



CLIENT ALERT RECENT DEVELOPMENTS IN EXECUTIVE PAY

May 15, 2009

The mainstream press has been abuzz with stories on executive compensation, primarily as it relates to banks. The purpose of this client alert is to cut through the noise and bring some clarity to what appears to be happening in the executive compensation arena.

There are two important topics underlying the current discussion.

- Treasury is expected to issue regulations soon with respect to compensation for any bank that has received or will receive TARP funds. The regulations will amplify and clarify the compensation provisions contained in the American Recovery & Reinvestment Act of 2009 (ARRA, popularly known as the “Stimulus Bill”), which was enacted this past February.
- Earlier this week, the Administration (the President and Treasury) announced that it is considering additional guidance on executive pay for *all financial institutions*. No specifics are available now, but some general precepts have been put forth and this broad-based guidance is expected to be developed over the course of this year.

American Recovery & Reinvestment Act of 2009 (ARRA) – Treasury Guidance

On February 17, 2009, the President signed ARRA into law. As detailed in our February 16th Client Alert, ARRA contains a number of restrictions on executive and highly-paid employee compensation for those institutions that have received, or will receive, government assistance under the Troubled Asset Relief Plan (TARP). Many questions arising from the statutory language have left the banking industry looking for clarification and guidance. The forthcoming Treasury regulations should provide answers to most questions. The New York Times recently reported that Treasury is signaling that these long-awaited regulations may be issued prior to the Memorial Day holiday.

Key provisions contained in the ARRA legislation are summarized as follows:

- Prohibits all bonuses and incentive compensation (with the exception of limited amounts of restricted stock) for specified individuals, depending upon the level of government assistance received by the institution.
- Prohibits all golden parachute payments (with the exception of benefits already earned or accrued) for specified individuals.
- 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.
- Mandated a non-binding “say on pay” vote of shareholders for all TARP participants.
- Instituted mandatory “claw back” provisions on certain compensation.
- Mandated a policy on luxury expenditures.
- Provided TARP participants with the ability to “opt out” by repaying any assistance received without raising additional capital (subject to consultation with the appropriate Federal regulator).

Our clients that are TARP participants are struggling with many questions raised by the statutory language. A few examples of such questions include, but are not limited to, the following:

- What is the effective date of the regulations covered under ARRA?
- What is the definition of compensation to be used in defining “highly compensated employee”?
- What is the effective date for determining applicability of the regulations, i.e., previous year or current year?
- In meeting the limits for granting restricted stock, what is included in the calculation of 1/3 of total annual compensation?

Financial Regulatory Reform – New Proposals

In reviewing the initial reports on the Administration’s intention to develop broad-based compensation guidance, a number of points have surfaced: the guidance is intended to cover all financial institutions, including those that are not chartered as banks, and the stated intent is to assure that compensation programs promote long-term profitability and are consistent with “safety and soundness” principles. What is also clear is that any future guidance on compensation is in the formative stages and is subject to change, probably multiple iterations, over the coming weeks and months before being finalized.

Certain foundation points have emerged from the Administration on this new initiative on compensation applicable to potentially all financial institutions. First, as stated by an Administration official, “This will not be about capping compensation or micro-management.”

Second, the Administration has not determined the method of implementation for future guidance on executive compensation. The limitations could be in the form of regulations by any number of regulatory bodies including, but not limited to, the Securities & Exchange Commission or any of the bank regulatory bodies such as the Federal Reserve, FDIC, OCC or the OTS. Guidance could also come in the form of new legislation.

Third, the Administration is focusing on safety and soundness as an underpinning of future guidance on compensation. This notion, of course, already exists under present regulatory authority for banking organizations. Regulators are already empowered to mandate changes in bank compensation schemes thought to be inconsistent with safety and soundness. That said, regulatory agencies have generally only utilized these powers when a banking organization was in a troubled state; that is, these powers have been used reactively and infrequently. The Administration appears intent on a more proactive approach.

Last, a key concept emphasized by the Administration is that compensation should support and be aligned with long-term financial performance. In speeches by Mr. Bernanke, Mr. Geithner and other Administration officials, they have stated that current compensation should not be paid in the short-term for transactions with a long-term horizon. This notion, is consistent with the November 12th Interagency Statement on Meeting the Needs of Creditworthy Borrowers published by the FDIC. The bulletin states the following with respect to compensation programs:

Poorly-designed management compensation policies can create perverse incentives that can ultimately jeopardize the health of the banking organization. Management compensation policies should be aligned with the long-term prudential interest of the institution, should provide appropriate incentives for safe and sound behavior, and should structure compensation to prevent short-term payments for transactions with long-term horizons. Management compensation practices should balance the ongoing earnings capacity and financial resources of the banking organization, such as capital levels and reserves, with the need to retain and provide proper incentives for strong management. Further it is important for banking organizations to have independent risk management and control functions.

Keeping You Informed

Given the number of changes with respect to compensation in the banking marketplace, our goal is to ensure that you are as well informed as possible. To that end we are conducting two free webinars in the coming weeks, with additional ones as the Administration's proposals become more specific.

- **ARRA Treasury Regulations:** Within two weeks following Treasury's publication, we will co-host a webinar with Vedder Price on the upcoming regulations on executive compensation and corporate governance for TARP participants.
- **2008 Bank Compensation Trends:** With the 2008 proxy season coming to a close, we will be conducting a free webinar on executive compensation based on our analysis of more than 800 publicly filing banking institutions next month, June, 2009.
- **Future Guidance:** As the Administration proceeds in developing new broad-based guidance for compensation, we will host additional webinars to keep you informed.

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

This publication is provided by Amalfi Consulting, LLC as a service to clients and to the banking community. The information contained in this publication is not to be considered as a formal opinion 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 Sean Bateman (1-866-280-3720; sean.bateman@amalficonsulting.com) in our Minneapolis office.

CONTACTS

Todd Leone	1-952-893-6711	todd.leone@amalficonsulting.com
Gayle Appelbaum	1-952-893-6795	gayle.appelbaum@amalficonsulting.com
Jim Bean	1-952-883-1370	jim.bean@amalficonsulting.com
Jean Riley	1-781-934-8400	jean.riley@amalficonsulting.com
Chris Richter	1-952-883-1371	chris.richter@amalficonsulting.com
Katrina Gerenz	1-952-883-1384	katrina.gerenz@amalficonsulting.com