

# AGENDA

A Financial Times Service

## Boards Brace for Universal TARP-Style Comp Caps

Article published on November 10, 2008

Anticipating stricter compensation disclosure legislation and regulations that would mimic the caps mandated under the government's bank rescue plan, compensation committees are pressing their consultants and lawyers on how best to prepare.

The consultants and lawyers, in turn, are advising comp committee members to study the executive pay provisions of the recently enacted Troubled Assets Relief Program (TARP), which call for limits on base pay, bonus and incentive plans and golden parachutes.

Although the TARP comp limits only officially apply to financial sector firms drawing on federal assistance in the amount of \$300 million or more, the provisions are widely expected to serve as the model for legislation on everything from pay to severance packages. Those provisions include:

- Limits on base pay, established by reducing deductibility under IRS Section 162(m) from \$1 million to \$500,000
- Limits on incentives, including bonus programs, tied to inappropriate or excessive risk
- Clawback programs, to recover any bonus or incentive compensation paid to an executive that was based on financial statements or other performance metric criteria deemed materially inaccurate
- Prohibition on golden parachute payments

“The ideas [TARP provisions] embody are here to stay and likely will be visited with a vengeance beyond their current borders in the months and years to come,” says **Jim Barrall**, partner at **Latham & Watkins**.

Companies should brace themselves for even stricter comp limits, adds **Andrew Oringer**, partner at **White & Case**.

Anticipating broader application of these provisions, special advisories have been prepared and sent to board members at client firms of most of the nation's leading corporate law firms and compensation consultancies.

Congressional action is only one challenge prompting governance reforms and comp caps. “TARP provisions could work their way into shareholder resolutions in the coming proxy season,” says **Tim Bartl**, general counsel at the **Center on Executive Compensation**. He says shareholders and legislators will likely be motivated by the prospect of curbing risk taking, encouraged by short-term incentive and bonus programs, which many say laid the groundwork for the present economic crisis.

In light of the changed political landscape, comp committees will be expected to do more due diligence than ever. “Compensation committees and boards need to be proactive and aware of the trends and coming attractions in doing their work,” says Barrall. “TARP limits, or variations of them, will be extended to non-financial institutions in legislation enacted by the new Congress.”

Hints of such legislation have already been dropped, sometimes bluntly, by both **Henry Waxman**, chair of the House Oversight and Government Reform Committee, and **Barney Frank**, chair of the House Financial Services Committee. Waxman has been particularly concerned with limiting executive comp ever since the issue came to prominence in the wake of the Enron bankruptcy. Frank is a key proponent of say-on-pay legislation, and was a lead architect of the Emergency Economic Stabilization Act under which TARP was created.

“All companies, regardless of industry... should prepare for the possibility that they may be required to conduct nonbinding annual shareholder votes on their executive compensation... and may face some tightening of existing pay regulations under Sections 162(m) and 280G, as well as Sarbanes-Oxley,” warns the most recent advisory from **Towers Perrin**.

**Melissa Means**, managing director at **Pearl Meyer & Partners**, expects that the 111th Congress, which comes into session with large Democratic majorities in both houses, will “find it relatively easy to build on the executive compensation provisions [of TARP] in any future executive compensation-related legislation that may be applicable to all firms, not just those caught up in the current financial crisis.”

What should comp committee members do now? “Not understanding a complete view of executive compensation is no longer acceptable,” says **Thomas Lehner**, director of public policy at the **Business Roundtable**. “If a comp package doesn’t pass the smell test, the board should think long and hard about that number. The economic crisis has created heightened awareness that boards have to be more actively involved.”