ALSTON + BIRD LLP

Employee Benefits & Executive Compensation ADVISORY

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Treasury Announces Executive Compensation Rules Under the Emergency Economic Stabilization Act

On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 (EESA),[1] under which the Treasury Department ("Treasury") may spend up to $700 billion to restore liquidity and stability to the U.S. economy by purchasing troubled assets from financial institutions. As widely publicized, EESA contains limits on executive compensation for financial institutions that participate in the Troubled Asset Relief Program (TARP). Depending on the type and level of participation by the financial institution, these limitations include

- prohibition of incentives that encourage "unnecessary and excessive risks";
- substantial new limits on tax deductibility;
- prohibition of certain severance payments;
- new excise taxes and loss of deduction on "golden parachute" payments; and
- "clawback" provisions to recoup incentive compensation paid based on inaccurate financial criteria.

EESA defines two general categories of TARP participants:

- **Direct Purchase Participants** — financial institutions from which Treasury makes only direct purchases of troubled assets where no bidding process or market prices are available, and in which Treasury takes a "meaningful" equity or debt position in the institution.
- **Auction Purchase Participants** — financial institutions from which Treasury makes auction purchases of troubled assets, and the aggregate auction purchase and any direct purchases from the institution exceed $300 million.

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[1] *See* H.R. 1424, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h1424enr.txt.pdf. For more information about EESA, *see* the Alston & Bird advisories "President Signs Emergency Economic Stabilization Act of 2008: Policy Decisions Remain," http://www.alston.com/financial_services_economic_recovery_act_2008 (Oct. 3, 2008), and "Emergency Economic Stabilization Act of 2008: Senate Approves; House Action to Come," http://www.alston.com/financial_services_economic_stabilization

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On October 14, 2008, Treasury Secretary Paulson announced the development of three TARP programs under EESA,[2] which fall under these two main categories:

The first is a **Capital Purchase Program** (CPP), in which financial institutions can voluntarily participate in the TARP on a *direct-purchase basis*.

- Under this program, Treasury will use its authority under section 101(a) of EESA to purchase up to $250 billion of non-voting senior preferred stock in qualifying U.S. controlled banking organizations and receive warrants to purchase common stock.
- EESA authorizes Treasury to purchase — from "financial institutions" — "troubled assets." Section 3(9)(B) defines "troubled assets" to include "any other financial instrument that the Secretary of the Treasury, after consultation with the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability . . . ." This language is broad enough for Treasury to justify treating capital stock of financial institutions as "troubled assets" if the Secretary concludes that purchases are "necessary to promote financial stability."
- While the original focus of EESA was to purchase non-performing loans and mortgage-backed securities from troubled institutions, the CPP instead will shore up balance sheets of even healthy institutions with fresh capital intended to stimulate lending. The CPP will bolster the capital of U.S. banking organizations in a way that is designed to earn returns for taxpayers, at least in many cases.
- A public term sheet[3] sets forth the terms on which "qualifying financial institutions" may participate in the CPP. Such firms have until November 14, 2008, to elect to participate, although Treasury will not necessarily fund its purchases until December 31, 2008.
- Nine of the largest banking organizations in the United States — Bank of America, Merrill Lynch (which will become part of Bank of America), Citigroup, JPMorgan Chase, Wells Fargo, Goldman, Morgan Stanley, Bank of New York Mellon and State Street — have already agreed to participate in both the CPP and the FDIC's new Temporary Liquidity Guarantee Program (announced on the same day).[4] The nine organizations will issue a total of $125 billion in senior preferred stock to Treasury, thus taking half of Treasury's initial $250 billion commitment to the program.

Second, Secretary Paulson announced a **Troubled Asset Auction Program** (TAAP), under which Treasury may purchase troubled mortgage-related assets through an *auction format*. Treasury promises to flesh out terms of this program over the coming weeks.

Third, Treasury announced a **Program for Systemically Significant Failing Institutions** (PSSFI), to potentially provide direct assistance to certain failing firms on terms negotiated on a case-by-case basis. It is anticipated that this TARP program will entail direct purchases rather than auction purchases.

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2 *See* https://www.treasury.gov/press/releases/hp1208.htm (Oct. 14, 2008)

3 *See* http://www.treasury.gov/press/releases/reports/document5hp1207.pdf.

4 *See* http://www.treasury.gov/press/releases/hp1206.htm (Oct. 14, 2008).

Financial institutions participating in any of these three programs will be required to adopt specified executive compensation standards. This advisory focuses on the executive compensation rules that will apply in each program.

Executive Compensation Requirements Under the Capital Purchase Program

The specific standards imposed by Treasury for the CPP are listed below:

- **Prohibition on Risky Incentive Compensation**. Compensation must not encourage unnecessary and excessive risks that threaten the value of the financial institution. In order to comply with this requirement, the institution must conduct an appropriate review of senior executive compensation within 90 days after the purchase under the CPP and at least annually thereafter.

- **Clawbacks**. A clawback of bonus or incentive compensation based on statements of earnings, gains or criteria that are later proved to be materially inaccurate. This requirement is stricter than the forfeiture provisions applicable to public companies under the Sarbanes-Oxley Act, and will apply in more circumstances.

- **Prohibition on "Golden Parachute Payments."** In general, a golden parachute payment includes any payment to a senior executive officer upon involuntary termination of employment or in connection with any bankruptcy filing, insolvency or receivership of the institution, if the total of such payments equals or exceeds three times a "base amount." The base amount is determined by reference to recent compensation levels as provided under section 208G of the Internal Revenue Code (the "Code").

- **Limits on Tax Deductions.** A participating institution must agree to limit its tax deduction for compensation to $500,000 for each senior executive. The specific rules governing this deduction limitation are the same as those that apply under other EESA programs.[5]

Financial institutions participating in the CPP also must comply with any additional governance or executive compensation guidance or regulations issued by Treasury on or before the date of the investment.

The restrictions apply throughout the period that Treasury holds an equity or debt position in the institution. Participating institutions will be required to modify or terminate existing compensation agreements and benefit plans and arrangements to comply with these limitations, and both the institution and its covered officers will be required to deliver waivers releasing certain claims against Treasury arising out of these requirements.

Additional details of the executive compensation standards, including rules applicable in the event of mergers and acquisitions involving institutions covered by the CPP, are contained in interim final rules issued on October 14, 2008, by Treasury [6] and are summarized below.

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[5] Internal Revenue Service Notice 2008-94, issued on October 14, 2008, provides guidance with respect to the Internal Revenue Code golden parachute rules and the $500,000 deduction limitation applicable under TAAP, and may be found at http://www.treasury.gov/initiatives/eesa/docs/N-08-94.pdf.

[6] The interim final rules may be found at http://www.treasury.gov/initiatives/eesa/docs/Exec%20Comp%20CPP%20Interim%20Final%20Rule.pdf. These rules are scheduled to be published in the Federal Register on October 20, 2008.

Who is a "senior executive officer" for purposes of these restrictions?

The term ''senior executive officer" (SEO) means an individual who is "one of the top 5 highly paid executives of a public company whose compensation is required to be disclosed pursuant to the Securities Exchange Act of 1934." This includes a "named executive officer," as defined in Item 402 of Regulation S-K, who is employed by a financial institution that is participating in the CPP while Treasury holds an equity or debt position acquired under the CPP and is (i) the chief executive officer, (ii) the chief financial officer or (iii) one of the three mostly highly compensated executive officers other than the CEO or CFO.

For purposes of determining the three most highly compensated executive officers, compensation is determined as it is in Item 402 of Regulation S-K to include total compensation for the last completed fiscal year without regard to whether the compensation is includible in the executive officer's gross income. Until the compensation data for the current fiscal year are available, the financial institution should make its best efforts to identify the three most highly compensated executive officers for the current fiscal year.

In the case of non-reporting companies, analogous rules apply for determining their SEOs. Institutions that are not subject to SEC reporting will need to learn and apply the complex new SEC rules for determining "total compensation" for this purpose.

Will affiliates of a financial institution that participates in the CPP be required to adopt the executive compensation and corporate governance standards?

Yes, in some cases. The CPP requirements apply not only to the financial institution that participates in the CPP, but also to any other entity in its controlled group. For this purpose, the controlled group rules in section 414(b) and (c) of the Code apply, but only taking into account parent-subsidiary relationships, not brother-sister relationships. These tax rules generally base control on an 80-percent ownership basis.

What must a CPP participant do to ensure that its incentive compensation programs for senior executives do not encourage "unnecessary and excessive risks" that threaten the value of the financial institution?

Such a financial institution must comply with the following rules while Treasury holds an equity or debt position acquired under the CPP:

1. no more than 90 days after the purchase under the CPP, the financial institution's compensation committee must review the SEO incentive compensation arrangements with such financial 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 financial institution;

2. thereafter, the compensation committee must meet at least annually with senior risk officers to discuss and review the relationship between the financial institution's risk management policies and practices and the SEO incentive compensation arrangements; and

3. the compensation committee must certify that it has completed the reviews of the SEO incentive compensation arrangements required under (1) and (2) above.

Because each financial institution faces different material risks given the unique nature of its business and the markets in which it operates, the compensation committee should discuss with the financial institution's senior risk officers the risks (including long-term as well as short-term risks) that such financial institution faces that could threaten its value. The compensation committee should identify the features in the financial institution's SEO incentive compensation arrangements that could lead SEOs to take such risks. Any such features should be limited in order to ensure that the SEOs are not encouraged to take risks that are unnecessary or excessive.

How is the Certification Requirement of Such Rules Met?

The compensation committee of the financial institution must provide certifications stating that it has reviewed with such financial institution's senior risk officers the SEO incentive compensation arrangements to ensure that the incentive compensation arrangements do not encourage SEOs to take unnecessary and excessive risks.

Specifically, the rules suggest the following certification language or something similar: "The compensation committee certifies that it has reviewed with senior risk officers the SEO incentive compensation arrangements and has made reasonable efforts to ensure that such arrangements do not encourage SEOs to take unnecessary and excessive risks that threaten the value of the financial institution."

For SEC-reporting companies, this certification should be made in the Compensation Discussion and Analysis (CD&A) required pursuant to Item 402(b) of Regulation S-K, which means that it will be subject to the CEO and CFO certifications required under the Sarbanes-Oxley Act. A private financial institution should file the certification of the compensation committee with its primary regulatory agency.

What must a CPP participant do to comply with the incentive compensation "clawback" requirements?

A financial institution participating in the CPP must require that SEO bonus and incentive compensation paid during the period that Treasury holds an equity or debt position acquired under the CPP are subject to recovery or "clawback" by the financial institution, if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria.

This EESA requirement is broader than the similar clawback provisions of section 304 of the Sarbanes-Oxley Act in that it

- applies to all SEOs, as opposed to just the CEO and CFO;
- applies to both public and private financial institutions;
- is not exclusively triggered by an accounting restatement;
- does not limit the recovery period; and
- covers not only material inaccuracies relating to financial reporting, but also material inaccuracies relating to other performance metrics used to award bonuses and incentive compensation.

What are the limitations with respect to "golden parachute" payments?

A financial institution participating in the CPP must prohibit any golden parachute payment to an SEO during the period Treasury holds an equity or debt position acquired under the CPP. As provided under new section 280G(e) of the Code, a "golden parachute payment" means any payment in the nature of compensation to (or for the benefit of) an SEO made on account of an applicable severance from employment, to the extent the aggregate present value of such payments equals or exceeds an amount equal to three times the SEO's base amount. The term "base amount" for an SEO has the meaning set forth in Q&A-34 of the final regulations relating to golden parachute payments under section 280G of the Code,[7] except that references to "change in ownership or control" are treated as referring to an "applicable severance from employment."

An "applicable severance from employment" means any SEO's severance from employment with the financial institution (i) by reason of involuntary termination of employment with the financial institution (or with an entity that is treated as the same employer as the financial institution under these rules, as described above); or (ii) in connection with any bankruptcy filing, insolvency, or receivership of the financial institution (or with an entity that is treated as the same employer as the financial institution under these rules, as described above).

An 'involuntary termination from employment" means a termination from employment due to the independent exercise of the unilateral authority of the employer to terminate the SEO's services, other than due to the SEO's implicit or explicit request to terminate employment, where the SEO was willing and able to continue performing services. An involuntary termination from employment may include the financial institution's failure to renew a contract at the time such contract expires, provided that the SEO was willing and able to execute a new contract providing terms and conditions substantially similar to those in the expiring contract and to continue providing such services. In addition, an SEO's voluntary termination from employment constitutes an involuntary termination from employment, if the termination from employment constitutes a termination for good reason due to a material negative change in the SEO's employment relationship. Reference is made to the final regulations under section 409A of the Code for a discussion of terminations for good reason.[8]

A severance from employment by an SEO is by reason of involuntary termination even if the SEO has voluntarily terminated employment in any case where the facts and circumstances indicate that, absent such voluntary termination, the financial institution would have terminated the SEO's employment and the SEO had knowledge that he or she would be so terminated.

A payment "on account of an applicable severance from employment" means a payment that would not have been payable if no applicable severance from employment had occurred (including amounts that would otherwise have been forfeited if no applicable severance from employment had occurred), and amounts that are accelerated on account of the applicable severance from employment. Reference is made to Q&A-24(b) of the final regulations relating to golden parachute payments under section 280G of the Code,[9] for rules regarding the determination of the amount that is on account of an acceleration, such as accelerated vesting of equity awards or other deferred compensation amounts.

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[7] 26 U.S.C. 280G(b)(3) and 26 CFR 1.280G-1

[8] 26 CFR 1.409A-1(n)(2)

[9] 26 U.S.C. 280G(b)(3) and 26 CFR 1.280G-1

Payments on account of an applicable severance from employment do not include amounts paid to an SEO under a tax qualified retirement plan.

What are the special rules for an acquisition, merger or reorganization?

In the event that a financial institution ("target") that had sold troubled assets to Treasury through the CPP is acquired by an entity that is not related to the target ("acquirer") in an acquisition of any form, the acquirer will not become subject to the "direct purchase" executive compensation restrictions of EESA (section 111(b) of EESA) merely as a result of the acquisition. For this purpose, an acquirer is related to the target if stock or other interests of the target are treated as owned by the acquirer (under section 318(a) of the Code, other than paragraph (4) thereof). However, with respect to the target, any employees of the target who are SEOs prior to the acquisition will be subject to the prohibition on "golden parachute payments" (section 111(b)(2)(C) of EESA) until after the first anniversary following the acquisition.

> **Example.** In 2008, financial institution A sells $100 million of troubled assets to Treasury through the CPP. In January 2009, financial institution B, which is not otherwise subject to the "direct purchase" executive compensation restrictions of EESA (section 111(b) of EESA), acquires financial institution A in a stock purchase transaction, with the result that financial institution A becomes a wholly owned subsidiary of financial institution B. Based on the rules above, the SEOs of financial institution B are not subject to the "direct purchase" executive compensation restrictions of EESA solely as a result of the acquisition of financial institution A in January 2009. However, the SEOs of financial institution A at the time of the acquisition are subject to the prohibition on "golden parachute payments" until January 2010, the first anniversary following the acquisition.

How is the $500,000 deduction limit made applicable to a CPP participant even though the CPP is not an auction-purchase TARP?

Although new section 162(m)(5) of the Code[10] by its terms only applies in the case of auction-purchase TARP participation, a financial institution must agree, as a condition to participate in the CPP, that no deduction will be claimed for federal income tax purposes for remuneration that would not be deductible if new section 162(m)(5) of the Code were to apply to the financial institution. For this purpose, during the period that Treasury holds an equity or debt position in the financial institution acquired under the CPP, (i) the financial institution (including entities in its controlled group) is treated as an "applicable employer," (ii) its SEOs are treated as "covered executives" and (iii) any taxable year that includes any portion of that period is treated as an "applicable taxable year," each as defined in new section 162(m)(5) of the Code, except that the dollar limitation and the remuneration for the taxable year are prorated for the portion of the taxable year that Treasury holds an equity or debt position in the financial institution under the CPP.

What are the rules for determining and applying the new $500,000 deduction limit?

For non-public institutions that may not be familiar with the current deduction limits of section 162(m), that tax provision generally limits the otherwise allowable deduction for compensation paid or accrued with respect to a covered employee of a publicly held corporation to no more than $1 million per year.

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[10] Internal Revenue Service Notice 2008-94 may be found at http://www.treasury.gov/initiatives/eesa/docs/N-08-94.pdf.

- A covered employee is a person who, as of the last day of a taxable year, is the CEO or one of the three most highly compensated officers for the taxable year (other than the CEO and the CFO) required to be reported to the shareholders under the SEC's compensation disclosure rules.
- If an individual is a covered employee for a taxable year, then the deduction limit applies to all compensation not explicitly excluded from the deduction limit, regardless of whether the compensation is for services as a covered employee and regardless of when the compensation was earned.
- Because remuneration generally does not include compensation for which a deduction is allowable after a covered employee ceases to be a covered employee, the deduction limit does not apply to compensation that is deferred until after termination of employment.

The $1 million limit is reduced by excess parachute payments (as defined in section 280G of the Code) that are not deductible by the corporation. Under section 162(m), as in effect prior to the amendment included in EESA, the following types of compensation generally are not subject to the deduction limit and are not taken into account in determining whether other compensation exceeds $1 million:

- remuneration payable on a commission basis;
- remuneration payable solely on account of the attainment of one or more performance goals, if certain outside director and shareholder approval requirements are met ("performance-based compensation");
- payments to a tax-qualified retirement plan (including salary reduction contributions);
- amounts that are excludable from the executive's gross income; and
- any remuneration payable under a written binding contract that was in effect on February 17, 1993, and that was not materially modified thereafter.

Section 302(a) of EESA amends section 162(m) by adding a new section 162(m)(5), which reduces the deduction limit to $500,000 in the case of "executive remuneration" and "deferred deduction executive remuneration." This limit applies only to certain employers (an "applicable employer") for remuneration paid to certain executives ("covered executives") during certain taxable years (an "applicable taxable year"). Employers covered under section 162(m)(5) are not limited to publicly-held corporations (nor even to corporations). Importantly, the exception for performance-based compensation and certain other exceptions do not apply in the case of executive compensation covered under section 162(m)(5). Therefore, the $500,000 limit under EESA will serve as a real ceiling on deductibility, whereas are there are many ways to soften the effect of the existing $1 million deduction limit.

Notice 2008-94 provides detailed guidance, in question and answer format, on when an employer is an "applicable employer," when a taxable year is an "applicable taxable year," the determination of who is a "covered executive," the effect of mergers and acquisitions on the deduction limit, how to determine "executive remuneration" and the treatment of "deferred deduction executive remuneration."

Executive Compensation Requirements under the Troubled Asset Auction Program

In Notice 2008-TAAP, issued on October 14, 2008, [11] Treasury provides guidance on certain executive compensation provisions applicable to a financial institution from which Treasury acquired troubled assets via an auction process, such as the TAAP. If the assets acquired from the institution exceed $300 million, the institution is subject to section 111(c) of EESA and is thereby

1. prohibited, for the term of the TARP program, from entering into any "new employment contract" with a senior executive officer that includes a "golden parachute."

Such an institution is also an "applicable employer" subject to section 302 of EESA and, therefore,

2. may not deduct for tax purposes executive compensation in excess of $500,000 for each senior executive; and

3. may not deduct certain "golden parachute payments" to its senior executives and a 20-percent excise tax will be imposed on the senior executive for these golden parachute payments.

I.R.S. Notice 2008-94, issued on October 14, 2008, [12] addresses the amendments to section 162(m) of the Code to implement the new $500,000 limit and the amendments to section 280G of the Code to implement these more stringent golden parachute tax provisions. In each case, those amendments substantially change the application of the "normal" tax provisions in the case of TARP participants who are subject to the amended provisions. Notice 2008-94, and the new amendments to sections 162(m) and 280G of the Code, will be the subject of a separate advisory.

Additional details of the executive compensation standards involving institutions covered by the TAAP are contained in Notice 2008-TAAP and are summarized below.

To what financial institutions does section 111(c) of EESA apply?

Section 111(c) of EESA applies to any financial institution from which one or more troubled assets are acquired through auction purchases under TARP, but only if the aggregate amount of the assets acquired exceeds $300 million. The assets that are counted for the $300 million threshold include all assets that are acquired by Treasury under TARP by direct purchase under section 101(a) of EESA. However, if the only such acquisitions from a financial institution are through direct purchase, the financial institution is not subject to section 111(c) of EESA. A financial institution to which section 111(c) of EESA applies continues to be subject to section 111(c) of EESA through the TARP authorities period (without regard to whether the Treasury ceases to hold an equity or debt position in the financial institution). The TARP authorities period is the period from October 3, 2008, to December 31, 2009, or, if extended, the period from October 3, 2008, to the date so extended, but not later than October 3, 2010.

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[11] Notice 2008-TAAP may be found at http://www.treasury.gov/initiatives/eesa/docs/Exec%20Comp%20TAAP%20Notice.pdf.

[12] Internal Revenue Service Notice 2008-94 may be found at http://www.treasury.gov/initiatives/eesa/docs/N-08-94.pdf.

How is the $300,000 million limit calculated in the context of a controlled group?

For purposes of applying section 111(c) of EESA, including the determination of whether the aggregate amount of the assets acquired from a financial institution exceeds $300 million, two or more financial institutions that are treated as a single employer under section 414(b) or (c) of the Code (but only taking into account parent-subsidiary relationships, not brother-sister relationships) are treated as a single financial institution.

> **Example.** Bank holding company X is the sole owner of banks A, B and C. In December 2008, bank A sells $150 million of assets to the Treasury under TARP in an auction purchase. In February of 2009, bank B sells $100 million of assets to the Treasury under a TARP auction purchase. On August 14, 2009, bank C sells $100 million of assets to the Treasury under a TARP auction purchase. Bank holding company X, along with banks A, B and C (plus any other entity that is treated as the same financial institution under the controlled group rules described above) constitute a single financial institution and have sold in excess of $300 million of assets under TARP. The CEO and the CFO of bank holding company X and the three most highly compensated executive officers of the bank holding company X's controlled group are SEOs.

Who is an SEO under section 111 of EESA?

The determination of who is an SEO in this context is the same as described above with respect to participants in the CPP. The prohibition in section 111(c) of EESA applies to any arrangements entered into by a financial institution with an SEO during the TARP authorities period. Whether an employee is an SEO is determined at the time the employee enters into the arrangement.

What is a "golden parachute" under section 111(c) of EESA?

A golden parachute payment, and the related terms, in this context have the same meanings as described above with respect to participants in the CPP.

What is a new employment contract under section 111(c) of EESA?

A "new employment contract" means any material compensatory contract (including any plan, agreement or arrangement, whether or not written) entered into on or after the date when section 111(c) of EESA applies to the financial institution. For this purpose, a contract that is renewed is treated as entered into on the date of the renewal. In addition, if a contract is materially modified, it is treated as a new contract entered into as of the date of the material modification. A contract is materially modified if it is amended to increase the amount of compensation payable to the employee, to accelerate the date on which vesting occurs or to accelerate the payment under the contract. Reference is made to the Treasury regulations under section 162(m) of the Code for purposes of determining what constitutes a material modification.

> **Example 1**. Bank holding company A, a participant in TARP from which the Treasury has purchased over $300 million in troubled assets through auction purchases, amends the employment agreement of its CFO to increase his or her salary. In this case, the amendment is a material modification to an existing employment arrangement and thus is a new employment contract under section 111(c) of EESA.

Example 2. Community bank B, a participant in TARP from which the Treasury has purchased over $300 million in troubled assets through auction purchases, amends its existing incentive compensation arrangement in which the CEO and CFO participate and which provides benefits in the event of bankruptcy or insolvency. The amendment accelerates the vesting period under the arrangement. In this case, the amendment is a material modification to an existing contract and thus is a new employment contract under section 111(c) of EESA.

How does section 111(c) of EESA apply in connection with an acquisition, merger or reorganization?

In the event that a financial institution ("target") that had sold troubled assets to the Treasury under TARP is acquired by an entity that is not related to the target ("acquirer") in an acquisition of any form, the troubled assets sold to the Treasury under TARP by the target prior to the acquisition are not aggregated with any assets sold by the acquirer prior to or after the acquisition. For this purpose, an acquirer is related to the target if stock or other interests of the target are treated (under section 318(a) of the Internal Revenue Code other than paragraph (4) thereof) as owned by the acquirer. If, after an acquisition, troubled assets of the target are sold by the acquirer's controlled group (including the target, in the case of a stock acquisition), those assets must be aggregated with any assets sold by the acquirer, whether prior to or after the acquisition, for purposes of determining whether the acquirer is subject to section 111(c) of EESA. If the target was subject to section 111(c) of EESA at the time of the acquisition, the acquirer will not become subject to section 111(c) of EESA merely as a result of the acquisition.

Example. In 2008, financial institution A sells $100 million of troubled assets under TARP and financial institution B sells $350 million of troubled assets under TARP. In January 2009, financial institution A acquires financial institution B in a stock purchase transaction, with the result that financial institution B becomes a wholly owned subsidiary of financial institution A. In February 2009, financial institution A sells an additional $100 million of its troubled assets under TARP, and in March 2009 financial institution B (when it is a wholly owned subsidiary of A) sells an additional $150 million of troubled assets. Neither the sale of troubled assets by financial institution A nor the sale of troubled assets by financial institution B are solely through direct purchases. Based on the rules in Notice 2008-TAAP, financial institution A is not subject to section 111(c) of EESA as a result of the acquisition of B, or as a result of the assets sold in February 2009, because the $350 million of troubled assets sold by financial institution B prior to the acquisition are not aggregated with the troubled assets sold by financial institution A's controlled group prior to and after the acquisition of financial institution B. However, financial institution A becomes subject to section 111(c) of EESA in March 2009 when the amount of troubled assets sold by financial institution's controlled group (without regard to the sales by financial institution B prior to the acquisition of B by A) total $350 million. The employees of financial institution B are subject to section 111(c) of EESA in March 2009, assuming they are SEOs in financial institution A's controlled group.

Executive Compensation Requirements under the Program for Systemically Significant Failing Institutions

In Notice 2008-PSSFI, issued on October 14, 2008,[13] Treasury provides guidance as to the executive compensation standards that will apply to the firms participating in these PSSFI programs and their senior executives. These standards are similar in all respects to the CPP executive compensation standards described above, with one significant difference: In situations where Treasury provides assistance under the systemically significant failing institutions programs, golden parachutes will be defined more strictly to prohibit any payments in the nature of compensation to departing senior executives. In other words, the prohibition applies to the first dollar of compensation rather than being limited to payments that exceed 2.99 times the departing SEO's "base amount."

Observations

In keeping with the emergency nature of EESA, Treasury has worked with admirable efficiency to produce this detailed and cohesive guidance in the 11 days after EESA was adopted. There will undoubtedly be many unanswered issues as institutions scramble to weight the costs and benefits of voluntary participation in the CPP. Nevertheless, these collective notices and rules should give institutions more than enough information on the executive compensation provisions to make an informed decision by the November 14 deadline.

In the longer term, some of the EESA compensation principles (such as risk analysis in incentive plan design, expanded clawback policies and severance limits) may begin to shape the thinking of compensation committees (or politicians) over the next few months.

This advisory was written by **Laura Thatcher** (404.881.7546, laura.thatcher@alston.com) and **Carolyn Smith** (202.756.3566, carolyn.smith@alston.com).

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[13] Notice 2008-PSSFI may be found at http://www.treasury.gov/initiatives/eesa/docs/Exec%20Comp%20PSSFI%20Notice.pdf.

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Members of Alston & Bird's Employee Benefits & Executive Compensation Group

Robert A. Bauman
202.756.3366
bob.bauman@alston.com

Saul Ben-Meyer
212.210.9545
saul.ben-meyer@alston.com

Patrick C. DiCarlo
404.881.4512
pat.dicarlo@alston.com

Ashley Gillihan
404.881.7390
ashley.gillihan@alston.com

David R. Godofsky
202.756.3392
david.godofsky@alston.com

Anna Grant
404.881.7124
anna.grant@alston.com

Anne Tyler Hamby
404.881.4839
annetyler.hamby@alston.com

Amy S. Heppner
404.881.7272
amy.heppner@alston.com

John R. Hickman
404.881.7885
john.hickman@alston.com

H. Douglas Hinson
404.881.7590
doug.hinson@alston.com

James S. Hutchinson
212.210.9552
jamie.hutchinson@alston.com

Lindsay Jackson*
202.756.3002
lindsay.jackson@alston.com
*Admitted in Pennsylvania only

David C. Kaleda
202.756.3329
david.kaleda@alston.com

Laurie Kirkwood
404.881.7832
laurie.kirkwood@alston.com

Johann Lee
202.756.5574
johann.lee@alston.com

Blake Calvin MacKay
404.881.4982
blake.mackay@alston.com

Emily W. Mao
202.756.3374
emily.mao@alston.com

Sean K. McMahan
404.881.4250
sean.mcmahan@alston.com

Michael G. Monnolly
404.881.7816
mike.monnolly@alston.com

Craig R. Pett
404.881.7469
craig.pett@alston.com

Andrea Prather
202.756.3354
andrea.prather@alston.com

Nancy B. Pridgen
404.881.7884
nancy.pridgen@alston.com

Thomas G. Schendt
202.756.3330
thomas.schendt@alston.com

John B. Shannon
404.881.7466
john.shannon@alston.com

Maya D. Simmons
404.881.4601
maya.simmons@alston.com

Carolyn E. Smith
202.756.3566
carolyn.smith@alston.com

Michael L. Stevens
404.881.7970
mike.stevens@alston.com

Laura G. Thatcher
404.881.7546
laura.thatcher@alston.com

Katherine A. Tritschler
404.881.7582
katie.tritschler@alston.com

Kerry T. Wenzel
404.881.4983
kerry.wenzel@alston.com

ATLANTA
One Atlantic Center
1201 West Peachtree Street
Atlanta, GA 30309-3424
404.881.7000

CHARLOTTE
Bank of America Plaza
Suite 4000
101 South Tryon Street
Charlotte, NC 28280-4000
704.444.1000

DALLAS
Chase Tower
Suite 3601
2200 Ross Avenue
Dallas TX 75201
214.922.3400

LOS ANGELES
333 South Hope Street
16th Floor
Los Angeles, CA 90071-3004
213.576.1000

NEW YORK
90 Park Avenue
New York, NY 10016-1387
212.210.9400

RESEARCH TRIANGLE
Suite 600
3201 Beechleaf Court
Raleigh, NC 27604-1062
919.862.2200

SILICON VALLEY
Two Palo Alto Square
Suite 400
3000 El Camino Real
Palo Alto, CA 94306-2112
650.838.2000

VENTURA COUNTY
Suite 215
2801 Townsgate Road
Westlake Village, CA 91361
805.497.9474

WASHINGTON, D.C.
The Atlantic Building
950 F Street, NW
Washington, DC 20004-1404
202.756.3300

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