

## New Restrictions on Executive Pay Announced by Treasury

On February 4, 2009, the U.S. Department of Treasury announced preliminary guidelines on executive compensation which give insight into the Presidential Administration's philosophy and direction on executive compensation.

### Companies Receiving Exceptional Financial Recovery Assistance

The guidelines apply only to financial institutions receiving government assistance and they distinguish between companies needing "exceptional assistance" and those receiving assistance by participating in any new generally available capital access program.

According to the Treasury, institutions with specific negotiated agreements, outside of the broadly available programs, are classified as receiving "exceptional assistance." The following table describes the new guidelines for companies that receive this "exceptional assistance":

Provision	Comments
Restrict executive pay to \$500,000 with any additional pay in the form of restricted stock	<ul style="list-style-type: none"><li>• Applies to senior executives</li><li>• Current provision under Troubled Asset Relief Program (TARP) limits deductibility of compensation to \$500,000 annually; new provision limits compensation to \$500,000</li><li>• Restricted stock vests only after company satisfies repayment obligations to government</li></ul>
Allow shareholder "Say on Pay"	<ul style="list-style-type: none"><li>• "Say on Pay" not currently required under TARP programs</li><li>• Compensation structure and strategy must be fully disclosed and submitted to a non-binding shareholder resolution</li></ul>
Expand bonus clawbacks for deceptive practices	<ul style="list-style-type: none"><li>• Coverage expanded to include next twenty executives (beyond top five) if they knowingly engaged in deceptive practices related to their own incentive pay</li></ul>
Expand ban on golden parachutes	<ul style="list-style-type: none"><li>• Referred to as golden parachutes, but applies to any severance payment upon separation from service</li><li>• Top ten executives banned from receiving any severance payment</li><li>• Severance compensation for next twenty-five executives limited to one year's compensation</li></ul>
Adopt policy for approval of luxury expenditures	<ul style="list-style-type: none"><li>• Expands current guidelines, now requiring "certification" of expenditures</li><li>• Policy must be posted on company website</li></ul>

In addition, all companies that have received or will receive any form of government assistance must adhere to certain compliance and certification requirements:

- CEOs must re-certify annually, statutory compliance with executive compensation restrictions
- Compensation committees must explain how their executive compensation arrangements do not motivate undue risk-taking (this provision was first reported under the TARP)

### **Future Participants in Generally Available Capital Access Programs**

The Treasury also announced that it is considering adopting additional guidelines for any future generally available capital access programs. These guidelines, described below, would not apply retroactively to programs already in place (such as the Capital Purchase Program (CPP) and the Auction Purchase of Troubled Assets (TAAP)) and would be subject to public comment:

- Limit executives to \$500,000 in total annual compensation other than restricted stock, unless waived with full public disclosure and a shareholder vote, if requested
- Expand bonus clawbacks for deceptive practices to cover the next twenty executives (beyond the top five) if they knowingly engaged in deceptive practices related to their own incentive pay
- Expand the ban on golden parachutes to the top ten executives and limit severance value to one year's annual compensation for the next twenty-five
- Adopt a policy for the approval of luxury expenditures

### **Proposed Compensation Guidelines for All Public Financial Institutions**

In addition to the new restrictions, there are plans underway for future compensation reforms at financial institutions. These reforms would encompass all public financial institutions and cover compensation programs on a broader scale, not just those of senior executives. As part of the process, the Treasury and White House plan to host a conference with various interest groups to discuss long-term executive pay reforms. Items mentioned by the Treasury for inclusion in future reforms include:

- Required review and disclosure by compensation committees of strategies for aligning compensation with risk management; for example, the specifics of certain compensation arrangements and their consistency with risk management and long-term value creation
- Implementation of incentive compensation with a longer-term perspective, such as additional holding requirements on equity awards
- Passage of "Say on Pay" shareholder resolutions on executive compensation

### **Cogent Considerations**

While there is no direct near-term application for institutions not participating in government assistance, these guidelines tend to influence broader executive compensation and governance practices. Additionally, the amount of increased scrutiny and legislation in current periods could potentially lead to future legislation.

These new guidelines and proposals may have impact beyond the financial industry and should motivate a proactive response by public companies. We suggest companies do the following:

- Review the company's compensation strategy for alignment of the executive compensation strategy with business strategy and risk profile
- Review compensation mix for appropriate balance of short and long-term incentives
- Take a holistic view of executive pay programs as if they were required to be submitted for shareholder "Say on Pay" approval
- Prepare a review of executive severance arrangements to understand the impact on executives and external perspective
- Review information requirements of the Compensation Committee to ensure adequate support for decision making
- Critically assess public disclosure and transparency
- Review the Compensation Committee's performance evaluation of senior management to ensure adequate attention is given to governance, ethics, strategic planning, succession planning, and risk management
- Consider compensation related tools that help strengthen the alignment to non-financial, critical performance indicators

For more information please see the Treasury's website at <http://www.ustreas.gov/>

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## **About Cogent Compensation Partners**

Cogent Compensation Partners is a leading provider of objective and expert advice on the subject of executive compensation, corporate governance, and the linkage between company performance and executive pay.

Our executive compensation consultants assist in driving together the various interests involved in the executive pay debate: employees, shareholders, institutions, and other stakeholders. Our services include compensation committee advisory, incentive plan design, compensation strategy development, board of director compensation analysis, executive compensation related shareholder proposal assistance and stock ownership guidelines development.

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