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At the same time, there was a growing sentiment in Washington that excessive pay packages for Wall Street executives had led to some of the abuses that had caused the financial crisis. Adding to these sentiments were public statements by Senators John McCain and Barack Obama during their campaigning before the November 2008 presidential election.

When the then Republican administration introduced its $700 million bailout bill in September 2008, House Democrats insisted that limitations be placed on the compensation payable to executives of firms taking Federal money. Senator Charles Schumer (D-NY) wrote in a letter to then Treasury Secretary Paulson that restrictions on executive compensation will ensure that taxpayer money is not wasted enriching the same people whose poor decision-making created this crisis. It is imperative that these restrictions, including limitations on the incentives for executives to take excessive risks and the elimination of golden parachutes, should apply to any capital injection program.

As described below, the Emergency Economic Stabilization Act of 2008 (EESA), which was enacted on October 3, 2008 and created the Troubled Assets Relief Program (TARP) for federal assistance to financial firms, contained limitations on executive compensation and “golden parachute” payments and provided for a “clawback” of improperly paid compensation. Shortly thereafter, the Treasury issued guidelines on executive compensation and corporate governance restrictions for companies accepting money under EESA.

While EESA and Treasury guidelines imposed limitations on executive compensation for executives of companies accepting Federal funds, these limitations generally were limited to the compensation of only the five most senior corporate officers. A report released by the New York State Comptroller in early 2009 estimated that $18.4 billion in bonuses had been paid out by financial institutions in 2008. It was publicly reported shortly thereafter that Merrill Lynch & Co. had paid out $3.6 billion in bonuses just before the closing of its acquisition by Bank of America Corp. In a televised White House speech on January 29, 2009, President Obama remarked about these reports saying, “That is the height of irresponsibility. It is shameful. And part of what we’re going to need is for folks on Wall Street who are asking for help to show some restraint and show some discipline and show some sense of responsibility.”

Thereafter, on February 4, 2009, the Treasury announced new restrictions on executive compensation for companies accepting Federal bailout funds under EESA. According to the Treasury’s press release announcing the new restrictions, the measures were designed to ensure that public funds are directed only toward the public interest in strengthening the economy by stabilizing the financial system and not toward inappropriate private gain.

Scarcely one week later, a last-minute addition to the American Recovery and Reinvestment Act of 2009 (ARRA), President Barack Obama’s $787 billion economic stimulus bill, provided for even stricter limits on EESA’s executive compensation provisions. These new limits, included over the objection of the new administration, prohibit the top twenty-five most senior officers of any company that accepts government funds from receiving bonuses exceeding one-third of their annual pay, and requiring that all incentive compensation be paid in the form of restricted stock. The ARRA changes to EESA also created additional requirements and imposed additional limitations.

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3. Available at www.whitehouse.gov/blog_post/Shameful/.
on golden parachute payments, compensation committee activities, luxury expenditures, compliance certifications; added a prohibition on any compensation plan that would encourage manipulation of the reported earnings of such TARP recipient to enhance the compensation of any of its employees; directs Treasury to review executive compensation paid by TARP recipients prior to the date of ARRA’s enactment; and requires publicly traded firms receiving Federal financial assistance to submit their compensation arrangements to an annual non-binding “say on pay” shareholder vote. In this regard, in the revised language of section 111 of EESA, Congress adopted several common provisions found in the securities purchase agreements negotiated under TARP between the Treasury and certain bailout funds recipients.

§ 4:2 Treasury Regulatory Actions

The Treasury released the first of two interim final rules related to executive compensation as it applies to the Capital Purchase Program (CPP)\(^6\) under TARP on October 14, 2008 ("October Interim Rule"), discussing, in a question-and-answer format, the relevant procedures that a CPP TARP recipient must undertake to be in compliance with section 111(b)(3)(A) of EESA.\(^7\) Thereafter, on January 16, 2009, the Treasury released a new interim rule ("January Interim Rule"), amending various provisions of the October Interim Rule, along with a question-and-answer release addressing various aspects of the EESA executive compensation requirements.\(^8\)

On February 4, 2009, the Treasury issued a press release announcing new proposed restrictions on executive compensation for financial institutions receiving government assistance ("February Release").\(^9\)

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7. 73 Fed. Reg. 62,205 (Oct. 20, 2008). Pursuant to the then-effective executive compensation provisions of EESA, Treasury simultaneously issued guidance on executive compensation arrangements under other specific Treasury assistance programs, including the Troubled Asset Auction Program (TAAP) and one of the Treasury’s exceptional assistance programs, the Programs for Systemically Significant Failing Institutions (PSSFI), discussed below and in Chapter 2. See Treasury Notice 2008-TAAP; Treasury Notice 2008-PSSFI.
In issuing this release, the Treasury emphasized the need to align the executive compensation practices in the financial community with the interests of shareholders and taxpayers. The proposed restrictions detailed in this press release generally imposed new substantive restrictions on the compensation practices of financial institutions seeking assistance under future capital assistance programs, but also required financial institutions currently receiving government assistance to comply with enhanced compliance certification standards. In the case of financial institutions seeking new assistance, the Treasury’s guidelines drew a distinction between financial institutions participating in generally available capital access programs similar to the CPP and financial institutions that require exceptional assistance.\(^{10}\) The guidelines contained in the February Release have since been revised and incorporated into the Treasury’s interim final regulations under EESA section 111, discussed immediately below.

On June 10, 2009, the Treasury released an interim final rule ("Interim Final Rule") to provide more definitive guidance on the executive compensation and corporate governance provisions of EESA that apply to firms that receive financial assistance under TARP.\(^{11}\) In accordance with ARRA, the Interim Final Rule supersedes and consolidates all prior Treasury rulemaking and guidance concerning TARP executive compensation activities under EESA. Specifically, Treasury has stated that the provisions of ARRA and the Interim Final Rule supersed the October Interim Rule and all other Treasury notices, although the Interim Final Rule incorporates various of the provisions of the prior rulemaking and notices. The Interim Final Rule generally became effective upon its publication in the Federal Register on June 15, 2009.

The Interim Final Rule implements EESA, as amended by ARRA, by establishing a broad range of standards for executive compensation practices at firms receiving TARP assistance, consistent with the requirements of EESA, as amended by ARRA. In addition, however,

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10. Financial institutions receiving future exceptional assistance would include institutions similar to AIG under the PSSFI and Citigroup and Bank of America under the Targeted Investment Program (TIP), discussed in Chapter 2, supra.

the Interim Final Rule establishes supplemental requirements and oversight mechanisms for the small number of firms that receive “exceptional assistance” from the Federal government.\textsuperscript{12} The Interim Final Rule applies to all TARP recipients, although certain of the requirements (certain compensation committee review and certification activities, compensation “clawbacks,” golden parachute restrictions, bonus payment restrictions, supplemental compensation standards, say-on-pay, and CEO/CFO certification obligations) apply only during the period that a TARP recipient has a financial assistance obligation outstanding to the Federal government.\textsuperscript{13}

\textbf{§ 4:3 Compensation Standards and Restrictions}

With the passage of EESA and the creation of TARP, the Federal government effectively tied a financial institution’s receipt of bailout funds to the mandatory adoption of provisions restricting such financial institution’s executive compensation programs and corporate governance practices. Section 111 of EESA provides that any entity participating in TARP shall be subject to certain standards and restrictions applicable to such participant’s executive compensation practices. Furthermore, the Treasury Secretary (“Secretary”) is authorized pursuant to section 101(c)(5) of EESA to promulgate such rules and regulations as are necessary to carry out the purposes of that act.\textsuperscript{14} As discussed herein, the Secretary has released regulations and notices setting forth compensation restrictions applicable to the programs established by the Secretary under TARP. As a result, firms receiving financial assistance under TARP must comply with a variety of statutory and regulatory obligations in addition to the specific contractual provisions contained in the securities purchase agreements entered into between certain financial institutions and the Treasury.

\textsuperscript{12} Companies receiving exceptional financial assistance include those receiving assistance under PSSFI, TIP, and the Automotive Industry Finance Program (AIFP). See Chapter 2, supra. As of July 1, 2009, these firms include AIG, Citigroup, Bank of America, Chrysler, GM, GMAC and Chrysler Financial.

\textsuperscript{13} 31 C.F.R. § 30.2.

\textsuperscript{14} 12 U.S.C. § 5211(c)(5).
This chapter will identify and explain the various restrictions on executive compensation found in EESA and implementing Treasury regulations, and also focus on the revisions to EESA following the passage of ARRA.\textsuperscript{15}

§ 4:3.1 Overview and Definitions

EESA sets forth a general definitional framework applicable to the programs created under its authority. The Treasury has issued regulations expanding upon the EESA framework, clarifying the measures that must be taken by participating institutions in order to remain in compliance with the various restrictions related to executive compensation imposed under the statute. An understanding of the following definitions will provide the necessary backdrop in exploring the contours of the compensation restrictions found in EESA and TARP.

[A] TARP Recipients

Prior to the enactment of ARRA, section 111 of EESA was generally limited in application to financial institutions participating in direct purchase or auction purchase programs under TARP.\textsuperscript{16} For example, financial institutions in which Treasury held a direct debt or equity position, including those participating in CPP as well as PSSFI, were generally subject to the EESA section 111(b) restrictions that required:

(i) the development and adoption of standards for executive compensation (discussed below);

\textsuperscript{15} ARRA was passed by the House of Representatives and the Senate on February 13, 2009, and signed into law by the President on February 17, 2009. Section 7001 of ARRA amends and restates section 111 of the original EESA, adding additional executive compensation restrictions to the prior legislation.

\textsuperscript{16} “Financial institution” under the pre-amendment EESA was generally defined as any institution, including but not limited to any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States and its states and territories, and having significant operations in the United States but excluding any central bank of, or institution owned by, a foreign government. Under ARRA, TARP recipients would include the automotive industry by reason of its having received government assistance.
(ii) clawback provisions for firms paying incentive compensation based on materially inaccurate financial information (discussed below); and

(iii) limitations on golden parachute payments (discussed below), whereas institutions that sold over $300 million of troubled assets to Treasury under a TARP auction purchase program (such as TAAP) were subject only to the golden parachute restrictions of EESA section 111(c). The scope of EESA was significantly modified with the passage of ARRA, extending the coverage of EESA’s affirmative obligations to all TARP recipients. For purposes of EESA, a “TARP recipient” is defined as any entity that has received or will receive financial assistance under the TARP financial assistance provisions. Taking into consideration the extent that ARRA amendments to EESA modify the affirmative obligations of participating entities, the enforceability of the modified EESA as it applies to TARP recipients receiving assistance prior to enactment of ARRA could be called into question. In this regard, courts are often reluctant to apply statutes retroactively to individuals and entities without prior notice.

[B] Control Groups

The Treasury has further clarified the scope of section 111 of EESA by issuing guidance on control group rules in its Interim Final Rule. Under current rules, two or more financial institutions are treated as being a single entity if considered to be a “single employer” under section 414 of the Internal Revenue Code of 1986, as amended (“Code”). In the case of corporations, a TARP recipient is deemed to include, among other things, all 50% controlled subsidiaries; in this regard, the Code threshold for a single employer is 80%, but the Treasury regulations expressly changed this benchmark to 50%. The control group rules do

18. See 31 C.F.R. § 30.1 [definition of “TARP recipient”].
19. Id.
20. To provide an example, a corporation not otherwise participating in TARP (or any program created thereunder) would nevertheless be considered a TARP recipient if at least 50% of the total combined voting power of its capital stock were held by a TARP recipient.
not apply, however, to brother-sister relationships, nor do they apply to financial institutions that acquire a TARP recipient by way of merger, consolidation or reorganization (subject to certain anti-abuse rules).

Senior executive officers of an acquired TARP recipient, however, continue to be subject to the rules governing executive compensation as they relate to golden parachute payments, which will be discussed in further detail below.

[C] **Senior Executive Officers**

The executive compensation standards under EESA and TARP are primarily focused on the senior executive officers (SEOs) employed by a TARP recipient. A SEO is defined as an individual who is a “named executive officer” as defined under Securities and Exchange Commission (SEC) Regulation S-K, Item 402 who is an employee of a TARP recipient; in general, this reference includes one of the top five most highly paid executive officers of a public company, and whose compensation is required to be disclosed pursuant to the Securities Exchange Act of 1934, as amended (“Securities Exchange Act”), and non-public company counterparts. In the case of public companies, a SEO will

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21. *Id.*
23. A senior executive officer of an acquired TARP recipient is bound by EESA section 111(b)(3)(C) relating to golden parachute payments until the first anniversary following the acquisition.
25. 12 U.S.C. § 5221(a)(1). Under Item 402 of SEC Regulation S-K, 17 C.F.R. § 229.402 [2009] (“Regulation S-K”), compensation disclosure must be provided for all individuals serving as a company’s principal executive officer during the last completed fiscal year, all individuals serving as a company’s principal financial officer during the last completed fiscal year and the company’s three most highly compensated executive officers other than the principal executive officer and principal financial officer who were serving as executive officers at the end of the last completed fiscal year. The term “executive officer” is defined in Item 405 of Regulation S-K Rule 405, under the Securities Act of 1933, as amended (Securities Act), 17 C.F.R. § 230.405, to include a company’s “president, any vice president of the registrant in charge of a principal business unit, division or function [such as sales, administration or finance], any other officer who performs a policy making function or any other person who performs similar policy making functions” for the company and includes executive officers of subsidiaries if they perform policy making functions for the parent company.
often be among the “named executive officers” (as such term is defined in Regulation S-K, Item 402) identified in the TARP recipient’s Annual Report on Form 10-K or annual proxy statement. In order to meet the definition of a SEO, the named executive officer must also be employed by a TARP recipient while the Treasury holds an equity or debt position in the TARP recipient ("Treasury Holding Period").

For purposes of determining the most highly compensated officers of a TARP recipient, compensation is calculated according to the officer’s total compensation for the last completed fiscal year without regard to whether such compensation is includable in the officer’s gross income for federal income tax purposes. Analogous rules apply to participating financial institutions that are not subject to the federal securities laws, including those that do not have securities registered with the SEC.

As noted above, a SEO must be an employee of a TARP recipient. The Interim Final Rule clarified that, in general, a partner of a partnership, a member of a limited liability company or other similar owner in a similar type of entity will not be treated as employees. The form of the entity will be disregarded where its primary purpose was to avoid or evade the EESA or the regulations thereunder and where the entity is a personal service corporation or similar intermediary between the TARP recipient and an individual providing services to the TARP recipient.

[D] Most Highly Compensated Employee

In general, the term “most highly compensated employee” means the employee of the TARP recipient, other than the SEOs of the TARP recipient, whose annual compensation is determined to be the highest among all employees of the TARP recipient. The determination is based on the employee’s prior year compensation (determined under

27. 31 C.F.R. §§ 30.2, 30.3. The Treasury Holding Period does not include periods where the Federal Government only holds warrants to purchase common stock of TARP recipient. 12 U.S.C. § 5221(a)(5) (as revised by ARRA).
28. 31 C.F.R. § 30.3(a). Note that the standards applicable to determining a SEO for non-tax purposes [i.e., unnecessary and excessive risk-taking, clawbacks of certain bonus or incentive compensation and the prohibition on golden parachute payments] are different than those applied for tax purposes [i.e., rules relating to deductibility of executive compensation].
SEC executive compensation disclosure rules for determining “total compensation” of named executive officers, without regard to whether the compensation is includible in the employee’s gross income for federal income tax purposes.\footnote{31 C.F.R. § 30.3.}

A former employee who is no longer employed as of the first day of the relevant fiscal year of the TARP recipient is not a most highly compensated employee unless it is reasonably anticipated that the employee will return to employment with the TARP recipient during the applicable fiscal year.\footnote{31 C.F.R. § 30.1.}

For an entity that is created or organized in the same year that the entity becomes a TARP recipient, a most highly compensated employee for the first year includes the person that the TARP recipient determines will be the most highly compensated employee for the next year based upon a reasonable, good faith determination of the projected annual compensation of such person earned during that year. This determination must be made as of the later of the date the entity is created or organized or the date the entity becomes a TARP recipient, and must be made only once. However, a person need not yet be an employee to be treated as a most highly compensated employee, if it is reasonably anticipated that the person will become an employee of the TARP recipient during the first year.

\section*{§ 4:3.2 Risk-Related Restrictions on Compensation}

As previously noted, prior to the enactment of ARRA, section 111 of EESA distinguished between cases where the Secretary makes direct purchases of troubled assets from a financial institution under TARP’s CPP or PSSFI on the one hand, and those purchases where troubled assets are acquired through a competitive auction process under the TAAP on the other hand (the TAAP, however, has never become operational). Participants in the CPP or PSSFI were subject to the risk-based compensation restrictions found in former section 111(b) of EESA. Participants in the TAAP, on the other hand, would only be required to comply with compensation restrictions related to golden parachute payments under EESA section 111(c).
The ARRA amendments dispensed with this distinction, however, requiring all TARP recipients to comply with the executive compensation and corporate governance standards contained in new section 111(b)(3). ARR A also expanded the prior EESA provision to cover all employee compensation plans, and also to require that no employee compensation plan encourage the manipulation of earnings. The Interim Final Rule implements these provisions, and also requires that the compensation committee of the financial institution provide a narrative explanation of its analysis, allowing shareholders to determine and evaluate directors’ reasoning with respect to the risks presented by compensation plans.

[A] Compensation Committee

The Interim Final Rule requires that a TARP recipient must establish a compensation committee by the later of (i) ninety days after the closing date of the agreement between the TARP recipient and Treasury, and (ii) September 14, 2009, and maintain the compensation committee during the remainder of the TARP period. The compensation committee must be composed entirely of independent directors.

The mandated activities of the compensation committee include:

(1) Discussing, evaluating, and reviewing at least every six months with the TARP recipient’s senior risk officers the SEO compensation plans to ensure that the SEO compensation plans do not encourage SEOs to take unnecessary and excessive risks that threaten the value of the TARP recipient;

(2) Discussing, evaluating, and reviewing with senior risk officers at least every six months employee compensation plans in light of the risks posed to the TARP recipient by such plans and how to limit such risks;

32. 31 C.F.R. § 30.4.
33. 31 C.F.R. § 30.1. For this purpose, independence is determined pursuant to Item 407[a] of SEC Regulation S-K, which generally refers to the definitions of independence adopted by national securities exchanges.
(3) Discussing, evaluating, and reviewing at least every six months the employee compensation plans of the TARP recipient to ensure that these plans do not encourage the manipulation of reported earnings of the TARP recipient to enhance the compensation of any of the TARP recipient’s employees;

(4) At least once per TARP recipient fiscal year, providing a narrative description of how the SEO compensation plans do not encourage the SEOs to take unnecessary and excessive risks that threaten the value of the TARP recipient, including how these SEO compensation plans do not encourage behavior focused on short-term results rather than long-term value creation; the risks posed by employee compensation plans and how these risks were limited, including how these employee compensation plans do not encourage behavior focused on short-term results rather than long-term value creation; and how the TARP recipient has ensured that the employee compensation plans do not encourage the manipulation of reported earnings of the TARP recipient to enhance the compensation of any of the TARP recipient’s employees; and

(5) Certifying the completion of the reviews of the SEO compensation plans and employee compensation plans described in paragraphs (a)(1), (2), and (3) above.

A TARP recipient that does not have securities registered with the SEC and has received $25 million or less in financial assistance may, instead of creating and/or maintaining an independent compensation committee, ensure that all the members of the board of directors carry out the required duties of the compensation committee.

[B] Risk Assessment of SEO Compensation Arrangements

Section 111(b)(3)(A) of EESA states, in part, that a financial institution must, as a pre-condition of participating in any securities purchase arrangements under TARP, agree to limits on compensation that exclude incentives for SEOs of TARP recipients to take unnecessary and excessive risks that threaten the value of such recipient.34 EESA does not,
however, specify any compliance procedures or provide further clarification as to what constitutes an unnecessary and excessive risk.

Under the Interim Final Rule, the compensation committee of a TARP recipient participating in the CPP is required to review all SEO compensation arrangements at least every six months to ensure that the incentive and bonus structures of these arrangements do not encourage excessive risk-taking on the part of the TARP recipient’s SEOs. In reviewing these compensation programs, the committee must meet with the financial institution’s senior risk officers (or individuals acting in a similar capacity) to discuss the relationship between the TARP recipient’s risk management policies and the SEO compensation arrangements then in place. The compensation committee must make reasonable efforts to amend or terminate any SEO incentive structures that could jeopardize the value of the TARP recipient as a going concern.

The Treasury previously had noted, both in its January Interim Rule and in Notice 2008-PSSFI, that each TARP recipient participating in a direct purchase program faces risks unique to that particular TARP recipient. These risks stem, in part, from variations in the business models, target markets and product offerings applicable to each TARP recipient. Recognizing these differences, the Treasury in effect has directed each TARP recipient to identify both short- and long-term risks to the value and stability of the TARP recipient and how its SEO compensation arrangements mitigate or exacerbate those risks.

[C] Bonuses to SEOs

As originally enacted, EESA contained no outright prohibitions on a TARP recipient’s ability to pay bonus or incentive compensation to its employees. Commenting on the inadequacy of prior EESA legislation, Senator Dodd, Democrat from Connecticut, noted how “the decisions of certain Wall Street executives to enrich themselves at the expense of taxpayers have seriously undermined public confidence.” Addressing this issue, Senator Dodd introduced as amendment to EESA barring top executives from receiving bonuses exceeding one third of their annual pay.

35. 31 C.F.R. § 30.5.
36. 31 C.F.R. § 30.4.
New section 111(b)(3)(D) of EESA provides that a TARP recipient is prohibited from paying or accruing any bonus, retention award or incentive compensation during the Treasury Holding Period; provided, however, that a TARP recipient is not prohibited from granting long-term restricted stock awards that do not fully vest during the Treasury Holding Period and which do not equal more than one third of the total amount of annual compensation paid to the applicable employee. The Interim Final Rule defines long-term restricted stock to include both restricted stock and restricted stock units, which can be settled in stock or cash, and which may be designed to track a specific unit or division within a TARP recipient.\(^{38}\) Importantly, neither EESA nor the Final Interim Rule include any cap on base salary. Furthermore, the Interim Final Rule makes clear that a commission that is based on pre-established and reasonable rates, and is applied consistently to the sale of substantially similar goods or services, will not be treated as a bonus.

The scope of prohibitions contained in section 111(b)(3)(D) apply to a TARP recipient based on the level of assistance received from the Federal government by such TARP recipient. The various levels of restriction are as follows:

<table>
<thead>
<tr>
<th>Level of Government Assistance Received by TARP recipient</th>
<th>Employees Covered</th>
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<tbody>
<tr>
<td>( x &lt; $25M )</td>
<td>Most highly compensated employee</td>
</tr>
<tr>
<td>( $25M \leq x &lt; $250M )</td>
<td>Five most highly compensated employees</td>
</tr>
<tr>
<td>( $250M \leq x &lt; $500M )</td>
<td>SEOs and the 10 next most highly compensated employees</td>
</tr>
<tr>
<td>( $500M \leq x )</td>
<td>SEOs and the 20 next most highly compensated employees</td>
</tr>
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</table>

Consistent with ARRA, the Interim Final Rule limits bonuses paid to SEOs and to a specified number of the most highly compensated employees of TARP recipients to one third of total compensation, consistent with the legislation passed by Congress. The rule defines

\(^{38}\) 31 C.F.R. § 30.1.
“most highly compensated” employees by reference to total annual compensation as calculated under SEC registration and periodic reporting rules. As provided in ARRA (see table above), the number of most highly compensated employees covered by the limit depends upon the amount of financial assistance the company has received. The Interim Final Rule also encourages firms to pay salary in the form of stock that must be held for a long period of time and may not be entirely converted to cash until TARP funds are repaid, with the stated intent of aligning executives’ incentives with those of shareholders and taxpayers and effectively ensuring that executives experience a “clawback” effect if positive results prove illusory and the stock drops in value.

Although the Interim Final Rule contains an exception from the bonus limitation for payments of certain types of “commissions,” the rule limits commissions to amounts payable under commission programs similar to those already in place as of February 17, 2009 (the date of ARRA’s enactment). At firms receiving “exceptional assistance” under TARP, these payments and compensation structures for executive officers and the most highly compensated employees will also be subject to review by the newly appointed Special Master for TARP Executive Compensation (“Special Master”) (discussed below).

[D] Compliance Certification Requirements

Under EESA section 111(b)(4) and 31 C.F.R. Part 30, a TARP recipient must promptly certify the results of its compensation risk analysis in two related but separate processes. First, the compensation committee must certify the results of its semiannual review as part of its review obligations under EESA. The Treasury has adopted model language that can be utilized by the TARP compensation committee in making the required certifications. The compensation committee also must provide a narrative disclosure and discussion of each SEO compensation plan and explain how their executive compensation arrangements do not encourage excessive and unnecessary risk-taking, as well as an identification and explanation of each employee compensation plan. In the case of TARP recipients that are subject to the federal securities laws, the TARP recipient is directed to provide the certification as part of the Compensation Committee Report found in

39. 31 C.F.R. § 30.4.
40. 31 C.F.R. § 30.7.
41. Id.
the TARP recipient’s Annual Report on Form 10-K or annual proxy statement. TARP recipients that are not subject to the federal securities laws, or that do not have securities registered with the SEC, are directed to provide the certification to the TARP recipient’s primary financial regulatory agency and Treasury within 120 days after the close of the preceding fiscal year.

Second, in expanding on the certification requirements applicable to a TARP recipient’s compensation committee, ARRA requires the chief executive officer and chief financial officer (or equivalents thereof) to provide written certification of a TARP recipient’s strict compliance with all provisions found in section 111 of the revised EESA. In turn, under the Interim Final Rule, a TARP recipient’s principal executive officer and principal financial officer must make the appropriate certifications as to the TARP recipient’s compliance with EESA’s provisions and take steps necessary to preserve the documentary evidence of such certifications for a period of no less than six years following the date of certification. The initial review and certification process must be completed by the principal executive officer and principal financial officer no later than ninety days following the completion of the TARP recipient’s first annual fiscal year of which any portion was a Treasury Holding Period. In subsequent fiscal years that include a Treasury Holding Period, the certification must be provided within ninety days of the completion of that fiscal year. The Treasury also has provided model language for these certifications.

42. 31 C.F.R. § 30.7(c). See Item 407(e) of Regulation S-K, 17 C.F.R. § 229.407(e).
43. 31 C.F.R. § 30.7(d).
44. Commenting on the effective date of the certification requirement, Senator Dodd, in a February 20, 2009 letter to Mary Schapiro, Chairman of the SEC, noted that the chief executive officer and chief financial officer certification requirements would remain suspended pending the Treasury’s release of new executive compensation and corporate governance standards under revised EESA.
45. 31 C.F.R. § 30.15(a). The principal executive officer must make compliance certifications within ninety days of the completion of the first fiscal year during which TARP recipient has participated in the program. The principal executive officer must continue to make the ninety-day certifications for each fiscal year that TARP recipient has participated in the program.
46. The six-year document retention policy also applies to compensation committee certifications. See 31 C.F.R. § 30.15.
47. 31 C.F.R. § 30.15.
48. Id., app. A.
In the case of TARP recipients that are subject to the federal securities laws, the TARP recipient is directed to provide the certification as an exhibit to the TARP recipient’s Annual Report on Form 10-K.\(^49\) TARP recipients that are not subject to the federal securities laws, or that do not have securities registered with the SEC, are directed to provide the certification to the TARP recipient’s primary financial regulatory agency and Treasury.\(^50\) False or fraudulent statements under these requirements are punishable as criminal offenses under 18 U.S.C. § 1001 pertaining to false or fraudulent statements made to the Federal government.

§ 4:3.3 Limitations on Golden Parachute Payments

[A] Existing Parachute Payment Restrictions—Internal Revenue Code

Sections 280G and 4999 of the Code limit the ability of an employer to deduct certain payments made to restricted employees upon the termination of employment due to a change in ownership or control of the employer. Severance payments of this nature fall within the coverage of these deductibility rules if the aggregate present value of payments to the restricted employee equals or exceeds three times the employee’s average annualized gross income over the five taxable years ending immediately prior to the year during which the change of control occurs (the “Base Amount”).\(^51\) These covered payments, referred to as “parachute payments,” are not deductible and are subject to certain excise taxes to the extent they exceed the individual’s Base Amount.

[B] EESA Parachute Payment Restrictions

EESA expands on the Code’s golden parachute rules by limiting a participating financial institution’s ability to grant severance payments to a SEO. Prior to the passage of ARRA, the golden parachute restrictions applicable to a TARP recipient depended on the particular program of involvement. In the case of direct purchase programs, variations in the treatment of golden parachute payments stemmed from differences in the definition of “golden parachute payment” now

\(^{49}\) 31 C.F.R. § 30.15[a][4]. See Item 601[b][99][i] of Regulation S-K, 17 C.F.R. § 229.601[b][99][i].
\(^{50}\) 31 C.F.R. § 30.15[a][5].
\(^{51}\) Code § 280G[b].
found in Treasury regulations. TAAP participants, on the other hand, were not prohibited from making severance payments to SEOs under existing contracts, but were prohibited from entering into any new employment contracts that provided for severance payments to a SEO under certain circumstances. Under pre-ARRA rules, a TAAP recipient was prohibited from entering into any new contract, including a renewal or material modification of an existing contract that provided for golden parachute payments to a SEO upon the occurrence of an applicable severance from employment.\footnote{52}

The enactment of section 7001 of ARRA, amending and restating section 111 of the EESA in its entirety, extended the golden parachute payment prohibition to the next five most highly compensated employees of any TARP recipient during the Treasury Holding Period. Further, ARRA defined a golden parachute payment as a payment to a SEO made for departure from the company for any reason. The post-ARRA provisions of section 111 of EESA also have extended the absolute prohibition on golden parachute payments to TARP recipients participating in the TAAP and other future auction purchase programs [if any such programs become operational].\footnote{53}

Consistent with these legislative changes, the Interim Final Rules implements EESA’s limits on golden parachutes to payments to a SEO or any of the next five most highly compensated employees.\footnote{54} At the same time, while ARRA provides that a golden parachute includes payments for an employee’s departure for any reason (except for services performed or benefits accrued), the Interim Final Rule clarifies that it includes payments made in connection with a change in control of the company. For this purpose, a change in control includes any event that would qualify as a change in control event as defined in Code Regulations.\footnote{55}

\footnotetext{52}{See Treasury Notice 2008-TAAP. For purposes of providing guidance to financial institutions participating in the TAAP, the Treasury adopted definitions of “golden parachute payments” and “applicable severance from employment” identical to those applied to the CPP. Pre-ARRA TAAP golden parachute restrictions extended through the duration of the Treasury authority period under EESA.}

\footnotetext{53}{The ARRA amendments to EESA section 111 make no distinction between direct purchases and auction purchases under TARP.}

\footnotetext{54}{31 C.F.R. § 30.9.}

\footnotetext{55}{Specifically, this includes a change in control event as defined in 26 C.F.R. § 1.280G-1, Q&A-27 through Q&A-29 or as a change in control event as defined in 26 C.F.R. § 1.409A-3[i][5][i].}
§ 4:3.4 Recovery of Bonus and Incentive Payments (“Clawback Provisions”)


The Federal government first addressed the issue of executive compensation disgorgement with the passage of the Sarbanes-Oxley Act of 2002 (SOX). Under section 304 of SOX, the chief executive officer and chief financial officer of an “issuer” (a publicly traded company) must disgorge all bonus, incentive and equity-based compensation, and all profits realized from the sale of securities of the company during the twelve-month period immediately preceding the issuance of a financial report that is materially non-compliant with the applicable financial reporting requirements under the federal securities laws. Recoupment of executive compensation under SOX is limited, however, in the sense that an accounting restatement resulting from “misconduct” is a necessary predicate to the SEC successfully pursuing enforcement action. It is for this reason, perhaps, that section 304 of SOX has largely failed as an effective disgorgement remedy.

[B] Clawback Provisions Pre-ARRA

Under former section 111(b)(2)(B) of EESA, SEO bonus and incentive compensation paid by a direct purchase program TARP recipient during the Treasury Holding Period was subject to certain recoupment rules. Recoupment was triggered under these rules if such bonus and incentive payments were based on materially inaccurate financial statements or performance metric criteria. In an effort to prevent manipulative compensation practices, the Treasury further clarified that incentive and bonus payments were considered paid for purposes of the clawback rules when an SEO acquires a legally binding right to

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57. The term “issuer” means an issuer (as defined in section 3 of the Securities Exchange Act) the securities of which are registered under section 12 of the Securities Exchange Act or that is required to file reports under section 15(d) of the Securities Exchange Act, or that files or has filed a registration statement that has not yet become effective under the Securities Act.
the payment and such payment occurs during the Treasury Holding Period.\textsuperscript{60}

[C] Clawback Provisions Post-ARRA

Although the original EESA required a Clawback Provision applicable only to amounts paid to SEOs, ARRA extended the Clawback Provision to bonuses paid to SEOs and the next twenty most highly compensated non-SEO employees if the bonus payment was based on materially inaccurate performance criteria.\textsuperscript{61} Hence, similar to the post-ARRA golden parachute restrictions, there is no longer a distinction between direct purchase programs and auction programs; all TARP recipients are subject to the enhanced standard. Consistent with these changes, the Interim Final Rule implements these requirements, and requires that the TARP recipient actually exercise its clawback rights in such a case unless the TARP recipient can demonstrate that it would be unreasonable to do so (for example, if the expense of enforcing the clawback right exceeds the benefits of doing so).\textsuperscript{62}

\section*{§ 4:3.5 Additional Obligations Under ARRA Amendments}

[A] “Say on Pay”

EESA, as amended by ARRA, imposes upon a TARP recipient the affirmative obligation of submitting certain executive compensation packages to shareholders for a non-binding “say-on-pay vote.”\textsuperscript{63} All compensation packages that are required to be disclosed under the federal securities laws are subject to the say-on-pay provision. A TARP recipient may discharge its duty in this respect by submitting the applicable compensation packages to the shareholders at an annual meeting during which directors are elected or at a special or other meeting which is held in lieu of the annual meeting.\textsuperscript{64} In his letter to the Chairman of the SEC, Senator Dodd expressed his belief that the say-on-pay requirements would not apply to preliminary (and the related

\begin{itemize}
\item \textsuperscript{60} Id.
\item \textsuperscript{61} 12 U.S.C. § 5221(b)(3)(B).
\item \textsuperscript{62} 31 C.F.R. § 30.8.
\item \textsuperscript{63} 12 U.S.C. § 5221(c).
\item \textsuperscript{64} Letter from Christopher J. Dodd, U.S. Senator, to Mary Schapiro, Chairman of the U.S. Securities and Exchange Commission [Feb. 20, 2009].
\end{itemize}
definitive proxy even if filed after February 17, 2009) and definitive proxy statements filed with the SEC on or before February 17, 2009. In accordance with ARRA, the Interim Final Rule requires TARP recipients to permit such a vote consistent with SEC regulations and guidance.

In a separate but companion action, the SEC proposed changes to the Securities Exchange Act proxy rules to set forth relevant requirements for U.S. TARP recipients pertaining to “say on pay” under EESA section 111(e), as amended by ARRA. The proposed amendments are intended to help implement this requirement by specifying and clarifying it in the context of the SEC proxy rules.

[B] Luxury Expenditure Policies for TARP Recipients

Luxury expense policy requirements found in selected CPP agreements were codified by ARRA through an amendment to section 111 of EESA requiring boards of directors of any TARP recipient to implement a company-wide policy regarding excessive or luxury expenditures as identified by the Secretary. Under ARRA, these may include excessive expenditures on:

1. entertainment or events;
2. office and facility renovations;
3. aviation or other transportation services; or
4. 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 the business operations of a TARP recipient.

The Interim Final Rule implements these requirements and adds a number of further requirements. Section 30.12 of the Interim Final Rule requires that the board of directors of the TARP recipient adopt an excessive or luxury expenditures policy, file the policy with Treasury and post the text of the policy on its Internet website before the later of

65. _Id._
67. 12 U.S.C. § 5221(d). As noted above, the term “TARP recipient” is defined as any entity that has received or will receive financial assistance under the financial assistance provided under TARP.
[i] ninety days after the closing of the agreement with Treasury, and
[ii] September 13, 2009.\textsuperscript{68}

Section 30.1 of the Interim Final Rule defines an excessive or luxury expenditures policy to require the inclusion of standards to ensure appropriate review and approval of potentially excessive and luxury expenditures. Section 30.1 of the Interim Final Rule requires that the policy:

(i) identify the types and categories of expenses prohibited or requiring prior approval;

(ii) adopt approval procedures for those expenses requiring prior approval;

(iii) mandate CEO and CFO certification of the prior approval of any expenditures requiring the prior approval of any SEO, other similar executive officers, or the board of directors;

(iv) mandate prompt internal reporting of any violation of this policy; and

(v) mandate accountability for adherence to this policy.\textsuperscript{69}

Thus, the Interim Final Rule provides a general framework for the policy but leaves to the discretion of the board of directors of each TARP recipient the determination of excessive and luxury expenditures and the specific requirements for each policy.

**[C] Review of Prior Payments to Executives**

ARRA directs Treasury to review bonuses, retention awards, and other compensation paid to the SEOs and the next twenty most highly-compensated employees of each entity receiving TARP assistance before the date of ARRA’s enactment, to determine whether any such payments were inconsistent with the purposes of this section or the TARP or were otherwise contrary to the public interest.\textsuperscript{70} If it makes such a determination, Treasury must seek to negotiate with the TARP recipient and the affected employee for appropriate reimbursements to the Federal government. Under the Interim Final Rule, the Special Master (discussed below) will exercise this authority.

\textsuperscript{68} 31 C.F.R. § 30.12.

\textsuperscript{69} 31 C.F.R. § 30.1.

\textsuperscript{70} 12 U.S.C. § 5221(f).
[D] Withdrawal by TARP Recipients

ARRA allows a TARP recipient, subject to consultation with its appropriate Federal banking agency, to repay any assistance previously provided under the TARP to such financial institution, without regard to whether the financial institution has replaced such funds from any other source or to any waiting period. When such assistance is repaid, Treasury is directed to liquidate warrants associated with such assistance at the current market price.71

§ 4:3.6 Compensation and Governance Standards

The Interim Final Rule also contains certain other requirements in addition to those expressly required under EESA and ARRA, including the following.

[A] Compensation Practices of Firms Receiving Exceptional Assistance

Under the Interim Final Rule, any TARP recipient that receives exceptional assistance must obtain the approval by the Special Master (discussed below) of all compensation payments to, and compensation structures for, SEOs and the most highly compensated employees.72 TARP recipients that receive exceptional financial assistance must also obtain approval from the Special Master for all compensation structures for other employees who are executive officers or one of the one hundred most highly compensated employees of a TARP recipient receiving exceptional assistance (or both) who are not subject to the Interim Final Rule’s bonus limitations.73 The Special Master has the authority to require that such compensation payments or compensation structures be altered to meet the standards set forth in the regulations. Special Master approval, however, is not required with respect to an employee not subject to the bonus payment limitations to the extent that the employee’s annual compensation is limited to $500,000 or less, and any further compensation is provided in the form of long-term restricted stock.

71. 12 U.S.C. § 5221(g).
72. 31 C.F.R. § 30.16[a].
73. Id.
[B] Perquisites Disclosures

In conjunction with, but in addition to, expanding SEC registration and periodic reporting disclosure requirements, TARP recipients will be required to disclose any perquisites provided to any employee who is covered by the ARRA bonus limitations with a total value exceeding $25,000. TARP recipients will also be required to provide a narrative description of, and justification for, the benefit. Unlike existing SEC Regulation S-K, which only requires the disclosure of perquisites given to the five named executive officers of the company, the Interim Final Rule disclosures will include all employees subject to the EESA bonus limitations, and will also require a narrative discussion of the basis for providing the benefit.

[C] Compensation Consultants Disclosure

The Interim Final Rule requires TARP recipients to disclose whether it or its compensation committee engaged a compensation consultant, plus a narrative description of the services provided by any such consultant, including any non-compensation related services provided by the consultant or any of its affiliates.

[D] Tax Gross-Up Prohibitions

The Interim Final Rule prohibits the payment to SEOs and the twenty next most highly compensated employees of a tax “gross-up,” or a payment to cover taxes due on compensation such as golden parachutes and perquisites.

§ 4:3.7 Special Master for TARP Executive Compensation

The Interim Final Rule creates a Treasury infrastructure that is designed specifically to oversee the executive compensation process for financial institutions receiving TARP assistance, with emphasis specifically on firms that have received “exceptional assistance” from the Federal government. This infrastructure consists of a Special Master who will exercise the Treasury’s authority over TARP recipient executive and employee compensation, and review payments and compensation.
plans for the executives and the one hundred most highly compensated employees of TARP recipients that have received exceptional assistance, with the stated goal of assuring that compensation is structured in a way that gives those employees incentives to maximize long-term shareholder value and protect taxpayer interests.\footnote{31 C.F.R. § 30.16. Kenneth R. Feinberg simultaneously was appointed as the first Special Master.}

The Special Master’s oversight responsibilities are divided into two broad categories: (i) responsibilities with respect to the compensation practices of all financial institutions that receive TARP assistance; and (ii) additional responsibilities specifically with respect to the compensation practices of TARP firms receiving exceptional assistance.

[A] Special Master Responsibilities with Respect to All TARP Recipients

The Special Master has been given general authority to interpret and apply on behalf of the Secretary the provisions of section 111 of EESA, as amended by ARRA, and applicable regulations and guidance. In this regard, the Interim Final Rule creates a series of procedures for the Special Master’s fulfillment of his/her duties, as well as a mechanism for TARP recipients to request advisory opinions on EESA compensation matters.

As noted above, EESA section 111(f) requires the Secretary to review employee bonuses, retention awards, and other compensation paid before February 17, 2009 by TARP recipients to determine their consistency with the purposes of EESA and the public interest. The Special Master will perform this responsibility and also will have authority, where appropriate, to negotiate appropriate reimbursements to the Federal government.

Finally, the Interim Final Rule sets out a clear set of general principles that the Special Master will use to help determine whether TARP participants have designed executive compensation to maximize shareholder value and protect taxpayer interests, covering the following elements:

(a) Risk—The compensation structure should avoid incentives to take unnecessary or excessive risks that could threaten the value of the TARP recipient, including incentives that reward employees for short-term or temporary increases in value, performance,
or similar measure, and should be structured to be paid over a
time horizon that takes into account the risk horizon.

(b) **Taxpayer Return**—The compensation structure should reflect
the need for the TARP recipient to remain a competitive
enterprise, to retain and recruit talented employees who will
contribute to the TARP recipient’s future success, and ulti-
mately to be able to repay TARP obligations.

(c) **Appropriate Allocations**—The compensation structure should
appropriately allocate the components of compensation (for
example, salary, short-term and long-term incentives) based
on the specific role of the employee and other relevant
circumstances, including the nature and amount of current
compensation, deferred compensation, or other compensation
and benefits previously paid or awarded. According to the
guidelines, in the case of an executive or other senior level
position, a significant portion of the overall compensation
should be long-term compensation that aligns the interest of
the employee with the interests of shareholders and taxpayers.

(d) **Performance-Based Compensation**—An appropriate portion of
the compensation should be performance-based over a relevant
performance period. Performance-based compensation should
be determined through tailored and measurable performance
metrics that include individual performance and/or the
performance of the TARP recipient or a relevant business unit,
taking into consideration specific business objectives. In addi-
tion, the likelihood of meeting the performance metrics should
not be so great that the arrangement fails to provide an adequate
incentive for the employee to perform. As with allocations
between cash and incentive-based compensation, there should
be an appropriate allocation between performance and non-
performance based compensation. According to the guidelines,
in the case of an executive or other senior level position, a
significant portion of the overall compensation should be
performance-based compensation.

(e) **Comparability of Payments with Similarly-Situated Firms**—
The compensation structure, and amounts payable, should
be consistent with, and not excessively take into account,
compensation structures and amounts for persons in
similar positions or roles at similar entities that are similarly situated, including, as applicable, entities competing in the same markets and similarly situated entities that are financially distressed or that are contemplating or undergoing reorganization.

(f) Employee Contributions of Value to the Enterprise—The compensation structure, and amount payable, should reflect the current or prospective contributions of an employee to the value of the TARP recipient, taking into account multiple factors such as revenue production, specific expertise, compliance with company policy and regulation (including risk management), and corporate leadership, as well as the role the employee may have had with respect to any change in the financial health or competitive position of the TARP recipient.

[B] Special Master Responsibilities with Respect to TARP Recipients Receiving Exceptional Assistance

The Special Master’s duties with respect to TARP firms that have received exceptional assistance not only include those set forth above, but also extend to additional duties and responsibilities, including:

- reviewing any compensation for SEOs and the next twenty most highly compensated employees;
- approving the compensation structure for SEOs and the one hundred most highly paid employees;
- disapproving inappropriate, excessive or unsound salary and other compensation arrangements;
- providing “safe harbor” guidance on “exceptional assistance” compensation payments and structure; and
- negotiating executive compensation reimbursements from firms receiving exceptional assistance.

§ 4:4 Additional Contractual Obligations of Select Bailout Funds Recipients

The preceding sections of this chapter discussed in broad terms the general restrictions on a TARP recipient’s compensation practices. In
addition to these statutory and regulatory obligations, institutions receiving government bailout funds are subject to the various contractual obligations contained in their respective securities purchase and financing agreements with the Treasury. Certain members of the U.S. automotive industry have also received government bailout funds and, as a condition of participation, have agreed to be bound by select provisions of EESA, including provisions relating to executive compensation. The following sections will provide a brief survey of the contractual obligations assumed by institutions receiving EESA funds.

§ 4:4.1 Capital Purchase Program (CPP)—Standard CPP Public Term Sheet

As noted above, a substantial majority of the over 350 financial institutions participating in TARP have done so under the CPP. To be eligible to participate in the CPP, an applicant must be approved by the Treasury and agree to certain terms and conditions, and make certain representations and warranties as described in the application materials posted on the Treasury’s website. As part of the standard application process, a TARP recipient and its SEOs must agree to (i) amend or terminate all benefits plans, arrangements and agreements to the extent necessary to be in compliance with section 111(b) of EESA, and (ii) execute signed waivers releasing the Treasury from any and all claims that could arise in connection with such amendment or termination. Consistent with 31 C.F.R. Part 30, the standard CPP term sheet extends the restrictions on a TARP recipient’s compensation practices to the TARP recipient’s SEOs.

§ 4:4.2 Program for Systemically Significant Failing Institutions (PSSFI)—American International Group, Inc. (“AIG”)

On November 25, 2008, the Treasury and AIG entered into the first securities purchase agreement pursuant to the PSSFI (“AIG Agreement”), whereby the Treasury acquired $40 billion worth of preferred stock and stock warrants of AIG. AIG agreed, among other things, to comply with Notice 2008-PSSFI in its entirety and to extend certain provisions of EESA to its non-SEO employees who, as of November 25, 2008, were participants in the AIG Senior Partners
Plan (“Senior Partners”). The Senior Partners, as a result, agreed to be bound by the restrictions on golden parachute payments applicable to CPP participating financial institutions as if such Senior Partners were SEOs for purposes of EESA. As a further restriction on golden parachute payments, AIG agreed to limit the amount that could be paid to each Senior Partner in the form of annual bonuses, retention payments and severance payments, in each case during any period ending on or prior to March 31, 2010.

As a further restriction on its compensation practices, AIG agreed to freeze the 2008 and 2009 bonus pools available to pay incentive and bonus awards to its SEOs and Senior Partners at the average levels paid out in 2006 and 2007. These bonus pools could only be funded through dividend distributions paid to AIG by its subsidiaries exceeding a specified threshold amount. As a final condition, AIG agreed that no portion of the $40 billion purchase price could be used to pay annual bonuses or other future cash performance awards to executives of AIG or the Senior Partners.

§ 4:4.3 Targeted Investment Program (TIP)—Citigroup, Inc. (“Citigroup”)

The Treasury established the TIP in response to fears that the destabilization of certain large financial institutions could lead to significant disruptions in market stability and the impairment of the overall economy. On December 31, 2008, Citigroup applied for and received a $20 billion capital infusion under this program (“Citigroup

78. Similar to the standard CPP term sheet, AIG was required to cause all SEO and Senior Partner compensation arrangements to comply with the relevant terms of EESA, Notice 2008-PSSFI and the specific provisions of section 4.10 of the AIG Agreement, including the execution and delivery of SEO and Senior Partner agreements waiving any claims against the Treasury.

79. Equity-denominated awards settled solely in equity were excluded from the definition of “golden parachute payments” as such term applied to the Senior Partners. See section 4.10(b)(1) of the AIG Agreement.

80. See section 4.10(b)(2) of the AIG Agreement.

81. See section 4.10(c) of the AIG Agreement.

82. See section 4.10(e) of the AIG Agreement.

83. Id.
Agreement”). Citigroup, already a CPP participant and therefore subject to section 111(b) of EESA and 31 C.F.R. Part 30, agreed to extend the prohibition on golden parachute payments to its non-SEO employees who were members of the Citigroup Senior Leadership Committee (“Senior Leadership Members”).\textsuperscript{84} Citigroup also agreed, subject to certain carve-outs, to limit the bonus compensation payable to its SEOs and Senior Leadership Members for both 2008 and 2009 to 60% of the amounts paid out for the same purpose during 2007.\textsuperscript{85} In order to tie incentive compensation to the long-term health of Citigroup, the Treasury also stipulated that of the total 2008 bonus compensation paid to Citigroup SEOs and the ten next most senior executives, 60% be paid in the form of deferred stock or deferred cash awards and 40% be subject to performance-based vesting.\textsuperscript{86}

\section*{§ 4:4.4 Automotive Industry Financing Program (AIFP)—General Motors Corporation (“GM”)}

The AIFP was established to prevent the destabilization of financial markets resulting from the potential collapse of the U.S. automotive industry. Under the AIFP, the Treasury is authorized to allocate EESA resources to eligible participants under terms and conditions consistent with those mandated in EESA. On December 31, 2008, the Treasury and GM entered into a loan and security agreements under the AIFP whereby the Treasury committed to advance over $13 billion in funds to GM (“GM Agreement”). Pursuant to this financing arrangement, GM agreed to comply with the compensation restrictions contained in section 111(b) of EESA and the rules set forth in 31 C.F.R. Part 30 as they apply to CPP participants. GM further agreed to the following additional restrictions on its compensation practices:\textsuperscript{87}

- \textit{Bonus Suspensions}: agreement to suspend the payment and accrual of all bonus and incentive awards to the top twenty-five most highly compensated employees unless otherwise approved by an authorized representative of the President;

\textsuperscript{84} See section 4.10(b) of the Citigroup Agreement.  
\textsuperscript{85} See section 4.10(c)(i) of the Citigroup Agreement.  
\textsuperscript{86} See section 4.10(c)(ii) of the Citigroup Agreement.  
\textsuperscript{87} See section 7.17(a) of the GM Agreement.
• **Prohibition of Certain Compensation Plans:** prohibition of all compensation plans that encourage the manipulation of reported earnings to enhance employee compensation;

• **Continued Suspension of Certain Benefits Plans:** agreement to continue the suspension of contributions into certain employee benefits plans; and

• **Additional Clawback Provisions:** required clawback of any payments made in violation of the provisions contained in the GM Agreement.

§ 4:5 **Other Corporate Governance Standards and Restrictions**

In addition to the executive compensation provisions discussed above, the Federal government has also tied a financial institution’s receipt of bailout funds to the mandatory adoption of certain corporate governance practices. In general, these corporate governance requirements are not contained in the various pieces of legislation but rather in the agreements between the Treasury and the recipients of the funds, although some of these requirements since have been incorporated into the Interim Final Rule.

Under the CPP, the Treasury purchases preferred stock and equity warrants of qualified financial institutions. The Treasury published form documentation for the issuance of senior preferred stock and warrants by publicly traded financial institutions participating in the CPP. The documents include a standard form of a securities purchase agreement to be signed by all participating companies (“Standard CPP Securities Purchase Agreement”), preferred stock certificate of designation, and warrant to acquire such company’s shares of common stock (in the same manner, the terms of the preferred shares and warrants are standard for all participants). There are different forms for public institutions, that is, companies that are both required to file periodic reports under the Securities Exchange Act and the stock of which is traded on a national securities exchange, and private institutions.

88. *Available at* www.financialstability.gov/roadtostability/CPPappdocs.html.
In general, the terms of the Standard CPP Securities Purchase Agreement for private companies are very similar to those provided for public companies. As mentioned above, all participating companies, whether public or private, must adhere to certain limitations and sign a Standard CPP Securities Purchase Agreement; however, as discussed below, some of the executed agreements under the CPP included additional limitations to those included in the Standard CPP Securities Purchase Agreement.

§ 4:5.1 Line of Business Restriction

The CPP is available only for bank holding companies, financial holding companies, insured depository institutions, and savings and loan holding companies that engage solely or predominately in activities permissible for financial holding companies. In light of this, the Standard CPP Securities Purchase Agreement requires a participating company to commit, for as long as the Treasury owns any preferred shares or shares acquired upon exercise of warrants, to the extent the company is not itself an insured depository institution, to remain predominantly engaged in financial activities. A company is considered predominantly engaged in financial activities if the annual gross revenues derived by the company and all of its subsidiaries, on a consolidated basis, from engaging in activities that are financial in nature or are identical to a financial activity under subsection (k) of section 4 of the Bank Holding Company Act of 1956, as amended.

89. Although this direct capital infusion program is limited to bank and thrift organizations, the Treasury has indicated that such eligibility restrictions will not necessarily apply to other TARP programs. Under EESA, eligible “financial institution[s]” are defined as “any institution . . . established and regulated under the laws of the United States or any State, territory, or possession of the United States . . . and having significant operations in the United States” (section 3 of EESA). This definition expressly includes depository institutions, brokers, dealers and insurance companies, and expressly excludes “any central bank of, or institution owned by, a foreign government” (also, section 3 of EESA). In future programs, the Treasury will have to determine the full extent of the definition, including, for example, whether hedge funds or non-depository mortgage companies are eligible.

90. See section 4.12 of the Standard CPP Securities Purchase Agreement for public companies and section 4.11 of the Standard CPP Securities Purchase Agreement for private companies.

91. 12 U.S.C. §1843(k) [2009].
represent at least 85% of the consolidated annual gross revenues of the company.\textsuperscript{92}

\textbf{\textsection{4:5.2} Inspection of Books and Records}

Under the Standard CPP Securities Purchase Agreement, participating companies are under an obligation, from the date the agreement is signed and until the Treasury holds preferred shares aggregating less than 10% of the purchase price, to permit the Treasury and its agents, consultants, contractors and advisors to examine the corporate books of the recipient and make copies thereof and to discuss the affairs, finances and accounts of the company and its subsidiaries with the principal officers of the company.\textsuperscript{93}

A broader information right can be found in some of the executed agreements signed by companies participating in the CPP, under which the Treasury’s information rights include access to additional information or the Treasury’s rights were extended for a longer period. The broader information rights permit the Treasury and its agents to access personnel and any books, papers, records or other data to the extent relevant to ascertaining compliance with the financial terms and conditions of the agreements,\textsuperscript{94} and in other instances the information right given to the Treasury and its agents was extended until such time that the Treasury owns no preferred stock, as opposed to the standard term requirement of holding less than 10% of preferred shares.\textsuperscript{95}

Under the Standard CPP Securities Purchase Agreement for private companies, until all of the preferred shares and shares acquired upon exercise of warrants are redeemed in whole, recipients companies are subject to an additional obligation to deliver to the Treasury by the end of each fiscal year a consolidated balance sheet, consolidated statement of income, retained earnings and cash flows of the company for

\textsuperscript{92} See section 4.12 of the Standard CPP Securities Purchase Agreement for public companies and section 4.11 of the Standard CPP Securities Purchase Agreement for private companies.

\textsuperscript{93} See section 3.5 of the Standard CPP Securities Purchase Agreement for public and private companies.

\textsuperscript{94} See section 3.5 of the Citigroup Agreement, section 11.16 of the GM Agreement and section 3.5 of the securities purchase agreement signed by GMAC LLC (the “GMAC Agreement”), available at www.financialstability.gov/impact/contracts_list.htm#cppcontracts.

\textsuperscript{95} See section 3.5 of the AIG Agreement.
the year ended. In addition, the companies are also required to provide the Treasury a copy of any quarterly reports provided to the other shareholders or the company’s management.

In addition, under the Standard CPP Securities Purchase Agreement for private companies, the Treasury’s information rights may be assigned by the Treasury to a transferee or assignee of the purchased securities or the warrant shares or with a liquidation preference, no less than an amount equal to 2% of the initial aggregate liquidation preference of the preferred shares.96

However, it should be noted that neither the company (whether public or private) nor any of its subsidiaries is required to disclose any information to the Treasury to the extent it is prohibited by any law or regulation or if such disclosure would reasonably be expected to cause a violation of any agreement to which the company or any of its subsidiaries is a party or would cause a risk of a loss of privilege to the company or any of its subsidiaries (provided the company uses commercially reasonable efforts to make appropriate substitute disclosure arrangements). Moreover, the Treasury is under the obligation to use reasonable best efforts to hold, and to cause its agents to hold, in confidence all non-public information concerning the company or any of its subsidiaries made available to the Treasury pursuant to its inspection rights.

§ 4:5.3 Limitations on Certain Transactions and Transactions with Related Parties

The Standard CPP Securities Purchase Agreement for public companies provides that the company will not merge, sell, transfer or lease all or substantially all of its property or assets to any other party unless the successor expressly assumes the due and punctual performance and observance of each and every covenant, agreement and condition in the securities purchase agreement signed by the company.97 The Standard CPP Securities Purchase Agreement for private companies subject the participating companies to the same limitation and any future successor needs to accept and assume the

96. See section 3.5(d) of the Standard CPP Securities Purchase Agreement for private companies; see also section 3.5(d) of the GMAC Agreement.

97. See section 4.3 of the Standard CPP Securities Purchase Agreement for public companies.
securities purchase agreement signed by its predecessor. However, private companies are subject to additional restrictions on such transactions under the CPP whenever the transaction is with “related persons” discussed below.

Moreover, in some of the executed agreements under the CPP, the Treasury added a prior-consent requirement according to which the signing companies will not, at any time, directly or indirectly, enter into any transaction of merger or consolidation or liquidate, wind up, or dispose of all or substantially all of their property without the Treasury’s prior consent. In addition, Treasury’s prior consent was also requested before the companies enter into any partnership or other combination which could reasonably be expected to have a material adverse effect on the company.

§ 4:5.4 Transactions with Related Parties

Under section 4.09 of the Standard CPP Securities Purchase Agreement for private companies, a participating company may not enter into transactions with “affiliates” or “related persons,”

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98. See section 4.3 of the Standard CPP Securities Purchase Agreement for private companies.

99. See section 4.9 of the Standard CPP Securities Purchase Agreement for private companies.

100. See section 8.01 of the GM Agreement and section 8.01 of the loan and security agreement signed by Chrysler Holdings LLC on December 31, 2008 (“Chrysler Agreement”).

101. “Affiliates” means, with respect to any person, any person directly or indirectly controlling, controlled by or under common control with, such other person. For purposes of the foregoing, “control” (including, with correlative meanings, the terms “controlled by” and “under common control with”) when used with respect to any person, means the possession, directly or indirectly, of the power to cause the direction of management and/or policies of such person, whether through the ownership of voting securities by contract or otherwise. See section 5.7[a] of the Standard CPP Securities Purchase Agreement for private companies. This definition is identical to the definition contained in Rule 405 under the Securities Act.

102. The definition of “related person” refers to Item 404 of the SEC’s Regulation S-K, 17 C.F.R. § 229.404. Under Item 404 of Regulation S-K, a related person generally includes any director, executive officer or five percent stockholder of a company and any immediate family member of such person.
unless such transactions are on terms no less favorable to the company and its subsidiaries than could be obtained from unaffiliated third parties and have been approved by the audit committee or a comparable body of the company’s independent directors. This requirement does not appear, however, in the Standard CPP Securities Purchase Agreement for Public Companies.

§ 4:5.5 Exercise of Voting Rights

Under the Standard CPP Securities Purchase Agreement for public companies, the Treasury agreed not to exercise any voting rights with respect to shares acquired upon exercise of warrants.

§ 4:5.6 Expenses/Luxury Expenditures Policies

Although the Standard CPP Securities Purchase Agreements do not require the participating companies to adopt an expense policy or guideline regarding the company’s expenses, the AIG Agreement, the Citigroup Agreement and the agreements with the automotive companies contained a requirement for the companies to implement a company-wide expense policy.

Under the aforementioned provision, until the preferred shares acquired by the Treasury have been redeemed in whole or the Treasury has transferred all of the preferred shares to third parties that are not affiliates of the Treasury, the companies must maintain and implement expense policies on corporate expenses. In addition, any material amendments to the expense policy requires the prior written consent of the Treasury, and any material deviation from the expense policy must promptly be reported to the Treasury.

103. Limitation on transactions with a related party was also included in the agreements with the automotive industry; see section 4.9 of the GMAC Agreement, section 8.03 of the GM Agreement and section 8.03 of the Chrysler Agreement.

104. See section 4.6 of the Standard CPP Securities Purchase Agreement for public companies. Similar limitation does not exist under the Standard CPP Securities Purchase Agreement for private companies.

105. See section 4.12 of the AIG Agreement, section 4.10(e) of the Citigroup Agreement, section 7.19 of the Chrysler Agreement, section 4.8(c) of the GMAC Agreement, and section 7.19 of the GM Agreement.
The agreements provide general guidelines for the participating companies’ expense policy, and require that at a minimum the policies will:

(i) comply with all applicable law;
(ii) apply to the company and any of its subsidiaries;
(iii) govern (a) the hosting, sponsorship or other payment for conferences and events, (b) the use of corporate aircraft, (c) travel accommodations and expenditures, (d) consulting arrangements with outside service providers, (e) any new lease or acquisition of real estate, (f) expenses relating to office or facility renovation or relocations, and (g) expenses relating to entertainment or holiday parties; and
(iv) provide for internal reporting mechanisms for addressing non-compliance with the expense policy. While the policy may seem to cover items that are generally thought of as quite trivial in nature (for example, office renovations), most were included in specific response to widely-publicized, and criticized, excesses by companies receiving Federal funds.\footnote{106}

The automotive industry companies were also required to demonstrate that they or any of their subsidiaries that owned any private passenger aircraft or interest in such aircraft were taking all reasonable steps to divest themselves of such aircraft or interests.\footnote{107} In addition, the companies had to commit to not acquiring or leasing any private passenger aircraft or interests in private passenger aircraft.\footnote{108}

\section*{§ 4:5.7 Lobbying Policies and Rules}

The AIG Agreement and Citigroup Agreement contain a provision regarding the companies’ lobbying policy and provide that until the

\begin{footnotesize}
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\item \footnote{106}{In one such incident, a recipient of Federal funds was widely reported to have hosted a conference at an exclusive West Coast resort and spent considerable sums on luxurious rooms, lavish meals and spa services. In another case, the chief executive officer of a recipient was reported to have spent significant sums renovating his office.}
\item \footnote{107}{This was inserted in direct response to the much criticized use of private jets by company CEOs to fly to Washington to testify before Congress.}
\item \footnote{108}{See section 4.8(b) of the GMAC Agreement, section 7.18 of the Chrysler Agreement, and section 7.18 of the GM Agreement.}
\end{itemize}
\end{footnotesize}
Treasury ceases to own any preferred stock, the companies must maintain a policy on lobbying, governmental ethics and political activity and distribute the policy to all of the companies’ employees and lobbying firms involved in any such activity.\textsuperscript{109} Under the provision, the companies’ lobbying policy must:

(i) require compliance with all applicable law;
(ii) apply to the companies and their subsidiaries and any affiliated foundations;
(iii) govern (a) provision of items of value to any government officials, (b) lobbying, and (c) political activities and contributions; and
(iv) provide for (a) internal reporting and oversight and (b) mechanisms for addressing non-compliance with the policy.\textsuperscript{110}

The companies are also restricted in their ability to amend their lobbying policies and provide that until the Treasury ceases to own any preferred stock, any material amendments to the lobbying policy require the prior written consent of the Treasury, and any material deviations from the companies’ policy must promptly be reported to the Treasury.

On January 27, 2009, the Treasury Secretary, Timothy Geithner, announced in a press release new lobbying rules designed to limit the influence of lobbyists and special interests in the EESA process and ensure that investment decisions are guided by objective assessments.\textsuperscript{111} As announced, the Treasury’s new rules would prevent lobbyist influence in the EESA process by implementing safeguards to prevent lobbyist influence, including restricting contacts with

\textsuperscript{109} See section 4.11 of the AIG Agreement and section 4.10(d) of the Citigroup Agreement.

\textsuperscript{110} As with certain other provisions, the requirement for a lobbying policy appears to have been in response to public criticism after disclosure that many companies that had received Federal funds had spent significant sums on lobbying. Senators Dianne Feinstein (D-CA) and Olympia J. Snowe (R-ME) went so far as to introduce the “Troubled Asset Relief Program Transparency Reporting Act,” S. 133, 111th Cong. (2009), in order “[t]o prohibit any recipient of emergency Federal economic assistance from using such funds for lobbying expenditures or political contributions, to improve transparency, enhance accountability, encourage responsible corporate governance, and for other purposes.”

\textsuperscript{111} Available at www.ustreas.gov/press/releases/tg02.htm.
lobbyists in connection with applications for, or disbursements of, EESA funds. The rules would also ensure that political influence does not interfere with EESA decision making. In addition, in order to ensure objective decision making, the Office of Financial Stability would report to the Congress and certify that each investment decision is based only on investment criteria and the facts of the case.

On September 10, 2009, Treasury published its EESA lobbying rules. In a slight departure from what was previously suggested by Treasury in January 2009, the rules are patterned after the Office of Management and Budget’s guidelines for ARRA, which were revised on July 24, 2009. The new rules are quite strict. Among other things:

- The rules prohibit outright all communications between any outside person and a Treasury official regarding pending applications for EESA funding. At the same time, oral or written communications that do not advocate for a particular policy or application are acceptable.

- The rules allow communications between outside persons and Treasury officials regarding EESA funding that are of a purely logistical nature. Moreover, public communications of EESA questions at “widely attended gatherings” (as defined in the Treasury guidance) are also permitted.

- The rules do not impose any additional restrictions on federally-registered lobbyists wishing to communicate with Treasury officials regarding EESA funding. Communications on these matters between a federally-registered lobbyist and a Treasury official, however, will be documented and disclosed on the Treasury website within three days of its occurrence.

\section*{§ 4:5.8 Risk Management Committee}

The AIG Agreement requires that until the Treasury ceases to own any preferred stock, warrants or other equity or debt securities, AIG is required to maintain a risk management committee of its board of directors that will oversee the major risks involved in AIG’s business operations and review AIG’s actions to mitigate and manage those risks.\footnote{112. Available at www.financialstability.gov/docs/Lobbying-Guidelines.pdf. 113. See section 4.13 of the AIG Agreement.}