NATIONAL PENN
BANCSHARES, INC.

March 9, 2009

By E-mail (sigtarp.response@do.treas.gov) and Overnight Courier
Office of the Special Inspector General
Troubled Asset Relief Program
1500 Pennsylvania Avenue, N.W.
Suite 1064
Washington, D.C. 20220

RE: Special Inspector General's Information Request to TARP Participants

Ladies and Gentlemen:

This letter is provided in response to the letter dated February 6, 2009 from the Office of the Special Inspector General of the Troubled Asset Relief Program to National Penn Bancshares, Inc. ("National Penn") requesting information from National Penn about its use of TARP funds and its plans for implementing the executive compensation requirements imposed on TARP participants. To facilitate your review, set forth below is the full text of each of your information requests, followed by National Penn's response.

Request

(1) A narrative response specifically outlining (a) your anticipated use of TARP funds; (b) whether the TARP funds were segregated from other institutional funds; (c) your actual use of TARP funds to date; and (d) your expected use of unspent TARP funds. In your response, please take into consideration your anticipated use of TARP funds at the time that you applied for such funds, or any actions that [you] have taken that you would not have been able to take absent the infusion of TARP funds.

Response

- **National Penn's Strategy for TARP Funds**

On December 12, 2008, National Penn received $150 million from the U.S. Department of the Treasury ("Treasury") to fund the Treasury's purchase of 150,000 shares of National Penn's Series B Fixed Rate Cumulative Perpetual Preferred Stock ("Series B Preferred") with a liquidation preference of $1,000 per share. National Penn also issued warrants to purchase 1,470,588 common shares of National Penn in conjunction with the Treasury's capital investment. National Penn reflects the Treasury's $150 million investment in segregated capital accounts on its balance sheet, with the value of the capital investment allocated among the preferred stock account and the warrants as required by generally accepted accounting principles. National Penn does not segregate the actual funds into separate liquidity accounts on its books,

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however, all actions surrounding the strategic use of the TARP funds for lending and investing activities have been tracked and monitored since receipt of the funds on December 12, 2008.

[redacted]

In summary, National Penn's strategy is to profitably deploy and leverage the TARP funds to help provide economic stimulus in the markets we serve. It should also be noted that National Penn has already paid a $1,312,500 dividend to Treasury on February 17, 2009 from net income available to common shareholders. This dividend, and future quarterly dividends, represents the profits to United States taxpayers on their investment in National Penn.

- **Use of TARP Funds to Date**

National Penn has endeavored to swiftly deploy TARP funds into new loans for consumer and business clients. From December 12, 2008 through February 28, 2009, National Penn's loans have grown $117.9 million. Included in this total loan growth are several unique credits representing $18.7 million that do not fit National Penn's relationship-based guidelines. This includes a $5.0 million loan to a local retailer and major local employer to provide funding in support of its efforts to exit bankruptcy. To support this loan, National Penn was required to purchase $20.0 million of Treasury securities to provide collateral for the $30.0 million in related debtor-in-possession deposits. During the same period, National Penn invested $84.5 million in pools of mortgages secured by either Fannie Mae or Freddie Mac to help provide liquidity and stimulus to homeowners buying or refinancing their homes.

In summary, during its brief period of participation in the TARP, National Penn has deployed a total of $202.4 million in net new loans or investments in pools of mortgages. This represents $52.4 million in excess of the $150 million TARP capital investment in National Penn by Treasury.

- **Future Uses of TARP Funds**

[redacted]

- **Help for Homeowners and Other Borrowers**

National Penn has two parallel programs to help homeowners. One is for the modification of first lien residential mortgage loans, and the other is a refinance option developed by Fannie Mae and Freddie Mac to provide refinance solutions for distressed homeowners. National Penn's first lien residential loan modification program was designed using the Streamlined Modification Program developed by the FDIC, Treasury, Fannie Mae and Freddie Mac as a base. This program is now undergoing revisions to meet President Obama's recently announced Homeownership Affordability and Stability Plan guidelines.

We are acting in a proactive manner to assist distressed homeowners. Through March 5, 2009, we have responded to a total of 36 borrowers requesting assistance, and we are currently assessing the appropriate level of assistance to provide to these borrowers.

The second program is to assist low and moderate income first time homebuyers with closing costs. National Penn has developed its own program in response to the suspension of the First Front Door program previously provided by the Federal Home Loan Bank of Pittsburgh. First Front Door was used extensively with our CRA community homebuyer programs and was as important source of funds to help low and moderate income first time homebuyers. The loss of the program had a detrimental impact on National Penn's ability to assist low and moderate income first time homebuyers. National Penn has subsequently developed its own program with [redacted] (b) (4)

National Penn is a $25 million participant in a mortgage warehouse line of credit that provides wholesale funding to eight additional mortgage lenders. This helps to provide liquidity into a market that has faced a severe shortage of funds and helps to promote the flow of credit for new residential mortgages.

National Penn has increased its indirect auto lending efforts in order to provide support to our communities where other lenders have exited. Indirect auto lending has historically been neither a significant line of business nor a strategic focus for National Penn. Recently, however, as the captive lenders for automobile manufacturers as well as the large national lenders have curtailed or exited this type of financing in our marketplace, National Penn has stepped in to provide financing needed by our local consumers to acquire new or used vehicles. Two very specific examples show National Penn, in Northampton County, PA, moving from 12th place in this lending category to 1st place when comparing January 2009 new indirect loans to January 2008. Likewise, National Penn jumped from 12th place in Lehigh County, PA during the same time period to 5th place. From December 2008 to February 2009, National Penn originated 1,039 new indirect loans, compared to 489 indirect loans in the same prior year period, a 112.5% increase. These new loans amounted to $16.0 million during the most recent three months compared to $6.4 million in the same period last year, a 150.2% increase. This growth is during a period of time when new vehicle sales are down approximately 40%.

Request

(2) Your specific plans, and the status of implementation of those plans, for addressing executive compensation requirements associated with the funding. Information provided regarding executive compensation should also include any assessments made of loan risks and their relationship to executive compensation; how limitations on executive compensation will be implemented in line with Department of Treasury guidelines; and whether any such limitations may be offset by other changes to other, longer-term or deferred forms of executive compensation.

Response

National Penn has taken significant steps to implement the executive compensation requirements imposed on it as a recipient of TARP funds. National Penn has taken the steps it has determined are necessary to implement the requirements set forth in Treasury's Interim Final Rules issued on October 14, 2008 and January 16, 2009 (together, the "Interim Final Rules") interpreting Section 111(b) of the Emergency Economic Stabilization Act of 2008 as enacted on October 3, 2008 (the "EESA").[1] Specifically, National Penn has taken or plans to take the following actions:

- <u>Assessment of relationship between compensation and risk taking</u>. National Penn has undertaken a review of the significant risks associated with its business and whether its compensation program encourages its executive officers to take "unnecessary and excessive risks that threaten the value of the financial institution." Initially, a "risk committee" comprised of National Penn's senior risk officer, other officers of National Penn familiar with the risks to National Penn's business and a representative from National Penn's compensation consultant, Mosteller & Associates, identified the significant short- and long-term risks faced by National Penn. The risk committee then reviewed each element of National Penn's compensation program to determine whether each element of compensation could provide an incentive for National Penn's executive officers to increase any of the identified risks. As a result of this review, the risk committee determined that no element of National Penn's incentive compensation program encourages its executive officers to take unnecessary and excessive risks.

  On February 23, 2009 (73 days after National Penn's sale of its Series B Preferred Stock to Treasury), the risk committee presented its report and analysis to the Compensation Committee of National Penn's Board of Directors. The Compensation Committee reviewed the risk committee's report and, after its own review of National Penn's compensation program, also concluded that National Penn's incentive compensation program does not encourage its executive officers to take unnecessary and excessive risks. As required by Section 30.5 of the Interim Final Rules, the

[1] As set forth in the Questions and Answers Regarding the February 6, 2009 SIG TARP Letter, this response is generally limited to actions that National Penn has taken in response to Section 111(b) of the EESA as enacted on October 3, 2008 and the Interim Final Rules.

Compensation Committee's certification that it has complied with Section 111(b)(2)(A) of the EESA will be included in the Compensation Committee's report appearing in the proxy statement for National Penn's 2009 Annual Meeting of Shareholders. As required by the Interim Final Rules and the American Recovery and Reinvestment Act of 2009 (the "Recovery Act"), National Penn intends to undertake this same review at least semiannually during the period in which any obligation of National Penn arising from financial assistance under the TARP remains outstanding.

- Clawbacks of bonus and incentive compensation. In conjunction with National Penn's sale of its Series B Preferred stock to Treasury on December 12, 2008, each of National Penn's senior executive officers ("SEOs") entered into a CPP Clawback and Parachute Restriction Agreement (the "Clawback and Parachute Restriction Agreement"). The Clawback and Parachute Restriction Agreement provides that any bonus or incentive compensation paid to the SEO will be subject to recovery by National Penn if the payments were based on financial statements or performance metric criteria that are later proven to be materially inaccurate. A copy of the form of Clawback and Parachute Restriction Agreement entered into by National Penn's SEOs was filed as Exhibit 10.1 to National Penn's Current Report on Form 8-K filed with the Securities and Exchange Commission (the "SEC") on December 15, 2008. National Penn is currently analyzing the Recovery Act's clawback requirements and intends to comply with the Recovery Act and any rules or interpretations issued by Treasury thereunder.

- Prohibition on certain Golden Parachute Payments. The Clawback and Parachute Restriction Agreement also limits each SEO's severance payments so as not to exceed the amount allowable under Section 111(b) of the EESA as interpreted by the Interim Final Rules. National Penn is currently reviewing the revised definition of a "Golden Parachute Payment" set forth in the Recovery Act and the steps it may need to take to implement the Recovery Act's limitation on paying Golden Parachute Payments. National Penn intends to comply with the Recovery Act and any rules or interpretations issued by Treasury thereunder.

- Application of Section 162(m)(5) of the Internal Revenue Code. National Penn is currently applying the restrictions on deductibility of certain elements of executive compensation as set forth in Section 162(m)(5) of the Internal Revenue Code.

- Certification requirements. National Penn will submit the certification required by Section 30.12 of the Interim Final Rules no later than April 10, 2009 (120 days after the closing date of its participation in the TARP) and intends to submit on a timely basis the other certifications required by Section 30.12. National Penn is also currently reviewing the certification requirements of the Recovery Act and intends to comply with the Recovery Act and any rules or interpretations issued by Treasury thereunder.

- Say-on-Pay. As required by the Recovery Act and the SEC's guidance implementing the Recovery Act, National Penn will include in its proxy statement for its 2009 Annual Meeting of Shareholders an advisory (non-binding) proposal to approve the compensation of National Penn's executives.

National Penn would like to emphasize that it has a strong pay-for-performance philosophy and has taken steps to design its long-term incentive compensation program to reward the long-term success of National Penn and to mitigate risk taking by executive officers. As a consequence of this philosophy, when National Penn's earnings decrease, incentive compensation opportunities decrease. While National Penn delivered profitable financial results for 2008, National Penn did not meet the minimum threshold for the payment of short-term incentive compensation to its executive officers under National Penn's Executive Incentive Plan. Accordingly, National Penn's Compensation Committee determined that none of National Penn's SEOs would receive any bonus under National Penn's Executive Incentive Plan based on 2008 performance. For 2009 and beyond, the Compensation Committee has implemented a long-term incentive compensation program that is intended to comply with the requirements of the Recovery Act, including the use of performance-based restricted stock and service-based restricted stock. The performance-based restricted stock will vest if certain targets related to asset quality and improving liability acquisition and costs are met at the end of a two-year period and the executive remains employed by National Penn. These performance measures are designed to reward executives for increasing the quality of National Penn's assets and reducing National Penn's interest expense over the two-year period. The service-based restricted stock will vest if the executive remains employed by National Penn for five years after the grant date and is intended to incentivize executives to manage National Penn with a longer-term focus. National Penn has not implemented any forms of compensation with the purpose of offsetting the executive compensation provisions of the EESA as interpreted by the Interim Final Rules. National Penn is currently reviewing the incentive compensation provisions of the Recovery Act and intends to comply with the Recovery Act and any rules or interpretations issued by Treasury thereunder.

* * *

As requested, I, Michael R. Reinhard, certify that: I have reviewed this response and supporting documents, and, based on my knowledge, this response and the supporting documents do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading.

I hope you will find this letter responsive to your requests. If you have any questions regarding National Penn's responses set forth in this letter or require any additional information, please call me at (b) (6) [redacted]

Sincerely,

Michael R. Reinhard

Michael R. Reinhard
Chief Financial Officer