provider. An FCU must operate according to the third party pilot program standards when it is approved to engage in derivatives activities through an approved third party. NCUA therefore seeks comment on the approval standards for an FCU seeking to engage in derivatives activity through a third party.

**Question No.**
1. Should NCUA require an FCU to state a balance sheet management plan to hedge IRR based on risk management objectives as a condition for approval? Explain why or why not.
2. Is it useful for an FCU to rely on the expertise of a third party to assess the effectiveness of derivatives to hedge IRR on an ongoing and dynamic basis or should the FCU be required to demonstrate it has this expertise internally as a condition for approval? In either case explain why or why not.
3. Is it useful for an FCU to rely on the expertise of a third party to assess the credit quality of derivative counterparties? Explain why or why not.

**E. Approval To Engage Independently**

NCUA expects that approving an FCU to independently engage in derivatives activity would require extensive examination of the applicant FCU and also would require enhanced supervision. This approval would be similar to the granting of expanded authority for a corporate credit union under recently revised Part 704, 75 FR 64786 (Oct. 20, 2010) and would require a self-assessment by the FCU to support its request. The NCUA Board would expect an FCU to address the following items prior to granting approval for that FCU to engage in derivatives activities independently:

i. Board of directors’ policy identifying the specific purposes of specified derivatives activities and stating limits on maximum exposure in terms of notional principal amounts and mark-to-market values of individual and aggregate swaps;

ii. Ongoing assessment and reporting to the FCU’s board of directors of derivative performance in achieving explicit interest rate risk management objectives;

iii. Selection criteria for eligible counterparties that address the process of identification and credit monitoring; posting of bilateral collateral and process for maintenance of available collateral;

iv. Disclosure of derivative price at time of purchase expressed as dollar values of a basis point on each derivative instrument;

v. Disclosure of costs of terminating any derivatives in the course of pursuing any exit strategy.

NCUA would expect the FCU’s board of directors to review policy periodically, to review the FCU’s derivatives positions on an ongoing basis, and to actively enforce compliance with the stated IRR management purpose of derivative activities.

**Question No.**
1. Should approval of an FCU to engage in derivatives activities be in the form of additional authorization similar to the expanded authority available under Appendix B to Part 704—Expanded Authorities and Requirements? Explain why or why not.
2. Should an FCU demonstrate enhanced credit functionality in terms of the experience of the FCU’s personnel, credit analysis and reporting infrastructure in order to evaluate the creditworthiness of derivative counterparties? Explain why or why not and describe any minimum expectation.
3. Should an FCU demonstrate enhanced hedging expertise based on the experience of the FCU’s personnel or on additional derivatives management infrastructure? Explain why or why not, and describe any minimum expectation.
4. Is one year a sufficient amount of time for an FCU to fully prepare a self-assessment and application for approval to independently engage in derivatives to offset IRR? Explain why it is sufficient or why more time may be required.
5. Are there any additional aspects of the FCU besides items (i)–(v) above which NCUA should consider in its approval for the FCU to engage in derivatives activity independently? If so, explain why the item should be considered.

By the National Credit Union Administration Board on June 17, 2011.

Mary F. Rupp,
Secretary of the Board.

[FR Doc. 2011–15738 Filed 6–23–11; 8:45 am]
deduction limitation for certain employee remuneration in excess of $1,000,000 under the Internal Revenue Code (Code). The proposed regulations clarify that qualified performance-based compensation attributable to stock options and stock appreciation rights must specify the maximum number of shares with respect to which options or rights may be granted to each individual employee. The proposed regulations also clarify the application of the transition rule for taxpayers that are not publicly held corporations and then become publicly held corporations.

DATES: Written or electronic comments must be received by September 22, 2011.

ADDRESSES: Send submissions to: CC:PA:LDPD:PR (REG–137125–08), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LDPD:PR (REG–137125–08), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically via the Federal eRulemaking Portal at http://www.regulations.gov (IRS REG–137125–08).

FOR FURTHER INFORMATION CONTACT: Concerning these proposed regulations, Ilya Enkishev at (202) 622–6030; concerning submissions of comments, and/or to request a public hearing, Richard A. Hurst at Richard.A.Hurst@irs.counsel.treas.gov or (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains a proposed amendment to 26 CFR part 1 under section 162(m) of the Code.

Section 162(m) was added to the Code by section 3211(a) of the Omnibus Budget Reconciliation Act of 1993, Public Law 103–66. Proposed regulations under section 162(m) were published in the Federal Register on December 20, 1993 (58 FR 66310). Final regulations under section 162(m) were published in the Federal Register on December 20, 1995 (TD 8650) (60 FR 65534).

The IRS and the Treasury Department have received questions regarding the requirement that a stock-based compensation plan must state the maximum number of shares with respect to which stock options or stock appreciation rights may be granted under the plan to any employee to qualify as performance-based compensation under section 162(m). The IRS and the Treasury Department have also received questions regarding the application of the transition rule for taxpayers that are not publicly held corporations and then become publicly held corporations. These proposed amendments to §§ 1.162–27(e)(2), 1.162–27(e)(4), and 1.162–27(f)(1) are not intended to reflect substantive changes to the requirements in the current regulations, but rather to clarify the current language.

Explanation of Provisions

1. Maximum number of shares with respect to which options or rights may be granted to each individual employee.

Section 1.162–27(b) provides that section 162(m) precludes a deduction under chapter 1 of the Code by any publicly held corporation for compensation paid to any covered employee to the extent that the compensation for the taxable year exceeds $1,000,000. Section 1.162–27(e)(1) provides that the deduction limit in § 1.162–27(b) does not apply to qualified performance-based compensation. Section 1.162–27(e)(1) further provides that qualified performance-based compensation is compensation that meets all of the requirements of § 1.162–27(e)(2) through (e)(5).

Section 1.162–27(e)(2)(vi) sets forth special rules for performance-based compensation attributable to stock options and stock appreciation rights. This section provides that stock options and stock appreciation rights are deemed to satisfy the performance goal requirement in § 1.162–27(e)(2) if: (1) The grant or award is made by the compensation committee; (2) the plan under which the option or right is granted states the maximum number of shares with respect to which options or rights may be granted during a specified period to any employee; and, (3) under the terms of the option or right, the amount of compensation the employee can receive is based solely on an increase in the value of the stock after the date of the grant or award.

The legislative history for section 162(m) provides that “[in] the case of stock options, it is intended that the directors may retain discretion as to the exact number of options that are granted to an executive, provided that the maximum number of options that the individual executive may receive during a specified period is predetermined.” H.R. Conf. Rep. No. 213, 103rd Cong., 1st Sess. 586–87 (1993), reprinted in 1993 U.S.C.C.A.N. 1088, 1275–6.

The proposed 1993 Treasury Regulations (58 FR 66310) under section 162(m) explains the reason for requiring an individual limit on the maximum number of shares for which options may be granted.

Some have questioned why it would be necessary for the regulations to require an individual employee limit on the number of the shares for which options or stock appreciation rights may be granted, where shareholder approval of an aggregate limit is obtained for securities law purposes. The regulations follow the legislative history, which suggests that a per-employee limit be required under the terms of the plan. The IRS and the Treasury believe that a limit on the maximum number of shares for which individual employees may receive options or other rights is appropriate because it is consistent with the broader requirement that a performance goal include an objective formula for determining the maximum amount of compensation that an individual employee could receive if the performance goal were satisfied. A third party attempting to make this determination with respect to a stock option plan would need to know both the exercise price and the number of options that could be granted.

Section 1.162–27(h)(3)(i) of the final regulations provides that, under a transition rule that applies to plans or agreements approved by shareholders before December 20, 1993, a stock option plan was treated as satisfying the requirement to state a maximum number of shares for which an option could be granted to any employee over a specified period if the plan that was approved by the shareholders provided for an aggregate limit (consistent with SEC Rule 16b–3(b)) on the shares of employer stock for which awards could be made under the plan. This rule was available only during a limited reliance period specified in § 1.162–27(h)(3)(i).

These proposed regulations clarify § 1.162–27(e)(2)(vi) by providing that the plan under which the option or right is granted must specify the maximum number of shares with respect to which options or rights may be granted to any individual employee during a specified period. Accordingly, if a plan states an aggregate maximum number of shares that may be granted but does not contain a specific per-employee limitation on the number of options that may be granted, then any compensation attributable to the stock options or rights granted under the plan is not qualified performance-based compensation under § 1.162–27(e)(2)(vi). A plan satisfies § 1.162–27(e)(2)(vi) where the terms of the plan specify that an individual employee may be granted options or rights to receive the maximum number of shares authorized under the plan during a specified period. Example 9 of § 1.162–27(e)(2)(vi) of the regulations has been modified to illustrate these principles.
These proposed regulations also provide a related clarification of the shareholder approval requirement under § 1.162–27(e)(4). Specifically, § 1.162–27(e)(4)(iv) is clarified to provide that the requirement for description of the compensation in this section is satisfied where the maximum number of shares for which grants may be made to each individual employee during a specified period and the exercise price of those options is disclosed to the shareholders of the corporation.

2. Compensation payable under restricted stock units paid by companies that become publicly held

Section 1.162–27(f)(1) of the current regulations provides that in the case of a corporation that was not a publicly held corporation and then becomes a publicly held corporation, the $1,000,000 deduction limit "does not apply to any remuneration paid pursuant to a compensation plan or agreement that existed during the period in which the corporation was not publicly held and the corporation becomes publicly held in connection with an initial public offering (IPO), then the relief provided in § 1.162–27(f)(1) applies only to the extent that the prospectus accompanying the IPO disclosed information concerning the existing compensation plans or agreements and satisfied all applicable securities laws.

Pursuant to § 1.162–27(f)(2), a corporation may rely on § 1.162–27(f)(1) until the earliest of: (i) The expiration of the plan or agreement; (ii) the material modification of the plan or agreement; (iii) the issuance of all employer stock and other compensation that has been allocated under the plan; or (iv) the first meeting of shareholders at which directors are to be elected that occurs after the close of the third calendar year following the calendar year in which the IPO occurs or, in the case of a privately held corporation that becomes publicly held without an IPO, the first calendar year following the calendar year in which the corporation becomes publicly held. Section 1.162–27(f)(3) provides that the relief provided under § 1.162–27(f)(1) applies to any compensation received pursuant to the exercise of a stock option or stock appreciation right, or the substantial vesting of restricted property, granted under a plan or agreement described in § 1.162–27(f)(1) if the grant occurs on or before the earliest of the events specified in § 1.162–27(f)(2).

Practitioners have asked whether compensation payable under a restricted stock unit or a phantom stock arrangement is eligible for the relief provided in § 1.162–27(f)(3). A restricted stock unit is a right to an amount based on the value of the employer’s stock, and which is payable in cash, shares of the stock, or other property (as defined in § 1.83–3(e)), following the satisfaction of a specified vesting condition. Compensation payable under a phantom stock arrangement is compensation that is paid at a future date in cash or in property based on the value of the employer’s stock.

The preamble to the final 1994 Treasury Regulations (60 FR 65534) under section 162(m) specifically addressed the types of compensation covered under § 1.162–27(f)(3):

Commentators have asked that the relief provided in the 1994 amendments for stock options, stock appreciation rights, and restricted property be extended even further to cover other stock-based compensation and deferred compensation in general. After careful consideration of the comments received, the IRS and Treasury have concluded that there is not adequate justification for a further expansion of the 1994 expansion of the prior regulatory transition relief for previously approved plans and agreements, or the other similar relief provisions added in 1994.

Accordingly, only compensation attributable to stock options, stock appreciation rights, and restricted property is covered under § 1.162–27(f)(3). The proposed regulations clarify that the general rule of § 1.162–27(f)(1) applies to all compensation other than compensation specifically identified in § 1.162–27(f)(3).

Proposed Effective/Applicability Date

These regulations under section 162(m) are proposed to apply to taxable years ending on or after the date of publication of the Treasury decision adopting these rules as final regulation in the Federal Register.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are timely submitted to the IRS. The IRS and the Treasury Department specifically request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the Federal Register.

Drafting Information

The principal author of these proposed regulations is Ilya Enkishev, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *.

Par. 2. Section 1.162–27 paragraphs (e)(2)(vi)(A), (e)(2)(vii) Example 9, (e)(4)(iv) and (f)(3) are revised and paragraph (j)(2)(vi) is added to read as follows:

§ 1.162–27 Certain employee remuneration in excess of $1,000,000.

* * * * *

(e) * * *

(2) * * *

(vi) * * *

(A) In general. Compensation attributable to a stock option or a stock appreciation right is deemed to satisfy the requirements of this paragraph (e)(2) if the grant or award is made by the compensation committee; the plan under which the option or right is granted states the maximum number of shares with respect to which options or rights may be granted during a specified
period to any individual employee; and, under the terms of the option or right, the amount of compensation the employee could receive is based solely on an increase in the value of the stock after the date of the grant or award. Conversely, if the amount of compensation the employee will receive under the grant or award is not based solely on an increase in the value of the stock after the date of grant or award (for example, in the case of restricted stock, or an option that is granted with an exercise price that is less than the fair market value of the stock as of the date of grant), none of the compensation attributable to the grant or award is qualified performance-based compensation because it does not satisfy the requirement of this paragraph (e)(2)(vi)(A). Whether a stock option grant is based solely on an increase in the value of the stock after the date of grant is determined without regard to any dividend equivalent that may be payable, provided that payment of the dividend equivalent is not made contingent on the exercise of the option. The rule that the compensation attributable to a stock option or stock appreciation right must be based solely on an increase in the value of the stock after the date of grant or award does not apply if the grant or award is made on account of, or if the vesting or exercisability of the grant or award is contingent on, the attainment of a performance goal that satisfies the requirements of this paragraph (e)(2).

Example 9. Corporation V establishes a stock option plan for salaried employees. The terms of the stock option plan specify that no individual salaried employee shall receive options for more than 100,000 shares over any 3-year period. The compensation committee grants options for 50,000 shares to each of several salaried employees. The exercise price of each option is equal to or greater than the fair market value at the time of each grant. Compensation attributable to the exercise of the options satisfies the requirements of this paragraph (e)(2). If, however, the terms of the options provide that the exercise price is less than fair market value at the date of grant, no compensation attributable to the exercise of those options satisfies the requirements of this paragraph (e)(2) unless issuance or exercise of the options was contingent upon the attainment of a preestablished performance goal that satisfies this paragraph (e)(2). If, however, the terms of the plan also provide that Corporation V could grant options to purchase no more than 900,000 shares over any 3-year period, but did not provide a limitation on the number of shares that any individual employee could purchase, then no compensation attributable to the exercise of those options satisfies the requirements of paragraph (e)(2)(vi) of this section.

(iv) Description of compensation. Disclosure as to the compensation payable under a performance goal must be specific enough so that shareholders can determine the maximum amount of compensation that could be paid to any individual employee during a specified period. If the terms of the performance goal do not provide for a maximum dollar amount, the disclosure must include the formula under which the compensation would be calculated. Thus, if compensation attributable to the exercise of stock options is equal to the difference in the exercise price and the current value of the stock, then disclosure of the maximum number of shares for which grants may be made to any individual employee during a specified period and the exercise price of those options (for example, fair market value on date of grant) would satisfy the requirements of this paragraph (e)(4)(iv). In that case, shareholders could calculate the maximum amount of compensation that would be attributable to the exercise of options on the basis of their assumptions as to the future stock price.

(3) Stock-based compensation. Paragraph (f)(1) of this section will apply to any compensation received pursuant to the exercise of a stock option or stock appreciation right, or the substantial vesting of restricted property, granted under a plan or agreement described in paragraph (f)(2) of this section if the grant occurs on or before the earliest of the event specified in paragraph (f)(2) of this section. This paragraph does not apply to any form of stock-based compensation other than the forms listed in the immediately preceding sentence. Thus, for example, compensation payable under a restricted stock unit arrangement or a phantom stock arrangement must be paid, rather than merely granted, on or before the occurrence of the earliest of the events specified in paragraph (f)(2) of this section in order for paragraph (f)(1) to apply.

Example 9. Corporation V establishes a stock option plan for salaried employees. The terms of the stock option plan specify that no individual salaried employee shall receive options for more than 100,000 shares over any 3-year period. The compensation committee grants options for 50,000 shares to each of several salaried employees. The exercise price of each option is equal to or greater than the fair market value at the time of each grant. Compensation attributable to the exercise of the options satisfies the requirements of this paragraph (e)(2). If, however, the terms of the options provide that the exercise price is less than fair market value at the date of grant, no compensation attributable to the exercise of those options satisfies the requirements of this paragraph (e)(2) unless issuance or exercise of the options was contingent upon the attainment of a preestablished performance goal that satisfies this paragraph (e)(2). If, however, the terms of the plan also provide that Corporation V could grant options to purchase no more than 900,000 shares over any 3-year period, but did not provide a limitation on the number of shares that any individual employee could purchase, then no compensation attributable to the exercise of those options satisfies the requirements of paragraph (e)(2)(vi) of this section.

(iv) Description of compensation. Disclosure as to the compensation payable under a performance goal must be specific enough so that shareholders can determine the maximum amount of compensation that could be paid to any individual employee during a specified period. If the terms of the performance goal do not provide for a maximum dollar amount, the disclosure must include the formula under which the compensation would be calculated. Thus, if compensation attributable to the exercise of stock options is equal to the difference in the exercise price and the current value of the stock, then disclosure of the maximum number of shares for which grants may be made to any individual employee during a specified period and the exercise price of those options (for example, fair market value on date of grant) would satisfy the requirements of this paragraph (e)(4)(iv). In that case, shareholders could calculate the maximum amount of compensation that would be attributable to the exercise of options on the basis of their assumptions as to the future stock price.

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 54

[REG–125592–10]

RIN 1545–BJ62

Requirements for Group Health Plans and Health Insurance Issuers Relating to Internal Claims and Appeals and External Review Processes Under the Patient Protection and Affordable Care Act

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: Elsewhere in this issue of the Federal Register, the IRS is issuing an amendment to temporary regulations published July 23, 2010 under the provisions of the Patient Protection and Affordable Care Act (the Affordable Care Act) regarding internal claims and appeals and external review processes. The IRS is issuing the temporary regulations at the same time that the Employee Benefits Security Administration of the U.S. Department of Labor and the Center for Consumer Information & Insurance Oversight of the U.S. Department of Health and Human Services are issuing a substantially similar amendment to interim final regulations published July 23, 2010 with respect to group health plans and health insurance coverage offered in connection with a group health plan under the Employee Retirement Income Security Act of 1974 and the Public Health Service Act. The temporary regulations provide guidance to employers, group health plans, and health insurance issuers providing group health insurance coverage. The text of those temporary regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by July 25, 2011.

ADDRESSES: Send submissions to: CC:PA–LQP–PR (REG–125592–10), Room 5205, Internal Revenue Service, P.O.