



SIGTARP

OFFICE OF THE SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM

ADVANCING ECONOMIC STABILITY THROUGH TRANSPARENCY, COORDINATED OVERSIGHT AND ROBUST ENFORCEMENT

DESPITE EVOLVING RULES ON EXECUTIVE COMPENSATION, SIGTARP SURVEY PROVIDES INSIGHTS ON COMPLIANCE

**SIGTARP-09-003
AUGUST 19, 2009**



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for the Troubled Asset Relief Program

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Summary of Report: SIGTARP-09-003

Why SIGTARP Did This Study

The Troubled Asset Relief Program (“TARP”) was created by the Emergency Economic Stabilization Act of 2008 (“EESA”), which was enacted on October 3, 2008. TARP provided the Secretary of the Treasury with various authorities to restore the liquidity and stability of the United States financial system and to increase lending. The Act also placed restrictions on executive compensation for all TARP recipients. However, the American Recovery and Reinvestment Act of 2009 (“ARRA”) amended the original executive compensation requirements established under EESA. As of early July 2009, the Department of Treasury has disbursed about \$361 billion of TARP assistance to over 650 financial institutions, many of which are subject to executive compensation restrictions.

The Congress and the public frequently ask questions about compliance with executive compensation restrictions. Accordingly, in February 2009, SIGTARP sent survey letters to 364 financial and other institutions that had completed TARP funding agreements through January 2009. The survey instrument provided for open-ended responses. The goal was to elicit as much information as possible while allowing for different conditions at each institution. The review and analysis was confined to the survey responses—including supporting documentation— as provided, reported and certified by the TARP recipients.

The objective of this report was to address the efforts of TARP recipients’ to comply with executive compensation restrictions in place at the time of our survey and plans to comply with subsequently enacted changes in requirements. This report is set against the background of the evolving rules on executive compensation requirements for TARP recipients. Our work was performed in accordance with generally accepted government auditing standards.

What SIGTARP Recommends

SIGTARP makes no recommendations in this report.

In commenting on a draft of this report, Treasury concurred with the report.

What SIGTARP Found

This is the first of a series of SIGTARP audits on executive compensation. When SIGTARP conducted this survey, the requirements for executive compensation were still evolving. Shortly after SIGTARP distributed the survey, ARRA amended EESA’s executive compensation restrictions. When implemented by Treasury, the new restrictions would modify the original executive compensation requirements established under EESA. Neither EESA nor ARRA directly limit the annual base pay of senior executive officers; rather, executive compensation restrictions placed thus far on CPP recipients have more specifically targeted incentive compensation and severance payments.

Given the timing of the survey, many of the responses reflected uncertainty and a wait-and-see attitude about the emerging guidelines and restrictions on executive compensation. Nevertheless, many respondents provided insights regarding their efforts to comply with the requirements as they understood them. Survey responses regarding compliance with EESA bonus and severance pay restrictions varied from simple statements of compliance to detailed answers about efforts to assess compensation practices relative to the restrictions. Although some recipients expressed frustration with changing compensation guidance and legislation, many respondents noted actions they were taking at the time of the survey based on known requirements and with the understanding that final guidelines were pending. These actions included taking steps to assess risks and procure expert compensation consultants.

Similarly, some recipients noted the changing nature of legislative requirements and a lack of clear and final implementing guidance but provided a forward-looking perspective. For example, one institution reported that the “company was monitoring recent developments with respect to executive compensation limitations including the recent enactment of the ARRA. The company will take the steps necessary to comply with the 2009 Act, as the requirements are further defined by the issuance of implementing regulations by the Treasury.” Institutions also voiced concerns about future requirements for executive compensation—such as retroactive application—and uncertainty about future changes. Finally, other ongoing SIGTARP audit work has identified concerns about the potential for compensation restrictions to disadvantage some firms receiving TARP assistance in retaining key personnel. Several large firms stated that they have already lost a number of executives as a direct result of the executive compensation restrictions.

The responses to this SIGTARP survey provide necessary context for examining the evolution of executive compensation requirements, adding clarity to what was required, and highlighting some relevant issues that could impact implementation of requirements going forward. As the executive compensation picture becomes clearer in the future, SIGTARP plans to conduct follow-up audits on this important topic to build on these initial findings.

Special Inspector General for the Troubled Asset Relief Program



OFFICE OF THE SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM
1801 L STREET, NW
WASHINGTON, D.C. 20220

August 19, 2009

MEMORANDUM FOR: The Honorable Timothy Geithner, Secretary of the Treasury

SUBJECT: Despite Evolving Rules on Executive Compensation, SIGTARP Survey Provides Insights on Compliance (SIGTARP-09-003)

We are providing this audit report for your information and use. It discusses the responses of 364 institutions to a SIGTARP survey on executive compensation requirements associated with the receipt of TARP funds. The Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") conducted this audit, under the authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general of the Inspector General Act of 1978, as amended.

Formal written comments were received from the Office of Financial Stability and are included in the Management Comments appendix of this report.

We appreciate the courtesies extended to the SIGTARP staff. For additional information on this report, please contact Mr. Barry W. Holman at (202-622-4633/barry.holman@do.treas.gov).

Neil M. Barofsky
Special Inspector General
for the Troubled Asset Relief Program

Table of Contents

Introduction	1
Insights on Executive Compensation from SIGTARP Survey	7
Conclusions	13
Management Comments and Audit Evaluation	13
Appendices	
A. Scope and Methodology	14
B. Survey Letter	16
C. Summary of Treasury's June 15, 2009 Interim Rule on Executive Compensation	18
D. Interim Final Rule Calendar	26
E. Audit Team Members	27
F. Management Comments	28



DESPITE EVOLVING RULES ON EXECUTIVE COMPENSATION , SIGTARP SURVEY PROVIDES INSIGHTS ON COMPLIANCE

SIGTARP REPORT 09-003

August 19, 2009

Introduction

The Emergency Economic Stabilization Act of 2008 (“EESA”),¹ enacted on October 3, 2008, authorized the Secretary of the Treasury to establish the Troubled Asset Relief Program (“TARP”) to purchase troubled assets from financial institutions. As part of its implementation of EESA, Treasury has promulgated certain requirements with respect to executive compensation at the recipient organizations. Some of these limitations were explicitly stated in legislative requirements, and others were proposed pursuant to the authority granted to the Treasury under EESA. These requirements have evolved and changed over time; the latest requirements were set forth in a June 15, 2009, set of interim final regulations published by Treasury in the *Federal Register*. As of early July 2009, Treasury has disbursed about \$361 billion of TARP assistance to more than 650 financial institutions using funds authorized under EESA.

The Congress and the public frequently ask two questions about the investments made by Treasury:

- What have program recipients done with the money they received from Treasury?
- Have the recipients complied with the executive compensation requirements that were a condition of receiving the funds?

To address these questions, beginning on February 5, 2009, SIGTARP sent survey letters to 364 financial and other institutions that had completed TARP funding agreements through January 31, 2009 (See Appendix B). This report addresses the efforts of TARP recipients to comply with the restrictions on executive compensation in place at the time of our survey and their plans to comply with subsequently enacted and promulgated requirements.

Getting full information about compliance with requirements for executive compensation proved difficult for a number of reasons:

- the evolving nature of those requirements
- the lag time associated with meeting some of the requirements
- the American Recovery and Reinvestment Act was passed after the survey was sent to TARP recipients

¹ Public Law 110-343, October 3, 2008.

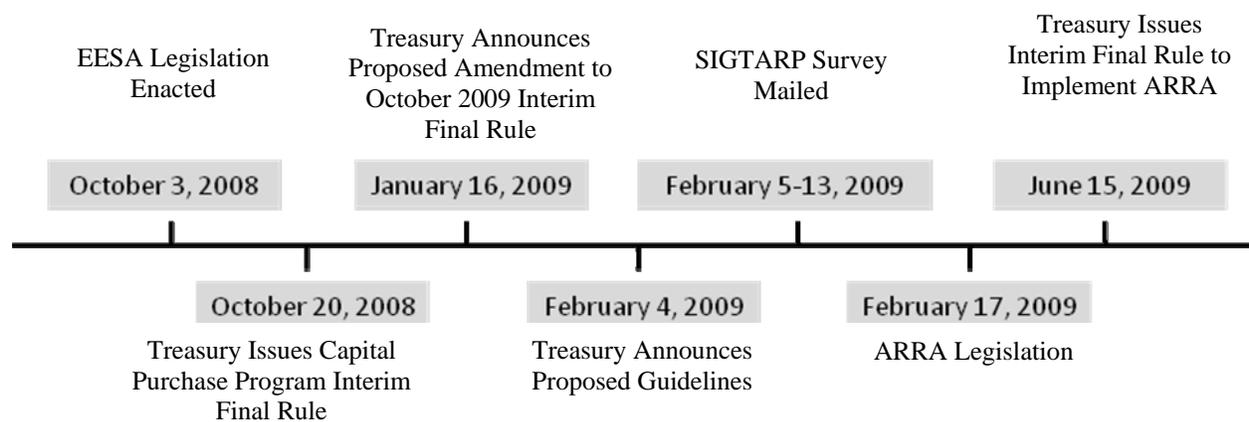
- the more recent regulations promulgated by Treasury after TARP recipients had responded to SIGTARP’s survey request

Nevertheless, SIGTARP believes that the responses provide necessary context for examining the evolution of executive compensation requirements, add clarity to the nature of the requirements, and highlight some relevant issues that could impact implementation of requirements going forward. SIGTARP issued a separate report on the use of funds on July 20, 2009.²

Background

From the outset of TARP, all financial institutions directly participating in TARP and under an ongoing obligation to Treasury were expected to abide by the requirements for executive compensation set forth in EESA and applicable Treasury regulations and guidance. Since EESA was enacted, additional regulations, amendments, and notices on executive compensation have been issued. Figure 1 illustrates the changes in executive compensation restrictions set forth by Congress and Treasury over time.

Figure 1: Timeline for TARP Executive Compensation Limitations



Source: SIGTARP Analysis of TARP Executive Compensation Guidance

Section 111 of EESA, as originally enacted, required all financial institutions that sell troubled assets to the Treasury under TARP to abide by certain rules on executive compensation intended to avoid unnecessary and excessive risks, to provide for recovery of bonus and incentive payments based on criteria later proven to be materially inaccurate, and impose restrictions on excessive departure pay (known as golden parachutes) to senior executive officers. On October 20, 2008, Treasury issued an interim final rule implementing the EESA restrictions on executive compensation. This interim final rule established the original standards for executive compensation for institutions participating in the Capital Purchase Program (“CPP”). The primary provisions are described below:

² SIGTARP-09-001, “Survey Demonstrates Banks Can Provide Meaningful Information On Their Use of TARP Funds,” July 20, 2009.

- **Excessive risk:** Incentive compensation for senior executive officers was required not to encourage unnecessary and excessive risks that threaten the value of the financial institution. The financial institution's compensation committee, or a committee acting in a similar capacity, was required to review the incentive compensation arrangements with its senior risk officers within 90 days of Treasury's purchase of preferred shares under the CPP.
- **Tax deductibility:** The institution could not deduct more than \$500,000 of executive compensation for each senior executive officer based on limitations set forth under Section 162(m)(5) of the Internal Revenue Code.
- **Clawback:** SEO bonus and incentive compensations was required to be subject to a clawback—the recovery of any bonus or incentive compensation paid to a senior executive officer if statements of earnings, gains, or other criteria are later proven to be materially inaccurate.
- **Golden parachute:** Golden parachute payments were prohibited for senior executive officers. A golden parachute was defined as “any payment in the nature of compensation to (or for the benefit of) a senior executive officer made on account of an applicable severance from employment to the extent the aggregate present value of such payment equals or exceeds an amount equal to three times the senior executive officer's base amount.”

These restrictions covered the institution's senior executive officers (“SEO”s), which were defined as the Chief Executive Officer, Chief Financial Officer, and the three most highly compensated executive officers. The restrictions were to apply for as long as Treasury held an equity or debt position in the institution.

On January 16, 2009, Treasury announced proposed amendments to its October 2008 CPP interim final rule to include requirements for reporting and recordkeeping with respect to the executive compensation standards for CPP recipients. The January announcement stated that these regulations would be effective on the date they were published in the *Federal Register*. However, due to the transition of administrations and the resulting hold on all new regulatory actions, these amendments were never published in the *Federal Register*; therefore, they were never put into force.

Additional uncertainties about executive compensation restrictions flowed from proposed guidance announced on February 4, 2009, and differing requirements enacted later that month. On February 4, 2009, Treasury proposed restrictions that, among other things, generally sought to limit going forward the total annual compensation of senior executives of TARP recipients to \$500,000, in addition to grants of long-term restricted stock and long-term incentive awards (or, in the case of TARP recipients that did not receive exceptional assistance, to have this limit waived through a shareholder vote on compensation)—and to increase the number of senior officers covered by the clawback and golden parachute provisions. Treasury also proposed that the guidelines would not apply retroactively to existing investments or to previously announced programs, but would apply to newly announced programs. Before the February 2009 guidance could be fully implemented, however, the American Recovery and Reinvestment Act (“ARRA”)

was signed into law on February 17, 2009. ARRA amended EESA requirements related to executive compensation, including these provisions:

- specifying what constitutes a golden parachute payment and the executives subject to a prohibition on such payments
- adding additional specificity to employees subject to clawback provisions
- limiting incentive compensation to one-third of selected employees' total compensation (the number of employees affected depends on the amount of TARP funding received)
- specifying categories of employees who would be subject to incentive compensation restrictions, depending on the amount of TARP assistance received by the institution
- requiring institutions receiving TARP assistance to provide for a non-binding shareholder vote on executive compensation packages, the so-called, "Say on Pay" requirement

ARRA required Treasury to issue implementing regulations.

On June 10, 2009, Treasury announced its latest interim final rule to implement the executive compensation requirements outlined in ARRA. The interim final rule stated that the rule was effective on June 15, 2009, the date published in the *Federal Register*, and would be finalized after consideration of comments received during a 60-day comment period. According to Treasury officials, the latest Interim Final Rule attempts to harmonize requirements in ARRA and prior guidance from Treasury as well as make the following changes to previous interim rules or proposed guidance:

- The annual compensation limit of \$500,000 proposed for recipients participating in new TARP programs proposed by Treasury in February 2009 (excluding long-term restricted stock) was not retained.
- Bonus payments to senior executive officers³ and to a specified number of the most highly compensated employees of TARP recipients were restricted to stock in an amount not to exceed one-third of total compensation.⁴
- The golden parachute prohibition will now extend beyond CEOs to include the next five most highly compensated individuals, and the definition of a golden parachute includes any and all payments made at the time of departure or change in control for services not performed.
- The clawback requirement applies to the CEOs and the next 20 most highly compensated individuals.

Although the above provisions generally apply to all TARP programs, the interim final rule established separate requirements for institutions receiving exceptional assistance under the

³ A "named executive officer" of a TARP recipient is defined under Federal securities law to generally include the principal executive officer ("PEO"), principal financial officer ("PFO"), and the next three most highly compensated employees.

⁴ The rule defines "most highly compensated" employees by reference to total annual compensation as calculated under federal securities regulations, in order to most accurately capture the amounts earned by these executives each year. The number of most highly compensated employees covered by the limit depends on the amount of financial assistance the company has received.

Targeted Investment Program (“TIP”), Systemically Significant Failing Institutions Program (“SSFI”), and the Automotive Industry Financing Program (“AIFP”), as noted below.⁵ For additional information on Treasury’s June 15, 2009, Interim Rule on Executive Compensation and the role of the Special Master for TARP Executive Compensation, see Appendix C. The rule also created an Office of the Special Master for TARP Executive Compensation within Treasury. For the TARP recipients receiving exceptional assistance,⁶ the Special Master will review compensation payments and structures for the CEOs and the next 20 most highly compensated employees at each institution. In addition, he will be reviewing compensation structures for executive officers and the next 75 most highly compensated employees (and the executive officers) of TARP recipients receiving exceptional assistance. According to Treasury, this is to ensure that compensation is structured to protect taxpayer interests and to promote long-term shareholder value.

Furthermore, the Special Master is granted a “look-back” authority to review, for all TARP recipients, certain payments between the closing date of the contract with the TARP recipient and February 17, 2009 (the date of ARRA’s enactment). The reviews will cover all bonuses, retention awards, and other compensation paid to the 5 CEOs and the next 20 most highly paid employees. This look back assessment will be conducted to determine whether any such payments were inconsistent with the purposes of TARP or were otherwise contrary to the public interest. The Special Master may then seek to negotiate for appropriate reimbursements.

The Special Master is also authorized to provide advisory opinions regarding the application of the interim final rule to particular payments and compensation plans. These opinions may be issued at the request of the participating TARP recipient or by the Special Master at his own initiative.

Objectives

SIGTARP distributed its survey to TARP recipients to obtain information regarding specific plans and the status of implementation of those plans to address executive compensation requirements associated with the receipt of TARP funding. This report principally addresses the efforts of banks to comply with restrictions on executive compensation that were in place at the time of our survey. Subsequent to distributing our survey, ARRA was enacted. Many respondents to our survey commented on the executive compensation restrictions in the new legislation; therefore, we also are reporting on recipients’ plans to comply with these requirements. This report is set against the background of the evolving rules on executive compensation for TARP recipients.

⁵The restrictions do not apply to those institutions that have repaid their TARP funds while Treasury still holds warrants to purchase the common stock of those institutions.

⁶ The seven companies are American International Group, Bank of America, Citigroup, General Motors, General Motors Acceptance Corporation, Chrysler Financial, and Chrysler.

Scope

SIGTARP sent the survey to 364 financial and other institutions that had completed TARP funding agreements through January 31, 2009. Because the objective of this report is broad, the open-ended survey elicited different levels of detail. Many banks were concerned about business-sensitive information and requested that we keep their responses confidential. Accordingly, pursuant to our legal obligations, SIGTARP is not attributing any results or comments in this report to a specific institution. However, SIGTARP is in the process of evaluating recipients' claims of confidentiality; when we complete that process we will post information provided by the respondents to the maximum extent permitted by law, allowing for any necessary redactions.

This report is limited to assessing reported compliance of recipients with EESA regulations as promulgated on October 14, 2008, and as they were proposed to be amended on January 16, 2009. We confined our review and analysis to the survey responses as reported and certified by the TARP recipients. SIGTARP did not review any additional information or documentation beyond that provided by respondents. Also, many TARP recipients responded within 90 days of receiving TARP funds; therefore, they were not yet required to have implemented all executive compensation requirements at the time of their response.

- For a more complete discussion of the audit scope and methodology, see Appendix A.
- For the letter sent to recipients of TARP funds through January 31, 2009, see Appendix B.
- For additional information on Treasury's June 15, 2009 Interim Rules on Executive Compensation and the role of the Special Master, see Appendix C.
- For the timeframe to implement the interim final rules issued on June 15, 2009, see Appendix D.
- For a list of audit team members, see Appendix E.
- For comments from the Department of the Treasury, see Appendix F.

Insights on Executive Compensation Compliance from SIGTARP Survey

When SIGTARP conducted this survey, the requirements for executive compensation were still evolving. Nevertheless, many respondents provided significant insights regarding their efforts to comply with the requirements as they understood them. Currently, neither EESA nor ARRA directly limits the annual base pay of senior executive officers; rather, the restrictions on executive compensation that have been placed thus far on TARP recipients have more specifically targeted incentive compensation and severance payments. Survey responses regarding compliance with EESA bonus and severance pay restrictions varied from simple statements of compliance to detailed answers regarding efforts to assess compensation practices relative to the restrictions. Although some recipients expressed frustration with changing compensation guidance and legislation, many respondents noted actions—such as the procurement of expert compensation consultants—that they were taking at the time of the survey based on known requirements with the understanding that final guidelines were pending.

Overall Pay Not Capped by Treasury’s Latest Interim Final Rule

In considering executive compensation restrictions, it is important to understand prior and current restrictions on employees’ base pay relative to other compensation. In its most recent executive compensation guidance, Treasury has shifted its emphasis on capping base salaries. Initially, EESA did not specifically limit overall compensation, but institutions could not deduct, for income tax purposes, executive compensation in excess of \$500,000 for each senior executive officer. As recently amended through the ARRA legislation, EESA limits bonus payments to senior executive officers and to other highly compensated employees of TARP recipients to one-third of total compensation, but does not otherwise specifically set a pay cap. At the same time, however, the \$500,000 figure still has some relevance; the latest guidance stipulates that the Special Master will automatically approve proposed compensation to employees of TARP recipients receiving exceptional assistance as long as the employee’s total annual compensation does not exceed \$500,000, with any additional compensation paid in long-term restricted stock. In addition, TARP recipients have agreed in their contracts with the Treasury not to deduct compensation in excess of \$500,000 for executives subject to the deduction limitation in Section 162 (m) of the Code. Appendix D shows the timeframes that recipients of exceptional TARP assistance must meet to comply with the new regulations.

In a press statement announcing the new compensation guidelines on June 10, 2009, the Secretary of the Treasury also announced plans to seek greater compensation reforms through legislation and the regulatory process. For example, he announced that legislation would be proposed to give the Securities and Exchange Commission (“SEC”) the authority to require companies to give shareholders a non-binding vote on executive compensation. He also emphasized the importance of efforts being taken by the Chairman of the Board of Governors of the Federal Reserve System and the other bank supervisors to lay out broad standards on

compensation that will be more fully integrated into the supervisory process.⁷ Such actions would apply uniformly to regulated entities rather than being limited to institutions receiving TARP assistance.

Survey Responses Address Compliance with Key Executive Compensation Restrictions

Treasury's approach to limit executive compensation of TARP participants has largely targeted restrictions on incentive compensation and severance payments. Three key restrictions have remained that were addressed in our survey:

- compensation tied to excessive risk taking
- bonuses based on materially inaccurate financial statements
- payments made to executives upon severance from the company

At the time of the SIGTARP survey, these initial EESA provisions were the most current guidelines placing executive compensation restrictions on TARP recipients. Based on self-reported data, CPP recipients appear to have been making a concerted effort to comply with EESA's restrictions on executive compensation, as noted below.

Risk Assessments Required of Bonus Compensation Plans

Because of the 90-day grace period after the date of their certification of compliance, only 52 institutions were required to have performed a risk assessment of SEO incentive compensation arrangements by the time they responded to the SIGTARP survey. All of these institutions reported having performed such a risk assessment as had approximately 60 percent of the remaining 312 institutions for which the grace period had not yet expired.

Respondents provided varying degrees of detail in their risk assessments, ranging from providing their risk assessment reports to simple statements of compliance. The following are examples of responses that specifically addressed the risk assessment provision:

- “An executive compensation risk assessment was performed by [the Bank's] senior risk officers within 90 days of Treasury's purchase of securities. Based on the materials reviewed and discussions with subject matter experts, [the Bank's] senior risk officers concluded that the executive compensation and incentive program does not encourage the SEOs to take unnecessary and excessive risks.”
- “[T]he Compensation Committee reviewed the SEO incentive compensation arrangements with the company's senior risk officers...to ensure that the SEO incentive compensation arrangements do not encourage SEOs to take unnecessary and excessive risk that threaten the value of the institution. The Committee met to review certain reports and: (1) Discuss with the bank's senior risk officers the long-

⁷ Treasury, “FINANCIAL REGULATORY REFORM: A New Foundation Rebuilding Financial Supervision and Regulation,” June 17, 2009.

term and short-term risks that the bank faces that could threaten the value of the company; (2) Identify the features of the company’s incentive compensation arrangements that could lead SEOs to take such risks; and (3) Limit any such feature in order to ensure that the SEOs are not encouraged to take risks that are unnecessary or excessive.”

Some recipients provided documentation to support their responses, such as Board minutes or compensation consultant reports.⁸ However, most respondents did not provide any documentation to support their responses, other than the attestation in the letter of response.

Clawback Provision Required

Nearly 80 percent of the institutions reported compliance with EESA provisions regarding clawbacks.⁹ The remaining 20 percent did not specifically address compliance with the clawback provision or report overall compliance with executive compensation restrictions.

The following examples are representative of the responses:

- “With respect to the clawback provisions, the SEOs of [the Bank] have executed agreements...which allow [the Bank] to recover or clawback any bonus or incentive compensation paid during the TARP period from SEOs if such bonus or incentive compensation was awarded based on materially inaccurate financial statements or other performance metric criteria.
- “[E]ach SEO also signed a letter agreement whereby [the Bank] and each of the SEOs...agreed that any bonus and incentive compensation paid to a SEO is subject to recovery or clawback by [the Bank] during the time the preferred stock remains outstanding if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria....”

Severance Pay Limitations on Golden Parachutes

Nearly 83 percent of survey respondents reported compliance with the golden parachute restriction.¹⁰ The remaining 17 percent did not specifically address compliance with the golden parachute provision or report overall compliance with executive compensation restrictions. About 55 percent of the recipients reported enacting policies through the execution of letter agreements, compensation agreements, amendments or waivers with the senior executive officers, or by changing general compensation policies. These are some examples of how institutions reported their compliance with these provisions:

⁸ The SIGTARP survey requested that a recipient’s “response should include copies of pertinent supporting documentation (financial or otherwise) to support your response.” The survey did not define “pertinent” or ask for specific documentation.

⁹ Institutions were considered to have reported compliance with the clawback provision if they stated that they were in overall compliance with EESA regulations, or if they specifically stated they were in compliance with the clawback provision. 288 institutions reported compliance as defined above.

¹⁰ Institutions were considered to have reported compliance with the golden parachute provision if they stated that they were in overall compliance with EESA regulations, or if they specifically stated that they were in compliance with the golden parachute provision. 296 institutions reported compliance as defined above.

- “[M]anagement of [the Bank] asked five Senior Executive Officers (SEO) of the holding company and subsidiary Bank to execute a letter agreement [supporting documentation provided] agreeing to: no golden parachute payments....Each SEO agreed to become legally bound by the letter.”
- “The company is prohibiting any golden parachute payment to you during any ‘CPP Covered Period’. A ‘CPP Covered Period’ is any period during which (a) you are a senior executive officer and (b) Treasury holds an equity or debt position acquired from the Company in the CPP.”¹¹

Almost one-fifth of the recipients provided documents to support their statements of compliance, such as agreements and waivers.

Recipients Reported an Intent To Comply with Future Requirements

Though not specifically asked by SIGTARP, nearly half of TARP recipients voluntarily reported that they intended to comply with the new requirements for executive compensation specified in the ARRA legislation. For example, one institution reported that:

- “[The] company is monitoring recent developments with respect to executive compensation limitations including the recent enactment of the ARRA. The company will take the steps necessary to comply with the 2009 Act, as its requirements are further defined by the issuance of implementing regulations by the Treasury.”

Nonetheless, some institutions voiced concerns about retroactive application, uncertainty about future changes, and about the executive compensation requirements enacted during the time of the survey.

Many recipients were aware that ARRA would place additional restrictions on executive compensation and stated that they intended to comply with the new restrictions once Treasury issued the required guidance. One institution made this comment:

- “We are currently in the process, with the assistance of counsel, of reviewing the ARRA to determine whether further modifications to our executive compensation arrangements or other actions will be required pending adoption of regulations and guidance by Treasury. In light of the provisions of ARRA, the Company’s Compensation Committee will recommend, and our Board of Directors will adopt, a TARP Compensation Compliance Policy that addresses each of the requirements contained in EESA, ARRA, and the related Treasury guidelines.”

Forty institutions (about 11 percent) reported that they used outside consultants to monitor and implement new developments on executive compensation restrictions. Most of these firms had received less than \$100 million in CPP funds. Several banks stated that they employed

¹¹ This statement is a portion of an SEO letter agreement.

consultants to assist in compliance, design, and ongoing monitoring activities with regard to executive compensation requirements. One institution stated that it hired an independent compensation consultant to:

- “assist [the Bank] in reviewing and assessing [the Bank’s] overall compensation programs to comply with the CPP executive compensation rules as well as to monitor and advise [the Bank] on additional regulations or changes required in light of evolving executive compensation requirements in U.S. Treasury guidance and in the [ARRA].”

Another bank used an outside consultant to determine independently whether the structure of the CEO’s compensation package could lead to excessive risk taking. The consultant concluded that it did not.

Some Concerns over New ARRA Requirements

ARRA was enacted after SIGTARP distributed the surveys but before TARP recipients submitted their responses. During this time, some institutions expressed uncertainty about the guidance for compliance with TARP executive compensation requirements and voiced concerns about the changes in executive compliance guidelines. These are some of the concerns raised by survey respondents regarding the new requirements under ARRA:

- **Unprecedented scope of the requirements:** “As your office is aware, the new executive compensation limitations of [EESA] and [ARRA] are without precedent in Federal law, are barely five months old but have nevertheless changed significantly within the short period...Nevertheless, we are working diligently to determine precisely how these new executive compensation [limitations] apply to [the Bank].”
- **Retroactive nature of the requirements:** “I’m sure that you can relate to our frustration in consummating our TARP transaction [in January 2009] with what we thought were set standards and restrictions that we agreed to—only to have new restrictions seemingly applied and changed almost daily.”
- **Fears about possible future changes:** “The fact that Congress in enacting ARRA endorsed much (but not all) of the Treasury Guidelines brings into question whether the other restrictions in the Treasury Guidelines will be enacted.”

Furthermore, some respondents stated that they may return CPP funds because the new limitations would or may lead to a competitive disadvantage and hamper their ability to retain top performers. One such recipient responded that it was “currently exploring the option of returning this funding given the changes that are contemplated in [ARRA], along with the demonstrated negative perception associated with financial institutions that have received TARP funding.” Additionally, senior officials at two major banks that SIGTARP staff interviewed as part of other ongoing work stated that they have lost employees to foreign and domestic competitors who are not under CPP compensation restrictions. One of those banks stated that it had lost five top executives to other firms as a direct result of compensation restrictions. Further,

other banks reported that they were having trouble recruiting new employees or were experiencing higher levels of early retirements.

Conclusions

Since EESA was enacted on October 3, 2008, the legislation and implementing guidance on executive compensation for TARP recipients have been in flux. Nevertheless, most CPP recipients report that they have made a concerted effort to comply with executive compensation limitations. Moreover, many institutions reported that they intend to comply with the additional restrictions on executive compensation enacted under ARRA. Nonetheless, some recipients voiced concerns about the new restrictions; in particular, they noted a need for further Treasury guidance or regulations to implement ARRA executive compensation limitations.

As part of regulatory reform, the Administration recently made three proposals:

- that regulators issue standards and guidelines to better align executive compensation practices with long-term shareholder value and to prevent compensation practices from providing incentives that could threaten the safety and soundness of supervised institutions,
- that the SEC be given the authority to require companies to allow shareholders to vote on executive compensation packages to help ensure that compensation packages are closely aligned with the interests of shareholders, and
- that the SEC be directed to promulgate independence standards for members of compensation committees and for consultants and advisors to compensation committees, to ensure that compensation committee are independent in fact not just in name.

These proposals could provide broad reform of executive compensation practices for all financial institutions, not just for those receiving TARP assistance.

Management Comments and Audit Evaluation

In commenting on a draft of this report, the Assistant Secretary for Financial Stability concurred with the report. The Office of Financial Stability also provided technical comments which SIGTARP incorporated as appropriate. A copy of Treasury's letter is reprinted in Appendix F of this report.

Appendix A—Scope and Methodology

We performed the audit under authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978, as amended. This audit reports on compliance with executive compensation requirements by 364 institutions that completed TARP funding agreements through January 31, 2009. Our objective was to assess the efforts of TARP recipients to comply with executive compensation restrictions that were in place at the time of our survey. Subsequent to distributing our survey, the ARRA legislation was enacted. Many respondents to our survey commented on the executive compensation restrictions in the new legislation; therefore, we also are reporting on banks plans to comply with these requirements.

SIGTARP conducted this performance audit from February to July 2009, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Within the limitations noted below, we believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To elicit in-depth information with greater richness of context, we developed a narrative survey letter that provided for open-ended responses. We chose this approach because the institutions are so diverse in terms of asset size, institution type, and institution-specific economic factors. Regarding executive compensation, we asked each recipient to provide a narrative response that outlined specific plans and the status of implementation of those plans for addressing executive compensation requirements associated with the funding. We also asked recipients to include:

- any assessments made of loan risks and their relationship to executive compensation
- how limitations on executive compensation will be implemented in line with Treasury guidelines
- whether any such limitations may be offset by other changes to other, longer-term or deferred forms of executive compensation

Furthermore, we encouraged recipients to include in their responses copies of pertinent supporting documentation to support their responses. We also used some information regarding the impact of executive compensation restrictions on retention of key personnel from interviews of the chief executive officers of major banks based on other ongoing audit work.

We contracted with Concentrance Consulting Group, Inc. (“Concentrance”), a Section 8(a) women-owned small business, to help us review and analyze the responses we received. We interacted and worked with the Concentrance team at least weekly from April through July 2009 to help develop the analysis and produce the report. We took a number of steps to ensure the consistency of our analysis. We developed a checklist for analysts to review each survey response. If an analyst had questions related to a survey response, another analyst reviewed the response; then we discussed these cases collectively until we reached consensus agreement in

interpreting the response relative to other responses. In addition, a quality control team that was not involved in the analytical process reviewed all of the data entry.

Limitations on Data

SIGTARP's review and analysis was confined to the survey responses and supporting documentation as provided, reported, and certified by the TARP recipients. We did not independently verify the data reported by the recipients. However, we did ask that each recipient certify the accuracy of its responses under the penalty of law.

Appendix B—Survey Letter

OFFICE OF THE SPECIAL INSPECTOR GENERAL
TROUBLED ASSET RELIEF PROGRAM
1500 Pennsylvania Ave., N.W., Suite 1064
Washington, D.C. 20220

February 5, 2009

(Addressee)

The Emergency Economic Stabilization Act of 2008 (“EESA”) that established the Troubled Asset Relief Program (TARP) also created the Office of the Special Inspector General for Troubled Asset Relief Program (SIGTARP). SIGTARP is responsible for coordinating and conducting audits and investigations of any program established by the Secretary of the Treasury under the act. As part of an audit into TARP recipients’ use of funds and their compliance with EESA’s executive compensation requirements,

I am requesting that you provide my office, within 30 days of this request, the following information:

- (1) A narrative response specifically outlining (a) your anticipated use of TARP funds; (b) whether the TARP funds were segregated from other institutional funds; (c) your actual use of TARP funds to date; and (d) your expected use of unspent TARP funds. In your response, please take into consideration your anticipated use of TARP funds at the time that you applied for such funds, or any actions that have taken that you would not have been able to take absent the infusion of TARP funds.
- (2) Your specific plans, and the status of implementation of those plans, for addressing executive compensation requirements associated with the funding. Information provided regarding executive compensation should also include any assessments made of loan risks and their relationship to executive compensation; how limitations on executive compensation will be implemented in line with Department of Treasury guidelines; and whether any such limitations may be offset by other changes to other, longer-term or deferred forms of executive compensation.

In connection with this request:

- (1) We anticipate that responses might well be quantitative as well as qualitative in nature regarding the impact of having the funds, and we encourage you to make reference to such sources as statements to the media, shareholders, or others concerning your intended or actual use of TARP funds, as well as any internal email, budgets, or memoranda describing your anticipated use of funds. We ask that you segregate and preserve all documents referencing your use or anticipated use of TARP funds such as any internal email, budgets, or memoranda regarding your anticipated or actual use of TARP funds.
- (2) Your response should include copies of pertinent supporting documentation (financial or otherwise) to support your response.
- (3) Further, I request that, your response be signed by a duly authorized senior executive officer of your company, including a statement certifying the accuracy of all statements, representations, and supporting information provided, subject to the requirements and penalties set forth in Title 18, United States Code, Section 1001.
- (4) Responses should be provided electronically within 30 days to SIGTARP at SIGTARP.response@do.treas.gov, with an original signed certification and any other supporting documentation mailed to: **Special Inspector General – TARP; 1500 Pennsylvania Avenue, NW; Suite 1064; Washington, D.C. 20220.**

We think this initiative is vital to providing transparency the TARP program and the ability of SIGTARP and others to assess the effectiveness of TARP programs over time. If you have any questions regarding this initiative, please feel free to contact Mr. Barry W. Holman, my Deputy Inspector General for Audit at (202) 927-9936.

Very truly yours,



Neil M. Barofsky
Special Inspector General

OMB Control No. 1505-0212
(Expires August 2009)

An agency is not authorized to conduct, and persons are not required to respond to, an information collection request unless it displays a valid control number. Response is mandatory for all selected participants in the TARP program.

Appendix C—Summary of Treasury’s June 15, 2009 Interim Final Rule on Executive Compensation

On February 17, 2009, the executive compensation provisions contained in Section 111 of EESA were amended by Section 7001 of the American Recovery and Reinvestment Act of 2009 (“ARRA”), which required that Treasury promulgate regulations to implement the ARRA amendments. On June 10, 2009, Treasury released its Interim Final Rule on TARP Standards for Compensation and Corporate Governance (the “Rule”), which implements EESA as amended by ARRA. The Rule is an “Interim Final Rule.” It took effect when it was published in the *Federal Register* on June 15, 2009, but there is a 60-day public comment period after which it may be changed. The Rule “implement[s] ARRA provisions, consolidates all of the executive-compensation-related provisions that are specifically directed at TARP recipients into a single rule (superseding all prior rules and guidance), and utilizes the discretion granted to the [Treasury] Secretary under ARRA to adopt additional standards, some of which are adapted from principles set forth” in guidance previously provided by Treasury in February 2009. The Rule applies to all TARP recipients, defined in the Rule to include “any entity that has received or holds a commitment to receive financial assistance” provided under TARP or any entity that owns 50 percent or more, or is 50 percent or more owned by, such an entity. In general, the executive compensation restrictions in the Rule apply only as long as the TARP recipient has an “obligation” to Treasury; an “obligation” does not include Treasury holding warrants to purchase common stock of the TARP recipient.

In general, the Rule defines financial assistance as “any funds or fund commitment provided through the purchase of troubled assets” by Treasury through a direct financial transaction between Treasury and the TARP participant. For example, CPP participants that directly sell preferred stock to Treasury generally have received financial assistance under the Rule. However, those institutions that post collateral to and receive loans from TALF are considered to have not “received financial assistance provided under TARP” and therefore are not subject to the Rule. Table 1 shows a breakdown of how the compensation and governance standards set forth in the Rule apply to all TARP programs.

Table 1: Interim Rule Executive Compensation Restrictions as They Apply to TARP Programs

TARP Program	Applicable	Notes
Capital Purchase Program	X	All participating institutions are subject to the executive compensation restrictions.
Capital Assistance Program	X	All participating institutions are subject to the executive compensation restrictions.
Systemically Significant Failing Institutions	X	Restrictions apply to AIG.
Targeted Investment Program	X	Restrictions apply to Citigroup and Bank of America.
Asset Guarantee Program	X	Restrictions apply to Citigroup.
Automotive Industry Financing program	X	Restrictions apply to GM, GMAC, Chrysler, and Chrysler Financial.
Auto Supplier Support Program	X	Executive compensation restrictions apply only to auto companies, not automobile purchasers
Auto Warranty Commitment Program	X	Executive compensation restrictions apply only to auto companies, not automobile purchasers.
Term Asset-Backed Securities Loan Facility		Program is not applicable to TALF participants.
Public Private Investment Program		Would apply only if there is a majority owner of the Public Private Investment Fund ("PPIF"). Because PPIF will be structured so that no entity can invest in more than 9.9% of the fund, executive compensation restrictions will not apply.
Making Homes Affordable		Program is exempted by statute. ^a
Unlocking Credit for Small Business	X	Restrictions apply only to the institution selling the eligible assets to Treasury.

Notes:

^a The Making Home Affordable program is exempted by statute from the executive compensation and corporate governance standards set forth in the ARRA amendments. See Section 1002 of the American Recovery and Reinvestment Act of 2009, P.L. 111-5, 2/13/2009.

Source: Treasury

Compensation Limits

The Rule establishes certain compensation requirements with which all TARP recipients must comply. The number of employees to whom the requirements apply varies; in general, however, the compensation limitations in the Rule apply to the TARP recipient's senior executive officers (SEOs) and most highly compensated employees, determined by reference to annual compensation. The Rule defines annual compensation as the dollar value for total compensation as determined under applicable federal securities laws.

Different types of compensation are addressed differently in the Rule. For example, the number of employees for whom bonus payments are limited is based on the amount of TARP funding received by the institution. The Rule did not include the proposed annual compensation limit for new TARP programs of \$500,000 (excluding long-term restricted stock) proposed by Treasury in February 2009. Table 2 shows the specific compensation requirements set forth in the Rule and how each requirement applies to TARP recipients.

Table 2: Compensation Limit Requirements

Requirement	Definition	How the Requirement Is Applied	To Whom the Requirement Applies
Bonus Payments	Bonus, retention award, or incentives	Bonus payments are prohibited—except for payments made in restricted stock (which cannot have a value greater than 1/3 of the employee’s total compensation and must be forfeitable if the employee does not continue providing services for the TARP recipient for at least two years from the date of grant).	Employees identified in Table 3 (based on the level of TARP assistance)
Commissions	Payment earned by an employee consistent with a program in existence for that type of employee as of February 17, 2009. If a substantial portion of the services provided by the employee consists of the direct sale of a product or services to an unrelated customer	Commissions meeting the definition in the Rule are exempt from the limitations on bonuses, retention awards, and incentive compensation; however, fees earned in connection with a specified transaction (e.g. an initial public offering) are not commissions for purposes of the Rule.	Employees identified in Table 3 (based on the level of TARP assistance)
Excessive Risk	Unnecessary risk taking encouraged by employee compensation plans	Review of employee compensation plans by the compensation committee, a narrative explanation of the committee’s analysis with respect to risk, and certification that the compensation committee has completed the review.	All TARP recipients
Clawback	Recovery by the company of amounts paid to an employee based on materially inaccurate performance criteria	All bonuses, retention awards, and incentive compensation must be subject to clawback if the payments were based on materially inaccurate performance criteria. The TARP recipient must actually exercise its clawback rights unless it can demonstrate that it would be unreasonable to do so.	SEOs and the next 20 most highly compensated employees
Golden Parachute	Any payment to an employee for departure for any reason, or any payment due to a change in control	Prohibits any and all golden parachute payments to the applicable employees made at the time of departure or upon a change in control.	SEOs and the next 5 most highly compensated employees
Perquisite	Personal benefit, including a privilege or profit incidental to regular salary or wages	Must disclose the amount, nature, and justification for any perquisite valued at more than \$25,000.	Employees identified in Table 3 (based on the level of TARP assistance).

Source: Treasury

Office of the Special Master for TARP Executive Compensation

Under the Rule, Treasury has created a new Office of the Special Master for TARP Executive Compensation (“Special Master”) which will be responsible for the review and analysis of executive compensation by TARP recipients. The Special Master’s scope is limited to executive compensation and corporate governance issues under the Rule for TARP recipients. The Special Master has the authority to accomplish these objectives:

- Review compensation payments and plans at TARP recipients that have received “exceptional assistance” (for the CEOs and 20 next most highly compensated employees) and compensation structures (for the 100 most highly compensated employees and any executive officers).
- Review bonuses, retention awards, and other compensation paid before February 17, 2009, by TARP recipients and, negotiate reimbursements when appropriate.
- Provide advisory opinions with respect to the application of the Rule and whether compensation payments and plans are consistent with EESA, TARP, and the public interest.

The Rule requires that the Special Master use specific principles when reviewing compensation payments and plans at TARP recipients:

- **Risk:** The compensation structure should avoid incentives for employees to take unnecessary or excessive risks that could threaten the value of the TARP recipient, including incentives that reward employees for short-term or temporary increases in value, performance, or similar measures that may not ultimately be reflected by an increase in the long-term value of the TARP recipient.
- **Taxpayer Return:** The compensation structure, and amount payable where applicable, should reflect the need for the TARP recipient to remain a competitive enterprise, to retain and recruit talented employees who will contribute to the TARP recipient’s future success, and ultimately to be able to repay TARP obligations.
- **Appropriate Allocation:** The compensation structure should appropriately allocate the components of compensation (for example, salary, executive pensions, bonus payments, and incentives). The appropriate allocation may be different for different positions and for different employees; in general, however, for executives or other senior-level positions, a significant portion of the overall compensation should be long-term compensation that aligns the interest of the employee with the interests of shareholders and taxpayers.
- **Performance-based Compensation:** An appropriate portion of the compensation should be performance-based over a relevant performance period. Performance-based compensation should be determined through tailored metrics that encompass individual performance and/or the performance of the TARP recipient or a relevant

business unit, taking into consideration specific business objectives.

- **Comparable Structures and Payments:** The compensation structure and pay should be consistent with pay for those in similar positions at similar entities.
- **Employee Contribution to TARP Recipient Value:** The compensation structure should reflect the current or prospective contributions of an employee to the value of the TARP recipient, taking into account multiple factors.

Exceptional Assistance Authority

Under the Rule, the Special Master has specific duties regarding payments and compensation plans for executives of TARP recipients that have received exceptional assistance. For companies receiving exceptional assistance, the Special Master will review compensation payments for the CEOs and the 20 next most highly compensated employees at each institution. In addition, he will be reviewing compensation structures for the 100 most highly compensated employees (and the executive officers) of a TARP recipient receiving exceptional assistance. According to Treasury, this is to ensure that compensation is fair and structured, to protect taxpayer interests, and to promote long-term shareholder value.

“Look-Back” Authority

The Special Master will also be conducting a “look-back” review of certain payments at all TARP recipients made prior to February 17, 2009 (the date of ARRA’s enactment). The review will cover all bonuses, retention awards, and other compensation paid to the 5 CEOs and the next 20 next most highly paid employees. This review will encompass approximately 436 institutions and 10,900 individuals. If the Special Master determines that payments were made inappropriately or contrary to the public interest, he will have the authority to negotiate for appropriate reimbursement to the federal government.

The American Recovery and Reinvestment Act of 2009—Expanded Provisions

The Rule expanded three ARRA provisions: review by the Board Compensation Committee of all employee compensation plans, the “Say on Pay” requirement, and enhanced luxury expenditure requirements.

Board Compensation Committee

Under the Rule, each TARP recipient must establish a Board Compensation Committee (the “Committee”). The Committee must include independent directors from the company’s board and will convene for the purpose of reviewing all employee compensation plans. An exception to this requirement is made for TARP recipients that are not registered under the Securities Exchange Act of 1934 and have received \$25 million or less in TARP assistance. These institutions may have their boards of directors carry out the duties of the Board Compensation Committee.

The Committee is required to meet at least semiannually to review with senior risk officers the proposed compensation plans of all employees and ensure that the TARP recipient is not

unnecessarily exposed to risks. In addition, the Committee will evaluate SEO compensation plans to ensure that the plans do not encourage SEOs to take unnecessary and excessive risks that could threaten the value of the TARP recipient. The Rule requires that the Committee submit an annual report to Treasury providing a narrative description of how it limited any features of compensation plans that would encourage SEOs to take unnecessary and excessive risks and any features of compensation plans that could encourage the manipulation of reported earnings to enhance the compensation of an employee.

“Say on Pay”

The Rule provides a provision for a non-binding vote by shareholders on executive compensation, sometimes referred to as “Say on Pay.” This provision requires all TARP recipients to permit an annual non-binding vote by shareholders on executive compensation as required by SEC regulations.

Luxury Expenditures

The Rule also addresses corporate luxury expenses. The Rule states that the board of directors of any institution receiving TARP funds must have a company-wide policy to define and prevent excessive or luxury expenditures on entertainment or events, office and facility renovations, aviation or other transportation services, and other activities or events that are not reasonable expenditures for staff development, reasonable performance incentives, and other activities conducted in the normal course of business operations.

The company must file this policy with Treasury and post it to the company website by the later of:

- 90 days after the closing of the transaction between Treasury and the TARP recipient

OR

- 90 days following publication of the Rule

The Rule also requires that the PEO and PFO of each institution provide certification that any expenditures needing approval by a senior executive or the board of directors have been properly approved.

Additional Compensation and Governance Standards

According to Treasury, the Rule provides additional requirements that will further protect shareholder value and increase transparency by all TARP recipients. In addition to the compensation and corporate governance standards explicitly required by Congress, the Rule includes three additional requirements: a prohibition on tax gross-ups, a requirement that TARP recipients provide additional disclosure of perquisites, and a requirement that TARP recipients provide disclosure with respect to compensation consultants.

Tax Gross-up

A tax gross-up is typically a specific payment to cover taxes due on certain compensation. According to Treasury, studies have shown that these payments cost the companies that provide

them far more than the benefits the payments provide to executives. The Rule prohibits TARP recipients from providing any tax gross-up payments to the CEO and to the next 20 highest-compensated employees.

Perquisites

In addition to disclosure requirements applicable to perquisites that are already enforced by the SEC, the Rule subjects TARP recipients to more stringent requirements. SEC rules require disclosure of perquisites given to the top five executive officers. The Rule expands this requirement to include perquisites over \$25,000 given to any employees of TARP recipients subject to the bonus limitations described in Table 3. Additionally, firms must provide a narrative description of, and justification for, these benefits.

Table 3: Employees Subject to Bonus Limitations, by Amount of TARP Funding

Amount of TARP Funding	Applicable Employees
< \$25,000,000	most highly compensated employee
≥ \$25,000,000 < \$250,000,000	at least the 5 most highly compensated employees
≥ \$250,000,000 < \$500,000,000	CEOs and 10 next most highly compensated employees
≥ \$500,000,000	CEOs and 20 next most highly compensated employees

Note: The ARRA amendments provide that, with respect to financial institutions that have received more than \$25 million in TARP assistance, the Secretary may apply the bonus limitations to a higher number of employees if the Secretary determines that this is in the public interest.

Source: Treasury

Compensation Consultants

Many firms hire compensation consultants to determine appropriate pay levels for top executives. According to Treasury, these consultants may have influence over the setting of compensation, and it may be helpful for shareholders to know whether TARP recipients have hired an outside consultant. Therefore, the Rule requires all TARP recipients to provide annually to the Treasury and its primary federal regulator a narrative description of the services provided by such consultants and a description of any benchmarking analysis performed by the consultants.

Certifications

As recommended by SIGTARP, the Rule provides certification and reporting requirements on the compensation and corporate governance guidelines that apply to TARP recipients. TARP recipients must provide a list of the CEOs and the 20 most highly compensated employees for the current fiscal year. Under the Rule, this determination is based on their prior fiscal year's total annual compensation. Each certification must also provide a statement by the officer certifying that they "understand that a knowing and willful false or fraudulent statement made in connection with the certification may be punished by fine, imprisonment, or both." Table 4

describes the reporting and certification requirements and the frequency with which the institution must provide the certifications. In addition to the requirements in Table 4, those TARP recipients classified as receiving exceptional assistance must certify to Treasury that the Special Master has approved their compensation payments and structures as required by the Rule.

Table 4: Executive Compensation Reporting and Certification Requirements

Compliance Category	Actions Requiring Certification	Certification Frequency
Board Compensation Committee	TARP recipient has created a Board Compensation Committee that meets the requirements of the Rule.	<ul style="list-style-type: none"> • Later of 90 days after the closing of the transaction or 90 days after publication of the Rule
Compensation Plans Excessive Risk	The Committee has evaluated CEO compensation plans and has identified and limited features of plans that could lead to unnecessary risks. The Committee has also reviewed employee compensation plans for features that could encourage the manipulation of reported earnings.	<ul style="list-style-type: none"> • Evaluate every 6 months • 90 days after the end of each fiscal year—must submit narrative description and certification
Bonus Payments	TARP recipient has limited bonus payments to applicable employees in accordance with Section 111 of EESA and guidance thereunder.	<ul style="list-style-type: none"> • 90 days after the end of each fiscal year
Luxury Expenditures	TARP recipient has established an excessive or luxury expenditures policy and has posted it to the company web-site, and its employees have complied with the policy.	<ul style="list-style-type: none"> • Later of 90 days after the closing of the transaction or 90 days after publication of the Rule • 90 days after the end of each fiscal year
Say on Pay	TARP recipient has permitted non-binding shareholder resolution on executive compensation (publicly traded TARP recipients only) in accordance with applicable SEC regulations.	<ul style="list-style-type: none"> • 90 days after the end of each fiscal year
Compensation Consultants	TARP recipient has disclosed whether an executive compensation consultant was hired and a description of services provided.	<ul style="list-style-type: none"> • 90 days after the end of each fiscal year
Perquisite	TARP recipient has disclosed the amount, nature, and justification for offering any perquisites greater than \$25,000 to each of its employees subject to bonus limitations.	<ul style="list-style-type: none"> • 90 days after the end of each fiscal year
Clawback	TARP recipient has required that all bonus payments are subject to recovery if the payments were based on materially inaccurate performance metrics.	<ul style="list-style-type: none"> • 90 days after the end of each fiscal year

Source: Treasury

Appendix D—Interim Final Rule Calendar

Timeframe	Action
June 15, 2009	Interim Final Rule published in the <i>Federal Register</i> .
August 14, 2009	Deadline for initial requests by TARP recipients receiving exceptional assistance to the Special Master on SEO and the next 20 most highly compensated employees structures and payments.
September 14, 2009, or 90 days after closing	Establish independent Compensation Committee. Establish, publish on company web-site, and provide to Treasury the excessive and luxury expense policy.
120 days after Interim Final Rule published	Deadline for initial requests to Special Master on compensation structure for executive officers and 100 most highly compensated employees not covered in August 14 submission.
90 days after end of fiscal year	Principal executive officer and the principal financial officer certifications due (ongoing).
120 days after end of fiscal year	Compensation Committee certifications due to Treasury and the company's primary regulatory agency, including perquisites and compensation consultant review (ongoing).

Appendix E—Audit Team Members

This report was prepared and the review was conducted under the direction of Barry Holman, Audit Director, Office of the Special Inspector General for the Troubled Asset Relief Program. Other key SIGTARP staff included Michael Kennedy, James Shafer, Anne Blank, Trevor Rudolph, Amanda Seese, and Kamruz Zaman. The Concentrance staff members who supported SIGTARP in the audit and report development include: Karmen Carr, Alex Kangelaris, Darius Grayson, Patricia Taylor, Christopher Laughlin, Matthew Herman, Yusuf Makhkamov, and Mandy Ho.

Appendix F—Management Comments



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

August 17, 2009

Neil M. Barofsky
Special Inspector General
Office of the Special Inspector General for the Troubled Asset Relief Program
1500 Pennsylvania Ave., NW, Suite 1064
Washington, D.C. 20220

Dear Mr. Barofsky:

Thank you for providing us the opportunity to review and comment on your draft audit report on executive compensation requirements for financial institutions participating in the Capital Purchase Program. We appreciate the concerns raised in your audit report. This letter provides the Department of the Treasury's (Treasury) official comment on the survey your office recently completed.

As you have noted in the report, the SIGTARP survey was distributed immediately prior to the passage of the American Recovery and Reinvestment Act of 2009 (ARRA), which amended the executive compensation provisions of the Emergency Economic Stabilization Act of 2008 (EESA). This timing no doubt heavily influenced the views of the survey respondents, including their concerns in regards to the potential for further shifting of the regulatory environment.

Since then, Treasury has implemented the legislative mandates of ARRA by promulgating an Interim Final Rule, thereby providing greater certainty and clarification for TARP recipients. The Rule consolidates all previous executive compensation-related guidance (including the executive compensation provisions of the ARRA) specifically directed at TARP recipients, superseding all prior rules and guidance. And, as you noted, the Special Master for TARP Executive Compensation, appointed by the Treasury, will review payments and compensation plans and structures for the executive officers and the 100 most highly compensated employees of TARP recipients that have received exceptional assistance. This review will ensure that compensation at these firms is structured in a way that gives those employees incentives to maximize long-term shareholder value and protect taxpayer interests.

Additionally, Treasury is gratified by your conclusion that this Administration's proposals for legislation that will mandate a "Say on Pay" shareholder vote on compensation and require independent compensation committees that are empowered to make truly independent decisions regarding executive compensation may lead to broad reform of executive compensation practices at all companies, including financial institutions receiving TARP assistance. In our continued efforts to work towards restoring the stability of our financial system, we look forward to working with you and your team to further improve TARP programs.

Sincerely,

Herbert M. Allison, Jr.
Assistant Secretary for Financial Stability

SIGTARP Hotline

If you are aware of fraud, waste, abuse, mismanagement, or misrepresentations affiliated with the Troubled Asset Relief Program, please contact the SIGTARP Hotline.

By *Online Form*: www.SIGTARP.gov

By *Phone*: Call toll free: (877) SIG-2009

By *Fax*: (202) 622-4559

By *Mail*:

**Hotline: Office of the Special Inspector General
for The Troubled Asset Relief Program**
1801 L Street, NW
Washington, D.C. 20220

Press Inquiries

If you have any inquiries, contact our Press Office:

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Legislative Affairs

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