NOTICE 2008-PSSFI

I. PURPOSE

This Notice, issued pursuant to sections 101(a)(1), 101(c)(5), and 111 of the Emergency Economic Stabilization Act of 2008, Div. A of Pub. Law No. 110-343 (EESA), provides guidance on certain executive compensation provisions applicable to a financial institution from which the Department of the Treasury (Treasury) acquires troubled assets through programs for systemically significant failing institutions (program).

II. BACKGROUND RELATING TO EESA EXECUTIVE COMPENSATION PROVISIONS

Section 101(a) of EESA authorizes the Secretary of the Treasury to establish a Troubled Asset Relief Program (TARP) to “purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary, and in accordance with this Act and policies and procedures developed and published by the Secretary.” Section 120 of EESA provides that the TARP authorities generally terminate on December 31, 2009, unless extended upon certification by the Secretary of the Treasury to Congress, but in no event later than two years from the date of enactment of EESA (October 3, 2008) (the TARP authorities period). Thus, the TARP authorities period is the period from October 3, 2008 to December 31, 2009 or, if extended, the period from October 3, 2008 to the date so extended, but not later than October 3, 2010.

Section 111 of EESA provides that financial institutions that sell assets to the Treasury may be subject to specified executive compensation standards. In the case of auction purchases from a financial institution that has sold assets to the Treasury in an amount that exceeds $300 million in the aggregate (including direct purchases), the financial institution is prohibited under section 111(c) of EESA from entering into any new employment contract with a senior executive officer (SEO) that provides a golden parachute to the SEO in the event of the SEO’s involuntary termination, or in connection with the financial institution’s bankruptcy filing, insolvency, or receivership. This prohibition applies during the TARP authorities period. The Treasury has issued separate guidance on these provisions (Notice 2008-TAAP).

In addition, for auction purchases, section 302 of EESA enacted tax provisions as amendments to sections 162(m) and 280G of the Internal Revenue Code that address compensation paid to certain executive officers employed by financial institutions that sell assets under TARP. The Treasury and the Internal Revenue Service have issued separate guidance on these provisions (I.R.S. Notice 2008-94).

In the case of direct purchases, section 111(b)(1) of EESA requires financial institutions to meet appropriate standards for executive compensation and corporate governance, as set forth by the Secretary of the Treasury. The Treasury has issued guidance on section 111(b) in the form of an interim final rule with respect to the TARP Capital Purchase Program (CPP) (31 CFR Part 30), which applies the following standards with respect to the CPP: (a) limits on compensation that exclude incentives for SEOs of financial institutions to take unnecessary and excessive risks that threaten the value of the financial institution; (b) required recovery of any bonus or incentive compensation paid to a SEO based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate; (c) prohibition on the financial institution from making any golden parachute payment to any SEO; and (d) agreement to limit a claim to a federal income tax deduction for certain executive remuneration. The provisions apply while the Treasury holds an equity or debt position in the financial institution.

This Notice 2008-PSSFI addresses the direct purchase provisions under section 111(b) of EESA as they pertain to financial institutions participating in the program, applying similar standards to those set out in the interim final regulations, except for a more stringent rule with respect to golden parachute payments. Further guidance will be issued for any additional programs.

Q-1: To what financial institutions does this Notice apply?

A-1: (a) <u>General rule</u>. This Notice applies to any financial institution that participates in the program.

(b) <u>Controlled group rules</u>. For purposes of section 111(b) of EESA, two or more persons who are treated as a single employer under section 414(b) of the Internal Revenue Code (employees of a controlled group of corporations) and section 414(c) of the Internal Revenue Code (employees of partnerships, proprietorships, etc., that are under common control) are treated as a single employer. However, for purposes of section 111(b) of EESA, the rules for brother-sister controlled groups and combined groups are disregarded (including disregarding the rules in section 1563(a)(2) and (a)(3) of the Internal Revenue Code with respect to corporations and the parallel rules that are in section 1.414(c)-2(c) of the Treasury Regulations with respect to other organizations conducting trades or businesses). See Q&A-11 of this Notice for special rules where a financial institution is acquired.

Q-2: Who is a SEO under section 111 of EESA?

A-2: (a) <u>General definition</u>. A SEO means a “named executive officer” as defined in Item 402 of Regulation S-K under the federal securities laws who: (1) is employed by a financial institution that is participating in the program while the Treasury holds an equity or debt position acquired under the program; and (2)(i) is the principal executive officer (PEO) (or person acting in a similar capacity) of such financial institution (or, in the case of a controlled group, of the parent entity); (ii) the principal financial officer (PFO) (or person acting in a similar capacity) of such financial institution (or, in the case of a controlled group, of the parent entity); or (iii) one of the three most highly compensated executive officers of such financial institution (or the financial institution’s controlled group) other than the PEO or the PFO.

(b) Determination of three most highly compensated executive officers. For financial institutions with securities registered with the Securities and Exchange Commission (SEC) pursuant to the federal securities law, the three most highly compensated executive officers are determined according to the requirements in Item 402 of Regulation S-K under the federal securities laws. The term “executive officer” has the same meaning as defined in Rule 3b-7 of the Securities Exchange Act of 1934 (Exchange Act).[1] For purposes of determining the three most highly compensated executive officers, compensation is determined as it is in Item 402 of Regulation S-K to include total compensation for the last completed fiscal year without regard to whether the compensation is includible in the executive officer’s gross income. Until the compensation data for the current fiscal year are available, the financial institution should make its best efforts to identify the three most highly compensated executive officers for the current fiscal year.

(c) Application to private employers. Rules analogous to the rules in paragraphs (a) and (b) of this Q&A-2 apply to financial institutions that are not subject to the federal securities laws, rules, and regulations, including financial institutions that do not have securities registered with the SEC pursuant to the federal securities laws.

Q-3: What actions are necessary for a financial institution participating in the program to comply with section 111(b)(2)(A) of EESA?

A-3: In order to comply with section 111(b)(2)(A) of EESA for purposes of participation in the program, a financial institution must comply with the following rules: (1) promptly, and in no case more than 90 days, after the purchase under the program, the financial institution’s compensation committee, or a committee acting in a similar capacity, must review the SEO incentive compensation arrangements with such financial institution’s senior risk officers, or other personnel acting in a similar capacity, to ensure that the SEO incentive compensation arrangements do not encourage SEOs to take unnecessary and excessive risks that threaten the value of the financial institution; (2) thereafter, the compensation committee, or a committee acting in a similar capacity, must meet at least annually with senior risk officers, or individuals acting in a similar capacity, to discuss and review the relationship between the financial institution’s risk management policies and practices and the SEO incentive compensation arrangements; and (3) the compensation committee, or a committee acting in a similar capacity, must certify that it has completed the reviews of the SEO incentive compensation arrangements required under (1) and (2) above. These rules apply while the Treasury holds an equity or debt position acquired under the program.

[1]Exchange Act Rule 3b-7: “The term ‘executive officer,’ when used with reference to a registrant, means its president, any vice president of the registrant in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function or any other person who performs similar policy-making functions for the registrant. Executive officers of subsidiaries may be deemed executive officers of the registrant if they perform such policy-making function for the registrant.”

Q-4: How should the financial institution comply with the standard under Q&A-3 of this Notice that the compensation committee, or a committee acting in a similar capacity, review the SEO incentive compensation arrangements to ensure that the SEO incentive compensation arrangements do not encourage the SEOs to take unnecessary and excessive risks that threaten the value of the financial institution?

A-4: Because each financial institution faces different material risks given the unique nature of its business and the markets in which it operates, the compensation committee, or a committee acting in a similar capacity, should discuss with the financial institution's senior risk officers, or other personnel acting in a similar capacity, the risks (including long-term as well as short-term risks) that such financial institution faces that could threaten the value of the financial institution. The compensation committee, or a committee acting in a similar capacity, should identify the features in the financial institution's SEO incentive compensation arrangements that could lead SEOs to take such risks. Any such features should be limited in order to ensure that the SEOs are not encouraged to take risks that are unnecessary or excessive.

Q-5: How should the financial institution comply with the certification requirements under Q&A-3 of this Notice?

A-5: (a) Certification. The compensation committee, or a committee acting in a similar capacity, of the financial institution must provide the certifications required by Q&A-3 of this Notice stating that it has reviewed, with such financial institution's senior risk officers, the SEO incentive compensation arrangements to ensure that the incentive compensation arrangements do not encourage SEOs to take unnecessary and excessive risks. Providing a statement similar to the following and in the manner provided in subparagraphs (b) and (c) of this Q&A-5, as applicable, would satisfy this standard: "The compensation committee certifies that it has reviewed with senior risk officers the SEO incentive compensation arrangements and has made reasonable efforts to ensure that such arrangements do not encourage SEOs to take unnecessary and excessive risks that threaten the value of the financial institution."

(b) Location. For financial institutions with securities registered with the SEC pursuant to the federal securities law, the compensation committee, or a committee acting in a similar capacity, should provide this certification in the Compensation Committee Report required pursuant to Item 407(e) of Regulation S-K under the federal securities laws.

(c) Application to private financial institutions. The rules provided in this Q&A-5 are also applicable to financial institutions that are not subject to the federal securities laws, rules, and regulations, including financial institutions that do not have securities registered with the SEC pursuant to the federal securities laws. A private financial institution should file the certification of the compensation committee, or a committee acting in a similar capacity, with its primary regulatory agency.

Q-6: What actions are necessary for a financial institution participating in the program to comply with section 111(b)(2)(B) of EESA?

A-6: In order to comply with section 111(b)(2)(B) of EESA for purposes of participation in the program, a financial institution must require that SEO bonus and incentive compensation paid during the period that the Treasury holds an equity or debt position acquired under the program are subject to recovery or "clawback" by the financial institution if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria. For this purpose, bonus and incentive compensation is paid to a SEO when the SEO obtains a legally binding right to that payment if the legally binding right occurs during any period that the Treasury holds an equity or debt position under the program.

Q-7: How do the standards and regulations under section 111(b)(2)(B) of EESA differ from section 304 of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) (Pub. Law No. 107-204)?

A-7: Section 304 of Sarbanes-Oxley requires the forfeiture by a public company's chief executive officer and the chief financial officer of any bonus, incentive-based compensation, or equity-based compensation received and any profits from sales of the company's securities during the twelve-month period following a materially non-compliant financial report. Section 111(b)(2)(B) of EESA differs from section 304 of Sarbanes-Oxley in several ways. The standard under section 111(b)(2)(B) of EESA: applies to the three most highly compensated executive officers in addition to the PEO and the PFO; applies to both public and private financial institutions; is not exclusively triggered by an accounting restatement; does not limit the recovery period; and covers not only material inaccuracies relating to financial reporting but also material inaccuracies relating to other performance metrics used to award bonuses and incentive compensation.

Q-8: What actions are necessary for a financial institution participating in the program to comply with section 111(b)(2)(C) of EESA?

A-8: In order to comply with section 111(b)(2)(C) of EESA for purposes of participation in the program, a financial institution must prohibit any golden parachute payment to a SEO during the period the Treasury holds an equity or debt position acquired under the program.

Q-9: What is a golden parachute payment under section 111(b) of EESA?

A-9: (a) <u>Definition</u>. For purposes of applying section 111(b) of EESA with respect to the program, a "golden parachute payment" means any payment in the nature of compensation to (or for the benefit of) a SEO made on account of an applicable severance from employment.

(b) <u>Applicable severance from employment</u>. (1) <u>Definition</u>. An applicable severance from employment means any SEO's severance from employment with the financial institution (i) by reason of involuntary termination of employment with the financial institution or with an entity that is treated as the same employer as the financial institution under Q&A-1 of this Notice; or (ii) in connection with any bankruptcy filing, insolvency, or receivership of the financial institution or of an entity that is treated as the same employer as the financial institution under Q&A-1 of this Notice.

(2) Involuntary termination. (i) An involuntary termination from employment means a termination from employment due to the independent exercise of the unilateral authority of the employer to terminate the SEO's services, other than due to the SEO's implicit or explicit request to terminate employment, where the SEO was willing and able to continue performing services. An involuntary termination from employment may include the financial institution's failure to renew a contract at the time such contract expires, provided that the SEO was willing and able to execute a new contract providing terms and conditions substantially similar to those in the expiring contract and to continue providing such services. In addition, a SEO's voluntary termination from employment constitutes an involuntary termination from employment if the termination from employment constitutes a termination for good reason due to a material negative change in the SEO's employment relationship. See section 1.409A-1(n)(2) of the Treasury Regulations.

(ii) A severance from employment by a SEO is by reason of involuntary termination even if the SEO has voluntarily terminated employment in any case where the facts and circumstances indicate that absent such voluntary termination the financial institution would have terminated the SEO's employment and the SEO had knowledge that he or she would be so terminated.

(c) Payments on account of an applicable severance from employment. (1) Definition. A payment on account of an applicable severance from employment means a payment that would not have been payable if no applicable severance from employment had occurred (including amounts that would otherwise have been forfeited if no applicable severance from employment had occurred) and amounts that are accelerated on account of the applicable severance from employment. See section 1.280G-1, Q&A-24(b), of the Treasury Regulations for rules regarding the determination of the amount that is on account of an acceleration.

(2) Excluded amounts. Payments on account of an applicable severance from employment do not include amounts paid to a SEO under a tax qualified retirement plan.

Q-10: Are there other conditions that are required under the executive compensation and corporate governance standards in section 111(b)(1) of EESA?

A-10: The financial institution must agree, as a condition to participate in the program, that no deduction will be claimed for federal income tax purposes for remuneration that would not be deductible if section 162(m)(5) of the Internal Revenue Code were to apply to the financial institution. For this purpose, during the period that the Treasury holds an equity or debt position in the financial institution acquired under the program: (i) the financial institution (including entities in its controlled group) is treated as an "applicable employer," (ii) its SEOs are treated as "covered executives," and (iii) any taxable year that includes any portion of that period is treated as an "applicable taxable year," each as defined in section 162(m)(5) of the Internal Revenue Code, except that the dollar limitation and the remuneration for the taxable year are prorated for the portion of the taxable year that the Treasury holds an equity or debt position in the financial institution under the program.

Q-11: How does section 111(b) of EESA operate in connection with an acquisition, merger, or reorganization?

A-11: (a) Special rules for acquisitions, mergers, or reorganizations. In the event that a financial institution (target) that had sold troubled assets to the Treasury through the program is acquired by an entity that is not related to target (acquirer) in an acquisition of any form, acquirer will not become subject to section 111(b) of EESA merely as a result of the acquisition. For this purpose, an acquirer is related to target if stock or other interests of target are treated (under section 318(a) of the Internal Revenue Code other than paragraph (4) thereof) as owned by acquirer. With respect to the target, any employees of target who are SEOs prior to the acquisition will be subject to section 111(b)(2)(C) of EESA until after the first anniversary following the acquisition.

(b) Example. In 2008, financial institution A sells $100 million of troubled assets to the Treasury through the program. In January 2009, financial institution B, which is not otherwise subject to section 111(b) of EESA, acquires financial institution A in a stock purchase transaction, with the result that financial institution A becomes a wholly owned subsidiary of financial institution B. Based on the rules in paragraph (a) of this Q&A-11, the SEOs of financial institution B are not subject to section 111(b) of EESA solely as a result of the acquisition of financial institution A in January 2009. The SEOs of financial institution A at the time of the acquisition are subject to section 111(b)(2)(C) of EESA until January 2010, the first anniversary following the acquisition.

Q-12: What actions are necessary for a financial institution participating in the program to comply with the executive compensation reporting and recordkeeping requirements?

(a) Reporting Requirements. (1) General. The PEO (or person acting in a similar capacity) of the financial institution participating in the program is required to provide to the Chief Compliance Officer (CCO) of TARP, the following certifications with respect to the compliance of the financial institution with section 111(b) of EESA as implemented under this Notice. The PEO of the financial institution is also required to provide copies of these certifications to the transfer agent under the program. To the extent that the PEO (or person acting in a similar capacity) of the financial institution is unable to provide any of these certifications in a timely manner, the PEO is required to provide the CCO an explanation of the reason such certification has not been provided. These certifications are in addition to the compensation committee certifications required by Q&A-3 of this Notice.

(2) <u>120 Day Certification</u>. Within 120 days of the closing date of the agreement between the financial institution and the Treasury under the program, the PEO (or person acting in a similar capacity) of the financial institution is required to provide a certification similar to the following to the CCO:

"I, [identify the principal executive officer of the financial institution], certify, based on my knowledge, that the compensation committee of [identify financial institution] reviewed within 90 days of the Department of the Treasury's purchase of the [identify financial instrument] of [identify financial institution] under the program the incentive compensation arrangements of the senior executive officers, as defined in subsection 111(b)(3) of the Emergency Economic Stabilization Act of 2008 and regulations and guidance issued thereunder (SEOs), of [identify financial institution] with senior risk officers of [identify financial institution] to ensure that the SEO incentive compensation arrangements do not encourage the SEOs to take unnecessary and excessive risks that threaten the value of [identify financial institution]."

(3) <u>First Fiscal Year Certification</u>. Within 135 days of the completion of the first annual fiscal year of the financial institution during any part of which the financial institution has participated in the program, the PEO (or person acting in a similar capacity) of the financial institution is required to provide a certification similar to the following to the CCO:

"I, [identify the principal executive officer of the financial institution], certify, based on my knowledge, that:

(i) The compensation committee of [identify financial institution] has met at least once during the most recently ended fiscal year with senior risk officers to discuss and review the relationship between the risk management policies and practices of [identify financial institution] and the incentive compensation arrangements of the senior executive officers, as defined in subsection 111(b)(3) of the Emergency Economic Stabilization Act of 2008 (EESA) and regulations and guidance issued thereunder (SEOs), to ensure that the SEO incentive compensation arrangements do not encourage the SEOs to take unnecessary and excessive risks that threaten the value of [identify financial institution];

(ii) The compensation committee of [identify financial institution] has certified to the review of the SEO incentive compensation arrangements required under (i) above;

(iii) [Identify financial institution] has required that SEO bonus and incentive compensation be subject to recovery or "clawback" by [identify financial institution] if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria;

(iv) [Identify financial institution] has prohibited any golden parachute payment, as defined in the regulations and guidance issued under section 111(b) of EESA, to a SEO;

(v) [Identify financial institution] has instituted controls and procedures to limit the deduction for remuneration for federal income tax purposes to $500,000 for each SEO for the most recently ended fiscal year as if section 162(m)(5) of the Internal Revenue Code applied to [identify financial institution]; and

(vi) The following individuals are the SEOs for the current fiscal year: [identify names and titles of SEOs of financial institution].”

(4) Years Following First Fiscal Year Certification. Within 135 days of the completion of each annual fiscal year of the financial institution after the first fiscal year during any part of which the financial institution has participated in the program, the PEO (or person acting in a similar capacity) of the financial institution is required to provide a certification similar to the following to the CCO:

“I, [identify the principal executive officer of the financial institution], certify, based on my knowledge, that:

(i) The compensation committee of [identify financial institution] has met at least once during the most recently ended fiscal year with senior risk officers to discuss and review the relationship between the risk management policies and practices of [identify financial institution] and the incentive compensation arrangements of the senior executive officers, as defined in subsection 111(b)(3) of the Emergency Economic Stabilization Act of 2008 (EESA) and regulations and guidance issued thereunder (SEOs), to ensure that the SEO incentive compensation arrangements do not encourage the SEOs to take unnecessary and excessive risks that threaten the value of [identify financial institution];

(ii) The compensation committee of [identify financial institution] has certified to the review of the SEO incentive compensation arrangements required under (i) above;

(iii) [Identify financial institution] has required that SEO bonus and incentive compensation be subject to recovery or “clawback” by [identify financial institution] if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria;

(iv) [Identify financial institution] has prohibited any golden parachute payment, as defined in the regulations and guidance issued under section 111(b) of EESA, to a SEO;

(v) [Identify financial institution] has instituted controls and procedures to limit the deduction for remuneration for federal income tax purposes to $500,000 for each SEO for the most recently ended fiscal year as if section 162(m)(5) of the Internal Revenue Code applied to [identify financial institution];

(vi) [Identify financial institution] has limited the deduction for remuneration for federal income tax purposes to $500,000 for each SEO for the fiscal year prior to the most recently ended fiscal year as if section 162(m)(5) of the Internal Revenue Code applied to [identify financial institution]; and

(vii) The following individuals are the SEOs for the current fiscal year: [identify names and titles of SEOs of financial institution]."

(b) Recordkeeping Requirements. The financial institution is required to preserve appropriate documentation and records to substantiate each certification required under paragraph (a) of this Q&A-12 for a period of not less than six years after the date of the certification, the first two years in an easily accessible place. The financial institution is required to furnish promptly to the TARP CCO legible, true, complete, and current copies of the documentation and records that are required to be preserved under paragraph (b) of this Q&A-12 that are requested by the representative of the TARP CCO.

(c) Penalties for Making or Providing False or Fraudulent Statements. Any individual or entity which provides information or makes a certification to the Treasury that is relating to purchases under section 111 of EESA or required pursuant to these guidelines is subject to 18 U.S.C. 1001, which generally prohibits the making of any false or fraudulent statement to a federal officer. Upon receipt of information indicating that any individual or entity has violated any provision of title 18 of the U.S. Code or other provision of federal law, the Treasury shall refer such information to the Department of Justice and the Special Inspector General provided for under EESA.

REQUEST FOR COMMENTS

The Treasury requests comments on the topics addressed in this Notice. Comments may be submitted to the Treasury by any of the following methods: Submit electronic comments by email to executivecompensationcomments@do.treas.gov; or send paper comments in triplicate to Executive Compensation Comments, Office of Financial Institutions Policy, Room 1418, Department of the Treasury, 1500 Pennsylvania Avenue, NW, Washington, DC 20220.

In general, the Treasury will post all comments to www.regulations.gov without change, including any business or personal information provided such as names, addresses, e-mail addresses, or telephone numbers. The Treasury will also make such comments available for public inspection and copying in the Treasury's Library, Room 1428, Main Department Building, 1500 Pennsylvania Avenue, NW, Washington, DC 20220, on official business days between the hours of 10:00 a.m. and 5:00 p.m. Eastern

Time. You can make an appointment to inspect comments by telephoning (202) 622-0990. All comments, including attachments and other supporting materials, received are part of the public record and subject to public disclosure. You should submit only information that you wish to make available publicly.

EFFECTIVE DATE

Financial institutions may rely on rules in this Notice for purposes of compliance with section 111(b) of EESA effective from October 3, 2008 (the date of enactment of EESA).

CONTACT INFORMATION

For further information regarding this guidance, contact the Office of Domestic Finance, the Treasury, at (202) 927-6618.