

ClientAlert

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New Limits on Executive Pay for Financial Institutions Receiving Federal Funds

Yesterday, President Obama announced a \$500,000 pay cap and other executive compensation reforms for senior executives of financial institutions receiving "exceptional assistance." The pay cap and other executive compensation reforms were announced in the form of Treasury Department guidelines and generally apply only to the future.

"Generally Available Capital Access Programs" vs. "Exceptional Assistance."

- The new guidelines distinguish between financial institutions participating in new "generally available capital access programs" and those requiring "exceptional assistance."
- "Generally available capital access programs" are programs that have the same terms for all recipients, with limits on the amount each institution may receive and specified returns for taxpayers.
- Financial institutions that negotiate individual agreements with the Treasury Department in amounts exceeding what is permitted under the generally available capital access programs will be deemed to receive "exceptional assistance."

Conditions Imposed on Financial Institutions Receiving Exceptional Assistance.

- **Senior Executive Pay Cap of \$500,000 Plus Restricted Stock.** Total annual compensation for senior executives is capped at \$500,000. To the extent a senior executive is paid more than \$500,000, the compensation must be in the form of restricted stock or other long-term

incentives that cannot be sold or liquidated generally until after the government has been repaid.

- **"Say on Pay."** Senior executive compensation arrangements, including the basis by which compensation is tied to results, must be submitted to a non-binding "say on pay" shareholder resolution.
- **Expanded "Clawback" Provisions.** Under existing federal funds programs, financial institutions must have "clawback" provisions for the top five senior executives. The guidelines expand the mandatory clawback provision to bonuses and incentive pay for the next twenty senior executives, if they are found to have knowingly engaged in providing inaccurate information related to the institution's financial statements or performance metrics used to calculate their own incentive pay.
- **Expanded Ban on Golden Parachutes.** The guidelines expand the ban on golden parachutes from the top five senior executives to the top ten senior executives. The guidelines also limit golden parachutes for the next top twenty-five executives to one year's pay.
- **New Policy on Luxury Expenditures.** Financial institutions must enact policies on expenditures such as company jets, office renovations, holiday parties, entertainment and certain other events. To increase transparency, financial institutions must post the text of their expenditures policies on their websites. Expenditures that may be considered excessive or luxury items would require certification by the CEO.

Conditions Imposed on Financial Institutions Receiving Generally Available Capital Access Programs.

- **Senior Executive Pay Cap of \$500,000 Plus Restricted Stock, Unless Waived.** The \$500,000 plus restrictive stock senior executive pay cap may be waived only by disclosure of compensation and, if requested, a non-binding say on pay shareholder resolution. All financial institutions must review and disclose the reason that compensation arrangements of both senior executives and other employees do not encourage excessive and unnecessary risk taking.
- **Expanded Clawback Provisions.** The same rule for financial institutions receiving exceptional assistance applies -- clawback provisions must be imposed upon the next twenty senior executives, if they are found to have knowingly engaged in providing inaccurate information related to the institution's financial statements or performance metrics used to calculate their own incentive pay.
- **Expanded Ban on Golden Parachutes.** Severance pay for the top five executives may not exceed one year's pay (as opposed to three years' pay under the current federal financial assistance program).
- **New Policy on Luxury Expenditures.** The same luxury expenditures policy in place for financial institutions receiving exceptional assistance will apply to all financial institutions receiving generally available federal funds.

The Treasury Department intends to issue proposed guidance (subject to public comment) on executive compensation limitations for future generally available capital access programs.

Certification

- The CEO of each financial institution that has received federal funds must certify that the institution has complied strictly with all legal and contractual executive compensation restrictions. Annual recertification is required.
- The compensation committees of each such financial institution must explain how their senior executive compensation arrangements do not encourage excessive and unnecessary risk-taking.

The new pay cap and other reforms were issued in response to recent reports that Wall Street firms paid more than \$18 billion in bonuses in 2008 while receiving federal "bail-out" assistance.

Critics of the restrictions fear that these new reforms will discourage financial institutions from accepting federal funds and thereby slow down or prevent recovery of the financial markets. It could also drive talent away from working for financial institutions receiving government funds, further hindering the recovery of the financial markets. Finally, it is unlikely to affect some of Wall Street's highest earners, such as brokers and dealers.

The new guidelines are expected to be the first of many executive compensation reform initiatives. Additional say on pay and pay cap legislation and executive compensation reforms have been proposed. We will keep you apprised of new developments in executive compensation reform.

Our client alerts are for general informational purposes and should not be regarded as legal advice. If you would like additional information or have any questions, please contact:

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