Executive Compensation

Sponsor: Treasury

Summary:

Executive Compensation and Corporate Governance Rules applicable to some participants in federal crisis related programs

Sources of the Rules:

- Emergency Economic Stabilization Act of 2008 (Stabilization Act)
- Treasury Regulations under the Stabilization Act
- Treasury February 4, 2009 Release
- American Recovery and Reinvestment Act of 2009 (Recovery Act) – amended the Stabilization Act
- More Treasury Regulations expected to address Recovery Act amendments
- SEC has issued interpretations on Say-on-Pay

What Entities are Subject to the Rules?

- Stabilization Act / TARP Rules:
  - Receive TARP funds **AND** Treasury hold a "meaningful" equity or debt position
  - OR: Receive over $300 million TARP funds in an auction (different executive compensation rules applied)
  - Also: If Treasury or another agency indicates that participants are subject
- Recovery Act (amends TARP) – New Standard:
  - Entity receives TARP financial assistance
  - Financial assistance provided under TARP remains outstanding (other than warrants)

What Employees are Subject to the Rules?

- Unless otherwise indicated – Senior Executive Officers (SEOs):
  - Chief executive officer / principal executive officer
  - Chief financial officer / principal financial officer
  - Next three mostly highly compensated executive officers based on the SEC method for determining compensation disclosure
- The newly amended rules reference "highly paid employees"
  - Not limited to executive officers
- Treasury regulations haven't been released yet interpreting the amended provisions

Changes

- Unclear scope of employees subject to new rules – no longer limited to SEOs

Compensation

- Entity cannot deduct compensation in excess of $500,000 (SEOs)
- No compensation arrangement may contain incentives to take unnecessary and excessive risks that threaten the value of the entity (SEOs)
- No compensation plan that would encourage manipulation of reported earnings (all)
- Bonus limit (subject to existing written contracts dated before February 11, 2009):
  - Only in the form of restricted stock
  - No more than 1/3 of annual compensation
  - May not fully vest while Treasury holds investment
  - Covered employees based on $ amount of Treasury investment:
    - Up to $25 million – most highly compensated employee
    - $25 million or more but less than $250 million – 5 most highly compensated employees
    - $250 million or more but less than $500 million – SEOs and 10 next most highly compensated employees
    - $500 million or more – SEOs and 20 next most highly compensated employees
- Clawback:
  - Any incentive compensation received during the time the rules apply, may be clawed-back at any time in the future, if received based on materially inaccurate statements
  - SEOs and 20 most highly compensated employees

Luxury Expenditures

- Board to establish company-wide policy
- Address Luxury or excessive expenditures
- May include: entertainment, events, office and facility renovations, aviation or other transportation services and other that are not reasonable expenditures for development or reward of performance

Golden Parachutes

- SEOs and 5 most highly compensated employees
- Any payment for departure for any reason (other than payments for services performed or benefits accrued
- CHANGE: Previously only payments made upon failure of the institution or involuntary termination were prohibited

Certifications

- CEO and CFO certify compliance with all rules to SEC (if public) or Treasury (if not public)
  - Certification within 120 days of receipt of funds and within 135 days of each fiscal year end (currently only CEO certification is required, Recovery Act added CFO)
- Compensation Committee Certification:
  - Compensation Committee certification in SEC-filed annual report or, if private, to Treasury
  - Annual certification

Say-on-Pay

- Immediately Effective – This Proxy Season
- Shareholders have non-binding vote on compensation included in disclosure for meeting to elect directors
- Appears to apply to private and public companies

Review of Prior Payments

- Treasury to review prior compensation of employees of TARP funds recipients
- SEOs and 20 most highly compensated employees
- To determine if payments were inconsistent with purposes of TARP, Recovery Act or public policy
- If found to be inappropriate - Treasury to negotiate "reimbursement"

Compensation Committee

- Must confirm that compensation arrangements do not include incentives that reward excessive risk taking (that is, amend any existing policies to come into compliance)
- Meet annually with senior risk officers to align policy objectives and compensation plans (old rule – see below, committee must also meet twice a year to assess risk)
- Recovery Act:
  - Board must have compensation committee comprised solely of independent directors (unless received $25 million or less from TARP)
  - Must meet 2x per year to assess compensation plans

Dated: March 6, 2009

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