

FREDERIC W. COOK & CO., INC.
90 PARK AVENUE, NEW YORK, N.Y. 10016 - TEL. (212) 986-6330
NEW YORK • CHICAGO • LOS ANGELES • SAN FRANCISCO • ATLANTA

November 18, 2008

Via Electronic Mail

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

Re: Interim Final Rule under the TARP
Capital Purchase Program (31 CFR Part 30)

Dear Sir or Madam:

On October 20, 2008, the Office of Domestic Finance of the Department of the Treasury published in the Federal Register an interim final rule providing guidance on the executive compensation provisions applicable to participants in the Troubled Asset Relief Program Capital Purchase Program (“CPP”) under the Emergency Economic Stabilization Act of 2008 (the “Act”). This letter sets forth the comments of Frederic W. Cook & Co., Inc. to the interim final rule.

Frederic W. Cook & Co., Inc. provides compensation consulting services to corporations, boards of directors and compensation committees with respect to the compensation of executives and directors. The Firm’s services are provided to companies in all industries and size categories, including financial institutions that are participating or eligible to participate in the CPP. We have provided compensation consulting services to more than 2,000 companies since we were founded 35 years ago, including approximately 28% of the *Fortune* 500 during the past two years. We do not represent or provide advice to individual executives.

Introduction

Our comments follow the organization of the interim final rule. In addition, we have commented on the deduction limitations under Internal Revenue Code (“IRC”) Section 162(m)(5) to which participating financial institutions must agree, as set forth in the guidance provided by Internal Revenue Service Notice 2008-94 (“Notice 2008-94”) and incorporated by Section 30.10 of the interim final rule.

General Application of the Interim Final Rule

Each of the executive compensation provisions in the interim final rule applies “while the Treasury holds an equity or debt position acquired under the CPP.” On October 31, 2008 the Treasury posted standardized final documents relating to the CPP to its website, including the Securities Purchase Agreement Standard Terms (the “Agreement”). Section 4.10 of the Agreement requires the financial institution participating in the CPP to comply with executive compensation restrictions issued pursuant to Section 111(b) of the Act until the Department of the Treasury “...ceases to own any debt or equity securities of the Company acquired pursuant to this Agreement or the Warrant...” The meaning of the quoted language is unclear. It can be interpreted to mean either:

- (i) The restrictions apply until the Treasury ceases to own (a) any debt or equity securities of the Company acquired pursuant to the Agreement or (b) the Warrant;
or
- (ii) The restrictions apply until the Treasury ceases to own any debt or equity securities of the Company acquired pursuant to (a) the Agreement or (b) the Warrant.

We believe that the first interpretation is more consistent with the purpose of the Act. At such time as the Treasury only owns common stock that it has purchased through the exercise of the Warrant, its relationship to the participating financial institution is no different than that of any other investor. There is no logic in the special executive compensation provisions of the Act continuing to apply since they were agreed to by the participating financial institution in exchange for the special benefits it received through the Treasury’s purchase of preferred stock that was made available to the Treasury under the CPP. The second interpretation could greatly decrease the attractiveness of the CPP program since a financial institution would need to factor into its evaluation of participating in the program the fact that the executive compensation provisions could potentially be of indefinite duration if the Treasury purchased stock pursuant to the Warrant.

In addition, if the second interpretation is deemed to be applicable it is possible that the executive compensation restrictions would cease to apply after the Treasury disposes of its equity or debt position in the financial institution and then be reinstated, if the Treasury exercised the Warrant and acquired additional equity in the financial institution.

We recommend that the interim final rule be revised to make it clear when the restrictions expire. In addition, the interim final rule should be revised to make it clear whether a Warrant issued under the CPP by a financial institution to the Treasury is treated as the equivalent of equity since Section 111(b) of the Act only refers to an equity or debt position in the financial institution.

Ensuring That Incentive Compensation Arrangements Do Not Encourage SEOs to Take Unnecessary and Excessive Risk

Guidance on Unnecessary and Excessive Risk. Sections 30.3 through 30.5 of the interim final rule provides guidance with respect to the requirement of Section 111(b)(2)(A) of the Act that a financial institution impose limits on compensation that exclude incentives for its senior executive officers (“SEOs”) to take unnecessary and excessive risks that threaten the financial institution’s value during the period that the Treasury holds an equity or debt position in the financial institution. Those sections of the interim final rule do not provide any guidance on what constitutes unnecessary and excessive risks, as stated in Section 304, “[b]ecause each financial institution faces different material risks given the unique nature of its business and the markets in which it operates...” We believe that it is critical to provide more guidance on the meaning of such unnecessary and excessive risk.

In the absence of guidelines, many compensation committees may be reluctant to adopt programs that encourage an appropriate level of risk taking. For example, companies might grant time-vested restricted stock awards in lieu of stock options because the latter may arguably create an incentive for management to engage in highly risky behavior to drive up share price and maximize exercise proceeds. Similarly, companies might use time-vested restricted stock in lieu of performance-based awards because the establishment of “stretch goals” could be viewed as encouraging high risk strategies in order to maximize payouts. Such actions could weaken the link between pay and performance, and therefore result in less accountability among executives and less correlation between return to shareholder and compensation delivered to SEOs.

By its nature incentive compensation creates variability in earned pay based on performance versus operating goals, strategic initiatives and changes in shareholder value. As such, a well designed incentive compensation program encourages SEOs to take “risks” in order to satisfy the goals and earn incentive compensation. Whether the risks are unnecessary and excessive is, of course, the key issue on which guidance is needed. Unless there are some guidelines, the effect of Section 111(b)(2)(A) as implemented by the interim final rule will likely be a substantial shift of compensation of SEOs to higher salaries, discretionary bonuses and non-performance based equity awards instead of performance-based compensation, which is likely to decrease the value of the financial institution.

One approach that should be considered is to create certain “safe harbors” in order to provide some guidance to financial institutions. For example the following could be deemed not to create unnecessary and excessive risk: (i) time-based awards of restricted stock and restricted stock units that, based on the grant date fair market value, represent less than a specified percentage of the SEO’s total compensation for the year of grant and (ii) stock option awards that require the number of shares acquired on exercise, net of the shares required to pay the SEO’s income and employment taxes from the compensation realized on exercise, be held for a specified number of years after exercise.

Compensation Committee Certification. Under Section 30.1 of the interim final rule, the compensation committee of a financial institution with securities registered with the Securities and Exchange Commission under the federal securities law must provide a certification in the Compensation Discussion and Analysis (“CD&A”) required by Item 402(b) of Regulation S-K that it has reviewed with the institution’s senior risk officers the incentive compensation arrangements of SEOs to ensure that the arrangements do not encourage the SEOs to take unnecessary and excessive risks. Although we are in favor of the compensation committee’s certification, we believe it should be in the compensation committee report required by Item 407(e)(5) of Regulation S-K rather than the CD&A.

The CD&A is the report of the management of the financial institution, not the compensation committee. As a filed document it is covered by the certification required to be given by the chief executive officer and chief financial officer of the financial institution that is required under the Sarbanes Oxley Act of 2002 and could subject them to liability for any inaccuracies. Accordingly the CD&A is not the appropriate place for the certification.

Clawback of Bonus and Incentive Compensation

Section 30.6 of the interim final rule implements the requirement of Section 111(b)(2)(B) of the Act and provides that a financial institution participating in the CPP must require that bonus and incentive compensation paid to SEO during the period the Treasury holds an equity or debt position acquired under the CPP be subject to “clawback” (i.e., recovery) by the financial institution if payment of the compensation was based on materially inaccurate financial statements or performance metric criteria. This section does not address bonus or incentive compensation paid during the period the Treasury holds an equity or debt position acquired under the CPP that is based on materially inaccurate performance metric criteria that occurred at least in part prior to such period (e.g., incentive compensation earned over a period of three fiscal years based on performance metrics for each fiscal year, where the material inaccuracy occurred in a fiscal year that ended prior to the Treasury’s acquisition of an equity or debt position). We recommend that the interim final rule be clarified with respect to this issue.

In addition, the interim final rule appears to be narrower than the provisions of Section 111(b)(2)(c) of the Act. It does not apply to bonus and incentive compensation paid after the period the Treasury holds an equity or debt position acquired under the CPP that was earned during that period. We believe that the interim final rule should be revised to apply the clawback in that situation.

Prohibition on Golden Parachute Payments

Determination of Amount Payable on Account of an Applicable Severance from Employment. Section 111(b)(2)(C) of the Act prohibits the payment by a financial institution of a golden parachute payment to an SEO during the period the Treasury holds an equity or debt position in the financial institution that was acquired under the CPP. One aspect of whether there is a golden parachute payment under Section 30.9 of the interim final rule is the amount of

compensation that is considered to be a payment on account of the applicable severance from employment. Under paragraph (c) of Section 30.9 of the interim final rule, amounts that would have been forfeited if there had not been an applicable severance of employment are treated as payments on account of an applicable severance from employment.

We recommend that paragraph (c) be clarified for purposes of calculating the amount of equity-based compensation (e.g., stock options and restricted stock) that would have been forfeited. If the equity-based compensation would have vested solely based on the SEO's continued employment the principle in IRS Regulation Section 1.280G Q&A 24(c) should be applied. Under Q&A 24(c) the amount of a payment that becomes vested as a result of a change in ownership or control that would have otherwise vested only on the continued performance of services for a specified time period is equal to the sum of (i) the excess of the amount of the accelerated payment over the present value of the payment and (ii) an amount that reflects the lapse of the obligation to continue to perform services.

Applying the principle of Q&A 24(c) is appropriate since Section 30.9 of the interim final rule applies the provisions of IRC Section 280G(e) to determine what is a golden parachute payment as well as the provisions of the IRC Section 280G regulations (modified to the extent required to be consistent with IRC 280G(e)).

Include "Single Trigger" Acquisition Payments. There may be an inadvertent loophole in Section 30.9 of the interim final rule with respect to payments related to an acquisition of a financial institution participating in the CPP. Section 30.11 of the interim final rule provides that if a participating financial institution is acquired by an unrelated entity during the period that the Treasury holds an equity or debt position in the financial institution, the SEOs of the acquired financial institution continue to be subject to Section 111(b)(2)(C) of the Act until after the first anniversary of the acquisition. If an SEO's employment is terminated involuntarily during the one-year period following the acquisition (as is often the case) payments in the nature of compensation to the SEO on account of the termination would be taken into account in determining whether the SEO has received a prohibited golden parachute payment.

However, if the vesting of equity-based compensation held by the SEO were accelerated on the acquisition date (i.e., "single-trigger" vesting) rather than on termination of employment following the acquisition (i.e., "double trigger" vesting) the amount of such compensation would not be included of purposes of determining whether the prohibition on golden parachute payments is applicable. In recent years, such single trigger vesting of equity-based compensation has become increasingly less common because it creates windfall compensation, acceleration of cost and share dilution by the company, and the loss of the retention power of outstanding awards. The ability to circumvent the golden parachute payment limitation by providing for single trigger vesting could create a perverse incentive for financial institutions to adopt such a practice unless this apparent loophole is closed. We recommend, therefore, that Section 30.9 of the interim final rule be revised to specify that any such single trigger payment must be included in determining whether the prohibition on golden parachute payments is applicable.

Agreement Not to Claim Deduction for Remuneration That Would Not Be Deductible If IRC 162(m)(5) Applied to the Financial Institution

Stock Option Remuneration. Under Section 30.10 of the interim final rule and Notice 2008-94, as a condition of participating in the CPP a financial institution must agree to be subject to the \$500,000 annual deduction limitation of IRC Section 162(m)(5) on all remuneration of an SEO attributable to services performed for a taxable year of the financial institution that includes any portion of the period that the Treasury holds an equity or debt position in the financial institution. Q&A 9 of Notice 2008-94 provides for an allocation of SEO remuneration for purposes of IRC Section 162(m)(5) over the period that the right of the SEO to the remuneration is subject to a substantial risk of forfeiture based on the requirement to perform substantial future services. Notice 2008-94 provides that if a stock option requires that the SEO continue in employment for a specified period of years in order to exercise the option (i.e., to vest in the option), the remuneration realized on exercise (i.e., the difference between the fair market value of the stock on the exercise date and the option exercise price) is allocated over the applicable number of years in the vesting period.

We do not think the allocation over the vesting period is appropriate for stock options. Although the option cannot be exercised until it is vested, the option exercise period is far greater (usually ten years from grant) than the vesting period (typically no more than four years from grant). We recommend that the remuneration attributable to stock options be allocated over the period from the grant date through the exercise date to take into account the nature of stock option remuneration.

In addition, we believe that applying the limitations of IRC Section 162(m)(5) to stock options and other performance-based compensation satisfying IRC Section 162(m)(4) and the regulations thereunder that were granted prior to the effective date of the Act unfairly penalizes financial institutions participating in the CPP, especially since the limitations are not included in the restrictions of the Act that are applicable to the CPP. When the stock options and other performance-based compensation were granted the financial institutions did so with the knowledge that when the options were exercised and the other performance-based compensation became vested, the remuneration attributable to the grants would not be subject to the otherwise applicable \$1,000,000 deduction limitation of IRC Section 162(m). We recommend that the Treasury revise the interim final rule to incorporate a “grandfather” provision to exclude stock options and other performance-based compensation granted prior to the Act’s effective date from the application of IRC Section 162(m)(5). Otherwise, stock options and other performance-based compensation granted many years before the effective date of the Act will be subject to the \$500,000 deduction limitation for financial institutions participating in the CPP if the option is exercised or the other performance-based compensation vests during the period that the Treasury holds an equity or debt position in the financial institution. The grandfather provision would be conditioned on the stock option and other performance-based compensation otherwise satisfying the requirements of IRC Section 162(m)(4) and the regulations thereunder.

Partial Taxable Years. Section 30.10 of the interim final rule provides that if the Treasury holds an equity or debt position in a financial institution under the CPP for less than the entire taxable year, the \$500,000 limitation and the remuneration of the SEO are prorated for the portion of the taxable year that the Treasury holds an equity or debt position. We request that the interim final rule be clarified with respect to the application of IRC 162(m)(5) to the remuneration of an SEO for such a taxable year. It is not clear whether the proration applies to all remuneration earned by the SEO for the taxable year (which would result in the inclusion of remuneration earned prior to the Treasury's acquisition of an equity or debt position) based on the number of months in the taxable year that the Treasury holds an equity or debt position, or only applies to remuneration for services after the Treasury acquire an equity or debt position. For example, if an SEO receives a sign-on bonus prior to the acquisition by the Treasury of an equity or debt position in the financial institution under the CPP, is that bonus included as remuneration and prorated based on the number of months that the Treasury holds its equity or debt position, or is it excluded in its entirety?

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We would be pleased to discuss any questions about our comments at your convenience. Please call me at 212-299-3599 if you have any questions or if we can provide other supporting information.

Very truly yours



Richard L. Alpern

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