M Benefit Solutions®
Bank Strategies
Total solutions for attracting, retaining, and rewarding top talent

Preferred SERVICE PROVIDER

First Quarter 2011

THE BOTTOM LINE
EXECUTIVE AND DIRECTOR BENEFITS AND BOLI

FSOC Study of Volcker Rule and Its Application to BOLI

In January, the Financial Stability Oversight Council (FSOC) issued its study and recommendations under Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, also known as the Volcker Rule. The Volcker Rule prohibits banking entities, which benefit from federal insurance on customer deposits or access to the discount window, from engaging in proprietary trading and from investing in or sponsoring hedge funds and private equity funds, subject to certain exceptions.

As a result of the language used in the Volcker Rule, there has been some concern that private placement BOLI could be considered a "hedge fund" or a "private equity fund." A number of concerned commentators, including M Benefit Solutions, submitted comments to the FSOC requesting that the regulations to implement the Volcker Rule specifically clarify that two common life insurance arrangements are not included under the restrictions which apply to investments by banking entities in hedge funds and private equity funds:

- Investments in life insurance products supported by an unregistered, separate account of an insurance company whose underlying investments are limited to assets that are eligible for investment by a national bank under the National Bank Act; and
- Investments in life insurance products supported by an unregistered, separate account of an insurance company to hedge obligations of banking entities under deferred compensation programs for bank personnel.

The study's response was a recommendation that banking "Agencies should examine this [definition] carefully so as not to preclude certain insurance products that may not have been intended to be limited by the Volcker Rule. One approach may be for Agencies to design, by rule, a process by which insurance companies can request an interpretative determination of whether particular separate accounts and products qualify under the definition of hedge or private equity fund. Another would be to determine whether the activity promotes the safety and soundness of the banking entity under Section 13(d)(1)(J) of the BHC Act."

We take the FSOC's comments to be positive and believe it gives bank regulators a good foundation on which to exempt private placement BOLI from the Volcker rule. However, M Benefit Solutions will continue to monitor regulatory activity with respect to this issue and will keep you informed of significant developments.

Securities offered through M Holdings Securities, Inc., a registered Broker/Dealer, member FINRA/SIPC.
M Financial Group is the parent company of M Benefit Solutions and M Holdings Securities, Inc.

Life Insurance: Call Report Modifications

Life Insurance Assets to be Reported as General Account, Separate Account, or Hybrid Account

Life insurance assets will no longer be reported in the aggregate if revisions by the Federal Financial Institutions Examination Council to the Consolidated Reports of Condition and Income (Call Report) are approved by the U.S. Office of Management and Budget (OMB). The revision to Item 5 of Schedule RC-F—Other Assets will break reporting of life insurance assets into three separately reported sub-items: general account assets (Item 5a), separate account assets (Item 5b), and hybrid account assets (Item 5c). The new reporting is proposed to begin with respect to the March 31, 2011 report date.

General account assets are life insurance policy cash values supported by the general assets of the insurance carrier. Separate account assets are life insurance policy cash values supported by assets segregated from the general assets of the insurance carrier. Hybrid account assets combine features of general account and separate account assets. Similar to a general account life insurance policy, the general assets of the insurance carrier support the policy's cash surrender value. However, the assets of a hybrid account are protected from claims on the insurance carrier. M Benefit will report the type of asset(s) held by its bank clients.

A draft of the revised report form can be found at: http://www.ffiec.gov/pdf/FFIEC_forms/FFIEC041_201103_f_changes3.pdf

A draft of the revised instructions can be found at: http://www.ffiec.gov/pdf/FFIEC_forms/FFIEC031_FFIEC041_201103_i_changes.pdf

Enhanced Compensation Structure Reporting Applicable to Banks and Other Covered Financial Institutions

Proposed Rules

Proposed rules to implement Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) are being considered by the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), the National Credit Union Administration (NCUA), the Securities and Exchange Commission (SEC); and the Federal Housing Finance Agency (FHFA), collectively, the Agencies.

All of the listed Agencies have yet to approve the draft of the proposal. This summary is based on a draft of the proposal dated February 4, 2011. If approved by the Agencies, the proposed regulations will be published in the Federal Register and a 45-day comment period will begin.

The rules would apply to banks with more than $1 billion in assets and other financial institutions (see below).

Section 956 of Dodd-Frank—Overview

Disclosure of Incentive-Based Compensation Arrangements

Section 956 of Dodd-Frank requires that the Agencies jointly prescribe regulations or guidelines to require each "covered financial institution" to disclose to the appropriate Federal regulator the structures of

(Continued on next page)

all incentive-based compensation arrangements offered by such covered financial institutions sufficient to determine whether the compensation structure:

- Provides an executive officer, employee, director, or principal shareholder of the covered financial institution with excessive compensation, fees, or benefits; or
- Could lead to material financial loss to the covered financial institution.

Prohibition of Certain Compensation Arrangements

Dodd-Frank Section 956 also required the Agencies to jointly prescribe regulations or guidelines that prohibit any type of incentive-based payment arrangement, or any feature of any such arrangement, that the regulators determine encourages inappropriate risks by covered financial institutions:

- By providing an executive officer, employee, director, or principal shareholder of the covered financial institution with *excessive compensation, fees, or benefits*; or
- That could lead to *material financial loss* to the covered financial institution.

Under Section 956, "**Covered financial institution**" means:

- A depository institution or depository institution holding company, as such terms are defined in Section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813);
- A broker-dealer registered under Section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o);
- A credit union, as described in Section 19(b)(1)(A)(iv) of the Federal Reserve Act;
- An investment advisor, as such term is defined in Section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11));
- The Federal National Mortgage Association;
- Any other financial institution that Agencies, jointly, by rule, determine should be treated as a covered financial institution for purposes of this section.

Exemption: The requirements of Section 956 do not apply to covered financial institutions with assets of less than $1 billion.

Proposed Regulations

Disclosure of Incentive-Based Compensation Arrangements

The proposed regulations would require that an annual report be filed by each covered financial institution containing:

- A clear narrative description of the components of the covered financial institution's incentive-based compensation arrangements applicable to covered persons (executive officers, employees, directors, and principal shareholders) and specifying the types of covered persons to which they apply;
- A succinct description of the covered financial institution's policies and procedures governing its incentive-based compensation arrangements;
- For "larger covered financial institutions," a succinct description of any specific incentive compensation policies and procedures for the institution's executive officers, and other covered persons whom the board or a committee thereof determines individually to have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance;
- Any material changes to the covered financial institution's incentive-based compensation arrangements and policies and procedures made since the covered financial institution's last report was submitted; and
- The specific reasons the covered financial institution believes the structure of its incentive-based compensation plan does not provide covered persons incentives to engage in behavior that is likely to cause the covered financial institution to suffer a material financial loss, and does not provide covered persons with excessive compensation.

(Continued on next page)

Prohibition on Excessive Compensation

Compensation for a covered person will be considered excessive when amounts paid are unreasonable or disproportionate to, among other things, the amount, nature, quality, and scope of services performed by the covered person. In making such a determination, the Agencies will consider:

- The combined value of all cash and non-cash benefits provided to the covered person;
- The compensation history of the covered person and other individuals with comparable expertise at the covered financial institution;
- The financial condition of the covered financial institution;
- Comparable compensation practices at comparable institutions, based upon such factors as asset size, geographic location, and the complexity of the institution's operations and assets;
- For postemployment benefits, the projected total cost and benefit to the covered financial institution;
- Any connection between the individual and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the covered financial institution; and
- Any other factors the Agency determines to be relevant.

Prohibition on Taking Inappropriate Risks that May Lead to a Material Financial Loss

This prohibition will apply only to those incentive-based compensation arrangements for individual covered persons, or groups of covered persons, whose activities may expose the covered financial institution to a material financial loss. Such covered persons include:

- Executive officers and other covered persons who are responsible for oversight of the covered financial institution's firm-wide activities or material business lines;
- Other individual covered persons, including non-executive employees, whose activities may expose the covered financial institution to a material financial loss (e.g., traders with large position limits relative to the covered financial institution's overall risk tolerance); and
- Groups of covered persons who are subject to the same or similar incentive-based compensation arrangements and who, in the aggregate, could expose the covered financial institution to a material financial loss, even if no individual covered person in the group could expose the covered financial institution to a material financial loss (e.g., loan officers who, as a group, originate loans that account for a material amount of the covered financial institution's credit risk).

The proposed regulation provides that an incentive-based compensation arrangement established or maintained by a covered financial institution for one or more of the above covered persons does not comply with the regulations unless it:

- Balances risk and financial rewards, for example by using deferral of payments, risk adjustment of awards, longer performance periods, or reduced sensitivity to short-term performance;
- Is compatible with effective controls and risk management; and
- Is supported by strong corporate governance.

These three standards are consistent with the principles for sound compensation practices in the Banking Agency Guidance.

Larger Covered Financial Institutions

Larger covered financial institutions (generally those with $50 billion of assets or more) are subject to further specific requirements.

(Continued on next page)

Deferral Arrangements Required for Executive Officers

Fifty Percent of Incentive-based Compensation Deferred for 3 Years

At larger covered financial institutions, at least 50 percent of the incentive-based compensation of an "executive officer," would have to be deferred over a period of at least three years.

The proposed regulation also requires that deferred amounts paid be adjusted for actual losses or other measures or aspects or performance that are realized or become better known during the deferral period.

Rationale for Deferral

The Agencies believe that incentive-based compensation arrangements for executive officers at larger covered financial institutions are likely to be better balanced if they involve the deferral of a substantial portion of the executives' incentive compensation over a multi-year period in a way that reduces the amount received in the event of poor performance.

Consistent with International Standards

Requiring deferral for executive officers is also consistent with international standards that establish the expectation that large interconnected firms require the deferral of a substantial portion of incentive-based compensation (identified as 40 to 60 percent of the incentive award, or more) for certain employees for a fixed period of time not less than three years and that incentives be correctly aligned with the nature of the business, its risks and the activities of the employee in question.

Large Organizations Pose Greater Risk to Financial System

Furthermore, in enacting the Dodd-Frank Act, Congress recognized that larger organizations may pose a greater risk to the financial system by requiring the creation of enhanced prudential standards for certain nonbank financial companies with total consolidated assets greater than $50 billion.

Pro-Rata Payments or Vesting Over 3-Year Period

A covered financial institution may decide to release (or allow vesting of) the full deferred amount in a lump-sum only at the conclusion of the deferral period. Alternatively, the institution may release the deferred amounts (or allow vesting) in equal increments, pro rata, for each year of the deferral period. However, in no event may the release or vesting be faster than a pro rata equal-annual-increments distribution.

Special Review and Approval Requirement for Other Designated Individuals

The proposed regulation also requires that, at a larger covered financial institution, the board of directors, or a committee thereof, identify covered persons (other than executive officers) that individually have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance.

The Covered Persons

The proposal notes that these covered persons may include, for example, traders with large position limits relative to the institution's overall risk tolerance and other individuals that have the authority to place at risk a substantial part of the capital of the covered financial institution.

(Continued on next page)

Board Approval of Compensation Arrangements

The proposed regulation would require that the board of directors, or board committee, approve the incentive-based compensation arrangement for such individuals, and maintain documentation of such approval.

Required Board Finding that Compensation Arrangement Balances Rewards and Risks

Under the proposal, the board (or committee) of a larger covered financial institution may not approve the incentive-based compensation arrangement for an individual identified by the board (or committee) unless the board (or committee) determines that the arrangement, including the method of paying compensation under the arrangement, effectively balances the financial rewards to the employee and the range and time horizon of risks associated with the employee's activities.

Methods of Balancing Rewards with Risks

The proposal recognizes that the methods used to balance the rewards and risks of the individual's activities may include deferral of payments, risk adjustment of awards, reduced sensitivity to short-term performance, or extended performance periods, or other appropriate methods. However, the board (or committee) must determine that the method(s) used effectively balance the financial rewards to the employee and the range and time horizons of the risks associated with the employee's activities. In performing its duties in this regard, the board, or committee thereof, must evaluate the overall effectiveness of the balancing methods used in the identified covered person's incentive compensation arrangements in reducing incentives for inappropriate risk taking by the identified covered person, as well as the ability of the methods used to make payments sensitive to the full range of risks presented by that employee's activities, including those risks that may be difficult to predict, measure, or model.

Welcome New BOLI Advisors

Please join us in welcoming our newest BOLI Advisors, **Mark Boomgaarden** and **Douglas Harper**. Each brings with him a wealth of BOLI experience and strong relationships within the community bank marketplace. Welcome!

Advisor Firms

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

Distributed throughout the country, these Advisors work interactively 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.

ECI/Bank Benefits

Thomas V. Lynch
tlynch@ecicompanies.com

Minneapolis, MN
Phone: 952.885.2727; Fax: 952.885.0995

Edgewater Advisors Ltd.

John F. Saunders
saunders@edgewateradvisorsltd.com

Pleasantville, NY
Phone: 914.747.0626

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

GW Financial, LLC

John Gagnon
jgagnon@cfnii.com

Reading, MA
Phone: 781.942.5700; Fax: 781.942.5710

M Benefit Solutions - Bank Strategies

Mark Boomgaarden
mark.boomgaarden@mben.com

St. Peter, MN
Phone: 507.931.7914

Douglas Harper
douglas.harper@mben.com

Carefree, AZ
Twin Falls, ID
Phone: 480.223.8141

Thomas J. Jordan
tjordan@ecicompanies.com

Austin, TX
Phone: 512.656.9950

Dan Wagner
dwagner@mben.com

Chesterfield, MO
Phone: 636.530.1635

SilverStone Group

Thomas J. Von Riesen
tvonriesen@ssgi.com

Omaha, NE
Phone: 800.288.5501; Fax: 402.963.4084

Jamie Corbin
jcorbin@ssgi.com

Des Moines, IA
Phone: 515.285.5882

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 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.mben.com/bank.

This information incorporated into this presentation has been taken from sources, which we believe to be reliable, but there is no guarantee as to its accuracy.

This material is intended for informational purposes only and should not be construed as legal or tax advice and is not intended to replace the advice of a qualified attorney, tax advisor or plan provider. Please consult with your attorney or tax advisor as applicable.

Pursuant to IRS Circular 230, M Benefit Solutions notifies you as follows: The information contained in this document is not intended to and cannot be used by anyone to avoid IRS penalties.

M Benefit Solutions®
Bank Strategies

An M Financial Group Company

ICBA
Preferred
SERVICE PROVIDER

M Benefit Solutions - Bank Strategies
M Financial Plaza
1125 NW Couch Street, Suite 900
Portland, OR 97209
503.238.1813
fax: 503.238.1815
www.mben.com/bank