Playing by the rules

How new executive compensation regulations may affect your business **Interviewed by Meredyth McKenzie**

New executive compensation regulations have been implemented for banks and financial institutions that received money through the federal Troubled Asset Relief Program, or TARP. Now, those tougher rules on executive compensation are spreading to public companies, and leaders need to make sure they know about them.

"You need to make sure your management team, board and compensation committees are aware of these rules," says Phil Stanton, firm officer and manager of the Corporate Practice Group at Greensfelder, Hemker & Gale, P.C. "They affect a number of decisions regarding compensation that may have previously been made without approval of the compensation committee or executive officers."

Smart Business spoke with Stanton about the differences between new and existing regulations, their legal ramifications, and how banks and other companies are affected.

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What are the changes in executive compensation regulations, and how do they impact banks and other businesses?

Most banks became involved through the Capital Purchase Program, a TARP subprogram, in which the Treasury invested in a bank's preferred stock. There were a number of strings attached to that money, including restrictions on executive compensation.

These included prohibitions on severance payments and bonus payments and other restrictions on compensation of highly paid executives. These financial institutions were also required to let their shareholders vote on a so-called 'say on pay' proposal, where shareholders must approve the overall executive compensation package at a company's annual meeting.

Once President Barack Obama came into office, the discussion broadened to executive compensation at nonbanking businesses. Recently, the Securities and Exchange Commission announced its intent to create new rules to change the information that public companies must disclose about their compensation.

These new rules may also include a 'say on pay' proposal for all public companies as well as requirements that are not part of the TARP rules, such as disclosures about the use of compensation consultants. Congress has also talked a lot about broad new executive compensation rules as part of a Shareholders Bill of Rights. Business leaders are understandably concerned that these changes would include outright compensation caps, but the Obama administration does not, as yet, support this.

What legal ramifications are associated with the new regulations?

One requirement for TARP participants is that CEOs and CFOs must deliver certifications to the Treasury concerning compliance with the executive compensation rules and also file these with securities filings if the bank is publicly traded. Those certifications expose executives to civil penalties if incorrect. It remains to be seen what, if any, additional penalties the SEC may impose in connection with its own regulations.

How do these regulations affect private companies?

Most of the TARP-based rules apply to any bank that took money under the TARP program, whether publicly traded or privately held. For instance, all participating banks must file certifications about their compensation process.

All banks that took public money are limited in how bonuses may be paid to executives, etc. However, private banks have been given some flexibility in that they do not need to have a separate compensation committee. The full board may perform the function that a compensation committee performs for a public company. Privately held companies other than banks should not be affected by any of the regulations we are discussing.

Do the regulations apply to banks that did not take TARP money?

There are not a lot of new regulations for banks that haven't taken TARP money, but they do need to be aware of the existing restrictions on golden parachutes and equity compensation in case they find themselves in a troubled condition. Also, a general overhaul of financial regulations at the federal level has started and could include more compensation reform.

The administration also created an executive 'compensation czar,' who can issue recommendations or provide guidance for any financial institution. There's some uncertainty, though, about how much power that office will have.

How can a business leader become educated about new and future regulations?

Executives and directors at banks and publicly traded companies need to pay close attention, whether through information from the press, law firms or state banking associations. These regulations come out quickly, and many at the federal level became effective immediately, without allowing for a comment period.

Banks and publicly traded companies will have to deal with these rules for several years, even after the recession ends. Banks can get out of some of the most restrictive requirements by giving back TARP money, but paying back TARP money to the Treasury can be tricky. You have to work with regulators and get approval that you're in good shape without the money. There will be more changes for all public companies and banks, either from the SEC, the new executive compensation czar or financial overhaul. <<

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