



AMALFI
CONSULTING, LLC

VEDDER PRICE®

TARP & Executive Compensation: A Regulatory Update

June 19, 2009

Todd Leone

President & Founder

todd.leone@amalficonsulting.com

(952)893-6711

Tom Desmond

Managing Shareholder

tdesmond@vedderprice.com

(312)609-7647

Webinar Agenda



- ★ There are three areas of discussion today all related to regulatory announcements on June 10th:
 - Treasury “statement of principles” on compensation
 - SEC announcements on pending proxy revisions
 - TARP regulations
- ★ We will have an additional webinar on July 16th to cover the TARP regulations in additional detail.

Treasury Principles on Compensation



Treasury Statement of Principles

- ★ On June 10, Treasury announced a number of principles on compensation that may potentially apply to many institutions
 - <http://www.ustreas.gov/press/releases/tg163.htm>

- ★ There were five areas of principles that were discussed:
 - Compensation plans should properly measure and reward performance.
 - Compensation should be structured to account for the time horizon of risks.
 - Compensation practices should be aligned with sound risk management.
 - Treasury will reexamine whether golden parachutes and supplemental retirement packages align the interests of executives and shareholders.
 - Treasury will promote transparency and accountability in the process of setting compensation.

- ★ Applicability
 - To be determined how far these guidelines will apply
 - Clearly beyond “just banks”; however, does this apply to all companies? Only public companies?

Treasury Statement of Principles

- ★ Discussed two items that will be pursued through legislation:
 - Say-on-Pay for all SEC filing institutions (public companies)
 - Compensation committee independence

- ★ Say-on-Pay Vote
 - A non-binding vote on executive compensation
 - Similar to what exists for TARP participants presently

- ★ Compensation committee independence
 - This will be similar to what Sarbanes-Oxley did for audit committee
 - Consistent theme is that independent advisors should be working for the compensation committee with committee's ability to hire/fire

The background features a blue-to-white gradient on the left side, transitioning into a white area on the right. A large, faint compass rose is centered on the right side, with the letters 'P', 'R', 'O', and 'S' visible on its points. A horizontal brown band is positioned across the middle of the image, containing the title text.

SEC Announcements on Pending Proxy Revisions

SEC Announcements on Pending Proxy Revisions

- ★ Mary Schapiro announced on June 10 the following items with respect to executive compensation
 - The SEC's role is not to set pay scales or cap compensation
 - The SEC is actively considering a package of new proxy disclosure rules that will provide further sunshine on compensation decisions.

- ★ Several proposals being considered would require disclosure about:
 - how a company, and its board, manage risk
 - a company's overall compensation approach including how compensation payments take into account long-term nature of risks
 - potential conflicts of interest by compensation consultants including any affiliate services provided by consulting firm
 - director nominees, including specifics on their experience/qualifications to serve on board and committees

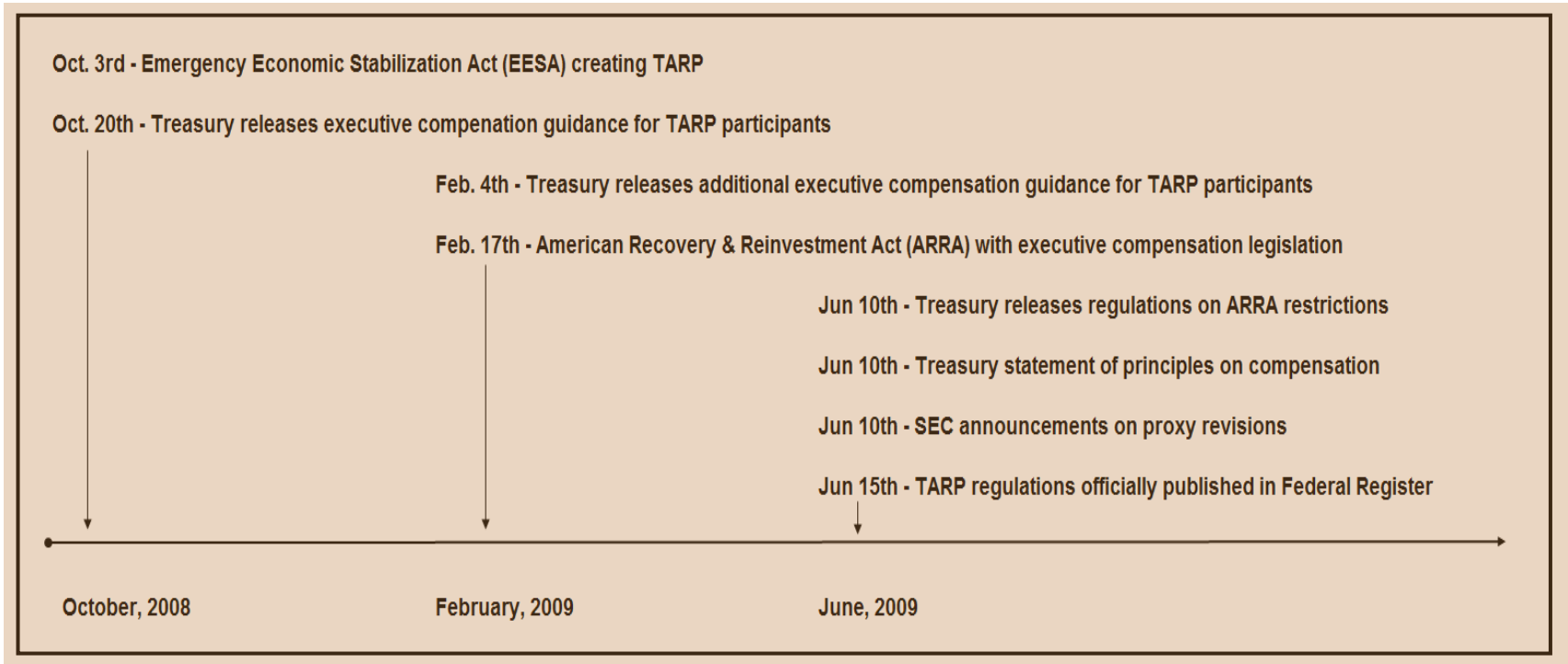
SEC Pronouncements on Pending Proxy Revisions

- ★ No immediate timetable for proposals
- ★ SEC proposals on proxy revisions are generally provided with a comment period prior to being enacted
- ★ Important items:
 - These changes would impact all SEC filing institutions, not just TARP institutions
 - Expectation is that this will impact proxy statements filed in 2010 for 2009 compensation
 - We expect see the proposals coming during third quarter

TARP Regulations



A Timeline of Change



- ★ The volume and breadth of change is unprecedented.
- ★ Moved quickly from a banking issue to the broader market.
- ★ The June 10th Treasury regulations integrate the previous laws and guidance into one set of guidelines.

TARP Regulation Topics

- ★ Effective Date
- ★ Employee Definitions
- ★ Annual Compensation
- ★ Bonuses, Incentive Compensation & Retention Awards
- ★ Base Salary
- ★ \$500,000 Deduction Cap
- ★ Long-Term Restricted Stock
- ★ Legally Binding Right Under Employment Contract
- ★ Commission Payments
- ★ Claw Back Provisions
- ★ Golden Parachute Payments
- ★ Tax Gross Up Payments
- ★ Unnecessary & Excessive Risk
- ★ Luxury Expenditures
- ★ New Reporting Requirements
- ★ Compliance Certification
- ★ Special Master for TARP Executive Compensation



★ *Regulatory Guidance*

- **Q-17: How do the effective date provisions apply with respect to the requirements under section 111 of EESA?**
 - The requirements under this part with respect to sections 111(b), 111(c), 111(d) and 111(f) are effective on June 15, 2009
- Bonus payments to the extent earned or paid prior to June 15, 2009 are permissible
 - All other bonuses earned but not paid cannot be paid until either TARP is paid back or the affected individual is no longer subject to the “no bonuses” rule
 - However, any historical compensation payments made while TARP recipient are still subject to review by special master for TARP executive compensation for consistency with TARP, ARRA, etc.

★ *Observations*

- These regulations are effective even in “interim final” form as of June 15, 2009

Employee Definitions

★ *Regulatory Guidance*

- Senior Executive Officers (SEO): Defined as the “named executive officers” (CEO, CFO and three highest paid executive officers) of a public company whose compensation is required to be disclosed pursuant to SEC regulations and non-public counterparts. Analogous rules apply to private companies.
- Q-1, Most Highly Compensated Employee (MHCE): ...the employee of the TARP recipient, *other than the SEOs of the TARP recipient*, whose annual compensation is determined to be the highest among all employees of the TARP recipient.
- Commissions are not counted as bonus for purposes of regulations; it is classified as salary, and thus compensation, for purposes of ranking employees. See additional information later in this presentation on commissions.

★ *Observations*

- We believe that the wording of “*other than the SEOs of the TARP recipient*” to be a drafting error by Treasury as applied to banks that took less than \$250 million in TARP funds.
- Annual compensation for ranking purposes is compensation for the previous fiscal year in accordance with Item 402(a) of Regulation S-K. (Determined consistent with proxy regulations)
- So, your 2009 SEOs and MHCEs are based on 2008 pay; for 2010 the determination will be based on 2009 pay.

Annual Compensation

★ *Regulatory Guidance*

– Q-1, Annual compensation.

- (1) General rule. The term “annual compensation” means, except as otherwise explicitly provided in this part, 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)). Accordingly, for this purpose the amounts required to be disclosed pursuant to paragraph (c)(2)(viii) of Item 402(a) of Regulation S-K (actuarial increases in pension plans and above market earnings on deferred compensation) are not required to be included in annual compensation.
- (2) Application to private TARP recipients. For purposes of determining annual compensation, a TARP recipient that does not have securities registered with the SEC pursuant to the federal securities laws must follow the requirements set forth in paragraph (1) of this definition.

★ *Observations*

- Annual compensation is all compensation (salary, commissions, bonus, equity, etc.) *excluding* defined benefit pension plan accruals, and above market interest on deferred compensation plans.
- Annual compensation is determined as of previous fiscal year in accordance with Item 402(a) of Regulation S-K. (Determined consistent with proxy regulations).
- Private companies have same definitions as public companies for annual compensation

Bonuses, Incentive Compensation & Retention Awards

★ *The Law*

- TARP participants are prohibited from paying or accruing any bonus, retention award or incentive compensation to a range of individuals, depending on the amount of TARP assistance as set forth below. Note that the new guidance reaches beyond Senior Executive Officers (SEOs) and includes “most highly-compensated employee(s) (MHCEs).”
- The number of MHCEs impacted is scaled to the size of the Treasury’s financial assistance and subject to Treasury discretion. Note, beginning at \$25 million of TARP participation, the number of officers that are covered represents a minimum; Treasury may increase number of officers covered.

<u>AMOUNT OF ASSISTANCE</u>	<u>INCENTIVE COMPENSATION RESTRICTIONS APPLY TO:</u>
Less than \$25 million	The most highly-compensated employee (1 officer only)
\$25 million but less than \$250 million	At least the 5 most highly-compensated employees (Minimum 5)
\$250 million but less than \$500 million	SEOs plus at least the next 10 most highly-compensated employees (Minimum 15)
\$500 million or more	SEOs plus at least the next 20 most highly-compensated employees (Minimum 25)

- The prohibition [on incentive compensation] does not apply to the granting of long-term restricted stock provided that the equity (a) does not otherwise vest during the period the TARP preferred remains outstanding; (b) has a value not greater than 1/3 of the total annual compensation of the recipient; and (c) is subject to other terms and conditions that may be determined by the Treasury to be in the public interest.

Bonuses, Incentive Compensation & Retention Awards

★ *Observations*

- Incentive compensation includes stock options; thus stock options are out
- For bonuses covering multi-years when bank is TARP recipient, no bonus accrual for period covering TARP participation and no bonus payment until after TARP is paid back or individual becomes “bonus eligible”
- For individuals who were not covered in one year (e.g. 2009), and then are covered in subsequent year (e.g. 2010)
 - You cannot pay the bonus in the subsequent year --- it goes in the drawer
 - You cannot increase base pay in subsequent year to effectively pay the prohibited bonus from the first year.
 - Treasury will review other similar executives to determine how they were paid to make determination
- Prohibition on bonus/incentive pay does not apply to commission payments (see subsequent slide)
- Prohibition does not apply to “any bonus payments required by a written employment contract executed on or before February 11, 2009.” (see subsequent slide)
- Bonus payments accrued or paid prior to June 15, 2009 are permissible

Base Salary

★ *Regulatory Guidance*

- **Q-1, Incentive Plan, (2) Salary or other permissible payments paid in property**
 - The term “incentive plan” does not include an arrangement under which an employee receives salary or another permissible payment in property, such as TARP recipient stock, provided that such property is:
 - not subject to a substantial risk of forfeiture (as defined in 26 CFR 1.83-3(c)) or other future period of required services (but the stock could be subjected to a holding period);
 - the amount of the payment is determinable as a dollar amount through the date such compensation is earned (for example, an agreement that salary payments will be made in stock equal to the value of the cash payment that would otherwise be due); and
 - the amount of stock or other property accrues at the same time or times as the salary or other permissible payments would otherwise be paid in cash.

★ *Observations*

- The ability to pay salary in the form of stock is one of the largest surprises in Treasury guidance.
- Key requirement is that stock must be fully vested when paid, just like a salary check would be
- Combination of stock and long-term holding period likely to be a useful tool for providing competitive pay based salary increases

\$500,000 Deduction Cap

★ *Regulatory Guidance*

- TARP participants were required to commit to abide by new section 162(m)(5) of the Internal Revenue Code which limits the annual tax deduction for remuneration of a CEO to \$500,000 per year. Remuneration covered by this limitation is broadly defined and includes performance-based compensation and deferred compensation.
- The Stimulus Legislation codifies this commitment so all TARP participants are subject to the \$500,000 deduction cap.
- The Treasury issued regulations on this requirement back in October, answering many questions about the mechanics for applying the limitations.

★ *Observations*

- No substantive change. CEO and CFO certification request reinforces need to have process in place to confirm compliance with deduction limitation.

Long-Term Restricted Stock

★ *Regulatory Guidance*

– Q-1, Long-Term Restricted Stock.

- Includes restricted stock or restricted stock units. For privates, value is tied to value of corporation
- Full vesting (ability to sell the stock) is tiered upon repayment of TARP in 25% increments; e.g., if you repay 25% to 49% you can vest in 25% of restricted stock
- Upon tax vesting, shares can be withheld or sold to pay for taxes due even if TARP repayments have not occurred and do not impact vesting percentages
- There is a minimum two year time vesting requirement from date of grant with exceptions for death, disability or CIC, even if TARP is unpaid before two years

– Q-10, What actions are necessary for a TARP recipient to comply with section 111(b)(3)(D) of EESA?

- Annual compensation for purposes of determining value of restricted stock to comply with 1/3 limitation is annual compensation for the year of grant not the previous year.
- The value of long-term restricted stock is calculated based on economic value on date of grant
- Annual compensation is “proxy compensation” but does not include 123R expense amounts, but does include grant value of the restricted stock

★ *Observations*

- You determine who is impacted by variable pay restrictions based on previous year; however, you determine the amount of restricted stock which may be granted based upon current year.

Legally Binding Right Under Employment Contract

★ *Regulatory Guidance*

- **Q-10, What actions are necessary for a TARP recipient to comply with section 111(b)(3)(D) of EESA?**
 - (i) *General rule.* The prohibition under paragraph (a) of this section does not apply to bonus payments required to be paid under a valid employment contract if the employee had a legally binding right under the contract to a bonus payment as of February 11, 2009.
 - “Bonus payment” in this context covers bonuses, incentive compensation and retention awards

★ *Observations*

- Historical equity grants made prior to February 11, 2009 can continue and vest per the award agreement, e.g., a 2007 stock option grant with a three year vest
- However, anything that has not yet been granted, even if covered under a contract made prior to February 11, 2009, cannot be awarded, vested or otherwise provided to those subject to the “no bonus” rule

Commission Payments

★ *Regulatory Guidance*

– **Q-1, Commission Compensation.**

- Compensation or portions of compensation earned by an employee consistent with a program in existence for that type of employee as of February 17, 2009,
- if a substantial portion of the services provided by this employee consists of the direct sale of a product or service to an unrelated customer,
- these sales occur frequently and in the ordinary course of business of the TARP recipient,
- but not a specified transaction, such as an initial public offering or sale or acquisition of a specified entity(ies)

– **Q-1, Bonus.**

- ...provided that the rate of commission is pre-established and reasonable, and is applied consistently to the sale of substantially similar goods or services, commission compensation will not be treated as a bonus.

★ *Observations*

- Generally excludes typical insurance agents, brokerage or other commission based employees
- Note, this does not exclude commercial lending officers.

Claw Back Provisions

★ *Regulatory Guidance*

– Q-8, The “Clawback” Provision Requirement.

- To comply with the standards established under section 111(b)(3)(B) of EESA, a TARP recipient must ensure that any bonus payment made to a SEO and the next twenty most highly compensated employees during the TARP period is subject to a provision for recovery or “clawback” by the TARP recipient if the bonus payment was based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria.
- Determination of “materially inaccurate” includes knowingly failing to timely correct inaccurate information or material impact on performance criteria
- Ability to review clawback if you determine costs of recovery of bonus would exceed the amount recovered

★ *Observations*

- More stringent than the clawback as defined under Sarbanes-Oxley
 - Covers 25 individuals and is not adjusted for the size of the entity
 - Applies to private as well as public companies
 - Does not require a restatement of earnings to trigger
 - Does not limit the recovery period
 - Covers inaccurate performance metrics as well as inaccurate financial reporting

Golden Parachute Payments

★ *Regulatory Guidance*

– Q-1: Golden Parachute Payment

- The term “golden parachute payment” means any payment for the departure from a TARP recipient for any reason, or any payment due to a change in control (CIC) of the TARP recipient or any entity that is included in a group of entities treated as one TARP recipient, except for payments for services performed or benefits accrued
- Inclusion of CIC payments is a significant expansion
- This excludes qualified plan payments, benefits due to death/disability
- Services performed/benefits accrued refers to a payment which is fully vested and would be paid regardless of a voluntary or involuntary termination with exclusion for termination for cause

– Q-9: The prohibition on golden parachute payments.

- To comply with the standards ... a TARP recipient must prohibit any golden parachute payment to a CEO and any of the next five most highly compensated employees during the TARP period
- A golden parachute payment is treated as paid at the time of departure and is equal to the aggregate present value of all payments made for a departure. Thus, if departure or CIC occurs during the TARP period amounts cannot be delayed and paid after the TARP period

★ *Observations*

- This applies to 10 individuals (5 proxy + 5 MHCE)
- Note, upon merger with non-TARP institution, you may be allowed to remove TARP status
- This means no payment at all, versus no payments for anything over “three times”

Tax Gross Up Payments

★ *Regulatory Guidance*

– Q-1: Gross Up Payment.

- The term “gross up” means any reimbursement of taxes owed with respect to any compensation,
- provided that a gross-up does not include a payment under a tax equalization agreement, which is an agreement... that provides payments intended to compensate an employee for some or all of the excess of the taxes actually imposed by a foreign jurisdiction

– Q-11: Are TARP recipients required to meet any other standards under the executive compensation and corporate governance standards in section 111 of EESA?

- Except as explicitly permitted under this part, TARP recipients are prohibited from providing (formally or informally) gross-ups to any of the CEOs and next twenty most highly compensated employees during the TARP period.
- For this purpose, providing a gross-up includes providing a right to a payment of such a gross-up at a future date, for example a date after the TARP period.

★ *Observations*

- This applies to 25 individuals (5 proxy + 20 MHCE)
- This means no gross up payments for anything, e.g., tax gross ups for club dues, moving expenses, cell phones, gas cards, etc.

Unnecessary & Excessive Risk

★ Regulatory Guidance

- **Q-4, Evaluation of employee plans and potential to encourage excessive risk or manipulation or earnings?**
- The independent compensation committee must
 - Discuss, evaluate and review *at least every six months*:
 - With the TARP recipients' senior risk officers the *SEO comp plans* to ensure they do not encourage unnecessary and excessive risks
 - With the senior risk officers the *employee compensation plans* in light of the risks posed to the TARP recipient by such plans and how to limit such risks
 - The employee compensation plans to ensure these plans *do not encourage the manipulation of reported earnings* of the recipients' employees
 - At least *once per year*, provide a narrative of how the compensation committee has ensured the above has occurred, including a description of how the compensation plans do not encourage behavior focused on short-term results rather than long-term value creation.

★ Observations

- This requirement applies to *all compensation plans* at a bank.
- Each six-month period there is work for the compensation committee
- Given a vast majority of compensation plans are based on annual financial goals, how do these plans focus on long-term value creation?

Unnecessary & Excessive Risk

★ *Regulatory Guidance*

- For public companies
 - The compensation committee must provide certifications in proxy and to Treasury
 - The compensation committee must be comprised of entirely independent directors
- For private companies & smaller reporting companies
 - If less than \$25 million and no securities registered than it can be full board versus compensation committee
 - The compensation committee (or full board) must provide certifications to Treasury and primary regulator within 120 days of end of fiscal year

★ *Observations*

- Definition of independent director may well be legislated per the recently announced Treasury principles
- Note reporting to both Treasury as well as in either proxy or primary regulator

Luxury Expenditures

★ Regulatory Guidance

- **Q-12: The excessive or luxury expenditures policy requirement.**
 - By the later of ninety days after the closing date of the agreement between the TARP recipient and Treasury or September 14, 2009, the board of directors of the TARP recipient must adopt an excessive or luxury expenditures policy,
 - provide this policy to Treasury and its primary regulatory agency, and
 - post the text of this policy on its Internet Web site, if the TARP recipient maintains a company Web site.
- **Q-1: Excessive or luxury expenditures.**
 - The term “excessive or luxury expenditures” means excessive expenditures on any of the following to the extent such expenditures are not reasonable expenditures for staff development, reasonable performance incentives, or other similar reasonable measures conducted in the normal course of the TARP recipient’s business operations:
 - (1) Entertainment or events;
 - (2) Office and facility renovations;
 - (3) Aviation or other transportation services; and
 - (4) Other similar items, activities, or events for which the TARP recipient may reasonably anticipate incurring expenses, or reimbursing an employee for incurring expenses.
- **Q-1: Excessive or Luxury Expenditures Policy.**
 - Written standards addressing the four categories of expenses that are reasonably designed to “eliminate” excessive or luxury expenditures. The written standards must:
 - Identify the types or categories of expenditures which are prohibited (which may include a threshold expenditure amount below which the expenditure is permitted);
 - Identify the types or categories of expenditures for which prior approval is required (which may include a threshold expenditure amount below which approval is not required);
 - Provide reasonable approval procedures;
 - Require CEO and CFO certification that the approval of any expenditure requiring the prior approval was properly obtained with respect to each such expenditure;
 - Require the prompt reporting of violations to an appropriate person identified in the policy;
 - Mandate accountability for adherence to the policy.

★ Observations

- This needs to be posted on website no later than September 14, 2009
- Also needs to be provided to Treasury and primary regulatory agency
- Design issues will center around thresholds and approval process

New Reporting Requirements

★ *Regulatory Guidance*

- Q-11: Are TARP recipients required to meet any other standards under the executive compensation and corporate governance standards in Section 111 of EESA?
 - TARP recipients must file an annual statement with the Treasury and their primary regulator providing a narrative explanation of the amount, nature and justification for any perquisites provided if more than \$25,000 of perquisites are provided to any individual
 - TARP recipients must provide an annual narrative description of whether the company or committee uses a compensation consultant, the types of services provided, including non-compensation consulting
 - The reports are required to be filed with Treasury and the primary regulator with 120 days after the end of the year

★ *Observations*

- New requirements regarding compensation consultants is precursor to additional independence requests for committees

Compliance Certification

★ *Regulatory Guidance*

– Q–15: What actions are necessary for a TARP recipient to comply with certification requirements?

- To comply with section 111(b)(4) of EESA, the PEO and the PFO of the TARP recipient must provide the following certifications with respect to the compliance of the TARP recipient with section 111 of EESA as implemented under this part:
 - Within 90 days after end of first and subsequent years, certifications must be provided similar to models provided within the regulations.
 - Both of the models for first and subsequent years are 16 part certifications intended to confirm that the company has complied with each section of the regulatory guidance.
 - Public companies are to include certificate in Form 10-K

★ *Observations*

- Certifications are made “to the knowledge” of the certifying officer
- Violation of the certification could include imprisonment, fine or both for the PEO (CEO) and PFO (CFO).

Special Master for TARP Executive Compensation

★ *Regulatory Guidance*

- **Q-16: What is the Office of the Special Master for TARP Executive Compensation, and what are its powers, duties and responsibilities?**
 - The Special Master shall have the following powers, duties and responsibilities:
 - (1) *Interpretative authority.* The Special Master shall have responsibility for interpreting section 111 of EESA, these regulations, and any other applicable guidance, to determine how the requirements under section 111 of EESA, these regulations, and any other applicable guidance, apply to particular facts and circumstances.
 - (2) *Review of prior payments to employees.* Section 111(f) of EESA provides that the Secretary shall review bonuses, retention awards, and other compensation paid before February 17, 2009, to employees of each entity receiving TARP assistance before February 17, 2009, to determine whether any such payments were inconsistent with the purposes of section 111 of EESA, or otherwise contrary to the public interest.
 - (3) *Approval of certain payments to employees of TARP recipients receiving exceptional financial assistance.*
 - (4) *Advisory opinions on compensation structures or compensation payments to employees of TARP recipients.*

★ *Observations*

- The Special Master will review the prior payments for appropriateness
- The Special Master will make determinations on issues from an advisory perspective. These determinations will occur within 60 days.
- The Special Master has a number of abilities to apply special review to the banks receiving exceptional financial assistance

Questions & Answers



Contact Information



CONTACTS	1-866-280-3720	www.amalficonsulting.com
<hr/>		
Minneapolis		
Todd Leone	1-952-893-6711	todd.leone@amalficonsulting.com
Gayle Appelbaum	1-952-893-6795	gayle.appelbaum@amalficonsulting.com
Matt Brei	1-952-893-6705	matt.brei@amalficonsulting.com
<hr/>		
Dallas		
Mike Point	1-972-745-1978	mike.point@amalficonsulting.com
<hr/>		
Boston		
Jean Riley	1-508-630-1565	jean.riley@amalficonsulting.com

Contact Information

VEDDER PRICE®

CONTACTS

Chicago

Thomas P. Desmond	1-312-609-7647	tdesmond@vedderprice.com
Robert J. Stucker	1-312-609-7607	rstucker@vedderprice.com
Michael A. Nemeroff	1-312-609-7858	mnemeroff@vedderprice.com
Daniel C. McKay, II	1-312-609-7762	dmckay@veddereprice.com
James A. Kane	1-312-609-7533	jkane@vedderprice.com
Daniel O'Rourke	1-312-609-7669	dorourke@vedderprice.com

New York

Sara Stewart Champion	1-212-407-7785	schampion@vedderprice.com
Stewart Reifler	1-212-407-7742	sreifler@vedderprice.com



AMALFI
CONSULTING, LLC

VEDDER PRICE®

TARP & Executive Compensation: A Regulatory Update

June 19, 2009

Todd Leone

President & Founder

todd.leone@amalficonsulting.com

(952)893-6711

Tom Desmond

Managing Shareholder

tdesmond@vedderprice.com

(312)609-7647