Compensation and Benefits Provisions of the Financial Bailout Act

Mental Health Parity; Executive Compensation Limits

The financial bailout bill signed into law by President Bush on October 3, 2008, formally known as the Emergency Economic Stabilization Act (the "Act"), in addition to authorizing the Treasury Department to purchase troubled assets from financial institutions, contains several provisions affecting executive compensation and employee benefits. These provisions include a requirement that health plans provide the same coverage for mental illnesses and substance abuse as for other conditions, limits on the amount of compensation that can be paid to the executives of companies that sell troubled assets to the Treasury, and a number of miscellaneous provisions.

Mental Health Parity

Requirements. In 1997, the Mental Health Parity Act required that group health plans that provide mental health benefits apply the same annual and lifetime dollar limits to mental health benefits as they apply to medical and surgical benefits. The 1997 law contained a sunset provision that would have caused it to expire at the end of 2008. The Act revives the 1997 law and makes it permanent, and also extends the concept of mental health parity by providing that any group health plan (or health insurance coverage offered in connection with such a plan) that provides mental health benefits shall provide:

(a) Coverage for substance use disorders.
(b) That the deductibles, co-payments, co-insurance and out-of-pocket expenses are no more restrictive for mental health or substance use disorder benefits than they are for other medical and surgical benefits covered by the plan.
(c) That the limits on the frequency of treatment, number of visits, days of coverage, or other limits on the scope or duration of treatment with respect to mental health or substance use disorder benefits are no more restrictive than those applied to other medical or surgical benefits covered by the plan.
(d) That if the plan provides coverage for medical or surgical benefits provided by out-of-network providers, coverage shall also be provided for mental health or substance use disorder benefits provided by out-of-network providers.

Who Must Comply. The mental health parity provisions apply to group health plans and health insurance issuers offering coverage in connection with a group health plan for both medical/surgical benefits and mental health or substance use disorder benefits. Nothing in the Act requires a group health plan to provide mental health or substance use disorder benefits, but if such benefits are provided, they must meet the Act's requirements. The mental health benefit requirements do not apply to small employers (in general, those who employed an average of less than 50 employees during the preceding calendar year).

Disclosure. The criteria for medical necessity determinations made under the plan with respect to mental health or substance use disorder benefits shall be made available by the plan administrator (or the health insurance issuer) to any current or potential participant, beneficiary or contracting provider upon request, and in accordance with regulations to be issued by October 3, 2009. In addition, the reason for any denial of reimbursement or payment for services with respect to mental health or substance use disorder benefits shall be made available by the plan administrator (or the health insurance issuer) to the participant or beneficiary upon request and as otherwise required by the regulations. How this will change EOBs is not clear at this time.

Exemption. If the application of the health parity provisions results in an increase in the total costs of coverage with respect to medical and surgical benefits and mental health and substance use disorder benefits under the plan by an amount that exceeds a certain percentage (i.e., 2 percent in the case of the first plan year in which this provision is applied, and 1 percent in the case of each subsequent plan year), then the health parity provisions will not apply to such plan during the following plan year. The determination as to increases in costs under a plan must be made and certified by a licensed actuary. Note that if a group health plan (or a health insurance issuer offering coverage in connection with a group health plan) seeks an exemption, a determination as to increase in costs must be made after such plan has complied with the provision for the first six (6) months of the plan year involved.

Effective Date. The original 1997 Mental Health Parity Act, which would have expired on December 31, 2008, is revived and made permanent. The expanded requirements of the Act are effective for plan years beginning after October 3, 2009. For a calendar year plan, the effective date would be January 1, 2010. In the case of a plan maintained pursuant to a collective bargaining agreement, the requirements shall not apply to plan years beginning before the date the collective bargaining agreement terminates (determined without regard to any extension thereof).

Employer Action. Employers must decide whether to provide coverage for mental health and substance abuse going forward. Then, plan documents, summary plan descriptions and other employee communications must be reviewed and revised appropriately. In addition, contracts with insurers, third party administrators, and network providers will need to be reviewed and updated. Finally, claims procedures for all group health plans must be reviewed and revised to reflect the new disclosure requirements.

Limits on Executive Compensation for Companies Selling Troubled Assets

As described in more detail in our prior Management Alert, *Executive Summary of the Emergency Economic Stabilization Act*, the centerpiece of the Act is the establishment of the Troubled Assets Relief Program (TARP), which permits the Secretary of the Treasury to purchase "troubled assets" from financial institutions through December 31, 2009 (subject to extension until October 3, 2010).

Those financial institutions selling assets under TARP are subject to limitations on executive compensation that vary depending on whether the Treasury purchases troubled assets directly or through an auction. A high-level summary of applicable limitations is set forth in the chart below. Many of these limitations are stated in the Act only in general terms, and will require additional guidance from the Treasury Department. On October 14, the Treasury Department announced that it was issuing guidance on the executive compensation limits, but the details of the guidance are not yet available.

While these limitations apply only to financial institutions that sell troubled assets to the Treasury, two factors should be kept in mind:

- For purposes of the new golden parachute and deductibility limitations, the "controlled group" aggregation rules of Code Section 414 apply. Thus, a company may be subject to these limitations solely because it is under common ownership with a financial institution that sells troubled assets.

- The term "financial institution" is very broadly defined. One issue that is not yet clear is whether a pension plan itself may be a "financial institution" that may sell its troubled assets to the Treasury, and, if so, what the effect will be on the compensation of the executives of the company sponsoring the plan.

Direct Purchases	
"Direct Purchase" Description	• Applies to financial institution that sells any amount of troubled assets directly to the Treasury where no bidding process or market prices are available. "Troubled assets" for this purpose may include debt or equity securities issued by the financial institution in exchange for investment by the Treasury. • Only applies if the Treasury receives "meaningful" equity or debt position in the institution. • Compensation restrictions are effective for duration of period that the Treasury holds an equity or debt position in the institution.
Applies to "Senior Executive Officers"	• Senior executive officers of a public company are the CEO, CFO and three other most highly paid executives of a public company whose compensation must be disclosed in the company's proxy. • Senior executive officers of a non-public company are those who hold positions analogous to the proxy officers of a public company.
No "Risky" Incentives	Limitation on compensation programs that include incentives for senior executive officers to take "unnecessary and excessive risks" that threaten the institution's value.
No Golden Parachute Payments	Prohibition against golden parachute payments to senior executive officers.
Clawback	Mandatory recovery of any bonus or incentive compensation paid to senior executive officers based on materially inaccurate statements of earnings, gains or other criteria.

Auction Purchases	
"Auction Purchase" Description	• Applies to a financial institution that sells troubled assets to the Treasury in an auction. • Compensation restrictions apply only where the sales by the institution exceed $300 million in the aggregate (including sales by controlled group member). Direct sales are counted toward the $300 million threshold, but only if the institution has some auction sales.
No New Golden Parachutes	Prohibition against new employment contracts with senior executive officers that provide golden parachute payments in the event of involuntary termination, bankruptcy, insolvency or receivership while TARP is in effect.
Tax Deduction Limitations under Code §162(m)	• Annual deduction for compensation earned by covered executive capped at $500,000 (rather than normal $1,000,000 cap). • No exception for qualified performance-based compensation. • Applicable to public and non-public financial institutions, and not limited to corporations. • Applicable to compensation earned for an applicable year and paid in subsequent year (even after TARP has ended). • "Covered executive" includes the CEO, CFO and the three highest compensated officers determined based on application of SEC proxy disclosure rules (whether company is public or private). • Limitation applies even after employees are no longer covered executives, as long as either TARP is in effect or deferred compensation earned while a covered executive is payable.
Golden Parachute Rules under Code §280G	• No deduction for golden parachute payments to covered executives related to involuntary termination, bankruptcy, insolvency or receivership while TARP is in effect. • Not limited to payments after a change in control. • No exemption for payments approved by shareholders of privately held company. • Executive also subject to the 20% excise tax. • Other limits on golden parachutes may preclude gross-up.

Other Compensation and Benefits Provisions of the Act

In addition to the mental parity rules and limits on compensation for executives of companies participating in the TARP program, the Act contains a number of miscellaneous compensation and benefits provisions, including:

- Effective January 1, 2009, qualified bicycle commuting reimbursements are added to transit passes and parking reimbursements as transportation fringe benefits that are excludable from income. Qualified bicycle commuting reimbursements may include expenses incurred by the purchase, repair, and storage of a bicycle. The limit on reimbursements is $20 for each month during which the employee uses the bicycle for commuting, and the employee may not receive any other transportation fringe benefit in the same month.

- Deferred compensation paid by foreign companies whose income is not subject to US income tax or a "comprehensive" foreign income tax is subject to tax when it vests. The same rules apply to compensation paid by partnerships of foreign or tax-exempt entities. These rules are contained in new Code §457A, and are similar to the rules applicable to deferred compensation paid by tax-exempt employers under §457, but without any exception analogous to the exception that applies to §457(b) plans.

- The rule allowing an IRA to make tax-free distributions directly to a charity, previously scheduled to expire at the end of 2007, was extended through 2009.

If you have any questions about the benefits and compensation aspects of the Act, the significance of the current financial crisis for your company's benefit plans, or any other employee benefit or executive compensation matter, please contact your Seyfarth Shaw attorney or any other Seyfarth Shaw attorney on our website (www.seyfarth.com/EmployeeBenefits).

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