



## CLIENT ALERT

### ECONOMIC STIMULUS BILL IMPOSES NEW EXECUTIVE COMPENSATION LIMITS UNDER TARP

February 16, 2009

Congress passed the American Recovery and Reinvestment Act of 2009 (ARRA hereinafter referred to as the Stimulus Bill) that includes strict and restrictive new limits on executive compensation for all Troubled Asset Relief Program (TARP) participants<sup>1</sup>. The bill is expected to be signed into law by President Obama on Tuesday, February 17. The Stimulus Bill is more restrictive and far-reaching than the guidelines recently proposed by the Treasury and the new restrictions apply to all entities that have already received or will receive government financial assistance under the TARP.

#### Significant Provisions

As discussed in more detail below, the Stimulus Bill, among other things,

- Prohibits all bonuses and incentive compensation (with the exception of limited amounts of restricted stock).
- Prohibits all golden parachute payments (with the exception of benefits already earned or accrued).
- Directs the Treasury to review and negotiate reimbursement to the government for bonuses and incentive compensation paid prior to the enactment of the Stimulus Bill that are found to be inconsistent with the Stimulus Bill, the TARP or public policy.
- TARP Participants may “opt out” by repaying any assistance received without raising additional capital (subject to consultation with the appropriate Federal regulator).

#### Limits on Incentive Compensation

TARP participants<sup>1</sup> 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. This prohibition does not apply to any bonus payment required to be paid pursuant to a written employment contract executed on or before February 11, 2009.

This prohibition does not apply to the granting of long-term restricted stock provided that the equity (a) does not fully vest during TARP participation, (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.

These incentive compensation restrictions apply to the highest paid employees on a sliding scale depending upon the amount of government financial assistance the company has received. Note that the new guidance reaches beyond Senior Executive Officers (SEOs)<sup>2</sup> and includes “highly-compensated employee(s).”

#### Amount of Assistance

Less than \$25 million

\$25 million but less than \$250 million

\$250 million but less than \$500 million

\$500 million or more

#### Incentive Compensation Restrictions Apply To

The most highly-compensated employee

The 5 most highly-compensated employees

SEOs plus the next 10 most highly-compensated employees (Up to 15 employees)

SEOs plus the next 20 most highly-compensated employees (Up to 25 employees)

### **Prohibition on Golden Parachutes**

TARP participants<sup>1</sup> are prohibited from making any golden parachute payments to Senior Executive Officers<sup>2</sup> and the next 5 most highly-compensated employees (up to 10 total employees). Golden parachute payments are defined as any payment for departure from a company for any reason, except for payments for services performed or benefits accrued.

### **Review of Prior Payments to Executives**

The Treasury will review bonuses, retention awards and other compensation for CEOs and the next 20 most highly-compensated employees of TARP participants<sup>1</sup> (up to 25 total employees) that received assistance prior to enactment of the Stimulus Bill to determine whether any such payments were inconsistent with the provisions of the Stimulus Bill, the TARP or the public interest. The Treasury will “seek to negotiate” with the company and the subject employee for appropriate reimbursements to the Federal Government with respect to such compensation or bonuses.

### **Limitation on Deductions**

TARP participants<sup>1</sup> are subject to the provisions of section 162(m)(5) of the Internal Revenue Code which limits the deduction of compensation to \$500,000 per year for Senior Executive Officers<sup>2</sup>. Compensation covered by this limitation includes incentive compensation and deferred compensation.

### **Shareholder Approval of Executive Compensation (Say-on-Pay)**

TARP participants<sup>1</sup> must permit a separate shareholder vote to approve the compensation of executives with disclosure pursuant to the SEC compensation disclosure rules (compensation discussion and analysis, compensation tables and related material). The shareholder vote is not binding on the board of directors, does not overrule decisions by the board or create or imply any additional fiduciary duty by the board.

### **Additional Provisions Related to Compensation**

- Compensation plans must exclude incentives for Senior Executive Officers<sup>2</sup> to take unnecessary and excessive risks that threaten the value of the company.
- Compensation plans must provide for the recovery of any bonus, retention award or incentive compensation paid to CEOs and the next 20 most highly-compensated employees (up to 25 employees) that were based on financial statements or other criteria that are later found to be materially inaccurate.
- Compensation plans that would encourage manipulation of reported earnings to enhance the compensation of any employee are prohibited.
- TARP participants<sup>1</sup> must establish a Board Compensation Committee composed entirely of independent directors to review employee compensation plans. The committee must meet at least semi-annually to discuss and evaluate employee compensation plans in light of an assessment of any risk posed to the company from those plans. For companies that are not registered with the SEC and that have received \$25 million or less of TARP assistance, the duties of the committee may be carried out by the board of directors. (Note that the requirement appears to apply to all employee compensation plans, not just Senior Executive Officer<sup>2</sup> compensation.)

### **Opt-Out Provision**

TARP participants<sup>1</sup> may repay any assistance previously received under the TARP without regard to whether the company has replaced the funds from other sources or any waiting period, subject to consultation with the appropriate Federal banking agency. When such assistance is repaid the Treasury will liquidate associated warrants at the current market price.

### **Certification of Compliance**

The CEO and CFO of a TARP participant<sup>1</sup> must provide written certification of compliance with the guidelines to the SEC (public companies) or to the Treasury (private companies).

### **Limitation on Luxury Expenditures**

The Board of Directors of a TARP participant<sup>1</sup> must have a policy regarding excessive or luxury expenditures, including (a) entertainment or events, (b) office and facility renovations, (c) aviation or other transportation services and (4) other activities or events that are not reasonable expenditures for staff development or reasonable performance incentives.

### **Comments on the Stimulus Bill**

In as much as the Stimulus Bill provides new guidelines for executive compensation, it has raised as many questions as it has answered. The following is a list of questions that will need to be answered by Treasury (in regulations to follow) and addressed in consultation with your securities counsel and your compensation advisor (collectively your “advisors”):

- **Executive Definition**: For institutions that have received TARP funds in an amount less than \$250 million, there will be two classifications of officers: the Senior Executive Officers, or SEOs<sup>2</sup>, and the highly compensated officers. These two classes will need to be tracked for different filing requirements under the Stimulus Bill and SEC Regulations S-K for proxy filing purposes.
- **Base Salary**: Given the negative impact on applicable officers’ cash incentive payments and equity opportunities, we recommend reviewing potential changes to base salary within the context of the given TARP participant’s<sup>1</sup> facts and circumstances.
- **Previous Bonus Payments**: How should cash incentive payments that have already been made in 2009 to a TARP participant<sup>1</sup> be treated?
- **Future Bonus Payments**: TARP participants<sup>1</sup>, relative to 2009 fiscal year performance plans, should consult with advisors to make a determination regarding the removal of any and all cash incentive plans for applicable officers and employees.
- **Granted Stock Options**: How should stock options that have been granted to individuals while the company has been a TARP participant<sup>1</sup> be treated?
- **Granted Restricted Stock**: How should restricted stock that has been granted to an individual while the company has been a TARP participant<sup>1</sup> be treated if the grant date value exceeds 1/3 of the individual’s total annual compensation?
- **Future Equity Grants**: We recommend that TARP participants<sup>1</sup> review pending equity grants that are in the form of both stock options and restricted stock. These should be reviewed within the context of moving solely to a restricted stock basis within the guidelines of the Stimulus Bill.
- **Say-on-Pay**: For the coming proxy season, does a TARP participant<sup>1</sup> need to submit the say-on-pay provision in the proxy filing? Note, the Stimulus Bill allows one year from the date of enactment of the Stimulus Bill for the SEC to publish final regulations for this requirement.
- **Deferred Compensation**: Clarify that compensation in the form of nonqualified deferred compensation is not explicitly covered under the Stimulus Bill.
- **On-Going Compliance**: Once a TARP participant<sup>1</sup> has repaid all government financial assistance, is there residual liability for violations of the standards set forth in the Stimulus Bill that may have occurred while a participant was under the TARP?

#### **Footnotes:**

- 1 “TARP participant(s)” means any entity that has or will receive financial assistance under the TARP for the period of time in which obligations arising under TARP remain outstanding. It does not include any period in which the Federal Government holds only warrants to purchase common stock.
2. The term “Senior Executive Officer(s)” is defined as 1 of the top 5 most highly-paid executives of a public company whose compensation is required to be disclosed pursuant to SEC regulations and non-public counterparts.

## AMALFI CONSULTING, LLC

### ABOUT AMALFI CONSULTING, LLC

Amalfi Consulting, LLC (formerly the Compensation Group of Clark Consulting), has been providing compensation consulting solutions to clients for nearly 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 18 full time professionals located in Minneapolis, Atlanta, Dallas, and Boston. Amalfi is focused on solving today's banking 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.

### CONTACTING AMALFI CONSULTING, LLC

This publication is provided by Amalfi Consulting, LLC as a service to clients and to the banking community. The information contained in this publication should not be construed as formal opinions on legal, accounting, or actuarial issues. Questions regarding the information discussed in this publication may be directed to any of our consultants listed below. If you have not received this publication directly from us, you may obtain a copy of any past or future related publications from Christine Capra (1-866-280-3720; [christine.capra@amalficonsulting.com](mailto:christine.capra@amalficonsulting.com)) in our Minneapolis office.

### CONTACTS

---

#### Minneapolis

Todd Leone	1-952-893-6711	<a href="mailto:todd.leone@amalficonsulting.com">todd.leone@amalficonsulting.com</a>
Gayle Appelbaum	1-952-893-6795	<a href="mailto:gayle.appelbaum@amalficonsulting.com">gayle.appelbaum@amalficonsulting.com</a>
Matt Brei	1-952-893-6705	<a href="mailto:matt.brei@amalficonsulting.com">matt.brei@amalficonsulting.com</a>

---

#### Atlanta

Mike Blanchard	1-770-261-4047	<a href="mailto:mike.blanchard@amalficonsulting.com">mike.blanchard@amalficonsulting.com</a>
Diana Chase	1-770-261-4049	<a href="mailto:diana.chase@amalficonsulting.com">diana.chase@amalficonsulting.com</a>

---

#### Dallas

Mike Point	1-972-745-1978	<a href="mailto:mike.point@amalficonsulting.com">mike.point@amalficonsulting.com</a>
------------	----------------	--

---

#### Boston

Jean Riley	1-508-630-1565	<a href="mailto:jean.riley@amalficonsulting.com">jean.riley@amalficonsulting.com</a>
------------	----------------	--