NOTICE 2008-TAAP

I. PURPOSE

This Notice, issued pursuant to sections 101(a)(1), 101(c)(5), and 111(c) 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 an auction purchase. Section 111(c) of EESA prohibits such a financial institution from entering into any new employment agreement with certain executive officers that provides a golden parachute.

II. BACKGROUND RELATING TO EESA EXECUTIVE COMPENSATION PROVISIONS

Section 101(a) of EESA authorizes the Secretary of the Treasury to establish a Troubled Assets 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.

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. Section 111(b)(2) of EESA provides for the executive compensation and corporate governance standards to include: (a) limits on compensation that exclude incentives for senior executive officers (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 during the period that the Treasury holds an equity or debt position; 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. The Treasury has issued separate guidance on these provisions in the form of interim final regulations with respect to the TARP Capital Purchase Program (31 CFR Part 30) and with respect to programs for systemically significant failing institutions (Notice 2008-PSSFI).

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 that provides a golden parachute to a 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 continues during the TARP authorities period. This Notice 2008-TAAP addresses this provision.

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).

Q-1: To what financial institutions does section 111(c) of EESA apply?

A-1: (a) General rule. Section 111(c) of EESA applies to any financial institution from which one or more troubled assets are acquired through auction purchases under TARP, but only if the aggregate amount of the assets acquired exceeds $300 million. The assets that are counted for the $300 million threshold include all assets that are acquired by the Treasury under TARP in accordance with section 101(a) of EESA. However, if the only such acquisitions from a financial institution are through a direct purchase, the financial institution is not subject to section 111(c) of EESA. (See section 111(b) of EESA for special rules that apply with respect to financial institutions that sell assets through a direct purchase and interim final regulations issued by the Treasury with respect to the TARP Capital Purchase Program at 31 CFR Part 30.) A financial institution to which section 111(c) of EESA applies continues to be subject to section 111(c) of EESA through the TARP authorities period (without regard to whether the Treasury ceases to hold an equity or debt position in the financial institution).

(b) Controlled group rules. For purposes of applying section 111(c) of EESA, including the determination of whether the aggregate amount of the assets acquired from a financial institution exceeds $300 million, two or more financial institutions that 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 financial institution. However, for purposes of applying the aggregation rules to determine whether section 111(c) of EESA applies, 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-2 of this Notice regarding the determination of a SEO in a controlled group.

(c) Example. Bank holding company X is the sole owner of banks A, B, and C. In December 2008, bank A sells $150 million of assets to the Treasury under TARP in an auction purchase. In February of 2009, bank B sells $100 million of assets to the Treasury under a TARP auction purchase. On August 14, 2009, bank C sells $100 million of assets to the Treasury under a TARP auction purchase. Bank holding company X, along with banks A, B, and C, plus any other entity that is treated as the same financial institution under the rules described in paragraph (b) of this Q&A-1, constitute a single financial institution and have sold in excess of $300 million of assets under TARP. As provided in Q&A-2 of this Notice, the chief executive officer (CEO) and the chief financial officer (CFO) of bank holding company X and the three most highly compensated executive officers of the bank holding company X's controlled group are SEOs.

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

A-2: (a) General definition. 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 to which section 111 of EESA applies; 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.

[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."

(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.

(d) Time period. The prohibition in section 111(c) of EESA applies to any arrangements entered into by a financial institution with a SEO during the TARP authorities period. Whether an employee is a SEO is determined at the time the employee enters into the arrangement.

Q-3: What is a golden parachute under section 111(c) of EESA?

A-3: (a) General definition. As provided under section 280G(e) of the Internal Revenue Code, a "golden parachute" 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 to the extent the aggregate present value of such payments equals or exceeds an amount equal to three times the SEO's base amount. The term "base amount" for a SEO has the meaning set forth in 280G(b)(3) of the Internal Revenue Code and section 1.280G-1, Q&A-34, of the Treasury Regulations, except that references to "change in ownership or control" are treated as referring to an "applicable severance from employment."

(b) Applicable severance from employment. (1) Definition. An applicable severance from employment means any SEO's severance from employment with the financial institution (1) 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 (2) 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 employer'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-4: What is a new employment contract under section 111(c) of EESA?

A-4: (a) General definition. A "new employment contract" means any material compensatory contract (including any plan, agreement, or arrangement, whether or not written) entered into on or after the date when section 111(c) of EESA applies to the financial institution. For this purpose, a contract that is renewed is treated as entered into on the date of the renewal. See section 1.162-27(h)(1)(i) of the Treasury Regulations for rules regarding what constitutes a renewal of a compensatory contract that is treated as a new contract. In addition, for this purpose, if a contract is materially modified, it is treated as a new contract entered into as of the date of the material modification. A contract is materially modified if it is amended to increase the amount of compensation payable to the employee, to accelerate the date on which vesting occurs, or to accelerate the payment under the contract. The rules in section 1.162-27(h)(1)(iii)(A) and (B) of the Treasury Regulations apply for purposes of determining what constitutes a material modification.

(b) Example 1. Bank holding company A, a participant in TARP from which the Treasury has purchased over $300 million in troubled assets through auction purchases, amends the employment agreement of its CFO to increase his or her salary. In this case, the amendment is a material modification to an existing employment arrangement and thus is a new employment contract under section 111(c) of EESA.

(c) Example 2. Community bank B, a participant in TARP from which the Treasury has purchased over $300 million in troubled assets through auction purchases, amends its existing incentive compensation arrangement in which the CEO and CFO participate and which provides benefits in the event of bankruptcy or insolvency. The amendment accelerates the vesting period under the arrangement. In this case, the amendment is a material modification to an existing contract and thus is a new employment contract under section 111(c) of EESA.

Q-5: How does section 111(c) of EESA apply in connection with an acquisition, merger, or reorganization?

A-5: (a) Special rules for acquisitions, mergers, or reorganizations. In the event that a financial institution (target) that had sold troubled assets to the Treasury under TARP is acquired by an entity that is not related to target (acquirer) in an acquisition of any form, the troubled assets sold to the Treasury under TARP by target prior to the acquisition are not aggregated with any assets sold by acquirer prior to or after 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. If, after an acquisition, troubled assets of target are sold by acquirer's controlled group (including target in the case of a stock acquisition), those assets must be aggregated with any assets sold by acquirer, whether prior to or after the acquisition, for purposes of determining whether acquirer is subject to section 111(c) of EESA. If target was subject to section 111(c) of EESA at the time of the acquisition, acquirer will not become subject to section 111(c) of EESA merely as a result of the acquisition.

(b) Example. In 2008, financial institution A sells $100 million of troubled assets under TARP and financial institution B sells $350 million of troubled assets under TARP. In January 2009, financial institution A acquires financial institution B in a stock purchase transaction, with the result that financial institution B becomes a wholly owned subsidiary of financial institution A. In February 2009, financial institution A sells an additional $100 million of its troubled assets under TARP, and in March 2009 financial institution B (when it is a wholly owned subsidiary of A) sells an additional $150 million of troubled assets. Neither the sale of troubled assets by financial institution A nor the sale of troubled assets by financial institution B are solely through direct purchases. Based on the rules in paragraph (a) of this Q&A-5, financial institution A is not subject to section 111(c) of EESA as a result of the acquisition of B, or as a result of the assets sold in February 2009, because the $350 million of troubled assets sold by financial institution B prior to the acquisition are not aggregated with the troubled assets sold by financial institution A's controlled group prior to and after the acquisition of financial institution B. However, financial institution A becomes subject to section 111(c) of EESA in March 2009 when the amount of troubled assets sold by financial institution's controlled group (without regard to the sales by financial institution B prior to the acquisition of B by A) total $350 million. The employees of financial institution B are subject to section 111(c) of EESA in March 2009, assuming they are SEOs in financial institution A's controlled group.

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(c) 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.