or other meeting of any TARP recipient for as long as the TARP assistance remains outstanding. The resolution is to approve the compensation of the executives as disclosed pursuant to the compensation disclosure rules of the SEC, including the compensation discussion and analysis, the compensation tables, and any related materials. While the SEC disclosure rules are limited to SEC registered companies, the Recovery Act does not limit the nonbinding vote provision to just those entities that are SEC registered.

The Recovery Act states that the vote is nonbinding and it may not be construed as overruling a decision by such board nor is it to be construed to create or imply additional fiduciary duty by such board. The required vote is not to be construed as restricting or limiting the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation.⁶

Application to Previously Granted TARP Funds. The SEC is to issue final rules and regulations implementing these changes within one year of enactment. The Recovery Act gives the Secretary the authority to review

bonuses, retention awards, and other compensation paid to the Senior Executive Officers and the next 20 most highly compensated employees of each entity that received TARP assistance before the date of enactment to determine if any of such payments were inconsistent with the purposes of the new executive compensation rules enacted by the Recovery Act or with TARP. If the Secretary determines that any such payments are inconsistent, then the Secretary is authorized to negotiate with the TARP recipients and executives for appropriate reimbursements to the federal government.⁷

Differences From the Administration's Proposal on Feb. 4, 2009. The Recovery Act did not adopt the administration's original proposal that there be an absolute cap on total annual executive compensation, other than restricted stock, of \$500,000. However, the Recovery Act expanded the prohibition on its version of "golden parachute payments" to prohibit any payments to Senior Executive Officers, but did not adopt the administration's proposal to also limit the next 20 officers to one times annual compensation for such "golden parachute" payments. The golden parachute payments in the Recovery Act are broader than traditional golden parachute payments made on change in control and include all payments made upon separation from employment.

⁶ § 111(e) of EESA as amended by § 7001 of the Recovery Act.

⁷ § 111(f) of EESA as amended by § 7001 of the Recovery Act.