Katten
Katten Muchin Rosenman LLP

Client Advisory

January 27, 2009

Treasury Releases Additional Executive Compensation Guidance for TARP Capital Purchase Program

On January 16, the U.S. Treasury Department (UST) released an interim final Rule[1] (Revised Rule) and FAQs[2] to provide additional requirements and guidance for all institutions receiving TARP funds under the Capital Purchase Program (CPP). The Revised Rule requires new CEO certifications as to compliance with the executive compensation limitations and provides a few clarifications to the October interim final Rule[3] (Initial Rule). The Revised Rule amends and supplements the Initial Rule, which remains in effect. The Revised Rule will be effective upon publication in the Federal Register. However, it is not known at this point when the Revised Rule will be effective because of the Obama administration directive on January 20 suspending Federal Register publication of all rulemaking until review and approval by President Obama's designees.

The Initial Rule

The Initial Rule requires that the institution's compensation committee review the incentive compensation arrangements for the CEO, the CFO and the next three most highly compensated executives (SEOs) with the institution's senior risk officers (or other personnel acting in a similar capacity) to ensure that SEOs are not encouraged to take unnecessary and excessive risk that could threaten the value of the financial institution. The Initial Rule requires an initial determination promptly, and in no case more than 90 days, after the closing of the UST's purchase under the CPP. The Initial Rule also requires the compensation committee to perform subsequent annual reviews.

The Revised Rule

Certifications. The Revised Rule adopted three certifications on executive compensation to be signed by the institution's principal executive officer (PEO) and delivered to the TARP Chief Compliance Officer (TARP CCO) and the transfer agent under CPP. The first certification is due 120 days following the CPP closing (as early as February 25, 2009 for the initial CPP closings in late October 2008), the second certification is due 135 days following the first year end in which the UST held an investment (May 15, 2009 for calendar year institutions which had a CPP closing in 2008), and the third certification is due 135 days following each subsequent year end during which the UST holds an equity or debt investment in the institution. If the PEO cannot provide any of the certifications, the PEO is required to provide an explanation to the TARP CCO.

The 120-day certification is simply to confirm that the compensation committee completed its required review of incentive compensation arrangements with senior risk officers within 90 days after the CPP closing.

---

[1] http://www.treasury.gov/initiatives/eesa/docs/TARP_ExecutiveCompensationIFRJan2009.pdf

[2] http://www.treasury.gov/initiatives/eesa/docs/TARP_ExecutiveCompensationFAQs.pdf

[3] http://www.treasury.gov/initiatives/eesa/docs/Exec%20Comp%20CPP%20Interim%20Final%20Rule.pdf

For more information, contact one of the members of Katten's TARP Task Force listed below:

Eric Adams, Co-Chair
212.940.6783
eric.adams@kattenlaw.com

Shannon Skinner Anglin
312.902.5409
shannon.anglin@kattenlaw.com

Terra K. Atkinson
704.344.3194
terra.atkinson@kattenlaw.com

David J. Bryant
312.902.5380
david.bryant@kattenlaw.com

David R. Dlugie
312.902.5274
david.dlugie@kattenlaw.com

Steven Eckhaus
212.940.8860
steven.eckhaus@kattenlaw.com

Hays Ellisen, Co-Chair
212.940.6669
hays.ellisen@kattenlaw.com

Mark I. Fisher
212.940.8877
mark.fisher@kattenlaw.com

Andrew L. Jagoda
212.940.8520
andrew.jagoda@kattenlaw.com

Jeffrey R. Patt
312.902.5604
jeffrey.patt@kattenlaw.com

Jeffrey M. Werthan
202.625.3569
jeff.werthan@kattenlaw.com

Robert J. Wild
312.902.5567
robert.wild@kattenlaw.com

Frank Zarb
202.625.3613
frank.zarb@kattenlaw.com

The first year-end certification form requires the PEO to confirm the following:

- the compensation committee has met at least once during the prior fiscal year with the senior risk officers;
- the compensation committee has certified to this review in the proxy statement;
- the financial institution has required that SEO bonus and incentive compensation be subject to recovery or "clawback";
- the financial institution has prohibited any golden parachute payment to a SEO;
- the financial institution has instituted procedures to limit a compensation deduction under IRC Section 162(m)(5) to $500,000 (including any performance-based compensation) for each SEO; and
- the name and title of each of the current SEOs based on their compensation during the prior fiscal year.

The subsequent-year certification form covers all the matters listed above and adds that the institution has in fact limited the compensation deduction under IRC Section 162(m)(5) on its tax return to $500,000 for each SEO for the year prior to the most recently ended year.

Recordkeeping. The Revised Rule requires that the institution preserve appropriate documentation and records to substantiate each certification for a period of not less than six years after the date of the certification—the first two years in an easily accessible place—and to promptly furnish documentation to the TARP CCO upon request.

Criminal Penalties. The Revised Rule, consistent with one of the CPP closing deliverables, also affirms that any individual or entity making or providing false information or certifications to the UST relating to a CPP purchase is subject to the criminal penalties under title 18 of the U.S. Code.

Location of Compensation Committee Certification. For institutions that are SEC filers, the Revised Rule clarified that the compensation committee should include its certification in the compensation committee report required pursuant to Item 407(e) of SEC Regulation S-K rather than in CD&A as specified in the Initial Rule.

Incentive Compensation Clawback. The Revised Rule clarifies that the incentive compensation that is subject to clawback is any incentive compensation that a SEO obtains a legally binding right to receive during the period in which the UST has an investment, regardless of when the compensation is paid.

FAQs. The FAQs address the following questions:

- Determination of SEOs—SEOs are generally determined based on the executives listed in the summary compensation table of the most recent proxy statement. Until the current year proxy statement is filed, an institution must use best efforts for the current year determination. If any executive is a potential SEO and terminates employment in an involuntary termination prior to the identification of the current year's SEOs, the financial institution should avoid making any potential golden parachute payment until the year's SEOs are identified in the proxy statement so that it can be determined whether the executive is a SEO and, therefore, is not entitled to the golden parachute payment for the year.
- Compensation deduction limitation—The determination of the SEOs for the tax year of the deduction would be made based on the compensation during the tax year rather than upon the summary compensation table (based on prior-year compensation) in the most recent proxy statement.
- Incentive compensation clawbacks—An institution is not required to recover incentive compensation earned based on financial statements that become materially inaccurate solely because of revisions to generally accepted accounting principles where the financial statements were accurate based on generally accepted accounting principles applicable when the payment was earned.
- Golden parachute payments—Because golden parachute payments are determined on a present-value basis for future payments, payments to a SEO triggered by involuntary termination of employment that could be made after the period that the UST holds an equity or debt position under the CPP are included for purposes of determining if the termination payments are subject to the prohibition of golden parachute payments.
- Institutions which are SEC smaller reporting companies[4]—To the extent that TARP CPP compensation compliance requirements are broader than the scaled disclosure requirements of SEC Regulation S-K, the TARP CPP compensation limitations govern. Also, the compensation committee certification should be provided to the primary banking regulator rather than being included in the proxy statement.

---

[4] Institutions that have less than $75 million in public equity float qualify for the scaled disclosure requirements as smaller reporting companies. Institutions without a calculable public equity float will qualify if their revenues were below $50 million in the previous year. See Item 10(f) of Regulation S-K (Index of Scaled Disclosure Available to Smaller Reporting Companies).

Practical Considerations

The annual certification, in practice, will require coordination with the filing of the proxy statement which is due within 120 days after year end (April 30 for calendar year institutions), as the certification includes a statement as to the compensation committee certification which is required to be included in the proxy statement. Because of annual meeting timing, in many cases the proxy statement is filed, either in preliminary or final form, or both, substantially before the 120-day deadline; therefore, the annual certification should be delivered to the TARP CCO promptly following the filing of the proxy statement to ensure the timeliness of delivery of the certification. The annual certification includes a statement that the compensation committee met at least once during the prior year to review incentive compensation for purposes of the TARP. Because the initial review is required within 90 days following the closing, while the initial compensation committee review post-closing may have occurred in 2008, it was not required. Therefore, some institutions will need to clarify their compliance in the annual certification. Also, the Revised Rule provides that the subsequent year certifications are required in each year following the year during which the institution "participated in the CPP". Pending further change to the Revised Rule, the TARP CPP statutory provisions are clear that the compensation limitations are only applicable during the period that the UST holds an equity or debt position in the institution. This includes UST holding of warrants and/or stock acquired upon exercise of warrants. Therefore, it would seem that the subsequent year certifications should no longer be required beginning the year following the final year of the UST investment.

Based on the FAQs for determination of SEOs, consideration of golden parachute payments to senior executives must be made on the basis of both prior year compensation and best estimates of whether the executive would be a SEO based on current year payments.

Katten's TARP Task Force

Katten Muchin Rosenman LLP's multidisciplinary TARP Task Force advises clients on the UST's Troubled Asset Relief Program created under the Emergency Economic Stabilization Act of 2008. In particular, Katten's TARP Task Force advises clients on participating in the TARP Capital Purchase Program, issuing the necessary Preferred Shares or Senior Securities and related Warrants, determining how the executive compensation rules apply to them, and structuring their compensation arrangements appropriately.

Katten

Katten Muchin Rosenman LLP www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK PALO ALTO WASHINGTON, DC

Katten Muchin Rosenman LLP is an Illinois limited liability partnership including professional corporations that has elected to be governed by the Illinois Uniform Partnership Act (1997). London affiliate: Katten Muchin Rosenman Cornish LLP.

01/27/09