FINANCIAL INSTITUTION CLIENT ALERT

TREASURY ISSUES GUIDANCE ON EXECUTIVE COMPENSATION RESTRICTIONS FOR TARP CAPITAL PURCHASE PROGRAM

OCTOBER 17, 2008

On October 14 we alerted our banking and financial institution clients and friends to the release of the term sheet for the United States Department of the Treasury's Capital Purchase Program ("CPP" or the "Program"). Under the CPP, Treasury is proposing to offer equity financing to all qualifying U.S. financial institutions ("Institutions"). One of the most significant features of the CPP is its restrictions on executive compensation for senior executive officers ("SEOs"), which were only broadly described in the term sheet. On October 15, Treasury issued interim rules to implement these broad limitations.

IDENTIFYING SEOS

SEOs consist of the following officers of the Institution (or its parent): (i) the principal executive officer ("PEO") of such Institution (or its parent); (ii) the principal financial officer ("PFO") of such Institution (or its parent); and (iii) the three most highly compensated executive officers of such Institution (or its controlled group) other than the PEO or the PFO. Determination of the three most highly compensated executive officers after the PEO and PFO is determined by looking at all compensation, including salary, bonuses, equity compensation, non-equity incentive plan compensation, changes in pension value, changes in non-qualified deferred compensation plan value and fringe benefits.

Note: For publicly traded Institutions, the list of SEOs will be the same as the Institution's "named executive officers" for securities law reporting purposes.

ENSURING THAT SENIOR EXECUTIVE COMPENSATION DOES NOT ENCOURAGE EXCESSIVE RISK TAKING

The interim rules require that no later than 90 days after the purchase under the CPP and annually thereafter for as long as the Institution's securities are held by the Treasury, the Institution's (or its parent's) compensation committee must review incentive compensation arrangements with such Institution's senior risk officers to ensure that the SEO incentive compensation arrangements do not encourage SEOs to take unnecessary and excessive risks that threaten the value of the Institution. The compensation committee must make a certification, in a form prescribed by the rules, that the Institution's SEO compensation policies do not encourage such risk taking. A publicly traded Institution would satisfy this requirement by including a certification in the Compensation Discussion and Analysis section of its proxy statement. A private Institution would file the certification with its primary federal regulator.

The rules state that the compensation committee should (i) discuss with the Institution's senior risk officers the risks (including long-term as well as short-term risks) that the Institution faces that could threaten the value of the Institution, (ii) identify the features in the Institution's SEO incentive compensation arrangements that could lead SEOs to take such risks and (iii) limit any such features in order to ensure that the SEOs are not encouraged to take risks that are unnecessary or excessive. Obviously, these factors are not black and white and compensation committees of participating Institutions will need to give careful consideration to this analysis.

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CLAWBACK OF SEO BONUSES

An Institution must require that SEO bonus and incentive compensation paid during the period that the Treasury holds an equity or debt position acquired under the CPP to be subject to recovery or "clawback" by the Institution if the payments were based on "materially inaccurate financial statements or any other materially inaccurate performance metric criteria." No further guidance is provided as to how this must be implemented. At the least, an SEO's employment agreement would need to be amended to provide for a refund by the SEO of any bonus or incentive compensation earned as a result of "materially inaccurate financial statements or any other materially inaccurate performance metric criteria."

Note: publicly traded Institutions should not confuse this provision with the clawback rule of Section 304 of Sarbanes Oxley. The CPP rule is broader in that it applies to all SEOs, not just the PEO and PFO. The CPP rule also applies to any material inaccuracy, whether or not there has been a restatement and applies to any material inaccuracy, whether or not the inaccuracy appears in reported financial statements.

RESTRICTION ON "GOLDEN PARACHUTE PAYMENT"

Any Institution participating in the Program is prohibited from paying a "golden parachute payment" to an SEO during the period in which Treasury holds any of the Institution's equity or debt. "Golden parachute payments" are defined as compensation payment or other benefit received on account of an "applicable severance from employment" to the extent that the aggregate present value of such payment exceeds three times the SEO's average annual compensation over the past three years. An "applicable severance from employment" is a termination of employment either by reason of involuntary termination (which can include constructive termination) or the bankruptcy or receivership of the Institution.

These rules incorporate many of the provisions or Section 280G of the Code, which imposes an excise tax on "excess parachute payments" made in connection with changes of control. Determination of whether a payment constitutes a golden parachute will often be complex and fact specific, and careful consultation of the rules under Section 280G will be required. Institutions not familiar with Section 280G should be aware that the determination of the amount of a payment is broad based, as it includes both obvious severance payments as well as the value of any acceleration of unvested equity compensation or other unvested benefits.

$500,000 LIMIT ON DEDUCTION FOR SEO COMPENSATION

The most significant executive compensation limitation in the CPP may be the $500,000 per-SEO limit on the compensation deduction. The limitation applies during any taxable year in which the Treasury owns the equity or debt securities of an Institution, and the rules further limit the ability of Institutions to use deferred compensation plans to avoid the $500,000.

CONTACT GREENSFELDER

If you have any questions or would like to discuss how Greensfelder could assist your institution in participating in the program, contact Phil Stanton at 314-345-4738 (prs@greensfelder.com) or any member of our Banking and Financial Institution Practice Group.

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