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Because of the rapidly changing conditions in the financial markets, we have established this special series of Client Alerts to advise you of the newest economic and legal developments and their wide-ranging business implications.

IMPACT OF THE EMERGENCY ECONOMIC STABILIZATION ACT OF 2008 ON EXECUTIVE COMPENSATION DESIGN

Last Friday, following a whirlwind of legislative activity, President Bush signed into law the Emergency Economic Stabilization Act of 2008 ("EESA") designed to provide liquidity to troubled financial markets.¹ EESA establishes a program that will allow financial institutions to sell up to \$700 billion worth of "troubled assets" to the Treasury Department (the "Treasury") through the "Troubled Asset Relief Program" (or "TARP"). However, financial institutions will be forced to comply with certain EESA executive compensation restrictions as one of the costs of participating in the bailout program. Although the EESA executive compensation restrictions technically only apply to affected financial institutions, given the current environment of intense investor and political scrutiny of executive compensation practices, the restrictions can be expected to have some "trickle-down" effect on executive compensation practices for many companies.

The EESA executive compensation restrictions are noteworthy in part because they restrict certain elements of executive compensation design, as opposed to just imposing federal tax consequences for certain types of compensation. The scope of the EESA executive compensation restrictions depends on how the troubled assets are sold to the Treasury: through market mechanisms such as auctions or reverse auctions, or via direct purchases. The remainder of this client alert summarizes EESA's executive compensation provisions.

Direct Purchases

If the Treasury determines that a direct purchase of the assets is preferable and the Treasury obtains a "meaningful debt or equity position" in the financial institution as part of the sale, then the Treasury will require that the institution meet "appropriate standards for executive compensation and corporate governance." These standards must remain in effect as long as the Treasury holds the equity or debt position and include the following:

- Limits on incentives: The financial institution must impose limits on compensation that exclude incentives for senior executive officers of a financial institution (one of the top five highly paid executives of a public company based on SEC disclosure rules and any non-public company counterparts) to take "unnecessary and excessive" risks that threaten the value of the institution.
- Clawbacks: The financial institution must recover any bonuses or other incentive compensation paid to a senior executive officer based on statements of earnings, gains or other factors that are later proven to be materially inaccurate.
- Golden parachutes restricted: The financial institution may not make any golden parachute payments to senior executive officers while the Treasury holds its debt or equity position.

¹ The new bill, HR. 1424, consists of three separate laws: EESA, the Energy Improvement and Extension Act of 2008 and the Tax Extenders and Alternative Minimum Tax Relief Act of 2008. Our client alert discussing the key provisions of EESA may be found at: <http://www.wcsr.com/resources/pdfs/flit100408.pdf>. In addition to the EESA provisions, the 450-page bill contains provisions that, among other things, provide renewable energy tax incentives and provide some relief from the alternative minimum tax. The executive compensation provisions are set forth in Sections 111 and 302 of EESA.

Auctions

- No golden parachutes in new employment agreements: If (i) the Treasury determines that the auction purchase of troubled assets is preferable, and (ii) the total of the purchases is more than \$300 million (including any direct purchases), then no new employment contract with a senior executive officer may contain a golden parachute provision that applies in the event of an involuntary termination, bankruptcy filing, insolvency or receivership.
- Loss of corporate tax deduction for compensation in excess of \$500,000: EESA also amends Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code"), to impose a \$500,000 limit on deductible compensation paid to the chief executive officer, chief financial officer or one of the three highest paid officers (other than the CEO or CFO) of a financial institution which sells more than \$300 million of troubled assets to the Treasury, excluding assets sold by direct purchase to the Treasury. Compensation for this purpose includes deferred compensation, as well as stock option and other performance-based compensation that would otherwise be exempt from Code Section 162(m) application.
- Excise tax and loss of corporate tax deduction for golden parachute payments: Financial institutions participating in TARP will not be able to deduct certain excess golden parachute payments made to senior executive officers that are triggered by an involuntary termination of the executive or due to any bankruptcy, liquidation or receivership of the financial institution, and such officers will be subject to a 20% excise tax on such amounts.

The above provisions applicable in the auction context generally apply to arrangements entered into before December 31, 2009, the date the Treasury's authority to purchase troubled assets expires, unless that date is extended. Additional Treasury guidance is expected regarding certain aspects of the EESA executive compensation provisions.

The bill also includes a new Code provision that taxes compensation that an employee defers to a nonqualified deferred compensation plan ("NDCP") of a foreign company. This provision is intended to tax U.S. taxpayers who defer income to offshore tax havens. This provision is not part of the EESA and is applicable to all employees who make deferrals to an NDCP of a foreign company.

Conclusion; Contact Information

It is still unclear whether the EESA executive compensation restrictions will assuage investors' and legislators' concerns about excessive pay or impose significant hurdles upon executive compensation programs maintained by financial institutions seeking to participate in the bailout program. Affected financial institutions will need to consider the potential effect of EESA's executive compensation restrictions on their ability to recruit and retain senior executives and meet other compensation goals. In addition, while the executive compensation provisions discussed above are only applicable to financial institutions that sell troubled assets to the Treasury under EESA, all companies should be aware that more restrictive executive compensation practices may be forthcoming -- whether in the form of best practice pressures or future lawmaking. Both presidential candidates, as well as other members of Congress, have expressed support for restrictions on executive compensation.

We will continue to monitor these executive compensation developments. If you have questions regarding the executive compensation aspects of EESA, please contact [Elisa A. Cawood](#) or [Jane Jeffries Jones](#), the principal authors of the alert. You may also contact the Womble Carlyle attorney with whom you usually work, one of our Employee Benefits attorneys or one of our Corporate and Securities Attorneys.

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