



CLIENT ALERT

NEW SEC PROXY DISCLOSURE RULES AND TARP TECHNICAL CORRECTIONS

December 29, 2009

SEC Proxy Disclosure Rules

On December 16, 2009, the Securities and Exchange Commission (SEC) released final amendments to its reporting rules for proxy solicitations and other reports filed with the SEC. The new reporting rules require registrants to make new or revised disclosures about compensation policies and practices that present material adverse risks to the company, stock and option awards to executives and directors, director qualifications and legal proceedings, board leadership structure, the board's role in risk oversight and potential conflicts of interest of compensation consultants that advise companies and their boards. In addition, the disclosure of shareholder voting results has been moved from Forms 10-Q and 10-K to Form 8-K.

The new rules will be applicable to proxy and information statements, annual reports and registration statements under the Securities Exchange Act of 1934 and registrations statements under the Securities Act of 1933 as well as the Investment Company Act of 1940. The effective date is February 28, 2010.

Technical Corrections to TARP Standards for Compensation and Corporate Governance

On November 30, 2009, the Treasury announced a number of technical corrections to its June 15, 2009 Interim Final Rule (IFR) TARP Standards for Compensation and Corporate Governance. The corrections include a revision to the definition of Most Highly Compensated Employee (MHCE), a clarification of the period of applicability for the requirements of Section 111(c) (relating to the establishment and maintenance of an independent compensation committee and that committee's review of employee compensation plans and the establishment of a company-wide excessive and luxury expenditures policy), a clarification that the requirement to permit a shareholder vote to approve certain executive compensation is not applicable to TARP recipients not required to register any securities with the SEC, and a clarification that the certifications provided by the Principal Executive Officer (PEO) and the Principal Financial Officer (PFO) including the list of the names of the CEOs and the twenty next MHCEs only needs to be provided to the Treasury.

This Client Alert summarizes the new SEC rules and the TARP technical corrections.

New SEC Disclosure Rules

Narrative Disclosure of Compensation Policies and Practices as They Relate to Risk Management

Item 402 of Regulation S-K is amended to require disclosure regarding how the company's overall compensation policies for employees create incentives that can affect the company's risk and management of that risk and to revise the disclosures in the Summary Compensation Table. The company must provide a narrative disclosure of its compensation policies and practices for all employees (including non-executive officers) if those policies and practices create risks that are "reasonably likely to have a material adverse effect" on the company.

The "reasonably likely" threshold is the same threshold used in the Management Discussion and Analysis in which risk-oriented disclosures of material known trends and uncertainties are required to be disclosed.

By limiting disclosures to those that are reasonably likely to have an adverse effect, the Commission believes the final rule will avoid voluminous and unnecessary discussion of arrangements that may mitigate inappropriate risk-taking incentives. The Commission specifically notes that if a company has compensation policies and practices that mitigate or balance incentives, these mitigating factors can be considered in deciding whether risks arising from compensation policies and practices are reasonably likely to have a material adverse effect. The Commission also notes that the “adverse” qualifier will eliminate the need for disclosure of well-designed compensation policies could have a material positive effect on the company.

This new disclosure is to be made as a separate compensation disclosure (see Item 402(s) of Regulation S-K) instead of as part of the company’s Compensation Discussion and Analysis as was originally proposed.

Keeping in mind that each company’s disclosure will be dependent on its own unique business and compensation approach, the rules include a non-exclusive list of examples of the issues a company may need to address:

- The general design philosophy of the compensation policies and practices for employees whose behavior would be most affected by the incentives established by the policies and practices, as such policies and practices relate to or affect risk taking by employees and the manner of their implementation.
- The company’s risk assessment or incentive considerations, if any, in structuring its compensation policies and practices or in awarding and paying compensation.
- How the company compensation policies and practices relate to the realization of risks resulting from the actions of employees in both the short-term and the long-term, such as through policies requiring claw backs or imposing holding periods.
- The company’s policies regarding adjustments to its compensation policies and practices to address changes in its risk profile.
- Material adjustment the company has made to its compensation policies and practices as a result of changes in its risk profile.
- The extent to which the company monitors its compensation policies and practices to determine whether its risk management objectives are being met with respect to incentivizing its employees.

In its discussion of this new disclosure requirement the Commission also offers a non-exclusive list of situations that could trigger discussion. It includes discussion of compensation policies and practices:

- At a business unit of the company that carries a significant portion of the company’s risk profile
- At a business unit with compensation structured significantly differently than other units within the company
- At a business unit that is significantly more profitable than others within the company
- At a business unit where the compensation expense is a significant percentage of the unit’s revenues
- That vary significantly from the overall risk and reward structure of the company, such as when bonuses are awarded upon accomplishment of a task, while the income and risk to the company from the task extend over a significantly longer period of time

Smaller reporting companies will not be required to provide this new disclosure as they are considered less likely to have the types of compensation policies and practices intended to be addressed by the new rules.

A company that determines that the risks arising from its compensation policies and practices are not reasonably likely to have a material adverse effect on the company are not required to affirmatively state that.

Revisions to the Reporting of Equity Based Awards

Under the new rules, stock and option awards will be disclosed in the Summary Compensation Table and Director Compensation Table at their aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (formerly FAS 123R).

Notwithstanding the general effective date of February 28, 2010, this revised disclosure requirement is effective for companies with fiscal years ending on or after December 20, 2009. Included is the requirement to present recomputed disclosure for each preceding fiscal year required to be included in the Summary Compensation Table and the Director Compensation Table. The stock and option awards column amounts for each year presented must be disclosed at full grant date fair values and the total compensation column must also be recomputed accordingly.

It is important to note that the disclosure is required for the year in which the stock or option award is granted, not for the year in which services are provided for which awards are later granted.

The value of performance based awards should be computed based on the probable outcome of performance conditions as of the grant date. If the maximum potential value of an award is greater than the value based on the probable outcome, footnote disclosure of the maximum potential value is required in the Summary Compensation Table and the Director Compensation Table.

If a person who would be a named executive officer (NEO) for the most recent fiscal year (2009) also was disclosed as an NEO for 2007, but not for 2008, the NEO's compensation for each of those three fiscal years must be reported under the new rules.

Companies are not required to include different NEOs for any preceding fiscal year based on re-computing total compensation for those years under the revised calculations.

In certain circumstances, the revised computation of stock and option awards may result in the omission of an executive that otherwise would have been disclosed in the Summary Compensation Table. The Commission notes that in those circumstances where a large one-time multi-year award displaces an NEO that would otherwise have been subject to reporting, the company can consider including compensation disclosure for that executive officer to supplement the required disclosures.

Under the final rules the full grant date fair value of each equity award is to be disclosed in the Summary Compensation Table, Grants of Plan-Based Awards Table and the Director Compensation Table. (The proposed rules had included a provision to rescind this required disclosure for the Grants of Plan-Based Awards Table and the Director Compensation Table.)

Enhanced Director and Nominee Disclosure

Item 401 of Regulation S-K is amended to require expanded disclosure regarding directors and nominees.

- Disclosure Requirements Regarding Director and Nominee Qualifications

Companies must disclose for each director and any nominee for director the particular experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director as of the time that the filing is made with the Commission. If material, the disclosure should cover more than the past five years.

This new disclosure is required to be made annually and must be made for all nominees and for all directors, including those not up for reelection.

The final rules do not require disclosure of specific experience, qualifications or skills that qualify a person to serve as a committee member as was originally proposed. However, if an individual is chosen to be a director or nominee to the board because of specific qualifications, attributes or experience related to service on a specific

committee, those should be disclosed under the new requirements as part of the individual's qualifications to serve on the board.

Specific information to be disclosed is not set forth in the final rules but is left to the discretion of the company.

- Disclosure of Directorships

Companies must disclose any directorships of public companies or registered investment companies held by each director and nominee at any time in the past five years, even if the director or nominee no longer serves on that board.

- Disclosure of Legal Proceedings

Under the new rules the time period during which legal proceedings involving directors, nominees and executive officers must be disclosed is lengthened from five to ten years.

In addition, the new rules add additional legal proceedings to the present list requiring disclosure, as follows:

- Any judicial or administrative proceedings resulting from involvement in mail or wire fraud or fraud in connection with any business entity
- Any judicial or administrative proceedings based on violations of federal or state securities, commodities, banking or insurance laws and regulations, or any settlement to such actions
- Any disciplinary sanctions or orders imposed by a stock, commodities or derivatives exchange or other self-regulatory organization

- Disclosure Regarding Diversity

Item 407(c) of Regulation S-K is amended to require disclosure of whether, and if so how, a nominating committee considers diversity in identifying nominees for director.

If the board or nominating committee has a policy regarding the consideration of diversity in identifying director nominees, disclosure is required of how this policy is implemented and how the board or committee assesses the effectiveness of the policy.

The amendment does not define diversity and notes that companies should be allowed to define diversity in ways that they consider appropriate. It notes that the concept of diversity might include differences of viewpoint, professional experience, education, skill and other individual qualities or it may be focused on attributes such as race, gender or national origin.

New Disclosure about Board Leadership Structure and the Board's Role in Risk Oversight

Item 407 of Regulation S-K is amended to require disclosure of a company's board leadership structure and the board's role in risk oversight.

- Disclosure of Board Leadership Structure

A company is required to disclose whether it has chosen to combine or separate the principal executive officer and board chairman positions and why it so chose. The disclosure should include a discussion of the reasons the company believes that this structure is the most appropriate one for the company at the time of filing.

If the company has a combined position of board chair and principal executive officer (CEO) and a separate lead independent director is designated to chair meetings of the independent directors, the company must disclose why the company has such a lead independent director and describe the specific role the lead independent director plays in the leadership of the company.

- Boards Role in Risk Oversight

Companies must describe the board's role in the oversight of risk. The rules note that companies face a variety of risks, including credit risk, liquidity risk and operation risk and disclosure of the board's role in overseeing risk management will provide important information to investors about how the company perceives the role of its board and the relationship between the board and senior management in managing material risks.

The rules afford companies flexibility in describing how the board conducts its risk oversight function. The Commission suggests that the description may include whether oversight is through the whole board, through a separate risk committee or the audit committee. The company may also address whether individuals who supervise day-to-day risk management responsibilities report directly to the board as a whole, to a board committee or how the board or committee otherwise receives information from such individuals.

New Disclosure Regarding Compensation Consultants

Item 407 of Regulation S-K is amended to require disclosure about fees paid to compensation consultants or their affiliates under certain circumstances. This amendment adds to the current rule that requires description of the role of the compensation consultant in determining or recommending the amount or form of executive and director compensation.

- **Disclosure Required if the Board's Compensation Consultant Provides Additional Services to the Company**

If the board engages a compensation consultant to advise the board on executive and director compensation and if such consultant (or its affiliate) provides other non-executive compensation consulting services to the company and the fees for the non-executive compensation consulting services exceed \$120,000 during the company's fiscal year, disclosure of fees paid to the consultant is required.

The disclosures must include:

- The aggregate amount of fees paid for services provided to the board or the company for with regard to determining or recommending the amount or form of executive and director compensation
- The aggregate amount of fees paid for any non-executive compensation consulting services provided by the compensation consultant (or its affiliate)
- Whether the decision to engage the compensation consultant or its affiliate for the non-executive compensation consulting services was made or recommended by management and whether the board approved such other services

- **Disclosure Required if the Board Does Not Have a Compensation Consultant, But the Company Receives Executive Compensation and Non-Executive Compensation Services from Its Consultant**

If the board does not engage a compensation consultant, but management receives executive compensation consulting services and other non-executive compensation consulting services from a consultant (or its affiliate) and the fees for the non-executive compensation consulting services exceed \$120,000 during the company's fiscal year, disclosure of fees paid to the consultant is required.

The disclosures must include:

- The aggregate amount of fees paid for services provided to the board or the company for with regard to determining or recommending the amount or form of executive and director compensation
- The aggregate amount of fees paid for any non-executive compensation consulting services provided by the compensation consultant (or its affiliate)

- **Disclosure Not Required if the Board and Management Have Different Compensation Consultants**

If the board engages a compensation consultant to advise it on executive or director compensation and management engages a separate consultant to provide executive compensation consulting services, no disclosure

of fees paid to compensation consultants is required even if the consultant engaged by management provides other non-executive compensation consulting services.

This exception is available without regard to whether the management's consultant participates in board meetings.

Note that if the board's compensation consultant provides additional non-executive compensation consulting services to the company at or above the threshold of \$120,000 in the company's fiscal year, fee and related disclosures are required as described above.

- **Exceptions to the Disclosure Requirement for Consulting on Broad-based Plans and Provision of Survey Information**

No disclosures are required when the compensation consultant's only role in recommending the amount or form of executive or director compensation is:

- Consulting on broad-based plans that do not discriminate in favor of executive officers or directors
- Limited to providing information, such as surveys, that either is not customized for a particular company or this is customized based on parameters that are not developed by the compensation consultant. This exception is not available if the compensation consultant provides advice or recommendations in connection with the information provided in the survey.

Reporting of Voting Results on Form 8-K

New Item 5.07 to Form 8-K requires companies to disclose on Form 8-K the results of a shareholder vote and to have that information filed within four business days after the end of the meeting at which the vote is held. Such disclosure will no longer be included in Forms 10-K or 10-Q.

When contested elections take longer of periods of time to determine definitive voting results, companies are required to file the preliminary voting results within four business days after the end of the shareholders' meeting and then file an amended report on Form 8-K within four business days after the final voting results are known.

SEC Proxy Transition Rules

The effective date of the new rules is February 28, 2010. The SEC staff issued clarification of the effective date and transition to the new rules on December 22, 2009, as follows:

- **Companies with Fiscal Years Ending on or after December 20, 2009**
 - Forms 10-K and proxy statements must be in compliance with the new proxy disclosure requirements if they are filed on or after February 28, 2010.
 - If the company is required to file a preliminary proxy statement and expects to file its definitive proxy statement on or after February 28, 2010, the preliminary proxy statement must be in compliance with the new rules even if it is filed prior to February 28, 2010.
 - If the company files its 2009 Form 10-K before February 28, 2010 and its proxy statement on or after February 28, 2010, the proxy statement must be in compliance with the new rules.
- **Voluntary Early Compliance**

If a company is not required to comply with the new rules for its 2009 Form 10-K and related proxy statement, it may do so on a voluntary and discretionary basis subject to the following:

- If a company adopts the new rules for the Summary Compensation Table and the Director Compensation Table, it must also comply with all of the other new rules.

- A company may adopt any of the other new rules (other than the Summary Compensation Table and Director Compensation Table amendments) without having to comply with all of the new requirements.
 - Form 8-K Filing Required for Shareholder Vote
- The requirement to comply with the new rule requiring the result of a shareholder vote to be reported on Form 8-K is dependent upon the date of the shareholder meeting at which the vote is taken.
- Any shareholder meeting that takes place on or after February 28, 2010 is subject to the new Form 8-K filing requirement.
 - Any shareholder meeting that takes place prior to February 28, 2010 is not subject to the new Form 8-K filing requirement.

TARP Technical Corrections

On June 15, 2009, Treasury published an interim final rule implementing certain provisions of Section 111 of the Emergency Economic Stabilization Act of 2008, as amended (EESA) that directs Treasury to establish executive compensation and corporate governance standards for entities receiving financial assistance under the TARP. On November 30, 2009, Treasury released technical corrections to correct four errors in the IFR.

Definition of Most Highly Compensated Employee

As written, the IFR definition of Most Highly Compensated Employee (MHCE) excluded the Senior Executive Officers (SEOs). When applied literally with respect to the bonus limitations in Sections 30.10(b)(i) and (ii), the definition would have the effect of exempting SEOs from the bonus limitations applicable to certain MHCEs for recipients receiving less than \$25 million and from \$25 million to \$250 million in TARP assistance.

The correction restates the MHCE definition to mean the employee or employees of the TARP recipient whose annual compensation is determined to be the highest among all employees of the TARP recipient with an important exception. In the situation where the bonus limitation applies to both SEOs and MHCEs, then the SEOs of the TARP recipient are excluded when identifying the MHCE(s).

For example: If a company received less than \$250 million in assistance where the bonus limitation is only applicable to the MHCE, then the MHCE is subject to the provision regardless of whether the employee is also a SEO. If, however, a company received more than \$250 million in assistance where the bonus limitation is applicable to both the SEOs and a certain number of the MHCEs, then the SEOs are excluded for purposes of determining the MHCEs as they are already subject to the provision by virtue of being a SEO.

Clarifying the Period of Applicability for Section 30.2

Section 30.2 of the IFR provides that the requirements of EESA Section 111(c) (relating to the establishment and maintenance of an independent compensation committee and that committee's review of employee compensation plans, as well as the establishment of a company-wide excessive and luxury expenditures policy) apply through the later of the last day of the TARP period for recipients with an obligation or through the last day of the recipient's fiscal year including the sunset date for recipients that never had an obligation.

Since only one of these dates can be applicable to any specific TARP recipient, the later of language may render the provision confusing. Section 30.2 is therefore amended to remove the "later of" language.

Clarifying the Requirement for Shareholder Vote

Section 30.13 of the IFR relating to the requirement to permit a shareholder vote to approve certain executive compensation is clarified to provide that TARP recipients must comply with the rules and regulations promulgated by the SEC with respect to that requirement, but only to the extent the rules and regulations are applicable to the TARP

recipients. Therefore, a TARP recipient that does not register any securities with the SEC (a non-public entity) is not required to permit such a shareholder vote.

Revision to Certifications to Exclude List of SEOs and Twenty Next MHCEs

Section 30.15 of the IFR relating to certain certifications that the principal executive officer and the principal financial officer must provide, is revised to provide that the certification must state that the TARP recipient has provided the Treasury Department a complete and accurate list of the SEOs and the twenty next MHCEs for the current fiscal year, with the non-SEOs ranked in descending order of level of annual compensation. The IFR as originally written required the names of the SEOs and twenty next MHCEs to be included in the certification; which for SEC filing companies would be in the publicly filed 10-K filing.

The model certification in Section 30.15 is also corrected to properly reflect the deadlines set forth elsewhere in the regulation and to correct certain cross-references.

ABOUT AMALFI CONSULTING, LLC

Amalfi Consulting, LLC (formerly the Compensation Group of Clark Consulting), has been providing bank compensation consulting solutions to clients for over a decade. Our consulting focus is on the financial services industry, primarily banking and other financial institutions.

Amalfi has served over 400 clients on a national basis through our 15 full time professionals located in Minneapolis, Dallas, and Boston. Amalfi is focused on solving today's bank compensation issues. Our full array of compensation services aims to serve clients from start-up organizations to those that are publicly traded. Amalfi Consulting is truly independent. The owners are also employees of Amalfi Consulting, working with our clients each and every day.

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