

Corporate Governance Update

APRIL 2010

FEDERAL RESERVE UNVEILS E-APPS SYSTEM FOR REGULATORY FILINGS

The Federal Reserve unveiled in January its new E-Apps system for state member banks and holding companies to electronically submit their regulatory filings. E-Apps is intended for applications and notices related to bank holding company mergers, acquisitions, non-banking activities; and state member bank mergers, branch expansion and international banking applications. For more information about E-Apps and how to sign up, visit <http://www.federalreserve.gov/bankinforeg/eappsignup.htm>.

REGULATORS RELEASE GUIDANCE FOR MANAGEMENT OF INTEREST RATE RISK

On January 7, the FFIEC, on behalf of the federal banking regulators, issued its advisory on interest rate risk management. This advisory warns institutions that regulators will give more scrutiny during future examinations to an institution's management, modeling, stress testing and documentation of interest rate risk.

In particular, regulators have expressed concerns about interest rate risk associated with funding long-term assets with short-term liabilities in order to generate earnings. As a result, interest rate risk will be evaluated relative to the institution's capital and earnings, and management will be evaluated on its efforts to identify, measure, control, and document the institution's interest rate risk. Ultimately, it is the board of directors' responsibility to manage interest rate risk, so the board or a committee thereof should oversee the establishment, approval, implementation and annual review of interest rate risk management strategies, policies, procedures and limits. The board should receive and review regular reports allowing directors to assess interest rate risk sensitivity. The board must also approve comprehensive written policies and procedures to monitor and manage interest rate risk.

The advisory indicates that an institution's management should use modeling to determine the impact of changing rates on earnings, capital and liquidity, specifically evaluating risks of particular transactions over multiple timeframes: immediate, two years, and five to seven years. Such modeling should incorporate static and dynamic earnings simulations that quantify risk exposure. Other tools should also be used, such as stress testing including scenario and sensitivity analysis. The advisory detailing these approaches can be found at: <http://www.ffiec.gov/pdf/pr010710.pdf>.

OBAMA ADMINISTRATION PUSHES NEW SMALL BUSINESS LENDING CAPITAL PROGRAM

The Obama administration has been pushing Congress to take action on a new capital program for small banks for the purpose of boosting small business lending. The program, originally announced in 2009, would redirect \$30B from the TARP program to this new program. Participants would not be subject to the executive compensation restrictions applicable to TARP recipients. The President reiterated his interest in this program in his State of the Union address and in a February 2, 2009 town hall meeting.

The program would enable institutions with up to \$10B in assets to receive investments for up to three percent of their risk-weighted assets (or up to five percent for those with under \$1B in assets). As proposed, the dividend rate for capital investments provided under the program would begin at five percent, with reductions to as low as one percent if a bank demonstrates increased small business lending relative to a baseline. This low cost could even allow certain TARP recipients to shift their TARP participation to this program.

The program is still at the early proposal stage and will need an act of Congress to become law, where it faces some opposition. Stay tuned for further information.

FDIC PROPOSES BASING ASSESSMENT PRICING ON COMPENSATION PRACTICES

On January 12, 2010, the FDIC issued an advance notice of proposed rulemaking seeking comment on ways that the FDIC's risk-based deposit insurance assessment system could be changed to account for the risks posed by certain employee compensation programs. Specifically, the FDIC is exploring whether to incorporate employee compensation criteria into the risk-based assessment system.

The FDIC explained that it seeks to provide incentives for institutions to adopt compensation programs that better align employees' interests with the long-term interests of the institution and its stakeholders, including the FDIC. In the proposed rule, the FDIC stated that compensation programs that meet the agency's goals may include the following features:

- A significant portion of compensation for employees whose business activities can present greater risk to the institution (and who also receive a portion of their compensation according to formulas based on meeting performance goals) should be comprised of restricted, non-discounted company stock.
- Significant awards of company stock should only become vested over a multi-year period and should be subject to a clawback mechanism designed to account for the outcome of risks assumed in earlier periods.
- The compensation program should be administered by a committee of the board of directors composed of independent directors with input from independent compensation professionals.

The FDIC could conclude that financial institutions that could not attest that their compensation programs include these features present an increased risk to the Deposit Insurance Fund and, therefore, would face a higher risk-based assessment rate than those institutions that do make such attestations.

A copy of the proposed rule may be accessed through the Federal Register website, at: <http://edocket.access.gpo.gov/2010/pdf/2010-718.pdf>.

SEC APPROVES RULE CHANGE ON EXECUTIVE COMPENSATION

In December 2009, the SEC expanded proxy disclosures requirements relating to executive compensation and corporate governance. The new rules expand the discussion of the relationship of compensation policies and practices for all employees to risk management practices and risk-taking incentives, to the extent that the policies and practices are "reasonably likely" to have a material adverse effect on the company. It does not apply to companies making disclosures under the rules for smaller reporting companies.

The rule also modified disclosures regarding stock and options awards, expanded the disclosure of information regarding directors and nominees, added disclosures related to compensation consultants, and accelerated the reporting of voting results under form 8-K.

The new rule, effective February 28, 2010, can be found at <http://www.sec.gov/rules/final/2009/33-9089.pdf>. The law firm remains available to assist with institutions' annual meetings and proxy statements.

FOR ADDITIONAL INFORMATION...

If you have questions, please contact Mark Aldrich of Aldrich Bonnefin & Moore.