



VEDDER PRICE®

TARP & Executive Compensation: Decisions & Next Steps

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Webinar Agenda



- ★ The purpose of today's Webinar is to review common questions in the following areas that have arisen since the publication of the TARP Interim Final Rule in mid-June.
 - Compliance Steps
 - Interpretations of the Rule
- ★ Webinar format
 - First half devoted to questions we are seeing
 - Second half to questions from the audience

The background features a blue gradient that transitions from a lighter blue at the top to a darker blue at the bottom. A large, semi-transparent compass rose is positioned on the right side of the slide. The compass rose has a central circular element with a fleur-de-lis design and several pointed directions. The letters 'P', 'S', and 'O' are visible on the compass rose, likely representing 'Polaris', 'South', and 'North' respectively. A horizontal brown band is overlaid on the left side of the slide, containing the title text.

TARP & Executive Compensation Compliance Steps

Things to Do Now

- ★ Create list of CEOs + Top 20 MHCEs (non-CEOs) for 2009 based on 2008 annual compensation
- ★ Stop any bonus, incentive or retention awards or payments to CEOs and/or MHCE(s) subject to the “no bonus rule” unless an exception applies:
 - “Grandfathered” agreements which provide for a legally binding right as of February 11, 2009 for bonus, incentive or retention payments
 - Bonuses that were paid or accrued prior to June 15, 2009
 - Commission payments
 - Long-term restricted stock under 1/3 rule
- ★ Cease all tax gross-up payments to CEOs and top 20 MHCEs

Things to Do Now, *cont'd.*

- ★ Amend existing employment, severance, change in control and long-term incentives to prohibit acceleration of vesting or incremental payments upon termination of employment or change in control (CIC) if individual is a CEO or top five MHCE at time of separation or CIC
- ★ Require recipients of all bonus, incentive and retention awards or payments that are based on financial performance metrics to acknowledge a clawback provision

By September 14, 2009 *(or if later, 90 days after TARP closing)*

- ★ Establish an Excessive and Luxury Expenditures Policy
 - File with primary federal regulator and Treasury
 - Post on website
- ★ If public, or if private with more than \$25 million of TARP funds, establish an independent compensation committee to perform necessary actions relating to risk review of compensation plans (if not public and \$25 million or less of TARP funds, review can be done by the Board)

After September 14, 2009 *(or if later, 90 days after TARP closing)*

- ★ Every six months, the compensation committee must conduct a review of CEO compensation plans and all other employee compensation plans with respect to:
 - Risk to the institution,
 - Long-term focus versus short-term focus,
 - Risk of earnings manipulation, and
 - How these risks have been limited.

Within 90 Days After the End of the Fiscal Year

- ★ If public company, provide required CEO and CFO certifications in Form 10-K report and submit to Treasury
- ★ If a smaller public company or private company, file CEO and CFO certifications with primary federal regulator and Treasury

Within 120 Days After the End of the Fiscal Year

- ★ If public, include in the compensation committee report (not CD&A) included in the proxy statement, or if private file with the primary federal regulator, and Treasury
 - A certification of compensation committee relating to conduct of risk review and elimination of problematic provisions in the compensation plans, and
 - A narrative identifying
 - SEO compensation plans and explaining how those plans do not encourage unnecessary or excessive risk and encourage a long-term focus instead of short-term and
 - Each employee compensation plan, explaining how any unnecessary risks posed by the plan have been limited and explaining how the plan does not encourage the manipulation of earnings to enhance compensation of any employee

Within 120 Days After the End of the Fiscal Year, *cont'd.*

- ★ If the total value of perquisites provided to any SEO and/or MHCE subject to the “no bonus rule” for the completed calendar year exceeded \$25,000, disclose to the primary federal regulator and Treasury by narrative description
 - the amount and nature of all perquisites provided to the individual
 - the recipient of the perquisites, and
 - justification for offering each perquisite

Within 120 Days After the End of the Fiscal Year, *cont'd.*

- ★ File a narrative description with Treasury and primary federal regulator describing
 - whether the company, board or compensation committee has engaged a compensation consultant
 - if so, all types of services including non-compensation related services, the consultant or any affiliates have provided to the company, board or committee during the past three years, including
 - any “benchmarking” or comparisons employed to identify certain percentiles of compensation
 - the peer group used,
 - a justification for those entities, and
 - the lowest percentile level proposed for compensation

At the annual shareholder meeting

- ★ Provide for a non-binding advisory vote by shareholders (a say-on-pay vote) on executive compensation



TARP & Executive Compensation
Common Questions & Answers

Topics of Conversation

- ★ Definition of Most Highly Compensated Executive (MHCE)
- ★ Effect of partial repayment of TARP funds
- ★ Impact of Moving “In” or “Out” of “No Bonus Rule”
- ★ Impact of June 15th date on 2009 bonus pay
- ★ Commission based plans implemented after February 17th
- ★ Amending existing arrangements

Most Highly Compensated Employee Definitions

★ Background

- Q-1, Most Highly Compensated Employee (MHCE): ...the employee of the TARP recipient, *other than the CEOs of the TARP recipient*, whose annual compensation is determined to be the highest among all employees of the TARP recipient.
- Bonus, incentive compensation and retention awards
 - For banks receiving assistance less than \$250 million in assistance, the employees covered by the restriction is defined as 1 or 5 of the MHCEs, depending upon amount of assistance

★ Question

- As a result of drafting, is a proxy officer who is one of the most highly paid not an MHCE?

★ Observations

- On June 25, 2009, Amalfi Consulting submitted a letter to Treasury noting the drafting issue
- The Treasury responded (correctly) to the American Bankers Association that “*the bonus limitations for banks receiving less than \$250 million in TARP funds will apply to the “most highly compensated employee(s),” regardless of whether they are senior executive officers.*”

Effect of Partial Repayment of TARP Funds

★ Background

- Section 30.10 (Q-10) of the Interim Final Rules states that TARP recipients will be subject during the TARP period to the bonus limitation requirements based on the total amount of financial assistance outstanding under the TARP
- 30.10 (b)(2) Changes in level of financial assistance. The determination of which schedule in paragraph (b) of this section is applicable to a TARP recipient during the TARP period is determined by the gross amount of all financial assistance provided to the TARP recipient, valued at the time the financial assistance was received.

★ Question

- Which of these concepts controls how the restrictions are treated in the case of partial repayment?

★ Observations

- On June 25, 2009, Amalfi Consulting submitted a letter to Treasury noting the drafting issue
- The Treasury responded to the American Bankers Association that *“a partial repayment of TARP funds will not enable a bank to move to a less restrictive-bonus category. For example, if a bank received \$50 million in TARP funds and repaid \$26 million, leaving \$24 million in TARP funds to be repaid, the bonus restrictions would still apply to the five most highly compensated employees.”*

Impact of Moving ‘In’ or ‘Out’ of ‘No Bonus Rule’

★ Background

- Bonus payments (bonus, incentive compensation and retention awards) cannot be accrued (earned) or paid to CEOs and/or MHCEs subject to “no bonus rule”
 - Roster of “individuals” is determined each January 1 based on prior year’s “proxy” compensation

<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	CEOs plus at least the next 10 most highly-compensated employees (Minimum 15)
\$500 million or more	CEOs plus at least the next 20 most highly-compensated employees (Minimum 25)

★ Question

- What is the effect of moving into or out of being subject to the “no bonus rule” on an individual annual bonus and multi-year incentives?

Moving ‘In’ or ‘Out’ of ‘No Bonus Rule’, *cont’d.*

Individual	<u>Subject to No Bonus Rule</u>		
	2009	2010	2011
Steady Eddy	X	X	X
Rising Star		X	X
Updown Brown	X		X
One-year Wonder		X	

- ✳ None of the individuals can be granted or earn, or be paid, any bonus, incentive, or retention compensation in a year marked with an “X”
- ✳ Except for pre-February 11, 2009 contract amounts, commissions, long-term restricted stock or pro rata 2009 payments
 - Rising Star and One-year Wonder in 2009 and Updown Brown in 2010 may earn a full year bonus, but the check cannot be paid in the following year – it goes in a drawer until they are no longer subject to the no bonus rule. (For example, One-year Wonder may be paid the 2009 bonus in January 2011)
 - Rising Star and One-year Wonder may receive LTIP awards in 2009, however vesting or payments must be curtailed by the percentage of the service period during which the “no bonus rule” applies. For example, a July 1, 2009 stock option that vests in 36 months would be reduced by at least two-thirds for Rising Star (2010/2011) or one-third for One-year Wonder (2010). These reduced amounts cannot be restored, even if TARP is repaid
 - This disparate treatment may suggest the use of “one size fits all’ bonus and incentives for senior leadership teams to mitigate the impact of movements in and out of the proxy tables and MHCE status

Impact of June 15th Effective Date on 2009 Bonuses

★ Background

- Q-17, if a bonus payment relates to service period beginning before and ending after June 15, 2009 (or it later TARP closing date), an employee will not be treated as having accrued a bonus payment on or after that date if the bonus payment is at least reduced to reflect a portion of the service paid that occurs after June 15, 2009 (or, if later, the TARP closing)

★ Questions

- How is this provision applied? Do we have to determine the bonus as of June 15, 2009 based on performance through that date? Are we tied to our accounting accruals?

★ Observations

- The reference to the “portion of the service period” suggests a pro rata reduction based on the time period (6.5/12ths for June 15th to end of 2009), and not the actual performance or accounting accrued during that time period.”
- For 2009, this suggests a normal, full-year bonus determination process, followed by a reduction of the earned bonus to reflect the post-June 15th (or post-TARP closing) period
- However, this bonus cannot be paid until after individual is no longer a covered SEO or MHCE for purposes of prohibition on bonuses

Commission Plans Implemented After Feb. 17, 2009

★ Bonus: Treatment of Commissions

- If 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 prohibited bonus payment.

★ Commission Compensation Defined

- 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 the employee consists of the direct sale of a product or service to an unrelated customer, and
- 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)

Commission Plans Implemented After Feb. 17, 2009

★ Question

- How hard and fast is the February 17th deadline?

★ Observations

- The February 17th date is intended to preclude new bonus plans from being passed off as commission programs
- Critical qualification seems to be consistency with commission programs in effect before ARRA
- Uncertain whether a program patterned after what was in the marketplace before February 17th will qualify

Amending Existing Arrangements

★ Background

- IFR expands reach of certain compensation limitations beyond CEOs into the organization
- IFR adds new restrictions in the definition of a Golden Parachute (no single trigger changes in control (CIC) vesting or payments; no tax gross-ups)
- Most pre-ARRA TARP documents plan changes and waivers do not contemplate these added restrictions

★ Questions

- Should companies amend existing agreements or have omnibus amendments executed by affected individuals to reflect the new limitations?

★ Observations

- Companies should obtain agreements from potentially affected individuals confirming applicability of new limitations
- Any new agreements or awards should incorporate new limits as well
- Practical considerations suggest communicating any compensation program revisions at time new agreement is sought, particularly if adjustments to salaries, awarding of 2009 bonuses or long-term restructured stock agreements are being made

TARP & Executive Compensation Webinar Questions & Answers



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