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August 14, 2009

Executive Compensation Comments
Office of Financial Institutions Policy
Room 1418
Department of Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

Re: TARP Standards for Compensation and Corporate Governance, 74 Federal Register 28394 (June 15, 2009).

Dear Sir or Madam:

The American Bankers Association (ABA) appreciates the opportunity to offer comments on the Interim Final Rule (IFR) issued by the Department of the Treasury to provide guidance on the executive compensation and corporate governance provisions of the Emergency Economic Stabilization Act of 2008(EESA), as amended by the American Recovery and Reinvestment Act of 2009 (ARRA). These executive compensation and corporate governance provisions are applicable to those entities that have received financial assistance under the Troubled Asset Relief Program or TARP.

The ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members—the majority of which are banks with less than $125 million in assets—represent over 95 percent of the industry's $13.6 trillion in assets and employ over 2 million men and women.

The ABA welcomes the issuance of the guidance provided under the IFR. The executive compensation and corporate governance provisions included within ARRA have raised significant questions for those of our members currently participating in the TARP. Other members have deferred participation in the TARP pending issuance of the IFR. Indeed, ABA inquiries to Treasury regarding the coverage and effectiveness of these provisions reflect the many concerns and questions our members have expressed over the course of the last six months regarding the compensation and governance provisions associated with the program.[1]

[1] See Letters from ABA President and CEO Edward L. Yingling to Secretary of the Treasury Timothy F. Geithner, dated February 18, 2009 and March 6, 2009.

While we recognize that some of the executive compensation provisions included in ARRA are mandated by law and leave Treasury with little discretion, we are troubled by the fact that in several instances Treasury has chosen to impose additional restrictions and requirements beyond those required under the legislation. For example, Treasury has expanded the prohibition on "golden parachute" payments to include payments made under a change-in-control agreement. Under EESA, payments made in connection with severance were limited to three times a senior executive officer's[2] (SEO) base salary, while ARRA banned SEO severance payments totally. Neither provision prohibited payments, otherwise permissible under the Internal Revenue Code, in connection with changes in control. ABA would submit that it is bad public policy to discourage bank SEOs from negotiating a merger or acquisition with an acquiring institution—an acquisition that makes sense for the company and its shareholders—for fear that they will not be compensated if they do not retain their current positions in the combined company.

Moreover, under the Act, the executive compensation restrictions, including the ban on golden parachutes, apply only "during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding." There is no reason that golden parachute and similar contract provisions cannot be honored once an institution has repaid its TARP funds. Treasury has similarly exceeded the statute's requirements by banning tax gross-ups for the top twenty-five employees in connection with the receipt of permissible severance and other similar payments. These are just three of several examples where Treasury has chosen to add burdensome restrictions beyond those required by EESA and ARRA (the Act).

Given the fact that Treasury is currently earning a strong return on its investment in the banking industry,[3] we question the need for many of these overly burdensome and unnecessary provisions, especially when banks of all sizes were actively encouraged to participate in the program. We would strongly encourage Treasury to pare back on the unnecessary expansion of the very proscriptive compensation restrictions contained in the Act. Moreover, as we highlight below, many aspects of the IFR continue to have a disproportionate impact on small and mid-sized institutions, so care should be taken so as not to overburden these institutions.

We recognize that the IFR does not impose any dollar limits on overall compensation (other than the $500,000 limit on the TARP recipient's ability to deduct for Federal income tax purposes) and we believe that judgment to be wise. Financial institutions should be free to structure their compensation plans so as to reward talented employees, while at the same time, recognize that appropriate compensation levels for one institution operating in one market may not be appropriate for another operating elsewhere. In finalizing the IFR, we would urge Treasury to exercise caution, as onerous compensation restrictions will inevitably encourage top producers to move elsewhere, e.g., to financial institutions that are not participating in the program.[4] A significant drain on talent is not helpful to those banks seeking to make good on the taxpayers' investments.

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[2] "Senior Executive Officer" generally refers to the Principal Executive Officer (PEO), the Principal Financial Officer (PFO), and the three most highly compensated officers other than the PEO and PFO.

[3] As of June 30, 2009, 657 banks and savings associations have returned $6.4 billion in dividends to Treasury and, as of July 17, 2009, 34 banks have repaid $70.17 billion in TARP funds.

[4] See Luccheti, Aaron, *Wall Street's B-List Firms Trade on Bigger Rivals' Woes,* The Wall Street Journal, A1 (August 11, 2009).

We are also pleased that Treasury has made clear that the compensation and corporate governance restrictions apply only to those firms receiving "financial assistance provided under the TARP." Potential participants in the Term Asset-Backed Securities Loan Facility or TALF and other government programs had expressed concern that these restrictions might also apply to them, which application would not, we submit, be warranted by law or wise policy.

DISCUSSION

Impact on Community Banks

As noted above, many of the IFR requirements are statutorily mandated, leaving Treasury with little latitude to make adjustments. Nevertheless, Congress did provide Treasury under the Act with some discretion and ABA would strongly urge Treasury to utilize it to provide, where appropriate, relief for community banks. As we outline below, the IFR disproportionately impacts community banks, especially those that are not public companies and familiar with the regulations associated with being a public company.

Specifically, the IFR borrows heavily from the federal securities laws and the Internal Revenue Code. For example, definitions of senior executive officer and compensation are drawn from the Securities and Exchange Commission's Regulation S-K. Compensation committee independence standards are determined by reference to this same regulation which in turn cross-references to the listing requirements of the NYSE and other exchanges.

Further, the Internal Revenue Code must be consulted to determine if the bonus restrictions imposed under Section 111(b)(3)(D) apply or not. That section states that bonuses paid pursuant to a valid written employment contract executed on or before February 11, 2009 will not be restricted. IFR Q-10 provides that a valid employment contract exists if the employee had a legally binding right under the contract to a bonus payment as of February 11, 2009. "Legally binding right" is determined by reference to the Internal Revenue Service's regulations.

These and many other issues raised by the IFR are extremely complex and will require many companies affected by the IFR to hire outside legal counsel, who inevitably will become arbiters of critical compensation and bonus limits for the companies' top officers. This is especially true and most burdensome for smaller institutions that are less likely to have employment and securities lawyers on staff.

Even those community banks that are familiar with Regulation S-K are not immune from the complexity of these regulations. For example, smaller reporting companies, defined, under the federal securities laws, as companies with a market capitalization of less than $75 million, are generally only required to disclose in the company's proxy statement the compensation for three named officers, rather than the five normally required for larger public companies. While the IFR recognizes this, it nevertheless provides that this small company carve-out will not apply and that, where applicable, the five SEOs will be subject to the bonus, golden parachute and clawback provisions provided under the Act.

The varying number of employees captured by these regulations adds to the confusion, but even more so for small and mid-sized institutions. Bonus restrictions may only apply to one SEO, but the golden parachute limitations apply to the top five SEOs plus the next five most highly compensated employees, while the clawback provisions apply to the top five SEOs and the next 20 most highly compensated employees. Many small community banks do not even have twenty five employees and thus the bonuses

paid to all or nearly all employees may be subject to clawback. Even for mid-sized institutions, the list of the next 20 most highly compensated employees would include commission sales people and lower level managers that, we believe, were not the target of the Act's limitations.

This complexity continues at the Board level. The legislation requires compensation committees comprised solely of independent directors to be established to review employee compensation plans. The IFR goes further and places extensive responsibilities on affected compensation committees. For example, compensation committees will be responsible for meeting every six months with senior risk officers to discuss, review and evaluate SEO and other employee compensation plans and the risks these plans pose to the TARP recipient. Further, compensation committees are required to identify and to limit any features of these plans that could lead to excessive risk taking and/or pose unnecessary risks to the firm. Compensation committees are also required to provide annually a narrative description of what actions they took to limit unnecessary and excessive risk taking in SEO and other employee compensation plans. The narrative must also include a discussion of how these compensation plans do not encourage behavior focused on short-term results rather than long-term value creation or earnings manipulation. Finally, compensation committees are required to certify annually that they have completed all the necessary reviews. Depending on the size of the community bank and whether or not it was a public reporting company, this certification could be required to be publicly disclosed in periodic filings with the SEC, as well as provided to Treasury and/or the institution's primary regulator.

While larger firms have long had Board compensation committees responsible for overseeing company compensation plans, many community banks, particularly closely held institutions, have not had the need for these committees, particularly as community bank executive compensation plans are modest and not structured so as to reward excessive risk taking. Clearly, the added burdens associated with establishing a compensation committee will fall disproportionately on the community bank.

In exercising the warrants for private companies, Treasury has determined to treat public and private companies differently under the TARP program. There should be no reason why Treasury cannot exercise its discretion to provide community banks with appropriate relief from these very complex and proscriptive regulations.

Specific Comments

Bonus Restrictions

The Act prohibits TARP recipients from paying or accruing any bonus, retention award, or incentive compensation other than a bonus limited to one-third of the total amount of the employee's annual compensation and paid in long-term restricted stock that does not fully vest until the funds received under the TARP program are fully repaid. The statute scales the prohibition based on the dollar amount of TARP funds awarded to the institution. Thus, for institutions receiving less than $25 million, the bonus restriction would apply only to the most highly compensated employee, while for those institutions receiving $25 million to just under $250 million, the bonus restriction would apply to the five most highly compensated employees.[5]

[5] For those institutions receiving $250 to less than $500 million, the bonus restrictions would apply to the top five SEOs and the next 10 most highly compensated employees. For institutions receiving in excess of $500 million, the bonus restriction would apply to the top five SEOs and the next 20 most highly compensated employees.

Partial repayments of TARP funds should permit a bank to move from one category to another, less restrictive bonus category, since taxpayer exposure is concomitantly reduced. Thus, for example, if a bank that had received $50 million in TARP funds repaid $26 million, leaving $24 million in TARP funds outstanding, the bonus restrictions should only apply to the most highly compensated employee. We understand that Treasury has taken the opposing view, namely that partial repayments will not allow a firm to move to a less restrictive bonus category.[6] While we understand that the IFR specifies that bonus restrictions are based on the gross amount of all financial assistance provided to the TARP recipient, valued at the time the financial assistance was received,[7] we find nothing in the statute that states the bonus restrictions are based on gross amounts received. To the contrary, Section 111(b)(3)(D)(i) provides that the bonus restrictions are applicable "during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding," This language gives Treasury sufficient flexibility to allow banks that partially repay TARP funds to move to a less restrictive bonus category. As a policy matter, Treasury should take steps to encourage partial repayments of taxpayer funds, as a viable option for eventual withdrawal from the program and a return to normal capital conditions.

We agree with Treasury's position that partial repayments will allow bonuses paid in restricted stock or stock units to partially vest. Thus, for each 25% of total financial assistance repaid, 25% of the total long term restricted stock or stock units may be become transferable. Transferability is also permitted with respect to restricted stock awards, regardless of whether any repayment has been made, in order to allow the affected recipient to pay applicable taxes.

We also concur with Treasury's position that bonuses do not include contributions to qualified retirement plans and "commission compensation." With respect to the latter, "commission compensation" is considered base salary and would generally include fees earned in connection with providing wealth management services, and securities and insurance brokerage sales. Fees earned in connection with investment banking and proprietary trading activities should also be considered commission compensation.

In this connection, we note that the Q-1 definition of "commission compensation" provides that the commission compensation program must be in existence for that type of employee as of February 17, 2009, the date ARRA was signed into law. We are concerned that this temporal limitation may pose a problem for those TARP institutions that may in the future wish to modify their compensation programs in some manner, e.g., adjust the commission rate, in order to stay competitive with their peers.

As noted above, Section 111(b)(3)(D) states that bonuses paid pursuant to a valid written employment contact executed on or before February 11, 2009 will not be restricted and the IFR provides that a valid employment contract exists if the employee had a legally binding right to a bonus payment as of that date. "Legally binding right" under the IRS' regulations is vague and ambiguous and the advice of outside legal counsel will need to be sought. Guidance on this term would be most welcome.

Multi-Year Vesting, Accruals and Payments

[6] Additional TARP investments, however, will cause more bank employees to become subject to the bonus restrictions. See Q-10(a)(2).

[7] See Q-10(a)(2).

Clarification regarding the rules governing multi-year vesting, accruals and payments is sorely needed. We assume that a non-highly compensated employee (non-HCE), awarded a bonus in early 2008 for services performed in 2007 which vests in one-third increments over the following three years, would be entitled to receive these bonuses when they vest even if the bank accepted TARP funds in late 2008. An HCE who is awarded a bonus in early 2008 for services performed in 2007, payable in three yearly installments, also should be entitled to receive these funds on the payable dates even if the bank accepted TARP funds in late 2008. The IFR seems to suggest , however, that bonuses awarded during the time the employee was not subject to the prohibition but payable when the employee is subject to the prohibition should be suspended "until the employee is no longer subject to the prohibition."[8]

These issues are further complicated when the employee is a non-HCE when the first third of the bonus accrues, but then later becomes a HCE for the second and third year of accrual. The IFR states that "the employee will not be treated as having accrued the bonus, retention award, or incentive compensation during the portion of the service period the employee was subject to the limitation, if the bonus, retention award, or incentive compensation is reduced to reflect at least the portion of the service period that the employee was subject to the prohibition." It is unclear whether the "reduced to reflect" language requires that the bonus be suspended during the time the employee is an HCE or does it mean that the employee forfeits his bonus for these years to the extent that the bonus does not conform with the exception for grants of long-term restricted stock valued at no more than one-third of the HCE's salary. As we have stated above, banks should be able to reward and retain talented employees. Suspension until TARP funds are repaid, rather than partial forfeiture, is less draconian and will do less harm to the ability of banks to retain their most talented employees.

Most Highly Compensated Employee

Q-1 defines "most highly compensated employee" to exclude senior executive officers. This definition makes sense in the context of the bonus restrictions as two of the four bonus restriction tiers under the Act provide that the bonus limitations apply to the SEOs and either 10 or 20 next most highly compensated employees. However, for two of the tiers applicable to those banks accepting under $250 million, the bonus limitations apply only to the most highly compensated employees, which under Q-1 would exclude SEOs. This limitation puts many CEO and CFOs at community banks in the unacceptable and uncomfortable position of being required to impose bonus limitations on individual employees other than themselves.

We understand that Treasury has informally indicated that for those banks accepting less than $250 million in TARP funds, the limitations will apply to the "most highly compensated employee(s)" regardless of whether they are senior executive officers (SEOs). It would be helpful if Treasury could formally confirm that for banks accepting less than $25 million in TARP funds, the bonus restrictions will apply to the single most highly compensated employee which may or may not be the bank's CEO. At the same time, we would encourage Treasury to confirm formally that for those banks accepting less than $250 million, the bonus restrictions will apply to the five most highly compensated employees which, again, may or may not be senior executive officers.

Because the most highly compensated employees are determined based on annual compensation in the prior year, Treasury has raised the issue of "cycling," i.e., employees being intentionally cycled in and out

[8] See 74 Fed. Reg. at 28401 (bottom and top of second and third columns, respectively).

of the most highly compensated status in alternate years, and requested comment on the need to mitigate this possibility. Some suggestions for mitigation include identifying the most highly compensated employees based on an averaging of the preceding two or three years' annual compensation, or requiring that some or all of the most highly compensated employees identified for one year remain subject to the limitations for a prescribed number of additional years, regardless of their subsequent level of compensation.

The ABA strongly opposes employing any of the mitigation strategies suggested in the IFR. As we detail throughout this letter, these rules are extremely complex, overly proscriptive, most burdensome, and not mandated by the statute. To require bankers to average annual salaries or require that more employees than necessary be characterized as most highly compensated will contribute to the TARP institution's burden and encourage top performers to leave the firm. We believe that the possibility for cycling abuse is small and any concerns that Treasury may harbor about possible abuses can be addressed through the examination process.

Compensation Committee Responsibilities

While we have outlined above some of the significant responsibilities that compensation committees will assume in connection with our discussions about the disproportionate impact these provisions will have on community banks, the requirement contained in Q-6 that the compensation committee review the terms of each employee compensation plan to identify and to eliminate features in the plan that could encourage the manipulation of reported earnings is overly broad, unnecessary, and will distract the committee from performing its responsibilities. For example, compensation plans for many bank employees, such as tellers and other front line staff, do not have features that would encourage manipulation of reported earnings. ABA would strongly encourage Treasury to limit the compensation committee's responsibilities to those plans covering SEOs and other highly compensated employees that could have a material impact on the TARP recipient. This latter formulation would be consistent with a recent SEC proposal to require disclosure to investors regarding a public company's compensation policies and overall actual compensation practices for employees generally, if risks arising from those compensation policies or practices have a material effect on the company.[9]

Say-on-Pay

Section 111(e) of the Act requires companies participating in the TARP and subject to the SEC's compensation disclosure rules to provide shareholders with a non-binding vote to approve the compensation of executives (say-on-pay). More recently, the SEC proposed to amend its regulations to implement Section 111(e) and to require companies subject to the SEC's proxy rules to provide a separate shareholder vote on executive compensation in connection with an annual meeting at which directors are to be elected.[10] Additionally, the IFR makes clear throughout that the say-on-pay requirements apply to those TARP recipients that have securities registered with the SEC under the Federal securities laws. Even H.R. 3269, the Corporate and Financial Institution Compensation Fairness Act of 2009, recently approved by the House of Representatives, makes clear that the bill's say-on-pay provisions are applicable only to public companies.

[9] Proxy Disclosure and Solicitation Enhancements, 74 Fed. Reg. 35076 (July 17, 2009).

[10] Shareholder Approval of Executive Compensation of TARP Recipients, 74 Fed. Reg. 32474 (July 8, 2009).

Despite the fact that the Congress, the Treasury and the SEC have all indicated that the say-on-pay provisions are only applicable to public companies, i.e., companies that are subject to the SEC's proxy rules, advisers to many of our non-public members that are participating in TARP have suggested that compliance with the say-on-pay provisions is required. Shares in non-public community banks are generally held by members of a founding family, directors and executive management, none of whom need assistance in communicating their views on executive compensation. A few shares may be held by either the bank's employees in connection with their qualified pension or stock purchase plans or members of the local community. Giving employees and local community members who may hold only few shares in the bank information about CEO compensation could be disruptive, to say the least, to the smooth functioning of the institution and its role in the local community.

Luxury Policy Statement

The IFR requires that the Board of Directors of all TARP recipients adopt an excessive or luxury expenditures policy by the later of 90 days after the closing date of the agreement between the TARP recipient and Treasury or September 14, 2009. In addition, this policy must be provided to Treasury and the bank's primary regulator and posted on the bank's website, if the bank, in fact, maintains a company website. Finally, once adopted, the policy must be maintained during the period the bank's TARP obligations remain outstanding.

We question why a non-public bank should be required to post its luxury expenditure policy on its public web site. It should be sufficient that the policy is made available to bank directors and employees through the company's intranet site, if such a site is maintained.

Certifications

Section 111(b)(4) of the Act requires that the chief executive officer (CEO) and chief financial officer (CFO) provide a written certification of compliance with the requirements of Section 111. The IFR provides two model certifications: one for the first fiscal year of participation in the TARP (Appendix A) and the other for all other years (Appendix B), both of which subject CEOs and CFOs to criminal penalties for false or fraudulent certifications. The models require CEO and CFO certification of compliance with a list of sixteen items, including the compensation committee's responsibilities and the various limitations and restrictions imposed by the Act and the IFR on such things as golden parachute payments, bonuses, perquisites, and tax gross-ups.

Several of our members have expressed concern regarding the requirement to include within the certification the identity of the twenty most highly compensated employees, ranked in order of compensation. For public companies, these certifications will be made available to the public as an exhibit to the Form 10-K, while non-public companies are required to provide these certifications to Treasury and their primary bank regulator and may be available to the public under the Freedom of Information Act. SEOs of public companies understand when they accept an SEO position that their compensation will be disclosed to the public; the twenty next most highly compensated employees do not and did not at the time of hiring. Instead, these employees have a valid expectation that their names and salaries will be kept private. We are equally concerned that Treasury may make this same information for non-public companies publicly available as part of its effort to ensure transparency regarding the TARP. We would strongly recommend that Treasury respect these individuals' privacy and amend the certification to require, at most, disclosure regarding the identity and relative compensation of only the SEOs of public companies. Nor do we believe that risks to privacy are mitigated if the most

highly compensated employees are identified by position rather than name as it would be quite common at community banks for only a few individuals to occupy the same position.

The timing required for filing these certifications has also raised questions among those of our members that closed their TARP transactions in 2008. Specifically, Q-15(a)(2) requires that the first fiscal year certification (Appendix A) is to be completed within 90 days of the completion of the first fiscal year. For those TARP recipients whose fiscal year coincides with the calendar year, the first fiscal year certification would have been required on March 31, 2009, long before the Treasury issued the IFR. Similar transitional issues are presented if these TARP recipients use Appendix B, which requires certifications that compensation committees have performed their obligations under the IFR to meet every six months. Because the compliance date for compensation committee commences at the earliest on September 14, 2009, these TARP recipients would not be able to certify to the meeting requirements as required under Appendix B. We believe that the IFR recognizes that CEOs and CFOs may need to amend these certifications, as appropriate, to recognize timing variations in some of these transactions but we would welcome further clarification from Treasury on this point.

Effective Date

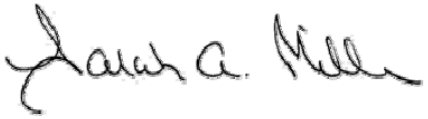
Q-17 makes clear that the standards under the IFR are effective June 15, 2009, except with respect to those sections of ARRA that were effective upon enactment, e.g., the say-on-pay provisions. In this regard, we appreciate the Treasury's statement that bonus limitations will not apply to bonuses paid or accrued by TARP recipients and their employees prior to June 15, 2009. Many ABA members were concerned that 2008 bonuses not paid prior to February 17, 2009 would be subject to the Act's bonus limitations. We are unclear, however, whether the June 15th date will allow TARP recipients to distinguish between bonuses earned for work performed both prior to and after June 15th, but paid at the end of 2009 or, in some cases, early 2010.

Finally, it would be most helpful for those TARP institutions that repaid Treasury's investment after June 15th or those that are contemplating doing so soon, if Treasury were to provide certainty as to what aspects, if any, of the IFR would still apply. Some authorities have suggested that these institutions would have a continuing responsibility to provide certifications for any fiscal year in which the institution held TARP funds.

Conclusion

The ABA appreciates the opportunity to offer these comments. We remain concerned about the federal government's continuing efforts to remove corporate governance responsibilities from the jurisdiction of the states. We are hopeful that Treasury and other regulatory authorities will exercise restraint in this regard. In addition, the ABA strongly urges Treasury to refrain from imposing unnecessary, burdensome and costly restrictions on the many TARP institutions that were encouraged by their regulators to participate in the TARP.

Sincerely yours,



Sarah A. Miller