LAW OFFICES

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TALLY SHEETS AND OTHER COMPENSATION COMMITTEE BEST PRACTICES

Executive compensation remains a hot topic among investors, the Securities and Exchange Commission, Congress and the media, and the actions of boards and compensation committees continue to be subjected to increased scrutiny in this area. For corporate directors, the best protection against liability from shareholder suits has always been to maintain their disinterestedness, be well-informed and follow good processes that reflect thorough discussion and consideration of all relevant factors before making a decision. In today's environment, for compensation committees taking actions on executive pay, this means knowing the total amount of compensation currently being paid to the company's executive officers, and fully understanding the implications to the company of the termination of their employment under all employment, retirement and other termination agreements and arrangements. In order to most effectively do this, and be able to document that it has been done, every compensation committee should have a compensation tally sheet for each executive officer of the company.

What is a tally sheet?

The tally sheet has emerged as the centerpiece of best compensation committee practices. It involves identifying and quantifying *all* components of an executive's pay, including compensation that would be owed to him or her upon retirement or other termination of employment. The compensation committee should review and discuss the executive's tally sheet before making *any* decision on the executive's pay, in order to support the committee's position that the particular decision (whether to increase salary, pay a bonus, grant an option or restricted stock, adopt a SERP, provide a perquisite, etc.) was reasonable in the context of the executive's overall compensation package. For example, while increasing an executive's base salary or awarding the executive a discretionary bonus may, by itself, seem reasonable and not excessive, the compensation committee should also consider the impact of that increase on the other components of the executive's compensation, particularly change in control, retirement and other termination benefits, which are often tied directly to salary, bonus and other compensation.

What should go into the tally sheet?

While the concept of a tally sheet is relatively simple, actually preparing one often requires some thought, depending on the complexity of the executive's compensation package. At a minimum, every tally sheet should include, for the current fiscal year and the last two or three fiscal years, the following, to the extent applicable: base salary; annual bonus (for prior years, amounts actually paid; for current year, minimum, targeted and maximum amounts); retirement plan contributions, including 401(k) and supplemental plans, employer contributions and employee stock ownership plan

allocations; the cost to the company of perquisites and other personal benefits; insurance premiums; the value of equity compensation, including grants of stock options, restricted stock and stock appreciation rights ("SARs"); long-term incentive plan ("LTIP") awards; and the costs to the company of benefits to be provided upon a change in control and/or termination of employment, including payouts under employment and change in control severance agreements, accelerated vesting of other benefits, including stock options and restricted stock, and payouts under deferred compensation, SERP and other non-qualified retirement arrangements. As noted above, these amounts should be considered any time the compensation committee is making a decision on an executive's compensation, not just on an annual basis or when considering whether to approve or modify a particular employment or change in control agreement or retirement plan or arrangement.

While there is no one-size-fits-all approach to preparing a tally sheet, we have attached a basic form of tally sheet that includes most of the components mentioned above and that can be modified as appropriate to fit your company's situation. This tally sheet generally tracks the SEC compensation disclosure rules, modified in certain places to provide more meaningful information to the compensation committee.

How should the tally sheet exercise be reflected in the proxy statement disclosure?

The numerical components will be reflected in the summary compensation table and other applicable tables The process itself should be disclosed in the Compensation Discussion and Analysis (CD&A) section and/or the discussion of compensation committee practices. In particular, the SEC has said that a company should describe the information contained in the tally sheet and discuss how it impacted the compensation committee's decisions on executive pay. While smaller reporting companies (i.e., those with a public float of less than $75 million) have fewer required tables and are not subject to the CD&A requirement, tally sheets for their executives should be prepared in the same manner as for companies that are not smaller reporting companies. Regardless of the level of disclosure required, the primary purpose of preparing tally sheets is to ensure that the compensation committee has a full picture of how much the executives are getting paid under all components of the company's compensation program, including potential future payouts upon termination of employment.

Is there anything else compensation committees should be doing now that they might not have been doing before?

Evaluate Stated Compensation Philosophies and Existing Components of Compensation Program. At least annually, the compensation committee should revisit the compensation philosophies previously articulated in the CD&A and consider: (1) whether the components of the company's compensation program fulfill the objectives of those philosophies, and if not, how the program should be modified; and (2) even if the answer to the first question is "yes," whether those philosophies, and the company's compensation program, should be changed.

As part of this analysis, the committee should be asking itself whether the company's executive officers have sufficient

incentive to maximize corporate performance and whether the interests of executive officers are sufficiently aligned with the long-term interests of shareholders. The committee also should be asking itself whether company's ability to attract and retain top quality executives and other key personnel could be enhanced by changes to the compensation program.

Accumulated Wealth Analysis. This is another tool that compensation reform advocates are increasingly encouraging compensation committees to utilize. While there is no set way to perform the analysis (and it could be included as part of the tally sheet), the basic idea is quantify the wealth accumulated to date by the executive. This might include current base salary and targeted current year annual incentive bonus, the value of current equity award holdings, the value realized to date from prior stock sales (of shares originally acquired under equity awards), and the current value of qualified and non-qualified retirement plan balances. The analysis can also include a projection of future values of each component at a particular point in time (e.g., five years into the future), based on specified assumptions. Projections may be helpful to the compensation committee in determining whether adding a new component to the executive's compensation package is warranted, in light of the expected growth in value of the existing components.

Survey Use. Comparing the executive's compensation package with his or her counterparts' pay at companies comparable in size, performance and complexity (sometimes referred to as "benchmarking") is something compensation committees have done for many years. While survey use remains a common practice, it is not without its critics, who argue that the data can be cherry-picked and manipulated so that the executive's compensation does not appear excessive. These critics get particularly irked where the peer companies used to compare the executive=s compensation differ from those used to compare corporate performance. Notwithstanding these criticisms, when used appropriately, giving due consideration to the company's and the individual's performance, compensation surveys can be helpful in determining the reasonableness of total executive pay. The SEC has recently said that if a benchmarking is a material part of a company's compensation philosophies and decisions, the company must in its CD&A identify the benchmarks and, if applicable, its components (including component companies). For example, if a company states that it seeks to set the base salaries of its executives at or above the median of companies in its "peer group," the company must identify the other companies comprising the peer group.

Internal Pay Equity. Historically less common than survey use but increasingly considered part of best compensation practices, particularly when evaluating the reasonableness of the CEO's total pay, is consideration of internal pay equity - that is, how does the executive's total compensation compare with the other executive officers and with rank and file employees. The SEC has said that material differences in compensation amounts among a company's named executive officers may warrant discussion in the CD&A of the differences in compensation policies and decisions for individual named executive officers. For example, if the CEO's total compensation is twice the amount of the next highest paid named executive officer, the company should explain why that is the case.

Employment Agreements. A number of provisions that have long been standard in executive employment agreements have come under increased criticism, including the following:

- **Evergreen Provisions.** Many employment agreements provide for automatic renewal of the term of the agreement for an additional year on each anniversary of the effective date as long as notice to the contrary is not provided to the executive at least 90 (or some other number of) days before the renewal date and the executive does not receive an unsatisfactory performance review. Although the agreement technically may not require any action by the board or compensation committee to renew the term, the board or compensation committee nevertheless should, after discussing the matter, affirmatively act to renew (or not renew) the term of the agreement in order to fulfill its compensation oversight responsibilities. In addition, it is critical that the members of the compensation committee who are deciding whether to renew the agreement fully understand the agreement and the benefits it confers (or potentially confers) upon the executive. This is especially the case where a new member is added to the compensation committee who has not previously reviewed the agreement.

- **Definition of "Termination for Cause."** Typically, an employment agreement will provide for severance benefits only if an executive is not terminated for "cause." Historically, the term "cause" has often been limited to extremely bad conduct, such as fraud, malfeasance or criminal conduct. Increasingly, institutional investors are urging that termination for poor performance, resignation under pressure or failure to cooperate with an investigation also be considered termination for cause.

- **Change in Control Payouts.** A lump sum payout of 299% of the executive's "base amount" has long been a standard employment agreement provision, particularly among community banks. The "base amount," as defined in Section 280G of the Internal Revenue Code, is essentially equal to the executive's Box 1, W-2 compensation for the last five calendar years. The problem is that the base amount can be manipulated by the executive (such as by exercising a large amount of in-the-money stock options) so that he or she ends up receiving a severance payment that is far in excess of what was originally intended. Increasingly, companies are moving to structures where the executive's change in control severance benefit is less susceptible to manipulation, such as basing the payout amount on a multiple (up to three times) of base salary and average bonus during the preceding two or three years.

- **Tax Gross Ups.** To the extent an executive receives change in control payments and benefits in excess of 299% of his or her "base amount," he or she will be subject to a 20% excise tax on the amount that is in excess of one times the base amount, and the company cannot deduct the amount that is in excess of one times the base amount. Because the excise tax can be arbitrary in operation, some companies provide in their executive employment agreements for the "grossing up" of change in control payments so that the executive

receives the full value of his or her severance package net of the excise tax. The problem is that the extra cost of providing the gross up can far exceed the benefit to the executive of the gross-up and the amount of the change in control payments themselves. Gross-ups are increasingly being frowned upon by investors. A common alternative is to cut back the amount of change in control payments to the highest level that will not trigger the excise tax. In some cases, the cutback is made only if the executive would not be better off receiving the higher amount and paying the excise tax; in others, the cutback is made regardless.

Compensation Consultants. Any third party compensation consultants should be retained by and report directly to the compensation committee. SEC rules require disclosure of the role, if any, of compensation consultants in determining or recommending executive or director compensation, the identity of the consultants, whether the consultants are engaged directly by the compensation committee, a description of the nature and scope of their assignment and the material elements of the instructions given to them with respect to the performance of their duties under the engagement.

Compensation Committee Charter. Although only New York Stock Exchange-listed companies are required to have a written compensation committee charter, we strongly believe that every public company should have one. The charter should specify in reasonable detail the committee's duties and responsibilities. The charter should be reviewed annually both to ensure the committee is fulfilling its duties as outlined in the charter and to consider whether any changes to the charter might be appropriate. Note that SEC rules require that a company state in its annual proxy statement whether it has a written compensation committee charter. As with the audit and nominating committee charters, the compensation committee charter must either be posted on the company's website or attached to the proxy statement every three years.

Director Compensation. While the spotlight remains (and likely will remain) on the compensation of executives, companies should from time to time review the structure of their director compensation programs. In some companies, this review is performed at the compensation committee level, and in others it is the responsibility of the nominating/corporate governance committee. Either way, the full board should have the final say on how directors are paid.

There is no question that the demands and liability risks of serving as a director of a public company have increased significantly in the past 5 -10 years, and director compensation levels have generally risen commensurately. There is also a greater transparency relating to director compensation as a result of changes in the SEC's compensation disclosure rules. This has led to a rethinking by some as to what best practices are for director compensation in the current environment. Trends include the following

- A shift in the cash compensation component away from meeting fees in favor of annual retainers. The idea is that attendance is a key requirement of board membership, and directors should not be paid simply for showing up. Directors are also spending more time outside of board meetings, including reviewing materials before meetings, meeting with management and attending

educational programs, all of which has led to a general recognition that the work of directors goes well beyond coming to meetings. An annual retainer may encourage directors to view board service as it should be seen – an ongoing service while performing an oversight function, rather than an intermittent activity in the form of periodic meetings.

- Paying more for positions with greater demands, such as membership on the audit or compensation committee, or serving as chairman or lead (independent) director.

- An increased proportion of total compensation paid in the form of equity awards, to better align the interests of directors with stockholders.

- A disdain by some investors for director "retirement" plans that provide payouts following termination of service if the director has served on the board for a specified number of years. Critics contend these plans foster a mindset of entitlement and guaranteed continued service, which is at odds with what they view as a cornerstone of good corporate governance: subjecting all directors to re-election annually.

- A reduction or discontinuation of perquisites. As with perquisites provided to executive officers, these tend to provide fodder for criticism. The same value can usually be provided without any headaches simply by increasing cash compensation by a small amount.

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For over 30 years, Silver, Freedman & Taff, L.L.P. has represented financial institutions and other companies nationwide in connection with initial public offerings and other capital raising transactions, mergers and acquisitions, regulatory and enforcement issues, tax and compensation matters, and corporate governance matters. With attorneys who previously served with the federal banking and thrift regulators as well as the Securities and Exchange Commission, Silver, Freedman & Taff, L.L.P. provides a full array of services to financial institutions and other companies.

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SAMPLE FORM OF TALLY SHEET

(to be modified as appropriate)

Name and Title
of Executive:

Section 1, Part A - Annual Compensation for 2010, 2009 and 2008

Component	2010	2009	2008
Base salary			
Bonus(1)			
Stock Option Grants(2)			
Restricted Stock Grants(3)			
Non-Equity Incentive Plan Compensation(4)			
Change in Pension Value(5)			
Earnings on Deferred Comp.(6)			
Perquisites(7)			
Car Allowance			
Club Dues			
Personal Use of Corporate Aircraft			
Life Insurance Premiums(8)			
401(k) Match or Other Employer Contributions			
Non-Qualified Plan Match or Other Employer Contributions			
ESOP Allocation(9)			
Pension Accrual			
All Other Compensation(10)			
PART A TOTAL			

Section 1, Part B - Equity Compensation Gains and Other Plan Balances for 2010, 2009 and 2008

Component	2010	2009	2008
Stock Option Exercises(11)			
Value of Option Holdings(12)			
Value of Unvested Restricted Stock(13)			
Vesting of Restricted Stock(14)			
Accumulated Balances Under:			
Deferred Compensation Plan			
Pension Plan (including SERP)(15)			
401(k) Plan			
ESOP			
Other retirement plans (specify)			
PART B TOTAL			

Section 2 - Termination Scenarios

Scenario	Quantified Obligation to Executive
Termination for Cause	
Describe and quantify any payout obligations	
Voluntary Resignation	
Deferred Comp. Payout	
SERP and Any Other Defined Benefit Payout	
Continued Health Benefits(16)	
TOTAL	

Normal or Early Retirement

Deferred Comp. Payout

SERP and Any Other Defined Benefit Payout

Continued Health Benefits

TOTAL

“Involuntary” or “Good Reason” Termination
(not in connection with change in control)

Salary and/or Bonus Payout
or Continuation

Deferred Comp. Payout

SERP and Any Other Defined Benefit Payout

Continued Health Benefits

Benefits Acceleration:

Stock Options

Restricted Stock

401(k) Plan

Non-Qualified Plans

TOTAL

“Involuntary” or “Good Reason” Termination
(in connection with change in control)

Salary and/or Bonus Payout
or Continuation

299% of “Base Amount” Severance Payment

Benefits acceleration:

Stock Options

Restricted Stock

401(k) Plan

Non-Qualified Plans

Lump Sum Payout of SERP or Other Defined Benefit

Lump Sum Payout of Deferred Comp.

Continued Health Benefits

Tax Gross-Up/Reduction for 280G Cutback

TOTAL

____

(1) Bonuses for 2009 and 2008 are the amounts actually paid to the executive for those years, and the bonus for 2010 is the executive's targeted bonus amount for that year. For 2008, the minimum and maximum potential bonus awards are $_____ and $_____, respectively.

(2) For SEC compensation disclosure purposes, the number appearing in the Summary Compensation Table would be the amount expensed for the year by the Company under SFAS 123(R) for options granted to the executive during that year and prior years. As an alternative or supplement to the SFAS 123(R) expense amount, the tally sheet number that might be more meaningful to the compensation committee is the Black-Scholes value of the options granted during the year, as well as the exercise price and number of shares underlying each option granted.

(3) For SEC compensation disclosure purposes, the number appearing in the Summary Compensation Table would be the amount expensed for the year by the Company under SFAS 123(R) for restricted stock granted to the executive during that year and prior years. As an alternative or supplement to the SFAS 123(R) expense amount, the tally sheet number that might be more meaningful to the compensation committee is the number of shares awarded multiplied by the market value of the Company's stock on the date of grant.

(4) Represents earnings during year on non-equity incentive plan awards.

(5) Represents aggregate change in actuarial present value of accumulated benefit under all defined benefit and actuarial pension plans (including SERPs) from pension plan measurement date used for financial statements for prior year to pension plan measurement date for covered year. This is the methodology used for SEC compensation disclosure purposes.

(6) Represents aggregate interest or other earnings accrued on deferred compensation during the year. Under SEC compensation disclosure rules, only above-market or preferential earnings require disclosure.

(7) Represents the incremental cost to the Company of providing these perquisites to the executive. This is the methodology used for SEC compensation disclosure purposes.

(8) Represents life insurance premiums paid on the executive's behalf.

(9) Determined by multiplying the number of shares allocated by the market price of the Company's stock on the last day of the year. The amount for 2010 reflects the estimated number of shares that will be allocated multiplied by the market value of the Company's stock on ____, 2010.

(10) Represents all other compensation not included in above categories, consisting of the following ______________.

(11) Represents the value realized upon the exercise of stock options based on the difference between the market value of the Company's stock at the time of exercise and the exercise price.

(12) Represents the value of unexercised stock options based on the difference between the market value of the Company's stock (at year-end for 2008 and 2009 and at ______, 200_ for 2010) and the exercise price. It would also be prudent for the compensation committee to be provided with a detailed breakdown of the executive's unexercised options, including exercise price, number of underlying shares and vesting dates.

(13) Represents the value of unvested restricted stock based on the market value of the Company's stock (at year-end for 2008 and 2009 and at ______, 200_ for 2010). It would also be prudent for the compensation committee to be provided with a detailed breakdown of the executive's unvested restricted stock grants, including number of shares and vesting dates.

(14) Represents the market value of shares previously awarded as restricted stock on the vesting date.

(15) Represents actuarial present value of the executive's accumulated benefit, computed as of measurement date used for financial statement purposes for the year. This is the method utilized for SEC compensation disclosure purposes.

(16) For SEC compensation disclosure purposes, should be quantified based on assumptions applied under FAS 106.