



BUSINESS ORGANIZATION & BANKING

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EXECUTIVE COMPENSATION STANDARDS UNDER THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

While restrictions on executive compensation for recipients of Troubled Assets Relief Program ("TARP") funds are still under discussion, the final text of the stimulus bill, the American Recovery and Reinvestment Act of 2009 (the "Recovery Act"), contains a number of executive compensation provisions. For the most part, these provisions modify and expand on the executive compensation standards that were originally issued a few months ago under the TARP. Essentially, the Recovery Act amends Section 111 of the Emergency Economic Stabilization Act, the source of the TARP standards, to substitute the new standards. As with the original TARP standards, each TARP participant will be required to comply with these new standards (as well as the \$500,000 deductibility limit of Section 162(m)(5)). We're providing a summary of the new Recovery Act standards.

General Limitations

TARP participant must comply with the following executive compensation and corporate governance standards:

- Limit compensation to exclude incentives for senior executive officers to take unnecessary and excessive risks that threaten the value of the institution during the period in which any obligation arising from financial assistance under TARP remains outstanding;
- Recover any bonus, retention award, or incentive compensation paid to a senior executive officer and any of the next 20 most highly-compensated employees based on statements of earnings, revenues, gains, or other criteria that are later found to be materially inaccurate;
- A prohibition on making any golden parachute payment to a senior executive officer or any of the next five most highly-compensated employees during the period in which any obligation arising from financial assistance under TARP remains outstanding (a "golden parachute payment" is defined as any payment to a senior executive

officer for departure from a company for any reason except for accrued benefits or payments for services performed); and

- A prohibition on any compensation plan that would encourage manipulation of the reported earnings of the TARP participant to enhance the compensation of any of its employees.

For purposes of these standards, "senior executive officers" of a TARP participant are its named executive officers in its proxy statement (or non-public company counterparts).

Bonus or Incentive Compensation Limit

The new standards include a prohibition on the TARP participant paying or accruing any bonus, retention award, or incentive compensation during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding. However, this prohibition does not apply to a payment of long-term restricted stock by the TARP participant as long as the restricted stock award:

- Does not fully vest during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding;
- Has a value that is not greater than one-third of the total amount of annual compensation of the employee receiving the restricted stock; and
- Is subject to such other terms and conditions as the Secretary of the Treasury determines to be in the public interest.

The application of the bonus or incentive compensation limit depends on the amount of financial assistance that a TARP participant has received.

- Where the financial assistance is less than \$25 million, the limit only applies to the participant's most highly-compensated employee (presumably, its CEO);
- Where the financial assistance is at least \$25 million but less than \$250 million, the limit applies to at least the

participant's five most highly-compensated employees (or such higher number as the Secretary of the Treasury determines to be in the public interest);

- Where the financial assistance is at least \$250 million but less than \$500 million, the limit applies to the senior executive officers and at least the participant's 10 most highly-compensated employees (or such higher number as the Secretary of the Treasury determines to be in the public interest); and
- Where the financial assistance is at least \$500 million or more, it applies to the senior executive officers and at least the participant's 20 most highly-compensated employees (or such higher number as the Secretary of the Treasury determines to be in the public interest).

The bonus or incentive compensation limit does not apply to any bonus payment required to be paid pursuant to any written employment agreement executed on or before February 11, 2009 (subject to a determination of the validity of the agreement by the Secretary of the Treasury).

Compliance Certification

The CEO and CFO of each TARP participant must provide a written certification of the participant's compliance with the compensation standards. In the case of a publicly-traded TARP participant, this certification is to be filed with the SEC when the participant files its annual report on Form 10-K. In the case of a TARP participant that is not publicly-traded, the certification is to be filed with the Secretary of the Treasury.

Compensation Committee Review

Each TARP participant must have a compensation committee of its board of directors, comprised entirely of independent directors, to review employee compensation plans. This committee is to meet at least semi-annually to discuss and evaluate these plans in light of an assessment of any risk posed to the participant from the compensation plans. In the case of TARP participants that are not publicly-traded and which have received less than \$25

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million in financial assistance, this review and evaluation may be performed by the participant's entire board of directors, rather than by a compensation committee.

Policy on Luxury Expenditures

The board of directors of each TARP participant must adopt a company-wide policy regarding "excessive" or "luxury" expenditures. These items are to be determined by the Secretary of the Treasury and would likely cover entertainment events, office and facility renovations, aviation and other transportation services, and any other activity or event that is not a reasonable expenditure for staff development, a reasonable performance incentive, or other similar measure conducted in the normal course of the participant's business.

Shareholder Advisory Vote on Executive Pay

During the period in which any obligation arising from financial assistance provided under the TARP remains outstanding, a TARP participant must arrange a non-binding shareholder vote on the compensation of executives as disclosed in the participant's proxy statement Compensation Discussion and Analysis and related compensation tables. The vote is not to be construed as overruling a decision of the board of directors, or to create or imply any additional fiduciary duty of the board of directors.

Retroactive Bonus Review and Negotiated Recovery

The new executive compensation standards direct the Secretary of the Treasury to review the bonuses, retention awards, and other compensation of the senior executives officers and the next 20 most highly-compensated employees of any TARP participant that received financial assistance before the enactment of the stimulus bill to determine if any such payments were inconsistent with the purposes of the new standards or the TARP or were otherwise contrary to the public interest. If the Secretary determines that any of these payments shouldn't have been made, the Secretary will negotiate with the TARP participant and the affected employee for an appropriate reimbursement of any improper payment.

Next Steps

Over the next few weeks, the Treasury Department is expected to issue regulations implementing the provisions summarized above. The Treasury Department's proposed executive compensation conference, which has not yet been scheduled, will probably be the source of further executive compensation reforms.

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