

**TREASURY GUIDANCE ESTABLISHES REPORTING OBLIGATIONS AND
CLARIFIES EXPANDED APPLICABILITY OF EXECUTIVE COMPENSATION
STANDARDS AND LIMITATIONS UNDER TARP**

In connection with the Troubled Asset Relief Program (“**TARP**”) established under the Emergency Economic Stabilization Act of 2008 (the “**Act**”), participating financial institutions must comply with certain standards and limitations relating to senior executive officer compensation. In October 2008, the Treasury published guidance on compliance with the TARP standards and limitations in the context of a direct-purchase TARP program, such as the Capital Purchase Program (the “**CPP**”). The Treasury recently issued revised guidance and established reporting and recordkeeping requirements for compliance with the TARP standards.

This memorandum discusses the January guidance and supplements our October 6, 2008, memorandum on the compensation-related provisions of the Act (www.willkie.com/files/tbl_s29Publications/FileUpload5686/2728/Domestic_Compensation_Limitations.pdf).

The Act: TARP Standards and Limitations

The Act establishes two categories of standards and limitations: (i) those applicable to TARP participants in which the Treasury acquires a “meaningful” equity or debt position by means of direct purchases of troubled assets (i.e., where no bidding process or market prices are available) (the “**Direct Purchase Standards and Limitations**”), and (ii) those applicable to TARP participants in which the Treasury acquires, through auction purchases alone or a combination of auction purchases as well as direct purchases, troubled assets that in aggregate exceed \$300 million (the “**Auction Purchase Standards and Limitations**”).

- The Direct Purchase Standards and Limitations require (i) limits on compensation for “senior executive officers” of the TARP participant (“**SEOs**”) that are intended to remove incentives for SEOs to take unnecessary and excessive risks that threaten the value of the TARP participant, (ii) policies requiring all SEOs to disgorge incentive compensation that is based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate, and (iii) a prohibition on making “golden parachute payments” to SEOs.
- The Auction Purchase Standards and Limitations (i) prohibit the TARP participant from entering into any new SEO employment contract that provides a “golden parachute payment” in the event of an involuntary termination, bankruptcy filing, insolvency, or receivership, (ii) amend Internal Revenue Code (“**Code**”) Section 162(m) to establish a \$500,000 limit on the deductibility by a TARP participant of *any* compensation paid to an SEO in respect of any year during which the Treasury’s TARP authority remains in effect (whether currently paid in such year or deferred), and (iii) expand the prohibition under Code Section 280G on deducting “excess parachute payments” made in connection with

a change in control to include any such payment (calculated pursuant to the same methodology as required under Code Section 280G prior to the enactment of the Act, disregarding any applicable exemptions) paid by a TARP participant upon a termination of an SEO's employment by reason of (x) an involuntary termination by the employer or (y) a bankruptcy, liquidation, or receivership of the employer. An involuntary termination of employment for purposes of the Auction Purchase Standards and Limitations includes (i) the employer's failure to renew a contract upon its expiration, provided the officer was willing and able to execute a new contract with substantially similar terms, as well as (ii) an officer's voluntary termination for "good reason" as such term is used for purposes of Section 409A of the Code.

The January Guidance: Expanded TARP Standards and Limitations

Affected Officers

The TARP standards and limitations apply only to the SEOs of a participating financial institution (and its controlled group). The term "SEO" is defined by reference to the "named executive officers" ("*NEOs*") for purposes of the executive compensation disclosure rules in Item 402 of Regulation S-K under the securities laws (or their private company counterparts), but includes only the CEO and CFO of the parent entity of the financial institution's controlled group and the top three most-highly paid individuals of the entire controlled group.

SEO Determinations

With respect to the non-tax-related TARP standards and limitations (i.e., the Direct Purchase Standards and Limitations and the prohibition against an auction purchase TARP participant from entering into any new employment contract with an SEO that provides a "golden parachute payment"), SEO status is based on compensation received in respect of the prior fiscal year (i.e., an individual would be an SEO for 2009 if he is an NEO in the financial institution's proxy statement or annual report that is filed in 2009, based on 2008 compensation). Therefore, a TARP participant that is subject to the Direct Purchase Standards and Limitations (including the prohibition against making any golden parachute payment to an SEO) should refrain from making any golden parachute payment to a potential SEO until the year's NEOs are identified in such year's proxy statement or annual report.

With respect to the tax-related TARP standards and limitations (i.e., the expanded limitations on deductibility under Code Sections 162(m) and 280G), SEO status is based on current-year compensation (i.e., the year with respect to which a deduction could otherwise be taken). An individual would be an SEO for 2009, therefore, if he is an NEO in the financial institution's proxy statement or annual report that is filed in 2010, based on 2009 compensation.

Acquisitions

In the event that direct-purchase TARP participant is the target of an acquisition in any form, the officers of the acquirer will not become subject to the TARP standards and limitations merely as a result of the acquisition. The SEOs of the acquired entity will remain subject to the TARP standards and limitations, however, until the first anniversary of the acquisition.

Eliminating Compensation that Encourages Unnecessary and Excessive Risks

A participating financial institution's compensation committee must, within 90 days after the Treasury's purchase of troubled assets, as well as annually, review with the financial institution's senior risk officers, and certify as to such review, the incentive compensation arrangements for CEOs to ensure that such arrangements do not encourage CEOs to take unnecessary or excessive risks. The review should take into account both long- and short-term risks that could threaten the value of the institution. The certification that such reviews have taken place must be provided by public employers in the Compensation Committee Report under Item 407(e) of Regulation S-K. Private employers must provide certification to their primary regulatory agencies.

Clawbacks

Unlike Section 304 of the Sarbanes-Oxley Act of 2002, the Act's provision on disgorgement of incentive compensation (i) applies to all CEOs, not simply the CEO and CFO, (ii) applies to all participating financial institutions, both public and private, (iii) is not triggered exclusively by an accounting restatement, and (iv) covers not only material inaccuracies in financial reporting, but also material inaccuracies relating to other performance metrics used to award bonuses and incentive compensation. The Act's provision applies to a financial institution's CEOs during the period that the Treasury holds any of its equity or debt, and for purposes of determining whether compensation is paid during the relevant period, such compensation is deemed to be paid to an CEO when he obtains a legally binding right to the payment (i.e., even if the payment is deferred).

Golden Parachute Payments

The January guidance raises an interpretive issue regarding the Act's absolute prohibition on the ability of direct-purchase TARP participants to make "golden parachute payments" to CEOs. For CPP participants, the guidance defines "golden parachute payment" by reference to the Code Section 280G definition (i.e., a payment in excess of three times an CEO's base amount) that is applicable by the terms of the Act only to auction-purchase TARP participants. With respect to *all* direct-purchase TARP participants, however, which includes CPP participants, the guidance defines "golden parachute payment" much more broadly to include a payment of *any* amount in the nature of compensation to or for the benefit of an CEO. The practical effect of this difference, which is expressly acknowledged by the Treasury, as well as the purpose of the definition used in the CPP guidance, remains unclear without further guidance, because participants in the CPP would also be subject to the general rule applicable to participants in direct-purchase programs.

Expanded Applicability of Auction Purchase Standards and Limitations

Notwithstanding the text of the Act, the January guidance expands the applicability of the \$500,000 deduction limitation otherwise applicable only in the auction context by requiring *all* TARP participants from whom the Treasury makes a direct purchase of troubled assets to agree, as a condition of TARP participation, to be subject to the new Code Section 162(m) limitation.

Additionally, the guidance clarifies that the \$500,000 deduction limitation, which applies in any year during which the Treasury's TARP authority remains in effect, will be prorated along with CEO remuneration for any taxable year in which the Treasury holds an equity or debt position in the financial institution under TARP for only a portion of such year.

The January Guidance: Reporting and Recordkeeping Requirements

In addition to clarifying the October guidance, the recent Treasury pronouncements establish a comprehensive reporting and recordkeeping regime relating to compliance. Under this regime, the CEO of each TARP participant must provide to both the Chief Compliance Officer of TARP and the transfer agent under TARP either the following certifications or an explanation of why such certifications have not been provided. This CEO reporting requirement is in addition to the compensation committee reporting requirements described above.

Reporting Certifications

Within 120 days of the Treasury's acquisition of troubled assets, the CEO of the TARP participant must certify that, to his knowledge, the compensation committee reviewed with the institution's senior risk officers, within 90 days following such acquisition, the CEO incentive compensation arrangements to ensure that such arrangements do not encourage the CEOs to take unnecessary and excessive risks that threaten the value of the institution.

Within 135 days of the completion of the first fiscal year of TARP participation (i.e., by May 15 for entities with a fiscal year ending December 31), the CEO must certify as to the identity of the institution's CEOs and that, to his knowledge, (i) the compensation committee has met with senior risk officers at least once during the most recently ended fiscal year to discuss and review the relationship between the risk management policies and practices of the institution and the incentive compensation arrangements of the CEOs to ensure that such arrangements do not encourage the CEOs to take unnecessary and excessive risks that threaten the value of the institution, (ii) the compensation committee has certified the review in (i) above, (iii) the financial institution has established adequate clawback policies affecting incentive compensation, (iv) the financial institution has prohibited "golden parachute payments" to CEOs, and (v) the financial institution has instituted controls and procedures to comply with the \$500,000 limitation on compensation deductions for CEOs. Although not discussed in the guidance, the CEO's certification as to the identity of the institution's CEOs could potentially require two separate lists--one for the tax-related TARP standards and limitations and one for the non-tax-related TARP standards and limitations.

Within 135 days of the completion of each subsequent fiscal year, the CEO must provide the same certifications as required following the first fiscal year, as described above, plus an additional certification that the institution has actually limited its deduction to \$500,000 for each CEO for prior the fiscal year.

Recordkeeping

Each TARP participant must keep appropriate records to substantiate the certification requirements described above for at least six years after the date of the applicable certification (and in an easily accessible place for at least the first two years).

Penalties

Any individual or entity providing information or certifications to the Treasury relating to purchases under TARP is subject to the general rule under the United States Code that prohibits the making of false or fraudulent statements to a federal officer. As such, any indication of the making of any false or fraudulent statements in connection with satisfying requirements under the Act will be disclosed to the Department of Justice, and such individual or entity providing such information could become subject to a fine, imprisonment for up to five years, or both.

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