

Executive Compensation Limits and Other Employee Provisions Under the Emergency Economic Stabilization Act of 2008

Executive Compensation Limits

The Emergency Economic Stabilization Act of 2008 (the "Act") provides the Secretary of the Treasury (the "Secretary") with \$700 billion to buy troubled assets held by financial institutions while establishing a federal program that would allow financial institutions to insure their troubled assets. The Act, among other things, also limits "excessive" deferred and non-deferred compensation for the top executives of participating companies.

Direct Purchases

If the Secretary obtains a meaningful equity or debt position in a financial institution through a direct purchase of troubled assets, such an institution will have to preclude the granting of incentives that would encourage or motivate executive officers to take unnecessary risks threatening or compromising the financial health or position of the financial institution, provide for the ability of such an institution to recover bonuses and other incentives for executive officers based on materially inaccurate financial reports, and refrain from making any golden parachute payments to senior executive officers while the government holds a meaningful equity position in the company.

Auction Purchases

If the Secretary purchases troubled assets through an auction, and the total purchases (including direct purchases) exceed

\$300 million, the selling financial institutions cannot enter into any new employment contracts with senior executive officers that provide for golden parachute payments upon involuntary termination, bankruptcy filing, insolvency, or receivership.

In addition, the selling financial institution cannot deduct executive compensation for services performed in excess of \$500,000 (lowered from \$1 million) by covered executives; there is no performance-based compensation exception. "Covered executive" means the CEO, the CFO, and any of the three highest-paid officers of the institution (other than the CEO and the CFO).

Finally, when a covered executive is severed from an applicable institution, all severance payments to that covered executive are considered parachute payments under section 280G of the Internal Revenue Code (the "Code"). Thus, these payments are not deductible by the company and may be subject to the 20% excise tax imposed under Code section 4999 on so-called "excess parachute payments."

Observations and Considerations

Many key terms in the Act are not defined, such as "golden parachute," "unnecessary and excessive risk," "meaningful equity or debt position," "materially inaccurate," and "involuntary termination." Involuntary terminations would appear to include terminations for "Good Reason."

How will the Treasury enforce the new law? Does it have any real teeth? What about executives enjoying binding agreements? What if they refuse to "cooperate"? Also, it is interesting to note that, once again, Congress believes the tax code is a good vehicle to moderate and regulate the behavior of executives and compensation committees as well as the magnitude of executive compensation. History would indicate, however, that this does not work well and, for the most part, has served only to shift the cost to the shareholders.

Mental Health and Addiction Provisions

Mental health parity requirements are extended and enhanced for group health plans as follows:

Mental Health Parity

The financial requirements for mental health or substance use disorder benefits must be no more restrictive than the most common financial requirements applicable to other medical and surgical benefits, and there must be no additional cost sharing requirements applicable only to mental health and substance use disorder benefits. The treatment limitations must not be more restrictive than those of substantially all medical and surgical benefits and there must be no additional restrictions that apply only to mental health and substance use disorder benefits. If the group health plan provides out-of-network coverage for medical or surgical benefits, then it must also provide out-of-network coverage for mental health and substance use disorder benefits.

The criteria for medical necessity determinations, as well as the reason for any denial under the group health plan for reimbursement, must be made available upon request to any current or potential participant, beneficiary, or contracting provider upon request.

Cost of Coverage and Exemptions

If these new requirements raise the cost of the group health plan by more than 2% in the first year, or 1% in each subsequent year, these new requirements will not be imposed, although an employer may still voluntarily adopt mental health and substance use disorder parity. A determination of cost may only be made after six months of compliance with these new rules.

An employer that wishes to use an exemption must notify the Secretary. Such notice must include a description of the number of covered lives under the plan, a description of the cost of coverage for all benefits for the year the exemption is sought and the year prior, and a description of the cost of coverage for mental health and substance use disorder coverage for the year the exemption is sought and the year prior.

Observations and Considerations

Clearly the purpose of the legislation is to make mental health and addiction benefits more meaningful and economically available to policy holders. Essentially, the Act provides that mental health and substance disorder benefits must generally be as available and economically accessible as other medical benefits under the group health plan. How will employers respond? Employers who provide mental health and addiction benefits may well increase the monthly contributions of employees to cover the increased cost. Less likely to occur (but certainly ironic if it were to happen), employers may instead increase the out of pocket co-pay and deductible costs of other health and medical benefits to bring them into parity with the more expensive and restrictive cost structure of mental health and substance disorder benefits.

Alternative Minimum Tax Relief

Increased Exemption

The AMT Exemption for 2008 is increased to \$69,950 for joint filers and \$46,200 for individuals.

Increased AMT Refundable Credit Amount

The refundable tax credit under Code section 53(e) is increased to allow more rapid utilization of unused alternative minimum tax credits.

Incentive Stock Option Relief

Any underpayments and related penalties and interest resulting from AMT attributable to incentive stock options for a taxable year prior to 2008 are abated. Furthermore, the refundable credit amount, and the minimum tax credit, for 2008 and 2009 is increased by 50% of the aggregate amount of interest and penalties already paid prior to enactment of the Act, and which would have been abated under the immediately preceding sentence (but for such payment).

Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at www.dechert.com/employeebenefits.

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