M Benefit Solutions
Bank Strategies®
An M Financial Group Company

The Bottom Line

Executive and Director Benefits and BOLI

Volume 42 September 2016

Highlights of this Issue

The "Clawback" of Erroneously Awarded Executive Compensation and Section 409A

Last summer, the SEC proposed rules that would direct national securities exchanges and associations to establish listing standards requiring companies to develop and implement policies to recover incentive-based executive compensation that later is shown to have been awarded in error. The proposed rules were issued under Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. No final rules have yet been issued.

Below we briefly summarize the proposed rules and then discuss the issues involved in the recovery of incentive compensation from nonqualified plans with respect to the application of Internal Revenue Code Section 409A to the recovery.

Highlights of Proposed SEC Rule 10D-1

Overview

- Listed companies would be required to adopt a compensation recovery policy.
- Compensation recovery ("clawback") would be required from current and former executive officers who received incentive-based compensation during the three fiscal years preceding the date on which the company is required to prepare an accounting restatement to correct a material error. The recovery would be required regardless of whether there was any misconduct by an executive officer.
- The amount of incentive-based compensation clawed back from an executive officer would be the amount in excess of the amount the executive officer would have received had the compensation been determined based on the accounting restatement.
- Companies would have discretion not to recover the excess compensation if the direct expense of enforcing recovery would exceed the amount to be recovered or, for foreign private issuers in specified circumstances, where recovery would violate home country law.

(Continued on next page)

Introducing!

M Benefit Solutions – Bank Strategies recently launched a redesigned website.

Please visit our new website at www.boli.mben.com.

- Under the proposed rules, a company would be subject to delisting if it does not adopt a compensation recovery policy that complies with the applicable standard, disclose the policy in accordance with Commission rules, or comply with the policy's recovery provisions.

Definition of Executive Officers

The proposed rules include a definition of an "executive officer" that is modeled on the definition of "officer" under Section 16 under the Exchange Act. The definition includes the company's president, principal financial officer, principal accounting officer, any vice-president in charge of a principal business unit, division or function, and any other person who performs policy-making functions for the company.

Incentive-Based Compensation Subject to Recovery

Under the proposal, incentive-based compensation that is granted, earned or vested based wholly or in part on the attainment of any financial reporting measure would be subject to recovery. Financial reporting measures are those based on the accounting principles used in preparing the company's financial statements, any measures derived wholly or in part from such financial information, and stock price and total shareholder return.

Proposed Disclosure

Each listed company would be required to file its compensation recovery policy as an exhibit to its annual report.

In addition, if during its last completed fiscal year the company either prepared a restatement that required recovery of excess incentive-based compensation, or there was an outstanding balance of excess incentive-based compensation relating to a prior restatement, a listed company would be required to disclose, among other things, the aggregate dollar amount of excess incentive-based compensation attributable to the restatement, the names of persons subject to a clawback from whom the company decided not to pursue recovery, the amounts due from each such person, and a brief description of the reason the company decided not to pursue recovery, and, if amounts of excess compensation to be clawed back remain outstanding for more than 180 days, the name of, and amount due from, each person at the end of the company's last completed fiscal year.

Covered Companies

The proposed rules would apply to all listed companies except for certain registered investment companies to the extent they do not provide incentive-based compensation to their employees.

Transition Period

The proposal requires an exchange's listing rules become effective no later than one year following the publication date of the final rule.

Each listed company would be required to adopt its recovery policy no later than 60 days following the date on which the listing exchange's listing rule becomes effective. Each listed company would be required to recover all excess incentive-based compensation received by current and former executive officers on or after the effective date of Rule 10D-1 that results from attaining a financial reporting measure based on financial information for any fiscal period ending on or after the effective date of Rule 10D-1.

Listed companies would be required to comply with the new disclosures in proxy or information statements and Exchange Act annual reports filed on or after the effective date of the listing exchange's rule.

Application to Nonqualified Deferred Compensation and the Effect of Code Section 409A

Incentive compensation otherwise subject to the clawback rules that is deferred into a nonqualified deferred compensation plan or which is taken into account under a nonqualified supplemental executive retirement plan is subject to clawback.

(Continued on next page)

SEC View of Clawbacks from Nonqualified Plans

With respect to how deferred compensation should be clawed back, the SEC stated in a footnote in its discussion of the proposed regulations that:

Similarly, for nonqualified deferred compensation, the executive officer's account balance or distributions would be reduced by the excess incentive-based compensation contributed to the nonqualified deferred compensation plan and the interest or other earnings accrued thereon under the nonqualified deferred compensation plan. In addition, for retirement benefits under pension plans, the excess incentive-based compensation would be deducted from the benefit formula, and any related distributions would be recoverable.

The SEC did not consider potential tax issues of these reductions.

Code Section 409A Issues

Some commentators have questioned whether the SEC treatment would result in a violation of Section 409A, specifically whether the clawback would be considered an accelerated payment of deferred compensation under Section 409A.

If the clawback is considered a repayment of a debt owed to the employer by the executive officer, there is support in the Section 409A regulations that such a repayment would be an acceleration of payment, at least to the extent the repayment exceeds $5,000. See IRS Reg. Section 1.409A-3(j)(4)(xiii) (a plan may provide for an acceleration of payment to satisfy a debt of the employee to the employer, but only to the extent the payment does not exceed $5,000; anything in excess of this amount would be an impermissible acceleration of payment and subject to Section 409A penalties).

There is also a question whether the mistaken addition to a participant's account itself would cause a violation of Section 409A. Mistaken additions to a deferral account in other circumstances can result in a Section 409A violation, which, according to the IRS, can only be corrected in certain prescribed ways within certain prescribed periods if Section 409A penalties are to be avoided. If the IRS applies these same standards to clawbacks, there may be 409A penalties to be paid with respect to the erroneous additions regardless of how such additions are paid back to the company.

Potential Solutions to Section 409A Issues

If clawbacks are looked at in another way, however, all Section 409A consequences and penalties could be avoided. Many nonqualified plans have forfeiture provisions and if a benefit is forfeited under these provisions, we are not aware of any IRS action or suggestion that such a forfeiture would cause a Section 409A violation, as long as there is no other benefit substituted for the forfeited benefit. This may suggest that nonqualified deferred compensation plans of listed companies should be amended to explicitly provide that any amounts that must be recovered under the SEC clawback rule (as well as any earnings on such amounts) should be considered forfeited under the plan.

This would seem a sensible way to treat clawbacks as the evils sought to be avoided by Section 409A are not implicated in the operation of the SEC clawback rule.

Another way the IRS could deal with the issue is to modify the 409A regulations to provide that to the extent a clawback results in an acceleration of payment, it is excepted from Section 409A consequences, in a manner similar to the current exception in the Section 409A regulations for acceleration of payments required to comply with conflict of interest laws.

In any case, we would suggest companies that have nonqualified deferred compensation benefits that could be impacted by the clawback rules to consult with their counsel about how to mitigate potential issues. In addition, we hope that the IRS will soon clarify its stance regarding clawbacks and Section 409A.

Upcoming Event

ABA National Convention

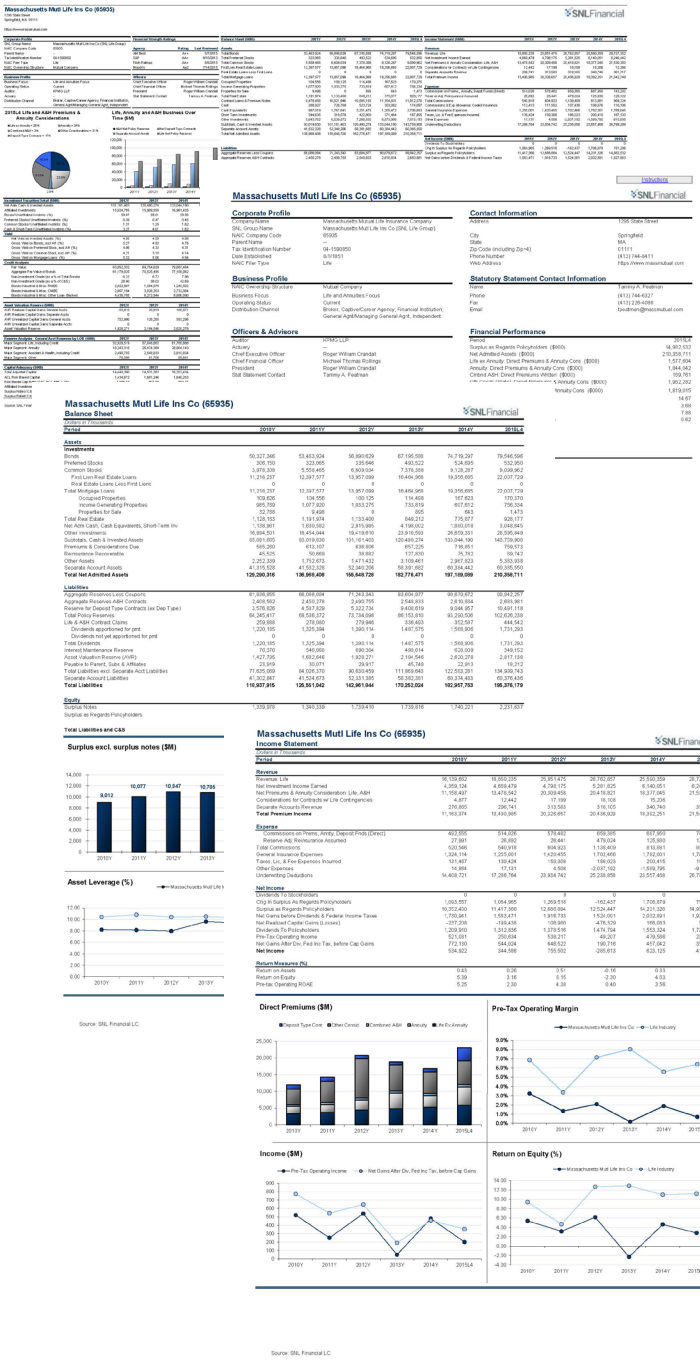
October 16–19, 2016
Music City Center, Nashville, TN

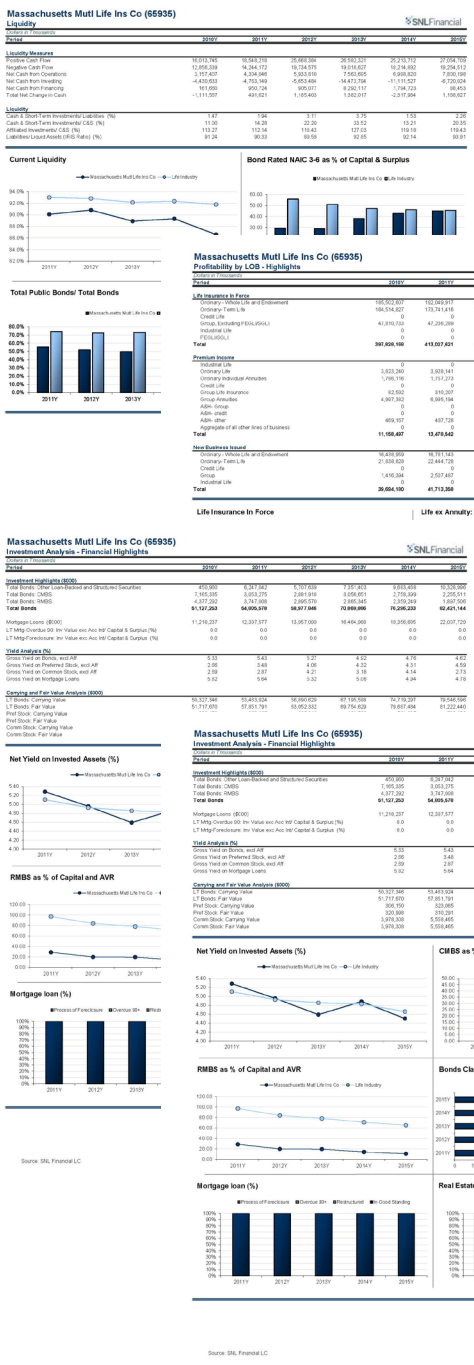
M Benefit Solutions
Bank Strategies®
An M Financial Group Company

BOLIPRO™

NEW ON BOLIPRO™

We are pleased to announce expanded financial reporting for life insurance carriers. These will be located in the Carrier Information section of the website.





Some Administration Tax Proposals from the 2017 Budget

The President has released his final budget proposal. Many of its tax provisions have been previously proposed and it is unlikely any of the provisions will pass through Congress this year. However, the budget provides insight into many Democratic priorities and it is likely that any subsequent Democratic administration would take up substantial portions of the President's budget as an initial set of policy positions.

Life Insurance Proposals

Expanded Interest Deduction Limits for COLI Policies

Current law limits corporate deductions of interest on loans to buy life insurance on individuals, with a de minimus key person exception. This is coupled with a separate pro-rata limit on all interest deductions based on the amount of interest expenses allocated to unborrowed cash values in life insurance policies, with exceptions for policies on 20% owners, officers, directors, and employees. The budget, as it has in previous years, proposes to expand the limit on interest deductions to eliminate the exceptions it currently provides for officers, directors, and employees. This would reduce the tax effectiveness of new COLI policies purchased after the effective date of the law. The proposal would apply to policies entered into after December 31, 2016, but with retroactive effect on any policies that are materially modified after that date.

Limited Exceptions to Transfer for Value Rules

The budget would modify the transfer-for-value rule by eliminating the exceptions that currently apply if the buyer is a partner of the insured, a partnership in which the insured is a partner, or a corporation in which the insured is a shareholder or officer. Instead, under the proposal, the rule would not apply in the case of a transfer to the insured, or to a partnership or a corporation of which the insured is a 20% owner.

Reporting for Sales of Existing Life Insurance Contracts

The budget imposes new reporting requirements on purchasers of existing policies with death benefits exceeding $500,000. The purchaser would need to disclose the policy issuer and number, buyer and seller's identity, and purchase price to the IRS, the insurance company that issued the policy, and the policy seller. Upon payment of death benefits the insurance company would be required to report the gross benefit paid, buyer's TIN, and estimated basis to the IRS and to the payee.

Income Tax Proposals

The 2017 budget re-proposes a variety of new tax rates and strategies that would significantly impact high net worth individuals. These proposals include:

- Increasing the capital gains tax rate to 24.2% (28% when including the net investment income tax)
- Impose capital gains tax upon gifts and bequests of appreciated assets by treating them as sales triggering gains on appreciated value
- Create a 30% "Fair Share Tax" on the adjusted gross income (AGI) of earners with over $1 million AGI (with a phase-in that begins at $1 million and with a full phase-in at $2 million)
- Reduce the value of some deductions in the 33% and greater tax brackets to 28%
- Consolidate charitable deductions while extending their carry-forward period to 15 years
- Tax carried interests as ordinary income instead of long-term capital gains

These tax changes generally narrow the gap in tax treatment between long-term capital gains and ordinary income, and limit the value of certain deductions in higher income brackets. Additionally, they incentivize charitable giving through an increased carry forward period and simplified compliance requirements.

Advisor Firms

M Benefit Solutions - Bank Strategies is structured to provide our clients with consistent nationwide coverage. We have identified several Advisors with extensive experience in bank executive and director benefits and BOLI to provide consulting services to clients nationwide.*

Distributed throughout the country, these Advisors work with M Benefit Solutions and bank clients to design programs which meet each bank's specific needs and to ensure high quality administrative and compliance services.

BoliColi.com

John Gagnon
jgagnon@bolicoli.com
Reading, MA
Phone: 781.942.5700; Fax: 781.942.5710

ECI/Bank Benefits

Thomas V. Lynch
tlynch@ecicompanies.com
Minneapolis, MN
Phone: 952.885.2727; Fax: 952.885.0995

Evergreen Consulting, Inc.

James Cheney
jcheney@evergreenci.com

Robert Kozloski
rkozloski@evergreenci.com
Chattanooga, TN
Phone: 423.756.3828; Fax: 423.265.0735

Financial Designs Ltd.

Gerald Middel
jmiddel@fdltd.com
Denver, CO
Phone: 303.948.4068; Fax: 303.832.7100

M Benefit Solutions - Bank Strategies

Mark Boomgaarden
mark.boomgaarden@mben.com
St. Peter, MN
Phone: 952.334.3239

Douglas Harper
douglas.harper@mben.com
Carefree, AZ
Phone: 480.223.8141

Thomas J. Jordan
tom.jordan@mben.com
Austin, TX
Phone: 512.656.9950

Dan Wagner
dan.wagner@mben.com
Chesterfield, MO
Phone: 636.530.1635

The VisionLink Advisory Group

Joe Miller
jmiller@vladvisors.com
Irvine, CA
Phone: 949.265.5708

Craig Rutledge
crutledge@vladvisors.com
Irvine, CA
Phone: 949.265.5712

**These Advisors represent independently operated firms and are registered with M Holdings Securities Inc. a registered Broker/Dealer, Member FINRA/SIPC. M Benefit Solutions and M Holdings Securities, Inc. are affiliated companies.*

About M Benefit Solutions - Bank Strategies

M Benefit Solutions - Bank Strategies, based in Portland, Oregon, is a division of M Benefit Solutions, a Subsidiary of M Financial Group. Please go to www.mfin.com/DisclosureStatement.htm for further details regarding this relationship. M Benefit Solutions is a recognized leader in the community bank executive and director benefits and BOLI marketplace. Through a network of firms located in key markets across the country, M Benefit Solutions - Bank Strategies helps banks attract, retain, and reward key executives and directors through the design, implementation, and administration of benefit programs that aim to maximize the use of a bank's financial resources. M Benefit Solutions - Bank Strategies is the Independent Community Bankers of America's (ICBA) Preferred Service Provider for executive and director benefits and BOLI. For more information, please visit www.boli.mben.com.

(MHS – #1310-2016)

M Benefit Solutions
Bank Strategies®

An M Financial Group Company

ICBA Preferred Service Provider®