



## CLIENT ALERT

### TARP SPECIAL MASTER TO REVIEW PAST COMPENSATION PAYMENTS

March 29, 2010

#### Data Request for All Institutions Receiving TARP Funds Prior to February 17, 2009

On March 23, 2010, the Special Master for TARP Executive Compensation issued formal requests for compensation data and certifications from over four hundred institutions that received financial assistance under the Troubled Asset Relief Program (“TARP”) prior to February 17, 2009. The data will be used by the Special Master to review all bonuses, retention awards and other compensation paid to the senior executive officers (“SEOs”) and the next 20 most-highly compensated employees (“MHCEs”) (collectively referred to as the “Covered Employees”) during the period beginning with the date the TARP recipient first received financial assistance and ending February 17, 2009 (“Review Period”).

#### Significant Points

Highlights of the Special Master’s review of past compensation payments are:

- The review is applicable to all institutions that received TARP assistance prior to February 17, 2009, regardless of whether (or when) the institution has repaid their TARP funds.
- Institutions first receiving TARP assistance on or after February 17, 2009 are not included in the review.
- Institutions must confirm receipt of the Special Master’s data request not later than April 6, 2010.
- Required data and certification must be submitted to the Special Master not later than April 22, 2010.
- Institutions are not required to submit compensation data for Covered Employees with annual compensation (as defined) of \$500,000 or less (“Excluded Employees”). Note that this exclusion does not relieve the certification requirement even if no Covered Employees had annual compensation greater than \$500,000 in any of the applicable fiscal years.
- Institutions that held TARP funds during two fiscal years spanning the review period prior to February 17, 2009 must compile separate lists of Covered Employees for each of the two fiscal years.
- Institutions must submit compensation data for all fiscal years under review for individuals that are Covered Employees in either or both of the fiscal years unless the individual is an Excluded Employee in all fiscal years under review.

Some specific compensation elements must be calculated differently under the instructions, depending on the purpose for which they are used in the review submission. For instance, in the calculation of “Annual Compensation” for purposes of determining Covered Employees, the value of stock-based awards are based on the annual cost recognized for financial reporting purposes for fiscal years ending prior to December 20, 2009. The value of stock-based awards for purposes of determining Excluded Employees (annual compensation equal to or less than \$500,000) must be based on the grant-date fair value for all fiscal years<sup>1</sup>. Stock-based awards, regardless of the fiscal year in which they were made, must be reported at grant-date fair value in the payments tab of the Compensation Review Data Request Form.

<sup>1</sup> In response to Amalfi Consulting inquiries, Treasury confirmed in a telephone conversation on Monday, March 29, 2010, that grant-date fair value is the appropriate method to use for equity-based awards in the calculation of Annual Compensation used to determine which, if any, Covered Employees meet the \$500,000 threshold test to be excluded from the required disclosures. Treasury indicated that it will be issuing a Q&A clarifying this point in a matter of days.

## Determination of Covered Employees

The first step in the review is the identification of the Covered Employees (SEOs and the next 20 MHCEs) for each of the fiscal years, any portion of which fall within the Review Period (the period beginning with the date the TARP recipient first received TARP funds and ending on February 17, 2009).

- If the Review Period falls within one fiscal year, Covered Employees only need to be identified for that fiscal year. If the Review Period spans two fiscal years, Covered Employees need to be identified for each of those two fiscal years. For example:
  - A TARP recipient has a calendar fiscal year and first received TARP funds on January 6, 2009 and no repayment occurred prior to February 17, 2009. The Review Period falls completely within the 2009 fiscal year and Covered Employees must be identified only for that fiscal year.
  - Same facts as above except that TARP funds were first received on December 29, 2008. The Review Period spans fiscal years 2008 and 2009. Covered Employees must be identified separately for each fiscal year.
  - TARP recipient has a calendar fiscal year and first received TARP funds on January 6, 2009 and repaid the TARP funds on February 13, 2009. The Review Period falls completely within the 2009 fiscal year and Covered Employees must be identified for that fiscal year even though the TARP funds were fully repaid prior to the end of the Review Period.
- Since Covered Employees may differ from year to year, a total of more than 25 employees may be identified as Covered Employees between the two lists when the Review Period spans two fiscal years. Therefore, compensation data may need to be provided for more than 25 employees (see below).
- Covered Employees are determined in accordance with the instructions included in Section 30.3 of the June 15, 2009 Interim Final Rule on TARP Standards for Compensation and Corporate Governance (“IFR”).
  - SEOs for a fiscal year are the institution’s named executive officers (NEOs) who are employees and are identified in the company’s annual report on Form 10-K or annual meeting proxy statement that report the NEOs’ compensation for the immediately preceding year. The NEOs are generally defined as the principal executive officer (usually the CEO), principal financial officer (usually the CFO) and the next three most highly compensated executive officers. These employees are considered the SEOs for the entire fiscal year. (Example: SEOs for calendar fiscal year 2009 are the NEOs identified in the 2009 Form 10-K or proxy in which the NEOs’ compensation for fiscal year 2008 is reported.) A TARP recipient that does not have securities registered with the SEC pursuant to Federal securities laws must follow analogous rules in determining its SEOs. The specific rules for determining the NEOs are set forth in Item 402(a) of Regulation S-K under the federal securities law (17 CFR 229.402(a)).
  - The next 20 MHCEs for a fiscal year are identified by looking back to the Annual Compensation for the immediately preceding fiscal year, without regard to whether the compensation is includible in the employee’s gross income for Federal income tax purposes. (Example: MHCEs for calendar fiscal year 2009 are identified by the Annual Compensation earned by the employees in fiscal year 2008.) Note that MHCEs are not limited to executive officers but may be any employee of the TARP recipient, based solely on Annual Compensation.
  - Annual Compensation means the dollar value for total compensation for the applicable fiscal year as determined pursuant to Item 402(a) of Regulation S-K under the federal securities laws (17 CFR 229.402(a)), not including actuarial increases in pension plans and above market earnings on deferred compensation. A TARP recipient that does not have securities registered with the SEC pursuant to Federal

securities laws must still follow this definition of Annual Compensation. Note that the definition of Annual Compensation refers to Item 402(a) of Regulation S-K which was amended for fiscal years ending on or after December 20, 2009 (referred to herein as the “new rule”). Under the old rule, stock and option awards were reported at the value recognized as expense for the fiscal year for financial reporting purposes. Under the new rule, stock and option awards are reported at the full grant-date fair value in the year granted. For purposes of determining Covered Employees, Annual Compensation will always be calculated under the old rule because the Review Period ends on February 17, 2009 and since the MHCEs are identified by looking back to Annual Compensation for the immediately preceding fiscal year, the latest fiscal year for which Annual Compensation is calculated for the purpose of identifying Covered Employees would end prior to the implementation of the new rule.

- ✓ Example: TARP recipient has a January 31 fiscal year end and received TARP funds on February 1, 2009. The Review Period falls within fiscal year 2010, ending January 31, 2010. MHCEs for fiscal year 2010 are identified by looking back to Annual Compensation for fiscal year 2009, ending on January 31, 2009. Since the new rule for determining Annual Compensation is applicable for fiscal years ending on or after December 20, 2009, the old rule applies for purposes of calculating fiscal 2009 Annual Compensation used to identify fiscal year 2010 MHCEs.

## Determination of Excluded Employees

Once the institution has identified the Covered Employees for each of the fiscal years, any part of which falls within the Review Period, the next step is to identify Excluded Employees, if any. Excluded Employees are those Covered Employees that earned Annual Compensation of \$500,000 or less *in each fiscal year* within the Review Period.

- Annual Compensation means the dollar value for total compensation for the applicable fiscal year as determined pursuant to Item 402(a) of Regulation S-K under the federal securities laws (17 CFR 229.402(a)), not including actuarial increases in pension plans and above market earnings on deferred compensation. For purposes of determining Excluded Employees, stock-based awards included in Annual Compensation for all fiscal years must be valued at grant-date fair value. A TARP recipient that does not have securities registered with the SEC pursuant to Federal securities laws must still follow this definition of Annual Compensation. However, Annual Compensation for purposes of determining which employees may be excluded is the Annual Compensation for the specific fiscal year for which the employee is listed as a Covered Employee. Note that this contrasts with the look back to the previous fiscal year’s Annual Compensation for purposes of identifying Covered Employees as described above.
- Where the Review Period spans two fiscal years, the Covered Employee must have earned \$500,000 or less of Annual Compensation *in both* of the fiscal years to be an Excluded Employee.
  - ✓ Example: TARP recipient has a calendar fiscal year and received TARP funds on November 1, 2008. Employee A is determined to be a Covered Employee for fiscal year 2008 but is not a Covered Employee for fiscal year 2009. Employee A earned Annual Compensation in 2008 of \$450,000 and \$550,000 in 2009. Employee A is not an Excluded Employee because Annual Compensation exceeded \$500,000 in one of the fiscal years (2009), even though Employee was not a Covered Employee in 2009. Compensation data must therefore be reported for the entire Review Period for Employee A.
- Compensation data (see below) are not required and should not be submitted for Excluded Employees.
- It is possible and even anticipated by the Office of the Special Master that some TARP recipients will have no Covered Employees with Annual Compensation in excess of \$500,000 in each of the fiscal years covered by the Review Period.
- A signed certification identifying the number of Covered Employees above the \$500,000 exclusion threshold in any applicable fiscal year must be submitted, even if the number is zero. The certification must be signed by the company’s chief executive officer and either the chairman of the board’s compensation committee or, where a compensation committee is not established, by a member of the board (other than the chief executive officer).

## Compensation Review Data Request Form

The Compensation Review Data Request Form consists of one spreadsheet with three tabs:

- Tab 1: Company Information. The instructions for this tab are self-explanatory and are not elaborated on in the interest of brevity.
- Tab 2: Covered Employees. This tab includes a listing of all the employees determined to be Covered Employees for all of the fiscal years included in the Review Period. While the instructions are relatively self explanatory, there are a number of noteworthy observations.
  - All Covered Employees are identified by name and title with corresponding Annual Compensation data. Data submitted to the Special Master may be disclosed by Treasury to private parties, Congress or numerous other agencies or organizations as described in Section 5 (Freedom of Information Act) and Section 6 (Privacy Statement) of the instructions. Questions about the company’s rights and obligations in this area should be directed to the company’s counsel. The instructions also note that furnishing the requested information is mandatory and “[f]ailure to provide the information will cause the TARP recipient to be adversely affected.”
  - No information should be entered on this tab for Excluded Employees.
  - In a March 29, 2010 telephone conversation in response to Amalfi Consulting inquiries, Treasury noted that the instructions for this tab are unclear and incomplete. Treasury indicated that, in a Q&A expected to be issued in a matter of days, they will clarify the instructions to require Annual Compensation data for Covered Employees for all fiscal years ending in 2007, 2008, 2009 and, if applicable, 2010. This will clarify the instructions from Item 6 through Item 12 and, presumably add a set of 2010 columns to the worksheet in tab 3.
- Tab 3: Payments to Covered Employees. Detailed compensation data must be entered in this tab for each Covered Employee listed in Tab 2. The instructions are relatively self-explanatory, but there items of note that are worthy of comment.
  - No data should be provided in this tab for Excluded Employees.
  - Information must be provided for each payment made during the entire Review Period for each Covered Employee, even if the employee was not a Covered Employee for the entire Review Period.
    - ✓ Example: TARP recipient has a calendar fiscal year, received TARP funds on December 1, 2008 and did not repay the TARP funds prior to February 17, 2009. Employee B was a Covered Employee in fiscal year 2008 but was not a Covered Employee in fiscal year 2009. Information for each payment made to Employee B during the Review Period from December 1, 2008 to February 17, 2009 must be entered in this tab.
  - Payments include every payment of compensation or right to future compensation delivered or granted to a Covered Employee during the Review Period. This includes the delivery of cash or stock, awards of restricted stock or stock options, grants under cash-based incentive plans, severance packages resulting from termination, acceleration of vesting and deferrals or other promises to pay (such as credits to supplemental executive retirement plans). Note that this requirement to list each form of compensation is more expansive than the definition of Annual Compensation used for determining who the Covered Employees are.
  - Each row should represent a single payment or award. Since “payments” includes individual salary payments, each Covered Employee may require many rows, depending upon the length of the Review Period and payroll frequency.

- Payments are categorized as follows:
  - ✓ Salary payments includes salary payments for services performed made in cash or other forms on a regular bi-weekly, monthly, annual or similar periodic rate.
  - ✓ Incentive payments refer to bonus payments defined in Section 30.1 of the IFR and include all bonuses, stock awards, option awards, non-equity incentive awards and equity awards. Additional examples listed include cash payment or deferral of an amount earned under an annual or longer-term incentive plan, vesting of previously granted equity awards, grants of equity- or cash-based incentives (whether or not requiring future service or performance), and entry into an agreement providing a legally binding right to a fixed or minimum payment in the future (such as a retention agreement or bonus guarantee).
  - ✓ Severance payments refer to golden parachute payments to a Covered Employee for departure from the company for any reason (other than death or disability) or any payment upon a change in control (other than for services performed or benefits already accrued). This includes payments that were actually made during the Review Period and payments that were triggered by a termination of employment during the Review Period (to be made at a later date).
  - ✓ Nonqualified Deferred Compensation (“NQDC”) payments include any amount accrued, credited to or set aside for or amounts paid to a Covered Employee under a deferred compensation plan. (Salary, incentive or severance payments earned, vested or triggered during the Review Period but deferred should be included in under the relevant Salary, Incentive or Severance payment categories, not under NQDC.)
  - ✓ Other payments include perquisites as defined in the IFR. Note that credits or contributions to any qualified retirement plan, benefits under broad-based employee benefit plans (group health, life, disability) and bona fide expense reimbursements are excluded from the data request.
- Grants of equity-based awards during the Review Period should be recorded at their aggregate grant-date fair value. Note that this valuation treatment is for all equity-based awards made in the Review Period, regardless of the fiscal year in which they occurred. This differs from the valuation treatment used for determining Annual Compensation used to identify Covered Employees as described above.
- Grants of cash-based awards during the Review Period should be recorded at their target value, unless they have a guaranteed minimum amount, in which case that amount should be used.

## ABOUT AMALFI CONSULTING, LLC

Amalfi Consulting, LLC is an independent consultancy which has been providing compensation consulting solutions for more than a decade. Our focus is banks and other financial institutions.

Amalfi has served over 400 banks on a national basis from de novo to large publicly-traded organizations. In addition to a full array of compensation services, we also offer board governance consulting. Our principal consultants are hands-on, personally and actively involved in every step of the consulting process.

## CONTACTING AMALFI CONSULTING, LLC

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