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MEMORANDUM TO CLIENTS AND FRIENDS

November 14, 1995

TO: Our Clients and Friends

FROM: Grady & Associates

RE: Adoption of "Bad Boy" Provisions in Compensation Plans

Sometimes the news that is not widely reported is more interesting than the news that is. Take for example the summer 1995 bid last summer by Lee Iacocca and Kirk Kerkorian to acquire the Chrysler Corporation, of which Mr. Iacocca had once been chairman. The bid was covered by all of the media with great fanfare, although few in a position to know believed that the bid would succeed. The fact that the bid cost Mr. Iacocca lost profits of approximately $40 million was considerably less widely reported.

How did Lee Iacocca's dream become a nightmare? At the time of his joint bid for Chrysler Corporation, Mr. Iacocca held Chrysler stock options valued at approximately $40 million. That's the good part. The bad part is that the stock option plan pursuant to which Mr. Iacocca's options were granted provides that he forfeits all of his options if, during the time his options are exercisable, he "(a) takes other employment or renders services to others without the written consent of [Chrysler] or (b) conducts himself in a manner adversely affecting [Chrysler]." In the judgment of the Chrysler Board of Directors, the takeover bid was conduct that adversely affected the corporation. Accordingly, the Board vaporized Mr. Iacocca's options.

There is no good reason for companies, including banks, thrifts and holding companies, to keep some sort of "bad boy" provision out of their compensation and benefit plans, particularly plans whose purpose is to promote continuing success of the corporation. A plan whose primary purpose is to compensate for services rendered, rather than to create or enhance incentives for continued valuable service to the corporation, would be less appropriate for use of a "bad boy" forfeiture provision.

Bad boy penalties can come in a variety of forms: requiring forfeiture of unexercised options or other continuing benefits; requiring restitution to the corporation of benefits already received (such as restitution of the spread at exercise for options already exercised) in addition to forfeiture of

unexercised options; and so on. The penalties can apply in stock option plans but by no means should consideration of bad boy penalties be limited to stock option plans. The penalties can be triggered by any of a number of acts or events that adversely affect the corporation, its reputation and standing. Penalties can be automatically imposed or they can be discretionary on the corporation's part, and they can be effective for a period the corporation chooses.

We thoroughly expect bad boy provisions to become commonplace, whereas they have heretofore been included by isolated corporations here and there (IBM, Dow Chemical, Goodyear and, of course, Chrysler, for example). Had Chrysler not had such a bad boy penalty in its stock option plan, it would have provided approximately $40 million of funds to those who sought to take it over. We believe it is fair to say that the overwhelming majority of companies, including financial institutions, do not have bad boy penalties in their plans.

Grady & Associates would be pleased to help you craft bad boy amendments to your existing plans, amendments that strike the appropriate balance between giving institutions the protections to which they are entitled and avoiding impairment of the value of plan benefits. Although application of the amendments should probably be limited to future grants and awards, we believe such well-balanced bad boy provisions ought to be considered by every institution. And the bad boy penalties can be added to existing plans without having to seek additional shareholder approval.

If you would like to weigh the costs and benefits of incorporating bad boy penalties into your institution's plans, or if your institution is ready to adopt bad boy penalties, please give us a call and we will gladly answer any questions you may have about the process.

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