Macy's, Inc.
Form DEFR14A
April 03, 2009

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

Filed by the Registrant þ Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

þ Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to §240.14a-12

Macy s, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement if Other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

þ No fee required

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

1) Title of each class of securities to which transaction applies:

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2) Aggregate number of securities to which transaction applies:

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3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined:

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4) Proposed maximum aggregate value of transaction:

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5) Total fee paid:

¨ Fee paid previously with preliminary materials

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount Previously Paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

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EXPLANATORY NOTE

The Registrant s definitive proxy statement filed with the Securities and Exchange Commission on April 1, 2009 is amended to correct certain typographical errors, which incorrectly referred to the shareholder proposal regarding simple majority vote as Proposal 3, when in fact, this shareholder proposal was Proposal 4. These references are on pages 39 and 40. These typographical errors do not appear in printed versions of the definitive proxy statement.

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MACY S, INC.

7 West Seventh Street Cincinnati, Ohio 45202

and

151 West 34th Street New York, New York 10001

April 1, 2009

To the Shareholders:

It is my privilege to invite you to attend Macy s 2009 annual meeting of shareholders. We are holding the annual meeting on Friday, May 15, 2009, at 11:00 a.m., Eastern Daylight Savings Time, at Macy s offices located at 7 West Seventh Street, Cincinnati, Ohio 45202. We are enclosing the official notice of meeting, proxy statement and form of proxy with this letter. The matters listed in the notice of meeting are described in the attached proxy statement.

Your vote is important and we want your shares to be represented at the meeting. Accordingly, we encourage you to read the proxy statement and cast your vote promptly by following the instructions on the enclosed proxy card.

We appreciate your continued confidence in and support of Macy s, Inc.

Sincerely,

Terry J. Lundgren

Chairman of the Board, President

and Chief Executive Officer

WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING,

PLEASE CAST YOUR VOTE PROMPTLY

BY FOLLOWING THE INSTRUCTIONS ON THE ENCLOSED PROXY CARD.

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MACY S, INC.

7 West Seventh Street, Cincinnati, Ohio 45202

and

151 West 34th Street, New York, New York 10001

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

and

Important Notice Regarding the Availability of Proxy Materials

For the Shareholder Meeting to be Held on May 15, 2009

To the Shareholders:

Macy s hereby gives notice that the annual meeting of its shareholders will be held at 11:00 a.m., Eastern Daylight Savings Time, on Friday, May 15, 2009, at Macy s offices located at 7 West Seventh Street, Cincinnati, Ohio 45202. The items on the agenda for the annual meeting are:

1. To elect eleven members of Macy s board of directors;

2. To ratify the appointment of KPMG LLP as Macy s independent registered public accounting firm for the fiscal year ending January 30, 2010;

3. To approve the Macy s, Inc. 2009 Omnibus Incentive Compensation Plan

4. To consider a shareholder proposal regarding simple majority vote, if properly presented at the meeting;

5. To consider a shareholder proposal regarding retention of equity compensation, if properly presented at the meeting; and

6. To act upon such other business as may properly come before the annual meeting or any postponements or adjournments thereof.

We recommend that you vote For the election of each director nominee, For items 2 and 3, and Against items 4 and 5. Each of these matters is more fully described in the attached proxy statement. The proxy statement and our annual report on Form 10-K are also available for your review at: www.proxyvote.com and www.macysinc.com/shareholders.

The Board of Directors has fixed March 20, 2009 as the record date for the determination of shareholders entitled to vote at the annual meeting or any postponements or adjournments of the annual meeting.

DENNIS J. BRODERICK

Secretary

April 1, 2009

YOU MAY VOTE IN PERSON AT THE ANNUAL MEETING OR BY PROXY. MACY S RECOMMENDS THAT YOU VOTE BY PROXY EVEN IF YOU PLAN TO ATTEND THE ANNUAL MEETING. PLEASE VOTE BY FOLLOWING THE INSTRUCTIONS ON THE ENCLOSED PROXY CARD. YOU MAY VOTE BY MAIL, BY TELEPHONE OR OVER THE INTERNET. IF YOU CHOOSE TO VOTE BY MAIL, PLEASE COMPLETE THE PROXY CARD AND RETURN IT PROMPTLY IN THE ENCLOSED POSTAGE-PAID ENVELOPE. IF YOUR SHARES ARE HELD IN STREET NAME BY A BROKER, BANK OR OTHER NOMINEE, AND YOU DECIDE TO ATTEND AND VOTE YOUR SHARES AT THE ANNUAL MEETING, YOU MUST FIRST OBTAIN A SIGNED AND PROPERLY EXECUTED PROXY FROM YOUR BANK, BROKER OR OTHER NOMINEE TO VOTE YOUR SHARES HELD IN STREET NAME AT THE ANNUAL MEETING.

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MACY S, INC.

7 West Seventh Street, Cincinnati, Ohio 45202

and

151 West 34th Street, New York, New York 10001

PROXY STATEMENT

Macy s board of directors (the Board) is furnishing this proxy statement in connection with its solicitation of proxies for use at the annual meeting of Macy s shareholders. The annual meeting will be held at 11:00 a.m., Eastern Daylight Savings Time, on Friday, May 15, 2009, at Macy s offices located at 7 West Seventh Street, Cincinnati, Ohio 45202. The proxies received will be used at the annual meeting and at any postponement or adjournment of the annual meeting for the purposes set forth in the accompanying notice of meeting. We will begin mailing the proxy statement, the notice of meeting and accompanying proxy on April 13, 2009.

Except where the context requires otherwise, the term Macy s includes Macy s, Inc. and its subsidiaries. Share and per share amounts in this proxy statement are adjusted to reflect a two-for-one stock split effected as a stock dividend on June 9, 2006.

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GENERAL

The record date for the annual meeting is March 20, 2009. If you were a holder of record of shares of Macy s common stock at the close of business on the record date you are entitled to vote those shares at the annual meeting. You are entitled to one vote for each share of common stock you owned on each of the matters listed in the notice of meeting. As of the record date, 421,869,213 shares of common stock were outstanding. This number excludes shares held in the treasury of Macy s.

The Board has adopted a policy under which all voting materials that identify the votes of specific shareholders will be kept confidential and will not be disclosed to Macy s officers, directors or employees or to third parties except as described below. Voting materials may be disclosed in any of the following circumstances:

- if required by applicable law;
- to persons engaged in the receipt, counting, tabulation or solicitation of proxies who have agreed to maintain shareholder confidentiality as provided in the policy;
- in those instances in which shareholders write comments on their proxy cards or otherwise consent to the disclosure of their vote to Macy s management;
- in the event of a proxy contest or a solicitation of proxies in opposition to the voting recommendations of the Board;
- in respect of a shareholder proposal that Macy s Nominating and Corporate Governance Committee of the Board, referred to as the NCG Committee, after having allowed the proponent of the proposal an opportunity to present its views, determines is not in the best interests of Macy s and its shareholders; and
- in the event that representatives of Macy s determine in good faith that a bona fide dispute exists as to the authenticity or tabulation of voting materials.

The policy described above will apply to the annual meeting.

A quorum of shareholders is necessary to hold a valid annual meeting. The holders of a majority of the stock issued and outstanding and entitled to vote at the annual meeting, present in person or represented by proxy, will constitute a quorum at the annual meeting for the transaction of business at the meeting. Macy s will treat all shares of Macy s common stock represented at the meeting, including abstentions and broker non-votes, as shares that are present and entitled to vote for purposes of determining the presence of a quorum. With respect to all matters other than Item 3, Macy s will treat abstentions and broker non-votes as shares not voted for purposes of determining whether the requisite vote on a matter has been obtained. In order to obtain approval of any such matter, the affirmative vote of the holders of a majority (or, in the case of the election of any nominee as a director, a plurality) of the shares of common stock represented at the annual meeting and actually voted is required. Consequently, abstentions and broker non-votes will have no effect on the outcome of the vote on any such matter. In order to obtain approval of the matter described under Item 3, the affirmative vote of a majority of the outstanding shares entitled to vote at the meeting is required and, with respect to such matter, abstentions and broker non-votes will have the effect of votes against such matter. If

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the persons present or represented by proxy at the annual meeting constitute the holders of less than a majority of the outstanding shares of common stock as of the record date, the annual meeting may be adjourned to a subsequent date for the purpose of obtaining a quorum. Broker non-votes are shares held by a broker, bank or other nominee that are represented at the meeting, but with respect to which the beneficial owner of such shares has not instructed the broker, bank or nominee on how to vote on a particular proposal, and with respect to which the broker, bank or nominee does not have discretionary voting power on such proposal.

All shares of common stock represented at the annual meeting by proxies properly submitted prior to or at the annual meeting will be voted at the annual meeting in accordance with the instructions on the proxies, unless such proxies previously have been revoked. If no instructions are indicated, such shares will be voted:

- FOR the director nominees identified below;
- FOR the ratification of the appointment of Macy s independent registered public accounting firm;
- FOR the proposal to approve the Macy s, Inc. 2009 Omnibus Incentive Compensation Plan;
- AGAINST the shareholder proposal regarding simple majority vote; and
- AGAINST the shareholder proposal regarding retention of equity compensation.

You may vote in person at the annual meeting or by proxy. Macy s recommends that you vote by proxy even if you plan to attend the annual meeting. You have three options for voting by proxy:

- <u>Internet</u>: You can vote over the Internet at the Web address shown on your proxy card. Internet voting is available 24 hours a day, seven days a week. When you vote over the Internet, you should not return your proxy card.
- <u>Telephone</u>: You can vote by telephone by calling the toll-free number on your proxy card. Telephone voting is available 24 hours a day, seven days a week. Easy-to-follow voice prompts allow you to vote your shares and confirm that your instructions have been properly recorded. When you vote by telephone, you should not return your proxy card.
- <u>Mail</u>: You can vote by mail by simply signing, dating and mailing your proxy card in the postage-paid envelope included with this proxy statement.

A number of banks and brokerage firms participate in a program that also permits shareholders whose shares are held in street name to direct their vote over the Internet or by telephone. If your bank or brokerage firm gives you this opportunity, the voting instructions from the bank or brokerage firm that accompany this proxy statement will tell you how to use the Internet or telephone to direct the vote of shares held in your account. The Internet and telephone proxy procedures are designed to authenticate your identity, to allow you to give your proxy voting instructions and to confirm that those instructions have been properly recorded. Votes directed over the Internet or by telephone through such a program must be received by 5:00 p.m., Eastern Daylight Savings Time, on Thursday, May 14, 2009. Requesting a proxy prior to the deadline described above will automatically cancel any voting directions you have previously given over the Internet or by telephone with respect to your shares. Directing the voting of your shares will not affect your right to vote in person if you decide to attend the annual meeting; however, you must first obtain a signed and properly executed proxy from your bank, broker or other nominee to vote your shares held in street name at the annual meeting.

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If you participate in Macy s Profit Sharing 401(k) Investment Plan you will receive a voting instruction card for the Macy s common stock allocated to your account in the plan. You may instruct the plan trustee on how to vote your proportional interest in any Macy s shares held by the plan by signing, dating and mailing the enclosed voting instruction card, or by submitting your voting instructions by telephone or over the Internet. The plan trustee will vote your proportional interest in accordance with your instructions and the terms of the plan. If you fail to vote, the trustee for the plan, subject to its fiduciary obligations under ERISA, will vote your proportional interest in the same proportion as it votes the proportional interests for which it receives instructions from other plan participants. Under the terms of the plan, the trustee must receive voting instructions from plan participants by 5:00 p.m., Eastern Daylight Savings Time, on Wednesday, May 13, 2009.

You may revoke your proxy at any time by:

- submitting evidence of your revocation to the Corporate Secretary of Macy s;
- voting again over the Internet or by telephone;
- signing another proxy card bearing a later date and mailing it so that it is received prior to the annual meeting; or
- voting in person at the annual meeting, although attendance at the annual meeting will not, in itself, revoke a proxy.

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STOCK OWNERSHIP

Certain Beneficial Owners. The following table sets forth information as to the beneficial ownership of each person known to Macy s to own more than 5% of Macy s outstanding common stock as of December 31, 2008.

Name and Address	Date of Most Recent Schedule 13G Filing	Number of Shares	Percent of Class
AXA Financial, Inc. (AXA Financial) 1290 Avenue of the Americas New York, NY 10104(1)	February 13, 2009	58,484,219	13.9%
Dodge & Cox 555 California Street, 40th Floor San Francisco, CA 94101(2)	February 11, 2009	23,018,524	5.5%
UBS AG Bahnhofstrasse 45 P.O. Box CH-8021 Zurich, Switzerland(3)	February 10, 2009	24,272,210	5.8%

(1) Based on a Schedule 13G filed with the Securities and Exchange Commission, referred to as the SEC , by: AXA Financial; AXA, which owns AXA Financial; and AXA Assurances I.A.R.D. Mutuelle (IARD) and AXA Assurances Vie Mutuelle (Vie) (collectively with IARD, the Mutuelles AXA), as members of a group which controls AXA. The address of the Mutuelles AXA is 26, rue Drouot, 75009 Paris, France. The address of AXA is 25, avenue Matignon, 75008 Paris, France. The Schedule 13G reports the ownership as follows:

	Deemed to have Sole Power to Vote or to Direct the Vote	Deemed to have Shared Power to Vote or to Direct the Vote	Deemed to have Sole Power to Dispose or to Direct the Disposition	Deemed to have Shared Power to Dispose or to Direct the Disposition
The Mutuelles AXA, as a group	0	0	0	0
AXA	0	0	0	0
AXA Entity or Entities:				
AXA Investment Managers Paris (France)	9,185	0	9,185	0

AXA Rosenberg Investment Management LLC	4,400	0	4,400	0
AXA Financial, Inc.	0	0	0	0
Subsidiaries of AXA Financial:				
AllianceBernstein	46,777,454	0	57,835,198	0
AXA Equitable Life Insurance	20,936		635,436	0
	46,811,975	0	58,484,219	0

(2) According to a Schedule 13G filed with the SEC by Dodge & Cox, this reflects the Macy s common stock beneficially owned by clients of Dodge & Cox, which clients may include investment companies registered under the Investment Company Act and/or employee benefit plans, pension funds, endowment funds or other institutional clients.

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(3) According to a Schedule 13G filed with the SEC by UBS AG, this reflects the Macy s common stock beneficially owned by the UBS Global Asset Management division of UBS AG and its subsidiaries and affiliates on behalf of its clients, and does not reflect Macy s common stock, if any, owned by any other division of UBS AG.

Stock Ownership of Directors and Executive Officers. The following table sets forth the shares of common stock beneficially owned (or deemed to be beneficially owned pursuant to the rules of the SEC), as of March 20, 2009 by each Macy s director who is not an employee of Macy s, referred to as a Non-Employee Director, by each executive named on the 2008 Summary Compensation Table, referred to as a Named Executive, and by Macy s directors and executive officers as a group. The business address of each of the individuals named in the table is 7 West Seventh Street, Cincinnati, Ohio 45202.

Name	**Number of Shares (1)**	**(2)**	**Percent of Class**
Stephen F. Bollenbach	8,750	3,750	less than 1%
Deirdre P. Connelly	2,500	2,500	less than 1%
Meyer Feldberg	91,666	76,500	less than 1%
Sara Levinson	79,622	76,500	less than 1%
Joseph Neubauer	141,540	76,500	less than 1%
Joseph A. Pichler	85,300	76,500	less than 1%
Joyce M. Roché	16,992	15,000	less than 1%
Karl M. von der Heyden	96,344	76,500	less than 1%
Craig E. Weatherup	82,500	76,500	less than 1%
Marna C. Whittington	101,626	76,500	less than 1%
Terry J. Lundgren	3,208,153	3,008,806	less than 1%
Karen M. Hoguet	680,082	586,317	less than 1%
Thomas L. Cole	543,102	463,759	less than 1%
Janet E. Grove	588,130	530,177	less than 1%
Susan D. Kronick	724,619	639,561	less than 1%
All directors and executive officers as a group (26 persons)	8,255,381	7,095,583	1.96%

(1) Aggregate number of shares of common stock currently held or which may be acquired within 60 days after March 20, 2009 through the exercise of options granted under Macy s 1995 Executive Equity Incentive Plan, referred to as the 1995 Equity Plan. Includes 17,314 shares pledged by Dr. Whittington as security in a brokerage firm customary margin account.

(2) Number of shares of common stock which may be acquired within 60 days after March 20, 2009 through the exercise of options granted under the 1995 Equity Plan.

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Securities Authorized for Issuance Under Equity Compensation Plans. The following table presents certain aggregate information, as of January 31, 2009, with respect to the 1995 Equity Plan and Macy s 1994 Stock Incentive Plan, referred to as the 1994 Stock Plan (included on the line captioned Equity compensation plans approved by security holders).

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights ($) (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	38,794,466	28.64	20,875,527
Equity compensation plans not approved by security holders	0	0	0
Total	38,794,466	28.64	20,875,527

As of January 31, 2009, 482,864 shares of restricted stock were outstanding and subject to possible forfeiture, and 3,611,136 shares of common stock were available for future issuance as restricted stock or restricted stock units under the 1995 Equity Plan and the 1994 Stock Plan. The shares remaining available for future issuance as restricted stock or restricted stock units are included in the totals reflected in column (c). Under the 1995 Equity Plan and the 1994 Stock Plan, if these shares are not issued as restricted stock they may be made subject to grants of stock options.

The foregoing table does not reflect stock credits issued under Macy s Executive Deferred Compensation Plan, the Director Deferred Compensation Plan, and the Associated Dry Goods Corporation Executives Deferred Compensation Plan (assumed by Macy s in connection with its acquisition of May). The Executive Deferred Compensation Plan and the Associated Dry Goods Corporation Executives Deferred Compensation Plan have not been approved by Macy s shareholders. Pursuant to the Executive Deferred Compensation Plan, eligible executives may elect to receive a portion of their cash compensation in the form of stock credits. For a discussion of stock credits issued to Non-Employee Directors under the Director Deferred Compensation Plan, see Further Information Concerning the Board of Directors Director Compensation. Pursuant to the Associated Dry Goods Corporation Executives Deferred Compensation Plan, participants elected to receive a portion of their cash compensation in the form of stock credits.

Under the plans described in the immediately preceding paragraph, entitlements due to participants are expressed as dollar amounts and then converted to stock credits in amounts equal to the number of shares of common stock that could be purchased by the applicable plan at current market prices with the cash that otherwise would have been payable to the participant. Under the Executive Deferred Compensation Plan and the Associated Dry Goods Corporation Executives Deferred Compensation Plan, each stock credit, other than a stock credit payable in cash, entitles the holder to received one share of common stock upon the termination of the holder s employment or service with Macy s. Payments include dividend equivalents on the stock credits equal to any dividends paid to shareholders on shares of common stock. No specific numbers of shares are authorized for issuance under these plans.

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ITEM 1. ELECTION OF DIRECTORS

Macy s current Certificate of Incorporation and By-Laws provide that, beginning with the annual meeting in 2008, all directors will be elected annually and will serve one-year terms.

In accordance with the recommendation of the NCG Committee, the Board has nominated Stephen F. Bollenbach, Deirdre P. Connelly, Meyer Feldberg, Sara Levinson, Terry J. Lundgren, Joseph Neubauer, Joseph A. Pichler, Joyce M. Roché, Karl M. von der Heyden, Craig E. Weatherup and Marna C. Whittington, each of whom is currently a member of the Board, for election as directors. If elected, such nominees will serve for a one-year term to expire at Macy s annual meeting of shareholders in 2010 or until their successors are duly elected and qualified. Information regarding these nominees is set forth below. Ages are as of March 30, 2009.

Each nominee has consented to being nominated and agreed to serve if elected. If any nominee becomes unavailable to serve as a director before the annual meeting, the Board may designate a substitute nominee and the persons named as proxies may, in their discretion, vote your shares for the substitute nominee designated by the Board. Alternatively, the Board may reduce the number of directors to be elected at the annual meeting.

The Board recommends that you vote FOR the election of the nominees named above, and your proxy will be so voted unless you specify otherwise.

Nominees for Election as Directors:

STEPHEN F. BOLLENBACH

Mr. Bollenbach, age 66, has been the Non-Executive Chairman of the Board of Directors of KB Home, a homebuilding company, since April 2007. He served as co-Chairman and Chief Executive Officer of Hilton Hotels Corporation from May 2004 until his retirement in October 2007. From February 1996 to May 2004 he served as Chief Executive Officer and President of Hilton Hotels Corporation. He is also a member of the board of directors of American International Group, Inc., KB Home and Time Warner Inc. Mr. Bollenbach has been a director since June 2007.

DEIRDRE P. CONNELLY

Ms. Connelly, age 48, has been President, North American Pharmaceuticals of GlaxoSmithKline since February 2009. From June 2005 through January 2009 Ms. Connelly served as President U.S. Operations of Eli Lilly and Company. From October 2004 to June 2005, Ms. Connelly served as Senior Vice President Human Resources of Eli Lilly and Company. From May 2004 to October 2004, she served as Vice President Human Resources of Eli Lilly and Company. From 2003 to May 2004, Ms. Connelly served as Executive Director, Human Resources U.S. Operations of Eli Lilly and Company. From 2001 to 2003, she served as Leader, Women s Health Business U.S. Operations of Eli Lilly and Company. Ms. Connelly has been a director since January 2008.

MEYER FELDBERG

Professor Feldberg, age 67, has been Dean Emeritus and Professor of Leadership and Ethics at Columbia Business School at Columbia University since June 2004. Prior to that time, he served as the Dean of the

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Columbia Business School at Columbia University from 1989 to June 2004. He is currently on leave of absence from Columbia University and is serving as a Senior Advisor at Morgan Stanley. In 2007 New York Mayor Michael Bloomberg appointed Professor Feldberg as the President of NYC Global Partners, an office in the Mayor s office that manages the relationships between New York City and other global cities around the world. Professor Feldberg is also a member of the boards of directors of Revlon, Inc., Primedia, Inc., UBS Global Asset Management and SAPPI Limited. Professor Feldberg has been a director since May 1992.

Sara Levinson

Ms. Levinson, age 58, was the Non-Executive Chairman of ClubMom, Inc. from October 2002 until February 2008 and was Chairman and Chief Executive Officer of ClubMom from May 2000 through September 2002. She was President of the Women s Group of Rodale, Inc. from October 2002 until June 2005. From September 1994 through April 2000, she was President of NFL Properties, Inc. Ms. Levinson is also a member of the board of directors of CafeMom (CMI Marketing, Inc.), Harley Davidson, Inc. and KickApps Corporation. Ms. Levinson has been a director since May 1997.

Terry J. Lundgren

Mr. Lundgren, age 57, has been Chairman of Macy s since January 15, 2004 and President and Chief Executive Officer of Macy s since February 26, 2003. Prior to that time, he served as the President/Chief Operating Officer and Chief Merchandising Officer of Macy s since April 15, 2002. From May 1997 until April 15, 2002, he was President and Chief Merchandising Officer of Macy s. Mr. Lundgren has been a director since May 1997.

Joseph Neubauer

Mr. Neubauer, age 67, has been Chairman and Chief Executive Officer of ARAMARK Holdings Corporation since January 2007. From September 2004 to January 2007, Mr. Neubauer served as Chairman and Chief Executive Officer of ARAMARK Corporation. From January 2004 to September 2004 he served as Executive Chairman of ARAMARK Corporation. Prior to that, he was Chief Executive Officer of ARAMARK Corporation from 1983 until December 2003 and Chairman from 1984 until December 2003. He is also a member of the boards of directors of ARAMARK Holdings Corporation and Verizon Communications, Inc. Mr. Neubauer has been a director since September 1992.

Joseph A. Pichler

Mr. Pichler, age 69, was Chairman of The Kroger Co. from June 2003 until June 2004 and was Chairman and Chief Executive Officer of The Kroger Co. from September 1990 until June 2003. Mr. Pichler has been a director since December 1997.

Joyce M. Roché

Ms. Roché, age 62, is the President and Chief Executive Officer of Girls Incorporated, a national non-profit research, education and advocacy organization. Prior to assuming her position at Girls Incorporated in September 2000, Ms. Roché was an independent marketing consultant from 1998 to August 2000. She served as President and Chief Operating Officer of Carson, Inc. from 1996 to 1998 and also held senior marketing positions with Carson, Inc., Revlon, Inc. and Avon, Inc. Ms. Roché is also a member of the boards of directors of AT&T, Inc. and Tupperware Corporation. Ms. Roché has been a director since February 2006.

Karl M. Von Der Heyden

Mr. Von der Heyden, age 72, was Vice Chairman of the Board of Directors of PepsiCo, Inc. from September 1996 to January 2001. He is also a member of the board of directors of Dreamworks Animation SKG, Inc. Mr. Von der Heyden has been a director since February 1992.

Craig E. Weatherup

Mr. Weatherup, age 63, worked with PepsiCo, Inc. for 24 years and served as Chief Executive Officer of its world-wide Pepsi-Cola business and President of PepsiCo, Inc. Mr. Weatherup also led the initial public offering of The Pepsi Bottling Group, Inc., where he served as Chairman and Chief Executive Officer from March 1999 to January 2003. Mr. Weatherup is also a member of the board of directors of Starbucks Corporation. Mr. Weatherup has been a director since August 1996.

Marna C. Whittington

Dr. Whittington, age 61, has been President of Nicholas Applegate Capital Management since 2001 and Chief Operating Officer of Allianz Global Investors, the parent of Nicholas Applegate Capital Management, since 2002. Dr. Whittington is also a member of the board of directors of Rohm & Haas Company. Dr. Whittington has been a director since June 1993.

FURTHER INFORMATION CONCERNING THE BOARD OF DIRECTORS

Attendance at Meetings

The Board held six meetings during the fiscal year ended January 31, 2009, referred to as fiscal 2008. During fiscal 2008, no director attended fewer than 75%, in the aggregate, of the total number of meetings of the Board and Board Committees on which such director served.

Director Attendance at Annual Meetings

As a matter of policy, Macy s expects its directors to make reasonable efforts to attend Macy s annual meetings of shareholders. All directors who were directors as of the date of the annual meeting attended Macy s most recent annual meeting of shareholders.

Communications with the Board

You may communicate with the full Board, the Audit Committee, the Non-Employee Directors, or any individual director by communicating through Macy s Internet website at www.macysinc.com/investors/governance or by mailing such communications to 7 West Seventh Street, Cincinnati, Ohio 45202, Attn: General Counsel. Such

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communications should indicate to whom they are addressed. We will refer any communications we receive that relate to accounting, internal accounting controls or auditing matters to members of the Audit Committee unless the communication is otherwise addressed. You may communicate anonymously and/or confidentially if you desire. Macy s Office of the General Counsel will collect all communications and forward them to the appropriate director(s).

Director Independence

Macy s Corporate Governance Principles require that a majority of the Board consist of directors who the Board has determined do not have any material relationship with Macy s and are independent. The Board has adopted standards for director independence to assist the Board in determining if a director is independent. These standards, disclosed on Macy s website at www.macysinc.com/investors/governance, are as follows:

The director may not be (and may not have been within the preceding 60 months) an employee and no member of the director s immediate family may be (and may not have been within the preceding 36 months) an executive officer of Macy s or any of its subsidiaries. For purposes of these Standards for Director Independence, immediate family includes a person s spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than domestic employees) who shares such person s home.

The director is not a party to any contract pursuant to which such director provides personal services (other than as a director) to Macy s or any of its subsidiaries.

Neither the director nor any member of his or her immediate family receives, or has received within the preceding 36 months, direct compensation of more than $120,000 per year from Macy s or any of its subsidiaries (other than director and committee fees and pension or other forms of deferred compensation for prior service that is not contingent on continued service or, in the case of an immediate family member, compensation for service as a non-executive employee).

Neither the director nor any member of his or her immediate family is (and has not been within the preceding 60 months) affiliated with or employed in a professional capacity, including as an executive officer, partner or principal, by any corporation or other entity that is or was a paid adviser, consultant or provider of professional services to, or a substantial supplier of, Macy s or any of its subsidiaries.

The director is not a current employee and no member of his or her immediate family is a current executive officer of a company that makes payments to, or receives payments from, Macy s for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of $1 million or 2% of such other company s consolidated gross revenues.

The director is not employed by an organization that received, within the preceding 60 months, eleemosynary grants or endowments from Macy s or any of its subsidiaries in excess of $250,000 in any fiscal year of Macy s.

The director is not a parent, child, sibling, aunt, uncle, niece, nephew or first cousin of any other director of Macy s.

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The director is not a party to any agreement binding him or her to vote, as a shareholder of Macy s, in accordance with the recommendations of the Board.

The director is not a director of any corporation or other entity (other than Macy s) of which Macy s Chairman or Chief Executive Officer is also a director.

Neither the director nor a member of the director s immediate family is employed as an executive officer (and has not been so employed for the preceding 12 months) by another company where any of Macy s present executive officers at the same time serves or served on that company s compensation committee.

The Board has determined that each of the following Non-Employee Directors qualifies as independent under New York Stock Exchange (NYSE) rules and satisfies Macy s standards for director independence: Stephen Bollenbach, Deirdre Connelly, Meyer Feldberg, Sara Levinson, Joseph Neubauer, Joseph Pichler, Joyce Roché, Karl von der Heyden, Craig Weatherup and Marna Whittington. To assist the Board in making that determination, the NCG Committee reviewed, among other things, each director s employment status and other board commitments and, where applicable, each director s (and his or her immediate family members) affiliation with consultants, service providers or suppliers of the company.

Non-Employee Directors Meetings

The Non-Employee Directors meet in executive session without management either before or after all regularly scheduled Board meetings. The chairpersons of the Board Committees preside at such sessions by rotation. Non-Employee Directors who are not independent under the NYSE listing standards may participate in these executive sessions, but the Board would then hold at least one executive session each year exclusively for Non-Employee Directors who are independent under the NYSE listing standards.

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Committees of the Board

The following standing committees of the Board were in existence throughout fiscal 2008: the Audit Committee, the Compensation and Management Development Committee, referred to as the CMD Committee, the Finance Committee and the NCG Committee. The table below provides the current members of each Board committee and meeting information for fiscal 2008:

Name	Audit	CMD	Finance	NCG
Stephen F. Bollenbach	**X**		**X**	
Deirdre P. Connelly				**X**
Meyer Feldberg		**X****		**X**
Sara Levinson		**X**		**X**
Terry J. Lundgren				
Joseph Neubauer	**X****	**X**	**X**	
Joseph A. Pichler		**X**		**X***
Joyce M. Roché	**X**			**X**
Karl M. von der Heyden		**X**	**X***	
Craig E. Weatherup		**X***		**X**
Marna C. Whittington	**X***		**X****	
2008 Meetings	**5**	**6**	**7**	**2**

* Chair

** Vice Chair

Audit Committee. The Audit Committee was established in accordance with the applicable requirements of the Securities Exchange Act of 1934 and the NYSE. Its charter is disclosed on Macy s website at www.macysinc.com/investors/governance. As required by the Audit Committee charter, all current members of the Audit Committee are independent under Macy s standards for director independence. The Board has determined that all members are financially literate for purposes of NYSE listing standards, and that Dr. Whittington qualifies as an audit committee financial expert because of her business experience, understanding of generally accepted accounting principles and financial statements, and educational background.

The responsibilities of the Audit Committee include:

- reviewing the professional services provided by Macy s independent registered public accounting firm and the independence of such firm prior to initial engagement of the firm and annually thereafter;

- reviewing the scope of the audit by Macy s independent registered public accounting firm;

reviewing any proposed non-audit services by Macy s independent registered public accounting firm to determine if the provision of such services is compatible with the maintenance of their independence, and approval of same;

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- reviewing Macy s annual financial statements, systems of internal accounting controls, material legal developments relating thereto, and legal compliance policies and procedures;

- reviewing matters with respect to the legal, accounting, auditing and financial reporting practices and procedures of Macy s as it may find appropriate or as may be brought to its attention, including Macy s compliance with applicable laws and regulations;

- monitoring the functions of Macy s Compliance and Ethics organization, including review and discussing with management and the Board the organization s reports describing its on-going projects, the status of its communications and training programs, the status of pending compliance issues and other matters;

- reviewing with members of Macy s internal audit staff the internal audit department s staffing, responsibilities and performance, including its audit plans, audit results and actions taken with respect to those results; and

- establishing procedures for the Audit Committee to receive, review and respond to complaints regarding accounting, internal accounting controls, and auditing matters, as well as confidential, anonymous submissions by employees of concerns related to questionable accounting or auditing matters.

See Report of the Audit Committee for further information regarding certain reviews and discussions undertaken by the Audit Committee.

Compensation and Management Development Committee. The charter for the CMD Committee is disclosed on Macy s website at www.macysinc.com/investors/governance. As required by the CMD Committee charter, all current members of the CMD Committee are independent under Macy s standards for director independence.

The responsibilities of the CMD Committee include:

- reviewing the salaries of the chief executive officer and other executive officers of Macy s and, either as a Committee or together with the independent directors (as directed by the Board), set compensation levels for these executives;

- administering the bonus, incentive and stock option plans of Macy s, including (i) establishing any annual or long-term performance goals and objectives and maximum annual or long-term incentive awards for the chief executive officer and the other executives, (ii) determining whether and the extent to which annual and/or long-term performance goals and objectives have been achieved, and (iii) determining related annual and/or long-term incentive awards for the chief executive officer and the other executives;

- reviewing and approving the benefits of the chief executive officer and the other executive officers of Macy s;

- reviewing and approving any proposed employment agreement with, and any proposed severance, termination or retention plans, agreements or payments applicable to, any executive officer of Macy s;

advising and consulting with Macy s management regarding pension, benefit and compensation plans, policies and practices of Macy s;

establishing chief executive officer and key executive succession plans, including plans in the event of an emergency, resignation or retirement; and

reviewing and monitoring executive development strategies and practices for senior level positions and executives to assure development of a pool of management and executive personnel for adequate and orderly management succession.

Finance Committee. The charter for the Finance Committee is disclosed on Macy s website at www.macysinc.com/investors/governance. As required by the Finance Committee charter, a majority of the members of the Finance Committee are independent under Macy s standards for director independence.

The responsibilities of the Finance Committee include:

reviewing capital projects and other financial commitments and approving such projects and commitments above $15 million and below $25 million, reviewing and making recommendations to the Board with respect to approval of all such projects and commitments of $25 million and above, and reviewing and tracking the actual progress of approved capital projects against planned projections;

reporting to the Board on potential transactions affecting Macy s capital structure, such as financings, refinancings and the issuance, redemption or repurchase of Macy s debt or equity securities;

reporting to the Board on potential changes in Macy s financial policy or structure which could have a material financial impact on Macy s;

reviewing the financial considerations relating to acquisitions and dispositions of businesses and operations involving projected costs or income above $15 million and below $25 million and approving all such transactions, and reporting to the Board on all such transactions involving projected costs or income of $25 million and above; and

reviewing the management and performance of the assets of Macy s retirement plans.

Nominating and Corporate Governance Committee. The charter for the NCG Committee is disclosed on Macy s website at www.macysinc.com/investors/governance. As required by the NCG Committee charter, all current members of the NCG Committee are independent under Macy s standards for director independence.

The responsibilities of the NCG Committee include:

identifying and screening candidates for future Board membership;

proposing candidates to the Board to fill vacancies as they occur, and proposing nominees to the Board for election by the shareholders at annual meetings;

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- reviewing Macy s Corporate Governance Principles and recommending to the Board any modifications that the NCG Committee deems appropriate;

- overseeing the evaluation of and reporting to the Board on the performance and effectiveness of the Board and its committees and other issues of corporate governance, and recommending to the Board any changes concerning the composition, size, structure and activities of the Board and the committees of the Board as the NCG Committee deems appropriate based on its evaluations;

- reviewing and reporting to the Board with respect to director compensation and benefits and make recommendations to the Board as the NCG Committee deems appropriate; and

- considering possible conflicts of interest of Board members and management and making recommendations to prevent, minimize, or eliminate such conflicts of interest.

The NCG Committee reviews the director compensation program periodically. To help it perform its responsibilities, the NCG Committee makes use of company resources, including members of senior management in Macy s human resources and legal departments. In addition, the NCG Committee engages the services of an independent outside compensation consultant to assist the NCG Committee in assessing the competitiveness and overall appropriateness of Macy s director compensation program.

Identification and Selection of Nominees for the Board

Macy s By-laws provide that director nominations may be made by or at the direction of the Board. The NCG Committee is charged with identifying individuals qualified to become Board members and recommending such individuals to the Board for its consideration. The NCG Committee is authorized, among other means of identifying potential candidates, to employ third-party search firms. In evaluating potential candidates, the NCG Committee considers, among other things, the following:

- personal qualities and characteristics, accomplishments and reputation in the business community;

- knowledge of the communities in which Macy s does business and Macy s industry or other industries relevant to Macy s business;

- relevant experience and background that would benefit Macy s;

- ability and willingness to commit adequate time to Board and committee matters;

- the fit of the individual s skills and personality with those of other directors and potential directors in building a Board that is effective, collegial and responsive to the needs of Macy s; and

- diversity of viewpoints, background, experience and demographics.

The NCG Committee also takes into consideration whether particular individuals satisfy the independence criteria set forth in the NYSE listing standards and Macy s standards for director independence,

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together with any special criteria applicable to service on various standing committees of the Board. The full Board (a) considers candidates that the NCG Committee recommends, (b) considers the optimum size of the Board, (c) determines how to address any vacancies on the Board, and (d) determines the composition of all Board committees.

Macy s Corporate Governance Principles provide for a mandatory retirement age for directors of 72. Non-Employee Directors are required to resign from the Board as of the annual meeting following their 72nd birthday. At its February 20, 2009 meeting, the NCG Committee determined that it was in the best interests of the Company to waive for one year the application of the mandatory retirement provision with respect to Mr. von der Heyden. Consequently, upon the recommendation of the NCG Committee, the Board of Directors has waived the application of the mandatory retirement provision with respect to Mr. von der Heyden for fiscal 2009 and has nominated him for election as a director at the annual meeting for a one-year term to expire at Macy s annual meeting of shareholders in 2010.

The NCG Committee will consider candidates for nomination recommended by shareholders of Macy s and will evaluate such candidates using the same criteria discussed above that it uses to evaluate director candidates identified by the NCG Committee. Shareholders who wish to recommend a candidate for a director nomination should write to the Nominating and Corporate Governance Committee, c/o Dennis J. Broderick, Secretary, Macy s, Inc., 7 West Seventh Street, Cincinnati, Ohio 45202. The recommendation should include the full name and address of the proposed candidate, a description of the proposed candidate s qualifications and other relevant biographical information.

Director Nominations by Shareholders

Macy s By-Laws also provide that director nominations may be made by the company s shareholders. The By-Laws require that shareholders intending to nominate candidates for election as directors deliver written notice thereof to the Secretary of Macy s not less than 60 days prior to the meeting of shareholders. However, in the event that the date of the meeting is not publicly announced by Macy s by inclusion in a report filed with the SEC or furnished to shareholders, or by mail, press release or otherwise more than 75 days prior to the meeting, notice by the shareholder to be timely must be delivered to the Secretary of Macy s not later than the close of business on the tenth day following the day on which such announcement of the date of the meeting was so communicated. The By-Laws further require, among other things:

- that the notice by the shareholder set forth certain information concerning such shareholder and the shareholder s nominees, including their names and addresses;
- a representation that the shareholder is entitled to vote at such meeting and intends to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice;
- the class and number of shares of Macy s stock owned or beneficially owned by such shareholder;
- a description of all arrangements or understandings between the shareholder and each nominee;
- such other information as would be required to be included in a proxy statement soliciting proxies for the election of the nominees of such shareholder; and
- the consent of each nominee to serve as a director of Macy s if so elected.

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The chairman of the Board may refuse to acknowledge the nomination of any person not made in compliance with these requirements. Similar procedures prescribed by the By-Laws are applicable to shareholders desiring to bring any other business before an annual meeting of the shareholders. See Submission of Future Shareholder Proposals.

Corporate Governance Principles and Code of Business Conduct and Ethics

Macy s Corporate Governance Principles, Non-Employee Director Code of Business Conduct and Ethics and Code of Conduct are disclosed on Macy s website at www.macysinc.com/investors/governance. Shareholders may obtain copies of these documents and the charters for the Board committees, without charge, by sending a written request to the following address: Secretary, Macy s, Inc., 7 West Seventh, Cincinnati, Ohio 45202.

Director Compensation

Non-Employee Directors receive the following compensation:

Type of Compensation	Amount of Compensation
Board Retainer	$60,000 annually
Board or Board Committee Meeting Fee	$2,000 for each meeting attended and for each review session with one or more members of management
Committee Chairperson Retainer	$10,000 annually
Equity Grant	up to 10,000 stock options annually
Matching Philanthropic Gift	up to $22,500 annually

Under Macy s Director Deferred Compensation Plan, 50% of the annual Board retainer (including the retainer payable to a committee chair) and 50% of the meeting fees payable to Non-Employee Directors (the Mandatory Stock Compensation) are paid in credits representing the right to receive shares of Macy s common stock (Mandatory Stock Credits), with the balance (Elective Compensation) paid in cash or deferred under the Director Deferred Compensation Plan. Mandatory Stock Compensation is reflected in the Stock Awards column of the 2008 Non-Employee Director Summary Compensation Table below. Elective Compensation is reflected in the Fees Earned or Paid in Cash column of the 2008 Non-Employee Director Summary Compensation Table below. If a Non-Employee elects to defer all or a portion of the Elective Compensation into either stock credits or cash credits under the Director Deferred Compensation Plan, those amounts are not paid to him or her until service on the Board ends. Mandatory Stock Credits and stock credits relating to Elective Compensation that is deferred as stock credits are calculated monthly. Shares of Macy s common stock associated with such stock credits are transferred quarterly to a rabbi trust for the benefit of the participating Non-Employee Director. Dividend equivalents on the amounts deferred as stock credits are reinvested in additional stock credits. Elective Compensation deferred as cash credits earn interest each year at a rate equal to the yield (percent per annum) on 30-Year Treasury Bonds as of December 31 of the prior plan year.

Non-Employee Directors typically receive a non-qualified stock option grant under the 1995 Equity Plan or the 1994 Stock Plan on the date of the annual meeting. If an individual is elected by the Board as a

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Non-Employee Director after the date of the annual meeting and prior to the end of the calendar year, the Non-Employee Director receives a pro-rated stock option grant shortly after his or her election to the Board based on the number of months remaining in the calendar year following the date of his or her election. All options have a 10-year term, vest 25% on each of the first four anniversaries following the grant date, and are priced at the closing price of Macy s common stock on the NYSE on the day prior to the grant date.

Non-Employee Directors may participate in the philanthropic matching gift program of the Macy s Foundation on the same terms as all company employees. Under this program, the Macy s Foundation will match up to a total of $22,500 of gifts made by the director to approved charities in any calendar year.

Each Non-Employee Director and his or her spouse and eligible dependents also receive executive discounts on merchandise purchased at Macy s stores. This benefit remains available to them following retirement from the Board. As described below, the retirement plan for Non-Employee Directors was terminated in 1997.

The following table reflects the compensation information for each Non-Employee Director for fiscal 2008. Mr. Lundgren does not receive separate compensation for his service as a Director; his compensation is reflected in the 2008 Summary Compensation Table in the section titled Compensation of the Named Executives for 2008.

2008 NON-EMPLOYEE DIRECTOR SUMMARY COMPENSATION TABLE

Name	Fees Earned or Paid in Cash (1)($)	Stock Awards (1)(3)($)	Option Awards (2)(3)($)	Change in Pension Value and Non-Qualified Deferred Compensation Earnings (4)($)	All Other Compensation (5) ($)	Total($)
Stephen F. Bollenbach	49,000	49,000	75,600	0	1,453	175,053
Deirdre P. Connelly	40,000	40,000	12,600	0	8,676	101,276
Meyer Feldberg	47,000	(199,277)	75,600	0	54,069	(22,608)
Sara Levinson	47,000	(189,749)	122,925	0	7,784	(12,040)
Joseph Neubauer	55,000	(228,968)	75,600	0	16,616	(81,752)
Joseph A. Pichler	53,000	(198,811)	75,600	0	24,946	(45,265)
Joyce M. Roché	45,000	8,493	82,375	0	12,720	148,588
Karl M. von der Heyden	60,000	(255,494)	75,600	166	32,958	(86,770)
Craig E. Weatherup	57,000	(176,143)	122,925	0	53,832	57,614
Marna C. Whittington	58,000	(247,602)	122,925	0	84,462	17,785

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(1) All Elective Compensation is reflected in the Fees Earned or Paid in Cash column, whether it is paid currently in cash or deferred under the Director Deferred Compensation Plan. Seven of the Non-Employee Directors elected to defer all or a portion of the Elective Compensation payable to them during fiscal 2008, as follows:

Name	Elective Compensation Deferred($)	Deferred as Cash Credits($)	Deferred as Stock Credits(#)
Bollenbach	49,000	0	3,169.5
Levinson	47,000	47,000	0.0
Neubauer	55,000	0	3,556.5
Pichler	53,000	53,000	0.0
Roché	33,750	0	2,164.0
Weatherup	57,000	0	3,759.5
Whittington	58,000	0	3,732.5

The amounts in the Stock Awards column reflect the Mandatory Stock Compensation payable in fiscal 2008 plus the variable accounting treatment and dollar amounts recognized for financial statement reporting purposes in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (FAS 123R) for fiscal 2008 for Mandatory Stock Credits issued in fiscal 2008 and prior years, as further detailed in the following table. The application of variable accounting and FAS 123R resulted in credits to compensation expense in 2008 due to declines in the market price for shares of Macy s common stock subsequent to the end of fiscal 2007.

Name	Mandatory Stock Credits(#)	Mandatory Stock Compensation($)	2008 Additional Expense/(Credit) Recognized for Financial Statement Reporting Purposes($)	Total($)
Bollenbach	3,169.5	49,000	0	49,000
Connelly	2,575.0	40,000	0	40,000
Feldberg	3,001.0	47,000	(246,277)	(199,277)
Levinson	3,001.0	47,000	(236,749)	(189,749)
Neubauer	3,556.5	55,000	(283,968)	(228,968)
Pichler	3,355.0	53,000	(251,811)	(198,811)
Roché	2,869.0	45,000	(36,507)	8,493
von der Heyden	3,908.0	60,000	(315,494)	(255,494)
Weatherup	3,759.5	57,000	(233,143)	(176,143)
Whittington	3,732.5	58,000	(305,602)	(247,602)

(2) The grant date fair value of the stock options granted to each of the Non-Employee Directors in fiscal 2008 was $75,600. The amounts in the Option Awards column do not necessarily reflect compensation actually received by the Non-Employee Directors. The amounts reflect the dollar amount recognized for financial statement reporting purposes in accordance with FAS 123R for fiscal 2008 for stock options issued pursuant to the 1995 Equity Plan. The tables below show that the amount recognized includes the awards granted in fiscal 2008 and in as many as four prior years.

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Since Mr. Bollenbach, Mr. Feldberg, Mr. Neubauer, Mr. Pichler and Mr. von der Heyden are over age 65, the full grant date fair market value of their 2008 stock option awards was expensed in fiscal 2008. The fair value of their stock option awards prior to fiscal 2008 has previously been fully expensed.

Assumptions and terms used in the calculation of the amounts expensed for fiscal 2008 are included in footnote 16 to Macy s audited financial statements included in Macy s Annual Report on Form 10-K for fiscal 2008 (the 2008 10-K), in footnote 14 to Macy s audited financial statements included in Macy s Annual Report on Form 10-K for fiscal 2007 (the 2007 10-K), and in footnote 15 to Macy s audited financial statements included in Macy s Annual Report on Form 10-K for fiscal 2006 (the 2006 10-K).

	Bollenbach			Connelly				Feldberg			
Grant Date	**Options (#)**	**FMV ($)**	**2008 Expense ($)**	**Grant Date**	**Options (#)**	**FMV ($)**	**2008 Expense ($)**	**Grant Date**	**Options (#)**	**FMV ($)**	**2008 Expense ($)**
5/16/08	10,000	7.56	75,600	5/16/08	10,000	7.56	12,600	5/16/08	10,000	7.56	75,600
7/2/07	5,000	14.60	0					5/18/07	10,000	14.34	0
			75,600					5/19/06	10,000	13.57	0
								7/13/05	10,000	13.12	0
								5/21/04	10,000	9.30	0
											75,600

	Levinson			Neubauer				Pichler			
Grant Date	**Options (#)**	**FMV ($)**	**2008 Expense ($)**	**Grant Date**	**Options (#)**	**FMV ($)**	**2008 Expense ($)**	**Grant Date**	**Options (#)**	**FMV ($)**	**2008 Expense ($)**
5/16/08	10,000	7.56	12,600	5/16/08	10,000	7.56	75,600	5/16/08	10,000	7.56	75,600
5/18/07	10,000	14.34	35,850	5/18/07	10,000	14.34	0	5/18/07	10,000	14.34	0
5/19/06	10,000	13.57	33,925	5/19/06	10,000	13.57	0	5/19/06	10,000	13.57	0
7/13/05	10,000	13.12	32,800	7/13/05	10,000	13.12	0	7/13/05	10,000	13.12	0
5/21/04	10,000	9.30	7,750	5/21/04	10,000	9.30	0	5/21/04	10,000	9.30	0
			122,925				75,600				75,600

	Roché			von der Heyden				Weatherup			
Grant Date	**Options (#)**	**FMV ($)**	**2008 Expense ($)**	**Grant Date**	**Options (#)**	**FMV ($)**	**2008 Expense ($)**	**Grant Date**	**Options (#)**	**FMV ($)**	**2008 Expense ($)**
5/16/08	10,000	7.56	12,600	5/16/08	10,000	7.56	75,600	5/16/08	10,000	7.56	12,600
5/18/07	10,000	14.34	35,850	5/18/07	10,000	14.34	0	5/18/07	10,000	14.34	35,850
5/19/06	10,000	13.57	33,925	5/19/06	10,000	13.57	0	5/19/06	10,000	13.57	33,925
			82,375	7/13/05	10,000	13.12	0	7/13/05	10,000	13.12	32,800
				5/21/04	10,000	9.30	0	5/21/04	10,000	9.30	7,750
							75,600				122,925

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Whittington			
Grant Date	Options (#)	FMV ($)	2008 Expense ($)
5/16/08	10,000	7.56	12,600
5/18/07	10,000	14.34	35,850
5/19/06	10,000	13.57	33,925
7/13/05	10,000	13.12	32,800
5/21/04	10,000	9.30	7,750
			122,925

(3) The table below shows the number of stock options and stock credits held by the Non-Employee Directors as of the end of fiscal 2008. Stock credits are valued based on a closing price at fiscal year-end of $8.95. The exercise prices for all stock options exceed the $8.95 per share market value for Macy s common stock at fiscal year end, resulting in a value at fiscal year end of $0 for all stock options.

	Stock Options Number of Securities Underlying Unexercised Options (#)		Stock Credits	
Name	Exercisable	Unexercisable	Number of Stock Credits (#)	Market Value of Stock Credits ($)
Bollenbach	1,250	13,750	8,160	73,032
Connelly	0	10,000	2,722	24,362
Feldberg	69,000	25,000	5,856	52,411
Levinson	69,000	25,000	22,283	199,433
Neubauer	69,000	25,000	67,011	599,748
Pichler	69,000	25,000	18,401	164,689
Roché	7,500	22,500	9,608	85,992
von der Heyden	69,000	25,000	45,483	407,073
Weatherup	69,000	25,000	42,195	377,645
Whittington	69,000	25,000	28,748	257,295

(4) The present value of benefits under the Non-Employee Director retirement plan for each individual was determined as a deferred temporary life annuity based on years of Board service prior to May 16, 1997. The present value basis includes a discount rate of 7.45% and mortality rates under the RP2000CH table projected to January 1, 2009 using scale AA. Scale AA defines how future mortality improvements are incorporated into the projected mortality table and is based on a blend of Federal Civil Service and Social Security experience from 1977 through 1993. The actuarial present value of the pension benefit for four directors decreased, as follows: Mr. Feldberg ($3,262), Mr. Neubauer ($2,557), Mr. Weatherup ($1,271), and Dr. Whittington ($7,244). The decrease in pension value is mainly attributable to the fact that the discount rate increased from 6.25% for fiscal 2007 to 7.45% for fiscal 2008. The calculations assume that the annual retainer remains at $60,000 and a retirement at age 72, the mandatory retirement age for Directors.

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(5) All Other Compensation includes the items shown below. Merchandise discounts are credited to the Directors charge accounts. Gross-up on taxes on the merchandise discount are paid in cash after the end of the year, so the amounts shown reflect the gross-up on the prior fiscal year amounts.

Name	Merchandise Discount ($)	Gross-Up ($)	Matching Philanthropic Gift ($)	Total ($)
Bollenbach	1,453	0	0	1,453
Connelly	5,376	0	3,300	8,676
Feldberg	24,457	7,112	22,500	54,069
Levinson	2,506	2,253	3,035	7,784
Neubauer	10,395	6,221	0	16,616
Pichler	1,242	1,204	22,500	24,946
Roché	4,608	2,109	6,003	12,720
von der Heyden	6,009	4,449	22,500	32,958
Weatherup	20,367	10,965	22,500	53,832
Whittington	48,204	13,758	22,500	84,462

Director Retirement Plan

Macy s retirement plan for Non-Employee Directors was terminated on a prospective basis effective May 16, 1997 (the Plan Termination Date). As a result of such termination, persons who first become Non-Employee Directors after the Plan Termination Date will not be entitled to receive any benefit from the plan. Persons who were Non-Employee Directors as of the Plan Termination Date will be entitled to receive retirement benefits accrued as of the Plan Termination Date. Subject to an overall limit in an amount equal to the aggregate retirement benefit accrued as of the Plan Termination Date (i.e., the product of the amount of the annual Board retainer earned immediately prior to retirement and the years of Board service prior to the Plan Termination Date), eligible retirees who retire from service as Non-Employee Directors will be entitled to receive an annual payment equal to the amount of the annual Board retainer earned immediately prior to retirement, payable in monthly installments, commencing at retirement and continuing for the lesser of such person s remaining life or a number of years equal to such person s years of Board service prior to the Plan Termination Date. There are no survivor benefits under the terms of the retirement plan. Five of the current Non-Employee Directors participate in the plan. If they had retired on December 31, 2008, each would have been entitled to a $60,000 annual payment for the following maximum number of years:

Name	Years
Feldberg	5
Neubauer	5
von der Heyden	5
Weatherup	1
Whittington	4

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Director Stock Ownership Guidelines

In fiscal year 2005, the NCG Committee recommended, and the Board adopted, stock ownership guidelines for Non-Employee Directors. Under these guidelines, Non-Employee Directors are required to accumulate over time shares of Macy s common stock equal in value to at least five times the annual Board retainer and maintain or exceed that ownership level for their remaining tenure on the Board. Currently, the annual Board retainer is $60,000, so the guideline currently is $300,000 worth of Macy s common stock. Shares counted toward this requirement include:

- any shares beneficially owned by the director;
- restricted stock before the restrictions have lapsed; and
- stock credits or other stock units credited to a director s account.

Macy s common stock subject to unvested or unexercised stock options granted to Non-Employee Directors does not count toward the ownership requirement. Non-Employee Directors must comply with these guidelines by December 9, 2010 or within five years from the date the director s Board service commenced, whichever is later.

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ITEM 2. APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee has appointed KPMG LLP, an independent registered public accounting firm, to audit the books, records and accounts of Macy s for the fiscal year ending January 30, 2010. KPMG LLP and its predecessors have served as the independent registered public accounting firm for Macy s since 1988, and the Audit Committee considers them well qualified. Representatives of KPMG LLP are expected to be present at the annual meeting and will have the opportunity to make a statement if they desire to do so. It is also expected that they will be available to respond to appropriate questions. The Audit Committee has asked the Board to submit to shareholders a proposal asking shareholders to ratify the appointment of KPMG LLP. If the appointment of KPMG LLP is not ratified by shareholders, the Audit Committee will take such action, if any, with respect to the appointment of the independent registered public accounting firm as the Audit Committee deems appropriate.

Fees Paid to Independent Registered Public Accounting Firm

The table below summarizes the fees paid to KPMG LLP during fiscal 2008 and fiscal 2007:

Year	Audit Fees($)	Audit-Related Fees($)	Tax Fees($)	All Other Fees($)	Total($)
2008	5,240,000	1,196,400	148,703	0	6,585,103
2007	5,297,200	1,526,300	180,500	0	7,004,000

Audit fees represent fees for professional services rendered for the audit of Macy s annual financial statements, the audit of Macy s internal controls over financial reporting and the reviews of the interim financial statements included in Macy s Forms 10-Q.

Audit-related fees represent professional services principally related to the audits of financial statements of employee benefit plans, audits of financial statements of certain subsidiaries and certain agreed upon procedures reports.

Tax fees represent professional services related to tax compliance and consulting services Such tax consulting services did not involve the provision of advice regarding tax strategy or planning.

The Audit Committee has adopted policies and procedures for the pre-approval of all permitted non-audit services provided by Macy s independent registered public accounting firm. A description of such policies and procedures is attached as Appendix A to this proxy statement and incorporated herein by reference.

The Board recommends that you vote FOR ratification of the appointment of KPMG LLP, and your proxy will be so voted unless you specify otherwise.

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ITEM 3. APPROVAL OF

THE MACY S, INC. 2009 OMNIBUS INCENTIVE COMPENSATION PLAN

Overview

This Item 3 relates to the proposed Macy s, Inc. 2009 Omnibus Incentive Compensation Plan, or 2009 Incentive Plan. As of March 31, 2009, the Board unanimously approved and adopted the 2009 Incentive Plan, subject to the approval of Macy s shareholders. The 2009 Incentive Plan affords the Board the ability to design compensatory awards that are responsive to Macy s needs, and includes authorization for a variety of awards designed to advance Macy s interests and long-term success by encouraging stock ownership among Macy s officers and other key executives, employees, non-employee directors and consultants and other advisors or otherwise linking the compensation of such persons to share price performance or the achievement of specified corporate objectives. These awards include equity and cash awards intended to qualify as performance-based compensation within the meaning of Section 162(m) of the Internal Revenue Code of 1986, as amended, which Macy s refers to as the Code.

Macy s has historically granted equity awards under various plans, including most recently the 1994 Stock Plan and the 1995 Equity Plan. Macy s refers to the 1994 Stock Plan and 1995 Equity Plan together as the Prior Plans. If the 2009 Incentive Plan is approved by Macy s shareholders as proposed, no further awards will be made under the Prior Plans, and, apart from the issuance of stock credits as described below, the 2009 Incentive Plan will become the primary equity and long-term cash compensation plan for Macy s. As of January 31, 2009, under the Prior Plans, stock options with respect to 38,794,466 shares of Macy s common stock were outstanding with a weighted average exercise price of $28.64 and a weighted average remaining term of 5.4 years, and there were 482,864 restricted shares outstanding. Under the Prior Plans, there were 20,875,527 shares available for grant as of January 31, 2009. The closing price of Macy s common stock on March 30, 2009 was $8.91 per share.

Commitment to Making Responsible Awards of Equity Compensation. The Board and the CMD Committee remain committed to making responsible awards of equity compensation under Macy s equity compensation plans. For example, under the 2009 Incentive Plan:

- The terms of option rights and stock appreciation rights, or SARs, do not exceed 10 years;
- The exercise price of option rights and the base price of SARs may not be less than the market price of the underlying common stock on the date of grant;
- There are no reload provisions;
- Option rights and SARs may not be repriced, unless approved by the shareholders; and
- Award documentation may include recoupment (*i.e.*, clawback) provisions and/or restrictive covenants.

Macy s executive officers and non-employee directors will be eligible to receive awards under the 2009 Incentive Plan, and therefore have an interest in Item 3.

Summary of the 2009 Incentive Plan

The Board and the CMD Committee recommend that the shareholders approve the 2009 Incentive Plan. If the holders of a majority of the shares of common stock which are represented and actually voted at the

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annual meeting, and which constitute a majority in interest of all of the common shares entitled to vote thereon, vote **FOR** the 2009 Incentive Plan, it will immediately become effective. Upon the effectiveness of the 2009 Incentive Plan, no further grants will be made under the Prior Plans. If Macy s shareholders do not approve the 2009 Incentive Plan, the 2009 Incentive Plan will not become effective, and the Prior Plans, as they presently exist, will continue in effect. The results of the vote will not affect any awards outstanding under the Prior Plans at the time of the annual meeting.

Set forth below is a summary of the principal features of the 2009 Incentive Plan, but the following summary is not intended to be exhaustive and is qualified in its entirety by reference to the 2009 Incentive Plan itself, a copy of which is attached to this proxy statement as **Appendix B**.

Purpose. As one of the key elements of its strategic plan, Macy s links the compensation of directors, key employees and other individuals to the achievement of Macy s business plans. The 2009 Incentive Plan is intended to help Macy s attract and retain directors, officers, other key executives and employees and consultants and advisors. The 2009 Incentive Plan is also intended to provide Macy s directors, officers, other key executives and employees and consultants and advisors with incentives and rewards relating to Macy s business plans to encourage such persons to devote themselves to the business of Macy s and its subsidiaries.

Eligibility. The officers, executives, and other employees of Macy s or its subsidiaries and Macy s non-employee directors may be selected by the CMD Committee to receive awards under the 2009 Incentive Plan. In addition, the CMD Committee may select certain consultants and advisors providing services to Macy s or its subsidiaries to receive awards under the 2009 Incentive Plan. The CMD Committee determines which eligible persons will receive awards and the size, terms, conditions and restrictions of such awards. Macy s refers to eligible persons who have been approved to receive awards under the 2009 Incentive Plan as participants. The number of persons eligible to participate in the 2009 Incentive Plan is estimated to be approximately 167,000 people, but Macy s historically has not granted awards to more than approximately 1,800 people in any single calendar year.

Administration. The 2009 Incentive Plan is to be administered by the CMD Committee. If, however, any matters are required to be administered by the Board under Macy s organizational and governance documents, including the CMD Committee s charter, the Board will administer such matters (to that extent, references to the CMD Committee include references to the Board). The CMD Committee may delegate authority to administer the 2009 Incentive Plan to a subcommittee. No member of the CMD Committee may be an employee of Macy s or its subsidiaries. Each member of the CMD Committee must also qualify as a non-employee director within the meaning of Rule 16b-3 under the Securities Exchange Act of 1934, qualify as an outside director within the meaning of Section 162(m) of the Code and be independent of Macy s within the meaning of the New York Stock Exchange listing standards. The CMD Committee may grant awards to eligible persons and, in addition, may delegate to one or more officers certain authority with respect to the granting of awards other than awards to executive officers, directors or individuals who beneficially own more than 10% of any class of Macy s securities. The CMD Committee is authorized to interpret the 2009 Incentive Plan and related agreements and documents and to take various other actions with respect thereto.

Available Awards. The 2009 Incentive Plan authorizes Macy s to provide equity-based compensation in the form of (1) option rights, including incentive stock options, or ISOs, entitling the optionee to favorable tax treatment under Section 422 of the Code, (2) SARs, (3) restricted stock, (4) restricted stock units, or RSUs,

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(5) performance shares, and (6) other stock-based awards. Macy s is also authorized under the 2009 Incentive Plan to provide cash-based incentive compensation in the form of performance-based cash awards, which Macy s refers to as Incentive Awards. Each type of award is described below under Types of Awards Under the 2009 Incentive Plan. Each of the awards will be evidenced by an evidence of award containing such terms and provisions, consistent with the 2009 Incentive Plan, as the CMD Committee may approve.

Section 162(m) of the Code. The 2009 Incentive Plan is designed to comply with the requirements of applicable federal and state securities laws and the Code, and to allow Macy s to grant awards that satisfy the requirements for the performance-based compensation exclusion from the deduction limitations under Section 162(m) of the Code.

The Board and the CMD Committee believe that it is in Macy s interests and the interests of Macy s shareholders to maintain an equity and long-term cash compensation plan under which compensation awards made to Macy s named executive officers can qualify for deductibility for federal income tax purposes. Accordingly, the 2009 Incentive Plan has been structured in a manner such that awards under it can satisfy the requirements for the performance-based compensation exclusion from the deduction limitations under Section 162(m) of the Code. In order for awards to satisfy the requirements for the performance-based compensation exclusion from the deduction limitations under Section 162(m) of the Code (which Macy s refers to as Qualified Performance-Based Awards), the 2009 Incentive Plan specifies performance measures and other material terms that must be approved by Macy s shareholders. Approval of the 2009 Incentive Plan by the required vote of Macy s shareholders described above is intended to constitute such approval.

Shares Available Under the 2009 Incentive Plan. Subject to adjustment as provided for in the 2009 Incentive Plan, the number of shares of common stock subject to grants under the 2009 Incentive Plan will not exceed in the aggregate:

- 51 million shares, *minus*
- one share for each share subject to an option right or SAR, and 1.75 shares for each share subject to another award, granted under the Prior Plans after January 31, 2009, *plus*
- one share for each share subject to an option right or SAR, and 1.75 shares for each share subject to another award, that is forfeited, expires or is settled for cash (in whole or in part) under the 2009 Incentive Plan or after January 31, 2009 under the Prior Plans.

These shares may be of original issuance, treasury shares or other shares, or a combination of the foregoing.

Share Counting. Under the 2009 Incentive Plan, each share of Macy s common stock that is subject to an option right or SAR counts against the aggregate 2009 Incentive Plan limit as one share and each share of Macy s common stock that is subject to another award under the 2009 Incentive Plan counts against the aggregate 2009 Incentive Plan limit as 1.75 shares. The following shares of Macy s common stock will not increase the number of shares available for grant under the 2009 Incentive Plan:

- Any shares of Macy s common stock tendered or relinquished by a participant or withheld by Macy s in full or partial payment of the exercise price of option rights or the full or partial satisfaction of tax withholding on any award;

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Macy s common stock subject to a SAR granted under either the 2009 Incentive Plan or the Prior Plans that is not issued when the SAR is exercised and settled in Macy s common shares; and

Macy s common stock reacquired by Macy s using cash proceeds from the exercise of option rights granted either under the 2009 Incentive Plan or the Prior Plans.

Shares of Macy s common stock issued as substitution awards in connection with Macy s merger with or acquisition of a company will not decrease the number of shares available for grant under the 2009 Incentive Plan, but shares of Macy s common stock subject to substitution awards will not be available for further awards under the 2009 Incentive Plan if the substitution awards are forfeited, expire or settled in cash. Macy s may use shares under a pre-existing, shareholder-approved plan of a company acquired by Macy s for awards under the 2009 Incentive Plan, which shares will not decrease the number of shares available for grant under the 2009 Incentive Plan, but such shares may only be used for grants of awards made prior to the expiration of the pre-existing plan and to persons who were not employees or directors of Macy s or any subsidiary prior to such acquisition.

2009 Incentive Plan and Per Person Limitations. The 2009 Incentive Plan places limitations on the number of shares of common stock that Macy s may issue or transfer in connection with certain awards (with such limits being subject to certain adjustments as provided for in the 2009 Incentive Plan):

ISOs. The aggregate number of shares of Macy s common stock actually issued upon the exercise of ISOs will not exceed 30,000,000 shares.

Option Rights and SARs. No participant will be granted option rights or SARs, in the aggregate, for more than 2,000,000 shares of Macy s common stock during any fiscal year of Macy s.

Restricted Stock, RSUs and Performance Shares. No participant will be granted Qualified Performance-Based Awards of restricted stock, RSUs or performance shares, in the aggregate, for more than 1,000,000 shares of Macy s common stock during any fiscal year of Macy s.

Incentive Awards. No participant will be granted a Qualified Performance-Based Award that is an Incentive Award for any performance period (as described below) for more than, in the aggregate, $6 million.

No Repricing. Except in connection with an adjustment involving a corporate transaction or event as provided for in the 2009 Incentive Plan, the CMD Committee may not authorize the amendment of any outstanding option right or SAR to reduce the exercise or base price, and no outstanding option right or SAR may be cancelled in exchange for other awards, or cancelled in exchange for option rights or SARs having a lower exercise or base price, or cancelled in exchange for cash, without the approval of Macy s shareholders.

Types of Awards Authorized Under the 2009 Incentive Plan

Option Rights. Option rights may be granted that entitle the optionee to purchase shares of Macy s common stock at a price not less than market value per share as of the date of grant. Option rights may be granted as ISOs, nonqualified stock options, or combinations of the foregoing, but ISOs may be granted only

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to certain participants who meet the definition of employee under the Code. The maximum term for option rights is 10 years. Each grant of option rights will specify whether the exercise price is payable:

- in cash or by check or wire transfer at the time of exercise;
- by the transfer to Macy s of shares of Macy s common stock owned by the optionee;
- by a combination of such payment methods; or
- by such other methods as may be approved by the CMD Committee.

To the extent permitted by law, any grant of an option right may provide for deferred payment of the exercise price from the proceeds of sale through a broker of some or all of the shares of Macy s common stock to which the exercise relates.

Each grant will specify the period of continuous service with Macy s or any of its subsidiaries that is necessary before the option rights will become exercisable, and may provide for the earlier vesting of such option rights in the event of retirement, death, disability, a change in control, hardship or special circumstances affecting the optionee. Successive grants may be made to the same optionee whether or not option rights previously granted remain unexercised. No grant of option rights may provide for dividends, dividend equivalents or other similar distributions to be paid on such option rights.

SARs. A SAR is a right, exercisable by surrender of the SAR and the related option right (if granted in tandem with an option right) or by surrender of the SAR only (if granted as a free-standing SAR), to receive from Macy s an amount equal to the product of the number of shares of Macy s common stock subject thereto and up to 100% of the spread between the base price (or exercise price, if a tandem SAR) and the per share value of Macy s common stock on the date of exercise. The base price of a free-standing SAR may not be less than market value per share at the date of grant. Any grant may specify that the amount payable on exercise of a SAR may be paid by Macy s in cash, in shares of Macy s common stock, or in any combination thereof, in the discretion of the CMD Committee, and such amount may be capped by the CMD Committee at the time of grant. Any grant of tandem SARs may specify that, in the event of a change in control, the SAR and the related option right will be deemed automatically surrendered by the grantee, and Macy s will pay the grantee an amount equal to the product of the number of shares of Macy s common stock subject thereto and the spread between the exercise price and the per share value of Macy s common stock on the date of surrender. Tandem SARs may be exercised only when the related option right is also exercisable and when the spread is positive.

No SAR may be exercisable more than 10 years from the date of grant. Successive grants may be made to the same grantee of free-standing SARs whether or not free-standing SARs previously granted remain unexercised. No grant of SARs may provide for dividends, dividend equivalents or other similar distributions to be paid on such SARs.

Restricted Stock. A grant of restricted stock involves the immediate transfer by Macy s to a participant of ownership of a specified number of restricted shares of common stock in consideration of the performance of services. The transfer may be made without additional consideration or in consideration of a payment by the participant. The participant is entitled immediately to voting, dividend and other ownership rights in such shares; provided, however, that at least a portion of the restricted stock covered by such issuance or transfer must be subject to a substantial risk of forfeiture within the meaning of Section 83 of Code for a period to be determined by the CMD Committee at the date of grant or to the achievement of specified performance measures. If, for awards other than grants to non-employee directors, the restricted stock vests upon the passage of time rather than the achievement of performance measures, the period of time may not be shorter than three years (with the possibility of ratable vesting during such three-year period), except that grants to newly hired participants to replace forfeited awards granted by their former employers or grants as payment for earned performance awards may vest after one year. If the restricted stock vests upon the achievement of performance measures, the restrictions may not terminate sooner than one year after the date of grant. To enforce these forfeiture provisions, the transferability of restricted stock will be prohibited or restricted in a manner and to the extent prescribed in the applicable evidence of award for the period during which the forfeiture provisions are to continue. The CMD Committee may provide for early termination of the applicable restrictions in the event of retirement, death, disability, a change in control, hardship or special circumstances affecting the grantee. Dividends on restricted stock may be deferred and reinvested until the performance measures are achieved, provided that all dividends on restricted stock subject to the achievement of performance measures must be deferred and deemed reinvested until the restricted stock is earned. Restricted stock may be granted in certificated or uncertificated form.

RSUs. An RSU represents the right of the grantee of the RSU to receive from Macy s a payment upon or after vesting of the RSUs equal to the per share value of Macy s common stock as of the date of grant, vesting date, or other date determined by the CMD Committee at the date of grant of the RSU. At the discretion of the CMD Committee, RSUs may be settled in cash, shares of Macy s common stock or any combination thereof, and the amount due upon settlement may be capped by the CMD Committee at the time of grant. For awards other than grants to non-employee directors, the RSUs will be subject to forfeiture for a period of (1) at least one year following the date of grant in the case of RSUs that vest upon the achievement of performance measures or (2) at least three years following the date of grant in the case of any grant of RSUs that vest upon the passage of time rather than the achievement of performance measures (with the possibility of ratable vesting during such three-year period), except that grants to newly hired participants to replace forfeited awards granted by their former employers or grants as payment for earned performance awards may vest after one year. To enforce these forfeiture provisions, the transferability of RSUs will be prohibited in a manner and to the extent prescribed in the applicable evidence of award for the period during which the forfeiture provisions are to continue. RSUs may entitle the participant to receive credits for dividend equivalents, but not voting or other rights as a shareholder. Dividend equivalents on RSUs subject to the achievement of performance measures must be deferred and deemed reinvested until the performance measures are achieved. Awards of RSUs may be made without additional consideration. The CMD Committee may provide for early termination of the restriction period in the event of retirement, death, disability, a change in control, hardship or special circumstances affecting the grantee.

Incentive Awards and Performance Shares. An Incentive Award is a cash award based on performance measures where the performance period (as described below) is more than one year, and a performance share is the equivalent of one share of Macy s common stock. The performance period for performance shares may not be shorter than one year, unless otherwise determined by the CMD Committee. Each grant of Incentive Awards or performance shares will specify one or more performance measures that must be satisfied within a specified period (which Macy s refers to as the performance period) in order for the Incentive Awards or performance shares to be earned. The CMD Committee may provide for early termination or modification of the performance period in the event of retirement, death, disability, a change in control, hardship or special circumstances affecting the grantee.

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Each grant of Incentive Awards or performance shares will specify in respect of the relevant performance measures a level or levels of achievement and may set forth a formula for determining the number of Incentive Awards or performance shares that will be earned if performance is at or above the minimum or threshold level or levels, or is at or above the target level or levels, but falls short of maximum achievement of the specified performance measures. To the extent earned, the Incentive Awards or performance shares will be paid to the participant at the time and in the manner determined by the CMD Committee. Any grant may specify that the amount payable with respect thereto may be paid by Macy s in cash, shares of Macy s common stock or any combination thereof at the discretion of the CMD Committee, and such amount may be capped by the CMD Committee at the time of grant. At the CMD Committee s discretion, any award of performance shares may provide for the participant to receive dividend equivalents, but such dividend equivalents on performance shares must be deferred and deemed reinvested until the performance measures are achieved.

Other Awards. The CMD Committee may, subject to limitations under applicable law, grant to any participant other stock-based awards, which may be denominated or payable in, valued in whole or in part by reference to, or otherwise based on or related to, shares of Macy s common stock or factors that may influence the value of Macy s common stock. These factors may include, without limitation, convertible or exchangeable debt securities or other securities, purchase rights for shares of Macy s common stock, awards with value and payment contingent upon Macy s performance or the performance of Macy s subsidiaries, other affiliates or business units, or other factors determined by the CMD Committee. Other stock-based awards may also be valued by reference to the book value of Macy s common stock, or the value of the securities of, or performance of, specified subsidiaries, affiliates or other business units of Macy s. The CMD Committee will determine the terms and conditions of these awards. Shares of Macy s common stock delivered pursuant to these types of awards will be purchased for such consideration and paid for at such time, by such methods and in such forms as the CMD Committee determines. Cash awards, as an element of or supplement to any other award granted under the 2009 Incentive Plan, may also be granted. The CMD Committee may also grant shares of Macy s common stock as a bonus, or may grant other awards in lieu of Macy s obligations or the obligations of a subsidiary to pay cash or deliver other property under the 2009 Incentive Plan or under other plans or compensatory arrangements, subject to such terms as are determined by the CMD Committee in a manner that complies with Section 409A of the Code. Other stock-based awards are not required to be subject to any minimum vesting period.

Performance Measures. Performance measures are measurable performance objectives established by the CMD Committee for participants who have received awards under the 2009 Incentive Plan. Performance measures may be described in terms of either company-wide objectives or objectives that are related to the performance of the individual participant or of the subsidiary or division, segment, department, region or function within Macy s or a subsidiary in which the participant is employed. The performance measures may be relative to the performance of one or more other companies or an index. Performance measures applicable to any award or portion of an award that is intended be a Qualified Performance-Based Award to a participant who is, or is determined by the CMD Committee to be likely to become, a covered employee within the meaning of Section 162(m) of the Code will be limited to specified levels of or growth or improvement in one or more of the following:

total sales;

comparable store sales;

gross margin;

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operating or other expenses;

earnings before interest and taxes;

earnings before interest, taxes, depreciation and amortization;

net income;

earnings per share (either basic or diluted);

cash flow;

return on investment (determined with reference to one or more categories of income or cash flow and one or more categories of assets, capital or equity, including return on net assets, return on sales, return on equity and return on invested capital);

stock price appreciation;

operating income;

net cash provided by operations;

total shareowner return;

customer satisfaction;

gross margin return on investment; and

inventory turn.

Each performance measure that is a financial measure for a Qualified Performance-Based Award will be determined in accordance with generally accepted accounting principles as consistently applied by Macy s. If the CMD Committee determines that a change in Macy s business, operations, corporate structure or capital structure, or the manner in which Macy s conducts business, or other events or circumstances render the performance measures unsuitable, the CMD Committee may in its discretion modify the performance measures or the minimum acceptable level of achievement, in whole or in part, as the CMD Committee deems appropriate and equitable (including to exclude the effects of extraordinary items, unusual or non-recurring events, cumulative effects of tax or accounting changes, discontinued operations, acquisitions, divestitures and material restructuring or asset impairment charges), except where such action would cause the award to fail to qualify as performance-based compensation within the meaning of Section 162(m) of the Code. In such case, the CMD Committee may not make any such modification of the performance measures or minimum acceptable level of achievement with respect to such covered employee.

Amendments. The Board may amend the 2009 Incentive Plan from time to time without further approval by Macy s shareholders, except where:

the amendment would increase:

the maximum number of shares of Macy s common stock that may be issued under the 2009 Incentive Plan;

the maximum number of shares of Macy s common stock that may be subject to option rights or SARs granted to any participant during any fiscal year of Macy s;

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the maximum number of shares of Macy s common stock that may be granted as Qualified Performance-Based Awards of restricted stock or performance shares or with respect to Qualified Performance-Based Awards of RSUs during any fiscal year of Macy s; or

the maximum amount of any Incentive Award that may be awarded for any performance period;

the amendment would cause Rule 16b-3 promulgated under the Securities Exchange Act of 1934, as amended, to become inapplicable to the 2009 Incentive Plan or awards granted under the 2009 Incentive Plan; or

shareholder approval is required by applicable law or NYSE rules and regulations.

The Board may not amend the repricing provisions referred to above under No Repricing without further approval by Macy s shareholders.

If permitted by Section 409A of the Code and, in the case of a Qualified Performance-Based Award, Section 162(m) of the Code, in case of a termination of employment by reason of death, disability or normal or early retirement, or in the case of hardship or other special circumstances, of a participant who holds an option right or SAR not immediately exercisable in full, or any restricted stock or RSUs as to which the substantial risk of forfeiture or the prohibition or restriction on transfer has not lapsed, or any Incentive Awards, performance shares or other stock-based awards that have not been fully earned, or who holds shares of Macy s common stock subject to any other transfer restriction imposed pursuant to the 2009 Incentive Plan, the CMD Committee may, in its sole discretion, take such action as it deems equitable in the circumstances or in the best interests of Macy s, including waiving or modifying any vesting, performance or other period, any performance measure or any other requirement, condition, restriction or limitation applicable to any such award.

Transferability. Except as otherwise determined by the CMD Committee, no award granted, issued or transferred under the 2009 Incentive Plan is transferable by a participant except (1) by will or the laws of descent and distribution, (2) pursuant to a qualified domestic relations order, or (3) to a fully revocable trust of which the participant is treated as the owner for federal income tax purposes, and in no event may any such award granted under the 2009 Incentive plan be transferred for value. Notwithstanding the foregoing, pursuant to terms and conditions established by the CMD Committee, awards will be transferable by a participant who at the time of such transfer is eligible to earn Long-Term Incentive (LTI) Awards under Macy s 1992 Incentive Bonus Plan, as amended (or any successor plan thereto), or to earn other long-term awards under another plan that limits eligibility to the same group as those who would be eligible for Long-Term Incentive (LTI) Awards, or is a non-employee director, without payment of consideration by the transferee, to any one or more members of the participant s immediate family (or to one or more trusts established solely for the benefit of one or more members of the participant s immediate family or to one or more partnerships in which the only partners are members of the participant s immediate family).

The CMD Committee may specify at the date of grant that part or all of the shares of Macy s common stock that are (1) to be issued or transferred by Macy s upon exercise of option rights or SARs or upon settlement of RSUs, performance shares or other stock-based awards or (2) no longer subject to the substantial risk of forfeiture and restrictions on transfer referred to in the 2009 Incentive Plan with respect to restricted stock, will be subject to further restrictions on transfer.

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Adjustments. The number and kind of shares covered by outstanding awards under the 2009 Incentive Plan and, in the case of stock options and SARs, the exercise or base prices applicable thereto, must be adjusted as the CMD Committee, in its sole discretion exercised good faith, determines is equitably required to prevent dilution or enlargement of the rights of participants or optionees in the event of stock dividends, stock splits, combinations of shares, recapitalizations, other changes in Macy s capital structure, mergers, consolidations, spin-offs, split-offs, spin-outs, split-ups, reorganizations, liquidations, extraordinary cash dividends or other distributions of assets or issuances of rights or warrants to purchase securities, and similar events. In the event of any such transaction or event or in the event of a change in control of Macy s, the CMD Committee, in its discretion, may provide in substitution for any or all outstanding awards under the 2009 Incentive Plan such alternative consideration (including cash), if any, as it, in good faith, may determine to be equitable in the circumstances and may require the surrender of all awards so replaced in a manner that complies with Section 409A of the Code. In addition, for each option right or SAR with an exercise price or base price greater than the consideration offered in connection with any such transaction or event or change in control, the CMD Committee may in its sole discretion elect to cancel such option right or SAR without any payment to the person holding such option right or SAR. The CMD Committee shall also make or provide for such adjustments in the number of shares available under the 2009 Incentive Plan, including the individual participant limits described in the 2009 Incentive Plan, as the CMD Committee may determine appropriate to reflect any transaction or event described above, except that any such adjustment will be made only to the extent that it would not cause any option right intended to qualify as an ISO to fail to so qualify. Additionally, Macy s may eliminate fractional shares or settle fractional shares in cash.

Withholding Taxes. To the extent that Macy s is required to withhold federal, state, local or foreign taxes in connection with any payment made or benefit realized by a participant or other person under the 2009 Incentive Plan, and the amounts available to Macy s for such withholding are insufficient, it will be a condition to the receipt of such payment or the realization of such benefit that the participant or such other person make arrangements satisfactory to Macy s for payment of the balance of such taxes required to be withheld, which arrangements (in the discretion of CMD Committee) may include relinquishment of a portion of such benefit. In certain circumstances, Macy s may withhold common shares that are deliverable to a participant to settle tax withholding obligations. Participants may elect to have common shares withheld by Macy s or may deliver other common shares to satisfy tax withholding obligations, but the value of any common shares withheld will not exceed the minimum amount of taxes required to be withheld.

Compliance with Section 409A of the Internal Revenue Code. To the extent applicable, it is intended that the 2009 Incentive Plan and any grants made thereunder comply with the provisions of Section 409A of the Code, so that the income inclusion provisions of Section 409A(a)(1) of the Code do not apply to the participants. The 2009 Incentive Plan and any grants made under the 2009 Incentive Plan shall be administered in a manner consistent with this intent.

Recoupment and Restrictive Covenants. Any evidence of award may allow Macy s to recoup all or any portion of an award if Macy s financial statements are required to be restated in connection with the participant s misconduct, and may include restrictive covenants that must be complied with during employment or within a specified period of time after termination of employment as a condition to receipt or retention of all or any portion of an award.

Termination. No grant will be made under the 2009 Incentive Plan more than 10 years after the date on which the 2009 Incentive Plan is first approved by Macy s shareholders, but all grants made on or prior to

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such 10-year anniversary of shareholder approval will continue in effect after such date subject to the terms thereof and of the 2009 Incentive Plan. Upon approval of the 2009 Incentive Plan by Macy s shareholders, no further grants will be made under the Prior Plans, but all outstanding awards under the Prior Plans will continue to be in effect subject to the terms thereof.

Federal Income Tax Consequences

The following is a brief summary of some of the federal income tax consequences of certain transactions under the 2009 Incentive Plan based on federal income tax laws in effect on January 1, 2009. This summary is not intended to be complete and does not describe state or local tax consequences. It is not intended as tax guidance to participants in the 2009 Incentive Plan.

Tax Consequences to Participants

Non-Qualified Option Rights. In general, (1) no income will be recognized by an optionee at the time a non-qualified option right is granted, (2) at the time of exercise of a non-qualified option right, ordinary income will be recognized by the optionee in an amount equal to the difference between the exercise price paid for the shares and the fair market value of the shares, if unrestricted, on the date of exercise, and (3) at the time of sale of shares acquired pursuant to the exercise of a non-qualified option right, appreciation (or depreciation) in value of the shares after the date of exercise will be treated as either short-term or long-term capital gain (or loss) depending on how long the shares have been held.

Incentive Option Rights. No income generally will be recognized by an optionee upon the grant or exercise of an ISO. The exercise of an ISO, however, may result in alternative minimum tax liability. If shares of Macy s common stock are issued to the optionee pursuant to the exercise of an ISO, and if no disqualifying disposition of such shares is made by such optionee within two years after the date of grant or within one year after the transfer of such shares to the optionee, then upon sale of such shares, any amount realized in excess of the exercise price will be taxed to the optionee as a long-term capital gain and any loss sustained will be a long-term capital loss.

If shares of Macy s common stock acquired upon the exercise of an ISO are disposed of prior to the expiration of either holding period described above, the optionee generally will recognize ordinary income in the year of disposition in an amount equal to the excess (if any) of the fair market value of such shares at the time of exercise (or, if less, the amount realized on the disposition of such shares if a sale or exchange) over the exercise price paid for such shares. Any further gain (or loss) realized by the participant generally will be taxed as short-term or long-term capital gain (or loss) depending on the holding period.

SARs. No income will be recognized by a participant in connection with the grant of a tandem SAR or a free-standing SAR. When the SAR is exercised, the participant normally will be required to include as taxable ordinary income in the year of exercise an amount equal to the amount of cash received and the fair market value of any unrestricted shares of Macy s common stock received on the exercise.

Restricted Stock. The recipient of restricted stock generally will be subject to tax at ordinary income rates on the fair market value of the restricted stock (reduced by any amount paid by the participant for such restricted stock) at such time as the shares are no longer subject to forfeiture or restrictions on transfer for purposes of Section 83 of the Code, which Macy s refers to as the Restrictions. However, a recipient who so elects under Section 83(b) of the Code within 30 days of the date of transfer of the shares will have taxable ordinary income on the date of transfer of the shares equal to the excess of the fair market value of such shares (determined without regard to the Restrictions) over the purchase price, if any, of such restricted stock. If a Section 83(b) election has not been made, any dividends received with respect to restricted stock that is subject to the Restrictions generally will be treated as compensation that is taxable as ordinary income to the participant.

RSUs. No income generally will be recognized upon the award of RSUs. The recipient of an award of RSUs generally will be subject to tax at ordinary income rates on the fair market value of unrestricted shares of Macy s common stock on the date that such shares are transferred to the participant under the award (reduced by any amount paid by the participant for such RSUs), and the capital gains/loss holding period for such shares will also commence on such date.

Incentive Awards and Performance Shares. No income generally will be recognized upon the grant of performance shares. Upon payment in respect of the earn-out of Incentive Awards or performance shares, the recipient generally will be required to include as taxable ordinary income in the year of receipt an amount equal to the amount of cash received and the fair market value of any unrestricted shares of Macy s common stock received.

Tax Consequences to Macy s or a Subsidiary

To the extent that a participant recognizes ordinary income in the circumstances described above, Macy s or the subsidiary for which the participant performs services will be entitled to a corresponding deduction provided that, among other things, the income meets the test of reasonableness, is an ordinary and necessary business expense, is not an excess parachute payment within the meaning of Section 280G of the Code and is not disallowed by the $1 million limitation on certain executive compensation under Section 162(m) of the Code.

Registration with the SEC

Macy s intends to file a Registration Statement on Form S-8 relating to the issuance of shares of Macy s common stock, par value $0.01 per share, under the 2009 Incentive Plan with the Securities and Exchange Commission pursuant to the Securities Act of 1933, as amended, as soon as is practicable after approval of the 2009 Incentive Plan by Macy s shareholders.

New 2009 Incentive Plan Benefits

Because awards to be granted in the future under the 2009 Incentive Plan are at the discretion of the CMD Committee, it is not possible to determine the benefits or the amounts to be received under the 2009 Incentive Plan by Macy s directors, officers or employees.

For grants made during Macy s fiscal year 2008 to Macy s named executive officers, please see the 2008 Grants of Plan-Based Awards table on page 70.

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Equity Compensation Plan Information

For information about Macy s equity compensation plans (other than qualified employee benefits plans and plans available to shareholders on a pro rata basis) as of December 31, 2008, please see the table under Stock Ownership Securities Authorized for Issuance Under Equity Compensation Plans and related disclosure on page 7.

Voting Recommendation

The Board unanimously recommends a vote FOR adoption of the Macy s, Inc. 2009 Omnibus Incentive Compensation Plan.

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ITEM 4. SHAREHOLDER PROPOSAL REGARDING SIMPLE MAJORITY VOTE

Mr. William Steiner, 112 Abbottsford Gate, Piermont, NY 10968, the beneficial owner of 1,500 shares of Macy s common stock, has advised Macy s that he intends to propose a resolution at the annual meeting. Mr. Steiner has appointed Mr. John Chevedden of 2215 Nelson Avenue, No. 205, Redondo Beach, CA 90278 and/or Mr. Chevedden s designee to act on his behalf relating to the proposed resolution. Mr. Steiner s proposed resolution and statement in support thereof are set forth below:

Proposal 4 Adopt Simple Majority Vote

RESOLVED, Shareholders request that our board take the steps necessary so that each shareholder voting requirement in our charter and bylaws, that calls for a greater than simple majority vote, be changed to a majority of the votes cast for and against related proposals in compliance with applicable laws. This includes each 80% shareholder voting provision in our charter and/or bylaws.

Statement of William Steiner

Currently a 1%-minority can frustrate the will of our 79%-shareholder majority. Our supermajority vote requirements can be almost impossible to obtain when one considers abstentions and broker non-votes. For example, a Goodyear (GT) management proposal for annual election of each director failed to pass even though 90% of votes cast were yes-votes. Supermajority requirements are arguably most often used to block initiatives supported by most shareowners but opposed by management.

The Council of Institutional Investors www.cii.org recommends adoption of simple majority voting. This proposal topic also won up to 89% support at the following companies in 2008:

Whirlpool (WHR)	Ray T. Chevedden (Sponsor)
Lear Corp. (LEA)	John Chevedden
Liz Claiborne (LIZ)	Kenneth Steiner

The merits of this Simple Majority Vote proposal should also be considered in the context of the need to initiate improvements in our company s corporate governance and in individual director performance. For instance in 2008 the following governance and performance issues were identified:

The Corporate Library www.thecorporatelibrary.com, an independent investment research firm, rated our company:
High Concern in Executive Pay 634,000 options in 2007 for Terry Lundgren (good profit potential simply from market swings).

Our directors served on 11 boards rated D or F by The Corporate Library www.thecorporatelibrary.com, an independent investment research firm:

Stephen Bollenbach	Time Warner (TWX)
Stephen Bollenbach	American International Group (AIG)
Stephen Bollenbach	KB Home (KBH) F-rated

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Joyce Roché	AT&T (T)
Joyce Roché	Anheuser-Busch (BUD)
Joyce Roché	Tupperware (TUP)
Meyer Feldberg	PRIMEDIA (PRM)
Meyer Feldberg	Revlon (REV)
Joseph Neubauer	Verizon (VZ)
Joseph Neubauer	Wachovia (WB)
Sara Levinson	Harley-Davidson (HOG)

Directors on D-rated boards held 9 of 16 seats on our key board committees of audit, nomination and executive pay.

Three directors had more than 15-years tenure (independence concern) and held 5 of 16 seats on our key board committees:
Meyer Feldberg

Joseph Neubauer

Karl von der Heyden

Marna Whittington

The above directors could be reelected with only one-vote each under our plurality voting system.

We had no shareholder right to:
An independent Chairman.

A Lead Director.

Cumulative voting.

To act by written consent.

The above concerns show there is need for improvement. Please encourage our board to respond positively to this proposal.

Adopt Simple Majority Vote

Yes on 4

For the reasons discussed below, the Board of Directors recommends that shareholders vote AGAINST the foregoing proposal.

Under the Company s governing documents and Delaware law, nearly all matters submitted to our shareholders for approval require the approval of a simple majority of the votes cast, including all matters voted upon at this year s annual meeting (other than the election of directors, which requires a plurality vote). As permitted by Delaware law, the Company s shareholder-approved Restated Certificate of Incorporation (the charter) and its bylaws do, however, provide that if certain actions are to be taken by shareholders, those actions will require more than a simple majority vote, including: (i) certain business combination transactions with an interested shareholder (subject to certain exceptions, including an exception for

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transactions approved by the Board), (ii) amendment of the bylaw provisions relating to shareholder annual and special meetings, board structure, board vacancies, director elections and director removal, and (iii) amendment of certain provisions of the charter.

These supermajority voting requirements relate to fundamental elements of our corporate governance. They have been included in our charter for many years and are commonly included in the corporate charters and bylaws of many publicly-traded Delaware companies. In general, these provisions are designed to provide minority shareholders with a measure of protection against changes in corporate governance and other self-interested actions by one or more large shareholders.

While some corporations have eliminated supermajority provisions, we do not believe that a formulaic approach as suggested by the proponent is appropriate. The Board believes that more meaningful voting requirements are appropriate for issues that have a long-lasting effect on the Company. For example, the provisions relating to business combinations are intended to provide minority shareholders with a measure of protection against business combination and other transactions that may be inadequately priced, unfair, coercive or otherwise not in their best interests. These provisions are not intended to, and do not, preclude unsolicited, non-abusive offers to acquire the Company at a fair price. They are designed, instead, to encourage any potential acquirer to negotiate directly with the Board, which the Board believes is in the best position to evaluate the adequacy and fairness of proposed offers, to negotiate on behalf of all shareholders, and to protect shareholders against abusive takeover tactics.

The Board also believes that there are important reasons for requiring a broad consensus of the shareholders to amend certain fundamental governance provisions in the Company s bylaws and charter, and that requiring a supermajority vote for such amendments protects shareholders against the self-interested actions of a few large investors. For example, if the proposal submitted by the proponent were implemented it could become possible for a small number of very large shareholders, whose interests may diverge from those of our other shareholders, to approve an amendment to the Company s bylaws and change the size or composition of the current Board. Importantly, the supermajority voting requirements in the bylaws and charter do not preclude changes to the Company s organizational documents. Rather, they help to ensure that certain fundamental changes to the organizational documents are made only with a broad consensus of shareholders, rather than by a simple majority of shareholders (which may, in practice, be the holders of a minority of shares outstanding).

The Board will continue to consider whether changes to the Company s charter and bylaws are appropriate and in the best interests of the shareholders and the Company in the future. For the reasons set forth above, however, the Board believes at this time that implementation of the proposal would not serve the best interests of our shareholders or the Company.

The Board recommends that you vote AGAINST this proposal. Proxies solicited by the Board will be so voted unless you specify in your proxy a contrary choice.

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ITEM 5. SHAREHOLDER PROPOSAL REGARDING RETENTION OF EQUITY COMPENSATION

The Company has been advised that the AFSCME Employees Pension Plan, 1625 L Street, N.W., Washington, D.C. 20036, the beneficial owner of 3,022 shares of Macy s common stock, intends to submit the following proposal at the annual meeting:

RESOLVED, that stockholders of Macy s Inc. (Macy s) urge the Compensation Committee of the Board of Directors (the Committee) to adopt a policy requiring that senior executives retain a significant percentage of shares acquired through equity compensation programs until two years following the termination of their employment (through retirement or otherwise), and to report to stockholders regarding the policy before Macy s 2010 annual meeting of stockholders. The stockholders recommend that the Committee not adopt a percentage lower than 75% of net after-tax shares. The policy should address the permissibility of transactions such as hedging transactions which are not sales but reduce the risk of loss to the executive.

SUPPORTING STATEMENT

Equity-based compensation is an important component of senior executive compensation and a core principle to align the interests of key executives with the interests of the stockholders at Macy s. According to the 2008 proxy statement, long term incentive pay made up 38 to 54% of named executive officer compensation for 2007. In 2007, Chairman and CEO Terry Lundgren realized over $10 million in reported value through the exercise of 225,000 options and vesting of 157,372 shares and Vice Chair Janet Grove realized over $6 million through the exercise of 202,000 options and vesting of 21,810 shares. Yet, as of March 21, 2008, Mr. Lundgren only held 205,759 shares outright and Ms. Grove held 57,767 shares outright. Thus, we believe that the alignment benefits touted by Macy s are not being fully realized.

We believe there is a link between stockholder wealth and executive wealth that correlates to direct stock ownership by executives. According to an analysis conducted by Watson Wyatt Worldwide, companies whose CFOs held more shares generally showed higher stock returns and better operating performance. (Alix Stuart, Skin in the Games, CFO Magazine (March 1, 2008))

Requiring senior executives to hold a significant portion of shares obtained through compensation plans after the termination of employment would focus them on Macy s long-term success and would better align their interests with those of Macy s stockholders. In the context of the current financial crisis, we believe it is imperative that companies reshape their compensation policies and practices to discourage excessive risk-taking and promote long-term, sustainable value creation. A 2002 report by a commission of The Conference Board endorsed the idea of a holding requirement, stating that the long-term focus promoted thereby may help prevent companies from artificially propping up stock prices over the short-term to cash out options and making other potentially negative short-term decisions.

Macy s has a minimum stock ownership guideline requiring executives to own a number of shares of Macy s stock as a multiple of salary. The executives covered by the policy have five years in which to comply. We believe this policy does not go far enough to ensure that equity compensation builds executive ownership. We also view a retention requirement approach as superior to a stock ownership guideline because a guideline loses effectiveness once it has been satisfied.

We urge stockholders to vote for this proposal.

For the reasons discussed below, the Board recommends that shareholders vote AGAINST the foregoing proposal.

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The Board agrees with the AFSCME Pension Plan that equity ownership by executive officers serves to align the long-term interests of senior executives and shareholders, and also sends a positive message to the investment community about the executive officers commitment to adding shareholder value. In addition, we realize that equity awards are an effective tool for compensation and recruitment of top management talent. In setting stock ownership guidelines, the Board believes that it needs to strike an appropriate balance between ensuring that the Company s executive officers have a significant equity stake in the future of the Company, while also allowing them to prudently manage their personal financial affairs. The Board believes that the type of retention guideline proposed by the AFSCME Pension Plan, with its high retention threshold and indefinite holding period, is not a prevalent practice and would result in a number of negative consequences.

Requiring executive officers to retain the high 75% stock ownership threshold suggested by the proposal could actually result in motivating senior executives to leave the Company in order to realize the value of their earned equity compensation. The high stock retention threshold suggested by this proposal could also result in significant non-diversification of the personal assets of executives, making our equity compensation programs less attractive and diminishing our ability to attract executive talent.

The Board believes that the Company s stock ownership guidelines, adopted in 2006, provide a balanced approach to aligning the long-term interests of executive officers and the other shareholders by requiring executive officers to own meaningful levels of stock based on their salary, while allowing them to realize the value of their equity incentive compensation and giving them the ability to manage their personal financial affairs. The AFSCME Pension Plan s proposal prescribes ownership solely through the retention of stock acquired through the Company s equity compensation plans, and prohibits executive officers from selling a substantial portion of such shares until they leave the Company. The proposal provides no guarantee of stock ownership by executive officers until their restricted stock vests or they exercise options. The Company s stock ownership guidelines, by contrast, require ownership of Macy s common stock, which may be acquired through a variety of means, including open market purchases, and set clear, reasonable and meaningful standards for the amount of stock to be owned.

In addition to the Company s stock ownership guidelines, the Company s equity compensation program includes significant holding requirements that provide the Company s executives with an incentive to manage the Company from the perspective of a shareholder with an equity stake in the business. Time-based restricted stock grants typically vest over three or more years, subject to continued employment by the executive. Other than dividends received on the shares of restricted stock, these executives realize full value from the grant only after the three or more years of service to the Company. The value realized upon vesting is directly tied to the long term appreciation of the Company s stock price over the vesting period, which benefits all shareholders. Similarly, stock credits granted under the Company s stock credit plans vest over a two year period and then are subject to two- and three-year holding periods following vesting. The executives realize value from their stock credit grants only after the holding periods end. Just as with restricted stock, the value realized is directly tied to the Company s stock price at the end of the holding periods.

For these reasons, the Board believes that the Company s compensation policies for executive officers have been responsibly designed and implemented, and that the Company s stock ownership guidelines align the interests of executive officers with the long-term interests of shareholders, while still permitting the Company to use equity incentives as part of a balanced approach to compensation that supports recruitment and retention of top talent.

The Board recommends that you vote AGAINST this proposal. Proxies solicited by the Board will be so voted unless you specify in your proxy a contrary choice.

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COMPENSATION DISCUSSION & ANALYSIS

Overview

Macy s is one of the nation s premier retailers, with fiscal 2008 sales of $24.9 billion. At the end of fiscal 2008, Macy s operated more than 840 department stores in 45 states, the District of Columbia, Guam and Puerto Rico under the names of Macy s and Bloomingdale s. Macy s also operates macys.com and bloomingdales.com. The company employs about 167,000 regular full-time and part-time employees.

Managing a nation-wide retail business requires a team of committed, talented and experienced executives. Macy s stores and direct-to-customer business compete with many retailing formats in the geographic areas in which they operate, including department stores, specialty stores, general merchandise stores, off-price and discount stores, new and established forms of home shopping (including the Internet, mail order catalogs and television) and manufacturers outlets, among others. In addition to competing with these other retailers for customers, Macy s also must compete very aggressively for executive talent. These talented executives are accountable for the performance of the business units they manage and are compensated based on that performance.

This Compensation Discussion & Analysis provides information regarding the compensation paid to the following individuals, referred to as the Named Executives, in fiscal 2008. The titles shown below are the positions held by the Named Executives during fiscal 2008. In connection with the restructuring of its management team as a result of the expansion of the Company s My Macy s localization initiative, the titles of Mrs. Hoguet and Mr. Cole were changed to Chief Financial Officer and Chief Administrative Officer, respectively, effective as of February 20, 2009.

- Terry J. Lundgren, Chairman, President and Chief Executive Officer;
- Karen M. Hoguet, Executive Vice President and Chief Financial Officer;
- Thomas L. Cole, Vice Chair;
- Janet E. Grove, Vice Chair; and
- Susan D. Kronick, Vice Chair.

Each year, the CMD Committee of the Board, which is made up entirely of independent directors, recommends to the Board the compensation for Mr. Lundgren and determines the compensation for the other Named Executives.

Macy s executive compensation philosophy is straightforward and consistent Macy s pays for performance. Macy s believes that pay-for-performance means that a significant portion of an executive s compensation is at risk and may vary from targeted compensation based upon the level of achievement of specified corporate objectives and share price performance. Macy s executives are accountable for the performance of the business units they manage and are compensated based on that performance. Executives are rewarded when defined objectives are achieved and value is created for Macy s shareholders.

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The at-risk elements of Macy s compensation program, such as short-term cash incentives, stock options, stock credits and restricted stock, are based on measures of business success and reflect a combination of specified internal financial measures of success, such as EBIT (earnings before interest and taxes), sales and cash flow, and external measurements of success, such as customer satisfaction and stock price performance. The performance-based cash incentive plan compensates the Named Executives for achieving specific financial goals established annually by the CMD Committee. The CMD Committee sets aggressive goals at the beginning of each fiscal year based on financial objectives in Macy s internal business plan for that fiscal year. Payments are not automatic, however, because the CMD Committee may exercise its discretion to reduce (but not increase) the amount of any incentive payment. Macy s relies heavily on long-term equity awards to attract and retain an outstanding executive team and to ensure a strong connection between executive compensation and financial performance, operational and strategic objectives and shareholder interests. The CMD Committee awards approximately 60% of the long-term equity awards in the form of stock credits and approximately 40% in the form of stock options. The CMD Committee awards restricted stock on a selective basis. Stock options and restricted stock foster employee stock ownership and, together with stock credits, focus the management team on increasing value for shareholders. Because the value of these equity-based awards depends on Macy s future stock price, the awards link compensation to future financial performance.

Macy s executive compensation program is highly responsive to the Company s performance and varies with changes in shareholder value. Although within the current poor economic environment the Company outperformed most of its primary competitors in the last quarter of fiscal 2007 and throughout fiscal 2008 in same-store sales, Macy s financial results were less than anticipated with respect to sales and profit. These financial results and the outlook for fiscal 2009 have directly impacted the Named Executives compensation. None of the Named Executives received an increase in base salary in fiscal 2008. The Named Executives received a bonus under the Company s 1992 Incentive Bonus Plan with respect to fiscal 2008 performance. The Company did not achieve the threshold level of performance under the EBIT and sales performance objectives for fiscal 2008, so no bonus amounts were paid with respect to those objectives. The Company did achieve the maximum performance level under the cash flow performance objective for fiscal 2008, resulting in a bonus of 60% of base salary for Mr. Lundgren and 30% of base salary for each of the other Named Executives. Although the CMD Committee awarded to each of the Named Executives stock options grants under terms consistent with Macy s annual stock option grant program and stock credit grants under a new 2008-2009 stock credit plan, the value of those grants has decreased as a result of the decrease in the Company s stock price.

EXECUTIVE COMPENSATION PROGRAM OBJECTIVES

Compensation Philosophy

Macy s overall compensation program is performance-driven and designed to support the needs of the business by:

Providing Competitive and Reasonable Compensation Opportunities.
Macy s compensation levels and individual compensation programs are assessed against market norms periodically by the CMD Committee, with input from independent outside compensation consultants

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as needed. Under ordinary circumstances, the CMD Committee has undertaken a comprehensive review of the program approximately every three years. Pay data has been reviewed against several benchmarks, including specific pay levels of other large retail and vendor organizations and information from published surveys of the retail industry and general industry, and determined to be reasonable. In addition, compensation of individual executives and specific compensation plans and practices may be reviewed more frequently, depending on business needs.

Focusing on Results and Strategic Initiatives.
Macy s compensation programs are based on measures of business success. They reflect a combination of specific internal measurements of success (such as EBIT, sales and cash flow) and external measurements of success (such as customer satisfaction and stock price performance). A portion of the compensation program focuses on the strategic initiatives that will help continue to differentiate Macy s from other retailers and that are important in making Macy s and Bloomingdale s the customer s first choice in shopping.

Fostering a Pay for Performance Culture.
A significant portion of an executive s compensation program is linked to variable compensation components, such as short- term cash incentives, stock options, stock credits and restricted stock. As a result, an individual s compensation level is dependent on individual and company performance, including stock price appreciation. The mix of components and the proportion of each as a percentage of total compensation may vary from year to year, but the total mix is designed to encourage maximum performance.

Attracting and Retaining Key Executives.
Macy s executives are recognized as some of the most talented and sought after people in the retail industry, and Macy s training and development programs have earned national recognition. The compensation programs are designed to attract and retain high caliber executives who are key to the continued success of the business, who can provide consistent leadership and whose talents support strong succession planning.

Providing a Strong Link to our Shareholders Interests.
The combination of the core principles above appropriately ties Macy s compensation to performance and thereby aligns the interests of key executives with the interests of the shareholders.

EXECUTIVE COMPENSATION PROGRAM DESIGN

Role of the CMD Committee

The CMD Committee administers the compensation program for the senior management group. This group includes the Named Executives and other corporate officers and division principals. The CMD Committee also oversees the Company s benefit plans and policies, including its incentive and equity plans, and also ensures that appropriate succession plans are in place for the chief executive officer and other key executive positions. For a more complete description of the responsibilities of the CMD Committee, see Further Information Concerning the Board of Directors Committees of the Board and the charter for the CMD Committee posted on Macy s website at www.macysinc.com/investors/governance.

Role of the Compensation Consultant

The CMD Committee engages the services of an independent compensation consultant to assist it with executive compensation matters. The compensation consultant does not provide any services to the Company s management. The compensation consultant works at the direction of the CMD Committee and maintains regular contact with the CMD Committee. Periodically the CMD Committee meets with the compensation consultant without the presence of management, as well as in executive session.

Prior to June 2008 and in relation to fiscal 2008 compensation matters, the CMD Committee used the services of Mercer as an outside compensation consultant to help the CMD Committee assess the competitiveness and overall appropriateness of Macy s executive compensation program. In 2008, Mercer supported the CMD Committee s annual evaluation of Mr. Lundgren s compensation, reviewed the compensation of the other Named Executives and advised the CMD Committee on market trends. During fiscal 2008, Mercer also advised the NCG Committee on the Company s compensation program for Non-Employee Directors. The CMD Committee does not believe that this service to the NCG Committee compromised Mercer s ability to provide the CMD Committee with an independent perspective on Macy s executive compensation program.

During fiscal 2008, the CMD Committee conducted a search for a new compensation consultant to provide a different perspective on Macy s executive compensation program. As a result of that process, the CMD Committee selected and engaged Frederic W. Cook & Co., or Cook, to assist the CMD Committee on compensation matters beginning in June 2008. Following the engagement, Cook began a comprehensive introductory review of the Company s executive compensation programs to identify strengths and weaknesses and potential areas of change. Cook reported its observations to the CMD Committee at meetings throughout the second half of fiscal 2008. Cook s recommendations with respect to any changes in the form and amount of executive compensation will be considered by the CMD Committee during fiscal 2009.

Role of Management

To help it perform its responsibilities, the CMD Committee makes use of company resources, including the Vice Chair who, during fiscal 2008, oversaw the human resources function and senior executives in Macy s human resources, legal and finance departments. These individuals provide input and make proposals regarding the design, operation, objectives and values of the various components of compensation in order to provide appropriate performance and retention incentives for the senior management group, including the Named Executives. These proposals may be made at the initiative of the executives or upon the request of the CMD Committee. These executives may attend and contribute to CMD Committee meetings from time to time as requested by the CMD Committee or its chairman.

Mr. Lundgren participates actively in the executive compensation program process. At the beginning of a fiscal year, Mr. Lundgren meets with each of his direct reports, including the other Named Executives, to set

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their individual performance objectives for the year. These objectives consist of matters such as meeting key financial and other business goals and effectively managing their business practice or corporate function. At the end of the fiscal year, Mr. Lundgren reviews the performance of each of his direct reports against company and individual performance objectives and the individual s contribution to Macy s financial performance. Mr. Lundgren takes an active part in CMD Committee discussions of compensation involving his direct reports, including the other Named Executives. He provides recommendations and input on such matters as individual performance and the size, scope and complexity of their positions and recommendations on changes to the compensation for the other Named Executives. Human resources executives, with the compensation consultant s assistance, provide the CMD Committee with data and analyses and annually prepare information to help the CMD Committee in its consideration of such recommendations. Mr. Lundgren does not participate in the portions of CMD Committee meetings during which the CMD Committee discusses his compensation.

Compensation Review

With respect to Named Executives, the CMD Committee annually reviews base pay, annual bonus payments and equity awards at its March committee meeting, at which time all financial results for the prior fiscal year for the Company are available and individual and company performance against applicable targets can be measured. Mr. Lundgren s compensation is generally targeted to fall between the 50th and 75th percentiles of the peer group of retailers and vendors listed below, but below the median of the consumer products peer group listed below. The compensation of the other Named Executives is generally targeted between the 50th and 75th percentile of the peer group of retailers and vendors listed below.

The CMD Committee periodically reviews the ongoing competitiveness of Macy s compensation program to test how well actual compensation levels reflect the targeted market position and promote Macy s compensation philosophy. As a general rule, the CMD Committee reviews a comprehensive comparative analysis with respect to Mr. Lundgren every year and with respect to the other Named Executives approximately every three years. In addition, in evaluating the compensation of the Named Executives, the CMD Committee also takes into account the executive s time in position, pay history and the value contributed by that position and the executive and reviews the compensation of other senior Macy s executives to ensure that the compensation is internally consistent and equitable.

For the Named Executives, the CMD Committee compares executive compensation levels with proxy data reported by a group of major retailers and vendors that compete with Macy s for executive talent. This group includes multi-line retailers, specialty apparel retailers, and apparel, accessories and luxury goods wholesalers. As a secondary test against the market, the CMD Committee compares Mr. Lundgren s compensation to the proxy data for chief executive officers reported by a peer group of consumer products companies that manage national brands and have revenues ranging from $10 to $60 billion. The data includes base salary, short-term and long-term incentives and actual and target total compensation levels for the relevant positions. These resources provide a realistic picture of the current compensation trends and levels of positions to which a Macy s executive could be attracted and from which outside talent, if needed, would be recruited. The component companies of both peer groups are listed below.

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Retailer and Vendor Peer Group

Abercrombie & Fitch	Kohl s	SuperValu
Ann Taylor Stores	Kroger	Talbot s
Best Buy	Limited Brands	Target
Dillards	Liz Claiborne	TJX Companies
Gap	Nordstrom	VF Corp
J.C. Penney	Polo Ralph Lauren	Wal-Mart
Jones Apparel Group	Sears Holdings	

Consumer Products Peer Group

3M	General Mills	PepsiCo
AnheuserBusch InBev	Johnson & Johnson	Procter & Gamble
Colgate Palmolive	Kimberly Clark	Sara Lee
Coca-Cola	Kraft	

EXECUTIVE COMPENSATION PROGRAM ELEMENTS

Macy s executive compensation program offers a balanced approach to compensation and includes the primary components outlined in the table below. This program is based on the fundamental premise of pay-for-performance, but each element has its own purpose. Many of the plans or programs in which the Named Executives participate are open to a broader leadership group or to the full employee population. Individual compensation packages and the mix of base salary, annual cash bonus opportunity and long-term stock incentives for each Named Executive vary depending upon the executive s level of responsibilities, potential, performance and tenure with the company. The portion of total compensation that is at risk (i.e., that varies based on performance) generally increases as an executive s level of responsibility increases.

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Overview of Key Compensation Elements for the Named Executives for Fiscal 2008

Element	Purpose	Description	Eligibility
Base Salary	Market-driven base-line compensation; amount recognizes differences in positions and/or responsibilities as well as experience and individual performance over the long term.	Fixed portion of pay	All employees.
Performance-Based Bonus	Aligns compensation with business strategy and operating performance by rewarding achievement of annual financial targets and, in some cases, individual performance.	Annual cash award	Broad leadership level group, including the Named Executives.
Long-Term Incentives	Opportunities for ownership and financial reward in support of the company s longer-term financial goal of stock price growth; also supports retention and, consequently, succession planning.	Stock options	Broad leadership level group, including the Named Executives.
		Restricted stock	Senior management group, including the Named Executives.
		Stock credits	Senior management group, including the Named Executives.
Broad-Based Benefits	Comprehensive health and financial protection programs to support the well being of employees and their families. Merchandise discount to create brand loyalty.	Medical and dental plans and various insurance plans, including disability and life insurance; paid holidays and time off; merchandise discount.	All full-time employees and, with respect to some benefits, part-time employees.

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Element	Purpose	Description	Eligibility
Management Level Benefits	Limited financial and perquisite benefits to recognize leadership level.	Deferred compensation plan; additional executive merchandise discount.	Select leadership level group, including the Named Executives.
		Financial planning; automobile program; and business luncheon club membership.	Senior management group, including the Named Executives.
		Use of corporate airplane.	CEO; one other executive on a limited basis.
Retirement Benefits	Contribution to retirement savings.	Cash account pension plan and 401(k) profit sharing plan.	All full-time employees and part-time employees who satisfy certain minimum hour requirements.
		Supplementary retirement plan.	Select leadership level group, including the Named Executives.

Compensation Mix

Because of the ability of executive officers to directly influence Macy s overall performance, and consistent with its philosophy of linking pay to performance, a significant portion of the Named Executives compensation is at risk and may vary from targeted compensation based upon the level of achievement of specific corporate objectives and share price performance. Total compensation and the amount of each element are driven by the design of the Company s compensation plans, the executive s years of experience, the scope of his or her duties and internal comparability. The CMD Committee applies the same policies and methodologies in setting the principal components of compensation for Mr. Lundgren as it applies for the other Named Executives. However, Mr. Lundgren s compensation targets are higher than those for the other Named Executives, which is in line with market data for the chief executive officer position and his responsibilities as chief executive officer.

The CMD Committee has established guidelines for annual performance-based bonuses and for long-term incentive awards. Based on the combination of the annual performance-based bonus and long-term award guidelines, 86% of Mr. Lundgren s targeted total direct compensation (salary, annual bonus and equity incentives) for fiscal 2008 was at risk and tied to financial performance, corporate objectives and/or stock price performance. For the other Named Executives, on average, more than 70% of targeted total direct compensation for fiscal 2008 was at risk and tied to financial performance, corporate objectives and/or stock price performance. Long-term incentive awards, which for fiscal 2008 consisted of stock options and

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performance-based stock credit awards, represent the largest element of pay for the Named Executives. These percentages are consistent with Macy s compensation philosophy of focusing on results and strategic initiatives and fostering a pay-for-performance culture.

CEO	Other Named Executives (average)

Base Salary

Base salaries are designed to provide a level of cash compensation that is externally competitive in order to attract and retain executive talent and to compensate an individual for his or her level of responsibility and performance. The CMD Committee decisions regarding an individual s base salary take into account external factors, such as inflation, and internal factors, including:

- division and/or company performance;
- the individual s current salary and, if applicable, the pay range for the position;
- the individual s current and historical performance and contribution to Macy s performance;
- the individual s future potential with Macy s;
- the individual s role and unique skills; and
- consideration of external market data for similar positions, adjusted for Macy s size, the scope of responsibilities and the uniqueness of the role.

Following the close of the fiscal year, the CMD Committee, with input from the full Board, conducts an annual performance review for Mr. Lundgren. Mr. Lundgren conducts an annual performance review for the other Named Executives. The CMD Committee bases its decisions about whether to increase base salaries and, if so, by how much, on a number of factors, including those listed above. The CMD Committee reviews preliminary recommendations for annual increases at its February meeting and approves final recommendations at its March meeting. Annual increases in base salary normally take effect on April 1st of each year.

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Fiscal 2008 Action: Following the conclusion of fiscal 2007, management, with input from Mercer and Mr. Lundgren, prepared for the CMD Committee a summary of the current total compensation package for each Named Executive and a proposed total compensation package for fiscal 2008 for each that reflected recommended increases in performance-based equity compensation (but no change to the overall dollar value of equity compensation) and recommended no increases in base salaries. The CMD Committee considered the current economic environment, the Company s performance relative to its peers, the general movement of salaries in the marketplace, the Company s stock price performance, the salaries of the Vice Chairs relative to that of Mr. Lundgren and to each other, and considered the other factors listed above with respect to each Named Executive. The CMD Committee also considered the results of its annual performance review of Mr. Lundgren and of Mr. Lundgren s annual review of the individual performance of the other Named Executives.

Following its review, the CMD Committee accepted the recommendation that base salaries for fiscal 2008 remain at the same levels as base salaries in fiscal 2007:

	Base Salary Rate($)
T. Lundgren	1,500,000
K. Hoguet	800,000
T. Cole	975,000
J. Grove	975,000
S. Kronick	1,100,000

Annual Performance-Based Bonus

The Named Executives participate in the 1992 Bonus Plan. The 1992 Bonus Plan is a non-equity incentive plan under current SEC rules. The 1992 Bonus Plan aligns compensation with Macy s business strategy and operating performance and is designed to motivate executives to meet or exceed corporate financial goals that are selected by the CMD Committee and approved by the full Board of Directors. The 1992 Bonus Plan provides an opportunity for senior executives, including the Named Executives, to earn a targeted percentage of base salary based on Macy s performance results. No bonus will be paid if Macy s does not achieve a net profit for the year, excluding the effects of extraordinary items, unusual or non-recurring events, cumulative effects of tax or accounting changes, discontinued operations, acquisitions, divestitures and material restructuring or asset impairment charges. The CMD Committee may exercise discretion to reduce, but not to increase, the amount of a bonus awarded under the 1992 Bonus Plan. In fiscal 2008, the CMD Committee did not exercise this discretion.

Each year the Board and management create a challenging financial and operating business plan for the Company. The CMD Committee sets the performance measures each year for the 1992 Bonus Plan based on the company s business plan. The CMD Committee may select one or more of the following performance measures under the 1992 Bonus Plan:

Total sales	EBIT	Cash flow	Net cash provided by operations
Comparable store sales	EBITDA	Return on investment	Total shareowner return
Gross margin	Net income	Stock price appreciation	Customer satisfaction
Operating or other expenses	Earnings per share	Operating income	

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For fiscal 2008, the CMD Committee selected EBIT (earnings before interest and taxes), sales and cash flow as the performance measures to determine bonuses under the 1992 Bonus Plan, with these measures being weighted 60%, 20% and 20%, respectively. The CMD Committee believes that rewarding the executives for strong performance measured by the combination of these three measures will support the business plan and give executives a strong incentive to focus on the business in a balanced way. The CMD Committee gave the greatest weight and bonus potential to the EBIT measure. The EBIT measure focuses the executives on maximizing operating income and is a good indicator of how effectively the business plan, which focuses on growth in profits, is being executed. The CMD Committee uses the sales and cash flow measures to balance the profit objective. Top-line sales are a priority for retailers and are a measure of growth. Sales provide opportunities for the achievement of various other financial measures, including EBIT and cash flow. Cash flow is indicative of the manner in which the Company s operating activities, together with its investing activities, actually generate cash. How a company increases its cash flow and then chooses to invest the cash are among the most important decisions management makes.

The retail industry is a highly competitive business, especially in a weakened economic environment. The CMD Committee sets the specific performance targets under the 1992 Bonus Plan so that the executives will receive the target level of bonus if the Company achieves the target levels of the EBIT, sales and cash flow measures set forth in its business plan. The sales target under the 1992 Bonus Plan excludes external sales adjustments, including delivery revenue and leased department income. Macy s does not disclose its business plan or the components thereof because they constitute confidential business information that, if publicly disclosed, would impair Macy s ability to compete effectively in the retail market place. However, by setting the target level of bonus based on achieving the plan level of performance under its business plan, the CMD Committee believes the performance targets are challenging based on historical Company performance and industry and market conditions. The maximum award target levels for the performance measures reflect very ambitious goals that are attainable only when business results are exceptional and well above Macy s business plan. Over the last seven years, the Company has achieved performance below the threshold level of performance twice, between threshold and target twice, and in excess of target three times. The Company did not achieve performance that met or exceeded the maximum level of performance during that period. The Named Executives would be entitled to the following percentages of base pay for achieving the following threshold, target and maximum levels of performance.

		Annual Bonus as a % of Base Pay		
Position	**Component**	**Threshold**	**Target**	**Maximum**
Chief Executive Officer	EBIT $	18%	90%	No maximum
	Sales $	10%	30%	60%
	Cash Flow $	12%	30%	60%
	Total	40%	150%	No maximum
Other Named Executives	EBIT $	9%	45%	No maximum
	Sales $	5%	15%	30%
	Cash Flow $	6%	15%	30%
	Total	20%	75%	No maximum

The CMD Committee sets the levels of annual bonus payable at the threshold , target and maximum levels of performance for Mr. Lundgren and the other Named Executives based on the factors described above. The CMD Committee gives the greatest weight to the EBIT measure because profit is the

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primary driver of long-term shareholder value creation. The CMD Committee gives lesser, yet significant, weight to the sales and cash flow measures because success under these measures is critical to driving business results and influences achievement of the EBIT measure.

Annual incentive bonuses are submitted to the CMD Committee for approval at its March meeting. Annual incentive bonuses are determined as a percentage of the executive s base salary as of the last day of the fiscal year. Bonus percentages are interpolated for performance results falling between threshold and target and between target and maximum for the applicable performance component, as measured against the Company business plan for those components. If a performance component has no maximum level of performance and performance exceeds the target level of performance, the annual bonus will be calculated at a rate established by the CMD Committee for above-target performance. For purposes of determining performance results, the calculations of EBIT, sales and cash flow performance are adjusted to exclude the following:

- extraordinary items (as determined under generally accepted accounting principles, referred to as GAAP);
- changes in accounting principles (as determined under GAAP); and
- income, gains, expenses, losses, cash inflows and cash outflows:
  - resulting from unusual or nonrecurring items (as reported in the Company s quarterly earnings releases and filings with the SEC and reviewed by KPMG LLP);
  - from discontinued operations (as determined under GAAP);
  - attributable to any division, business segment, material business operation, subsidiary, affiliate or material group of stores that are acquired during the year;
  - from the sale or disposition of any division, business segment, material business operation, subsidiary, affiliate or material group of stores; and
  - resulting from material restructuring charges (as reported in the Company s quarterly earnings releases and filings with the SEC and reviewed by KPMG LLP).

The intent of the adjustments is to focus on the core results of continuing operations by excluding distortions that may result from the items listed above.

Fiscal 2008 Action: The CMD Committee reviewed performance data at the end of fiscal 2008 with management at its March 2009 meeting and determined that Macy s had achieved a net profit for fiscal 2008 (excluding the effects of extraordinary items, unusual or non-recurring events cumulative effects of tax or accounting changes, discontinued operations, acquisitions, divestitures and material restructuring or asset impairment charges) and determined the extent to which the targeted levels of performance measures were achieved. The annual bonus payout percentages for the Named Executives for fiscal 2008 were as follows:

		Bonus Payout for fiscal 2008 as a % of Base Salary	
Bonus Component	**2008 Performance**	**T. Lundgren**	**Other Named Executives**
EBIT $	Below Threshold	0%	0%
Sales $	Below Threshold	0%	0%
Cash Flow $	Maximum	60%	30%

Total	60%	30%

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These payout percentages resulted in the following bonus amounts:

T. Lundgren	$900,000
K. Hoguet	$240,000
T. Cole	$292,500
J. Grove	$292,500
S. Kronick	$330,000

The maximum permitted annual bonus payment to any individual for any year under the 1992 Bonus Plan is $7.0 million. The Non-Equity Incentive Plan Compensation column of the 2008 Summary Compensation Table reflects the annual bonus that the Named Executives received with respect to fiscal 2008.

Long-Term Performance-Based and Other Equity Incentives

Each year the CMD Committee reviews the use of long-term incentives under three long-term plans:

- the 1995 Executive Equity Incentive Plan, referred to as the 1995 Equity Plan;
- the 1994 Stock Incentive Plan, referred to as the 1994 Stock Plan; and
- stock credit plans adopted from time to time, referred to as the stock credit plans.

Macy s shareholders have approved the 1995 Equity Plan and the 1994 Stock Plan. Approximately 1,800 executives are eligible for equity grants, including stock options and restricted stock, under these plans. Participation in the equity plans is based on an executive s position and that position s ability to make a significant contribution to the Company s financial results, an executive s level of responsibility, individual performance and competitive practices. The CMD Committee consults with management in considering and determining eligibility for equity awards, the number of shares of common stock underlying each award and the terms and conditions of each award.

Stock Options. The 1995 Equity Plan and the 1994 Stock Plan reflect Macy s commitment to effective management of equity-based compensation. Stock option grants are discretionary. The CMD Committee determines grant types and grant levels based on market data (as described above), emerging trends and other financial considerations, including the impact on shareholder dilution. Macy s does not grant discounted stock options. The plans do not provide for the granting of reload options and prohibit the repricing of previously granted options.

Macy s uses stock options as a long-term incentive vehicle because:

- Stock options align the interests of executives with those of the shareholders, support a pay-for-performance culture, foster employee stock ownership, and focus the management team on increasing value for the shareholders.
- Stock options are performance-based. All the value received by the recipient from a stock option is based on the growth of the stock price above the option price.
- Stock options offer a balance to the overall compensation program, each element of which serves a specific purpose.
- Stock options have retentive value and provide a long-term focus.

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Stock Credits. Since fiscal 2004, Macy s has utilized stock credit plans as part of its long-term compensation program for senior executives, including the Named Executives. The CMD Committee believes that stock credits align compensation to the achievement of certain financial, strategic and operational metrics tied to the Company s long-term business plan. Improving future sales and earnings performance requires innovation in engaging customers more effectively in every store, as well as reducing total costs. The performance metrics under the stock credit program are based, in part, on the Company s ability to execute its long-term core strategies with respect to store operations and customers. These core strategies, called the Four Priorities compelling and distinctive merchandise assortments, simplified pricing, improving the shopping experience, and creative marketing build the Company s brands and drive traffic to the stores. Each of the Four Priorities is integral to Macy s ability to successfully conduct business in its stores and interact with its customers.

Restricted Stock. The CMD Committee does not have a regular program of granting restricted stock under the 1995 Equity Plan or the 1994 Stock Plan. It may grant restricted stock from time to time for retention and performance reasons. Restricted stock grants under the two plans can be either time-based or performance-based. For more information about restricted stock, see the restricted stock discussion following the 2008 Grants of Plan Based Awards table. Restricted stock grants typically are approved by the CMD Committee at its March meeting and are granted as of that day. In addition, the CMD Committee may approve special restricted stock grants on other dates in special circumstances, such as to retain executives important to the success of the company.

Restricted stock complements stock options. Stock options work well (that is, they provide incentives) when the fair market value of the stock is above or slightly below the exercise price of the options. However, stock options do not work as well (that is, they provide little or no incentive) if the fair market value of the stock underlying the options falls significantly below the exercise price of the options. On the other hand, restricted stock can continue to work well even if the fair market value of the stock falls significantly below the value on the grant date.

Timing of Equity Grants. The CMD Committee approves annual stock option grants, restricted stock grants and stock credits grants at its March meeting. The March meeting occurs after financial results for the company are available at least three weeks after Macy s releases its year-end earnings. In addition to the annual grants, the CMD Committee may approve option grants or restricted stock grants on a limited basis on other dates in special circumstances, such as to newly hired executives, or to executives promoted into option eligible positions or to retain executives important to the success of the company.

Fiscal 2008 Actions: At the beginning of fiscal 2008, the CMD Committee approved a two-year, long-term incentive program for the senior officers, including the Named Executives, consisting of stock options and stock credits. To arrive at the number of stock options and stock credits to award in fiscal 2008 and fiscal 2009 under this program, the CMD Committee determined a grant date dollar value for each Named Executive that was consistent with grants in prior years and competitive with the equity awards granted by the other companies in the retail and vendor peer group. The CMD Committee then calculated the number of option shares and stock credits needed to provide the Named Executive with that dollar value for the two year fiscal 2008-2009 period, with 60% of the dollar value to be awarded as core stock credits and 40% of the dollar value to be awarded as stock options. In fiscal 2008, the CMD Committee awarded all of the stock credits under the 2008-2009 stock credit plan (described below) and the first installment of stock options under the 1995 Equity Plan.

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Stock Options: The first installment of stock options for the 2008-2009 period was granted to the Named Executives on March 21, 2008. These options expire on March 21, 2018, vest 25% on each of the first four anniversaries of March 21, 2008 and are priced at $24.85, which was the closing price of Macy s common stock on the New York Stock Exchange on March 20, 2008. The option grants are reflected in the 2008 Grants of Plan-Based Awards table under Compensation of the Named Executives for 2008.

Stock Credits: In fiscal 2004, the Named Executives received stock credits under a 2004-2005 stock credit plan that included time-based and performance-based stock credits, with performance measures tied to the Four Priorities. 95% of the performance-based stock credits were earned as of the end of fiscal 2005. The value of one-half of the time-based and earned performance-based stock credits granted under the 2004-2005 stock credit plan was paid in cash to the Named Executives at the end of a two-year holding period that expired on February 2, 2008, along with value of dividend equivalents accrued during the holding period. The value of the remaining one-half of the time-based and earned performance-based stock credits was paid in cash to the Named Executives at the end of a three-year holding period that expired on January 31, 2009, at the rate of $10.03 per share, which was the average closing price of Macy s common stock for the twenty-day period preceding the February 2, 2009 payment date. The payment also included the value of dividend equivalents that had accrued during the holding period. These payments are reflected in the 2008 Option Exercises and Stock Vested table under Compensation for the Named Executives for 2008.

In fiscal 2006, the Named Executives received stock credits under a 2006-2007 stock credit plan that included time-based and core and merger performance-based stock credits, with performance measures tied to the Four Priorities for core stock credits and to company-wide objectives related to achieving certain financial merger synergies for merger stock credits. Following the conclusion of fiscal 2007, the CMD Committee determined that the Named Executives had earned 95% of the core performance-based stock credits and 100% of the merger performance-based stock credits. These stock credits and the time-based stock credits awarded to the Named Executives under the 2006-2007 stock credit plan are subject to two- and three- year holding periods, which expire on February 1, 2010 and January 31, 2011, respectively. See Plan-Based Awards and Outstanding Equity Interests under Compensation for the Named Executives for 2008.

On March 21, 2008, the CMD Committee awarded stock credits to the Named Executives under the 2008-2009 stock credit plan for a fiscal 2008- 2009 performance period. These stock credits are intended to increase the executives focus on the Company s performance. The stock credits are 100% performance-based and include core stock credits, with performance measures tied to the Four Priorities updated for the 2008-2009 performance period, and additional stock credits, with performance measures tied to the Company s 2008 My Macy s/Consolidation initiatives. The Company s My Macy s initiative places more emphasis and talent at the local market level to differentiate stores, better serve customers and drive sales. The goal of the initiative is to ensure that core customers find merchandise assortments, size ranges, marketing programs and shopping experiences that are custom-tailored to their needs. The Company reallocated central office expense from three consolidated divisions in 2008 to allow it to invest in these market localization initiatives while reducing the planned level of Selling, General & Administrative (SG&A) expense. The CMD Committee believes that how successfully management carries out these initiatives will determine how well Macy s can attract customers to its stores and increase sales, which improves the bottom line and, ultimately, benefits the shareholders.

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At the conclusion of fiscal 2009, the CMD Committee will:

- with respect to the core stock credits, evaluate Macy s performance in fiscal years 2008 and 2009 against established objectives based on updated Four Priorities (Merchandise Assortments, Price Simplification, The Shopping Experience and Marketing); and

- with respect to the My Macy s/Consolidation stock credits, evaluate Macy s performance in fiscal 2008 and fiscal 2009 against objectives established by the CMD Committee based on sales objectives associated with the Company s My Macy s initiative and financial objectives associated with savings anticipated from the consolidations of three operating divisions.

Based upon that evaluation of Macy s performance, the CMD Committee will determine the percentage (from 0% up to 100%) of each type of stock credits that is earned by the participants. Stock credits that are not earned will be forfeited. The earned stock credits will then be subject to two- and three-year holding periods. The value of one-half of the earned stock credits held by participants will be paid in cash in Spring 2012 at the end of the two-year holding period and the value of the other half of such earned stock credits will be paid in cash in Spring 2013 at the end of the three-year holding period. In each case, the value will be determined on the basis of the then-current 20-day average closing price of Macy s common stock. In general, each stock credit is intended to represent the right to receive the value associated with one share of Macy s common stock and includes the value of dividends paid on shares of Macy s common stock during the holding period (the period from the end of fiscal 2009 until such stock credit is settled in cash).

Stock Credit	**Earning Criteria**	**Performance Period**	**Payout of Earned Benefit**	
Performance-Based Core	100% based on performance against the Four Priorities	2008-2009	50% in 2012	50% in 2013
My Macy s/Consolidation	50% based on sales performance objectives relating to My Macy s initiative	2008; 2009	50% in 2012	50% in 2013
	50% based on financial measures related to consolidation objectives	2008; 2009	50% in 2012	50% in 2013

The Named Executives received the following number of stock credits on March 21, 2008 pursuant to the 2008-2009 stock credit plan:

	Performance-Based Core Stock Credits	**My Macy s/Consolidation Stock Credits**
T. Lundgren	291,187	97,062
Other Named Executives	63,983	21,327

***Restricted Stock*:** None of the Named Executives received a restricted stock grant in fiscal 2008.

Fiscal 2009 Actions: On March 20, 2009, the CMD Committee (and the Non-Employee Directors with respect to Mr. Lundgren) approved awards of performance restricted stock units to certain senior executives of the Company, including the Named Executives. These Founders Awards are intended to unite senior management in a common set of goals and to reward them for the successful execution of the Company s multi-year strategic plan, including restructuring of the Company s operations to a centralized business model and the implementation of the My Macy s localization initiatives on a company-wide basis.

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The Founders Awards, including those provided to the Named Executives, were granted under the 1995 Equity Plan and the 1994 Stock Plan. The Founders Awards are structured as performance restricted stock units and vest over a three-year performance period covering fiscal years 2009-2011. Whether units are earned at the end of the performance period will be determined based on the achievement of relative total shareholder return (TSR) performance objectives set by the CMD Committee in connection with the issuance of the units. Relative TSR reflects the change in the value of Macy s common stock over the performance period in relation to the change in the value of the common stock of a 10-company executive compensation peer group over the performance period, assuming the reinvestment of dividends. Relative TSR was chosen as the performance metric because it ensures that the Founders Awards will vest only to the extent that returns to Macy s shareholders exceed the median of those delivered to the shareholders of the 10-company peer group. The use of relative TSR eliminates the need to measure the Company s success in its restructuring activities using internal standards, which may or may not be commensurate with changes in shareholder value, and instead measures success as determined by investor views as reflected in changes in shareholder value over time.

If Macy s TSR for the performance period is equal to or less than the median TSR for the peer group, the entire Founders Award opportunity will be forfeited. If Macy s TSR for the performance period is above the median but equal to or below the 66th percentile for the peer group, 75% of the award opportunity will vest. If Macy s TSR for the performance period is above the 66th percentile for the peer group, 100% of the award opportunity will vest. In all events, vesting is contingent on continued employment throughout the entire three-year performance period, except in the event of retirement, death or disability, in which cases the award will be earned on a prorated basis at the end of the three-year performance period based on performance versus the previously described TSR standards.

Performance restricted stock units that are earned at the end of the performance period will be paid to the Named Executives as shares of Macy s common stock (net of required tax withholding) within 2 1/2 months following the end of the performance period. Dividends, if any, paid on the Company s common stock will be credited to the Named Executives performance restricted stock unit accounts as additional restricted stock units and will be paid out as shares of common stock to the extent that the underlying performance restricted stock units are earned.

The named executive officers received the following number of performance restricted stock units, which will be earned as indicated:

		Percentage of Performance Restricted Stock Units Earned		
	Performance Restricted Stock Units Granted (#)	If Macy s TSR is ≤ the 50th Percentile of Peer Group TSR	If Macy s TSR is > the 50th Percentile but ≤ the 66th Percentile of Peer Group TSR	If Macy s TSR is > the 66th Percentile of Peer Group TSR
Terry Lundgren	666,666	0%	75%	100%
Karen Hoguet	151,255	0%	75%	100%
Thomas Cole	151,255	0%	75%	100%
Janet Grove	151,255	0%	75%	100%
Susan Kronick	151,255	0%	75%	100%

Benefits

Macy s provides benefits based upon an assessment of competitive market factors and a determination of what is needed to attract and retain high caliber executives. Macy s primary benefits for executives include participation in the Company s broad-based plans: the cash account pension plan; the 401(k) profit sharing plan; the company s health and dental plans and various other insurance plans, including disability and life insurance; and Macy s philanthropic matching gift program.

Macy s also provided the following benefits to the Named Executives in fiscal 2008:

Supplementary Retirement Plan Macy s provides a supplementary retirement plan to eligible executives described under Compensation of the Named Executives for 2008 Post Retirement Compensation. The Supplementary Retirement Plan supplements the pension benefits provided under the cash account pension plan, and takes into account compensation that the tax rules do not permit the cash account pension plan to take into account. In addition, it supports Macy s pay-for-performance culture by rewarding better performance with increased retirement benefits payable to eligible executives whose bonus compensation would otherwise not be taken into account under the broad-based cash account pension plan. The Named Executives are taxed on supplementary retirement benefits when those benefits are paid.

Deferred Compensation Plan Macy s provides executives the opportunity to defer receiving income until after they terminate their employment. This benefit offers tax advantages to eligible executives, permitting them to defer payment of their compensation and defer taxation on that compensation until after termination. The deferred compensation plan is described under the heading Compensation of the Named Executives for 2008 Post Retirement Compensation Non-qualified Deferred Compensation Plans.

Financial Counseling Macy s pays for financial counseling services, the cost of which depends upon the compensation level of the executive. The Named Executives receive imputed income for fees paid for the services. This benefit provides the Named Executives with access to an independent financial advisor who is familiar with the Macy s compensation and benefits programs and can provide the services efficiently and at the convenience of the executives, helping them focus more of their time on the Company s business.

Automobile Program Macy s provides the Named Executives other than Mr. Lundgren a choice of a car lease or an automobile allowance. This benefit is an additional form of compensation to these Named Executives. The car lease option includes insurance, maintenance and fuel. It provides the Named Executives with an opportunity to use a Company-provided car for both business and personal use. Where Macy s facilities do not have free parking, they also receive a parking allowance. This benefit helps put the Named Executives on an even level with executives in the car program who work in locations with free parking. The Company reports imputed income for income tax purposes for all Company-paid expenses.

Car and Driver Program Pursuant to an independent third-party security study Macy s obtained in 2007, Macy s is providing Mr. Lundgren with a car and driver for commuting in New York City, for certain business travel and for personal use. The driver is a trained security professional. This benefit is to ensure the personal safety of Mr. Lundgren, who maintains a significant public role as the leader of Macy s. The benefit also allows Mr. Lundgren to work productively during his commute. For tax purposes, with respect to any commuting to and from work and any personal use of the car and driver by Mr. Lundgren, the costs relating to the service (other than the cost of executive protection services)

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are imputed as income. The cost of the executive protection services provided to Mr. Lundgren is considered to be a tax-free working condition fringe benefit in accordance with IRC Sec. 132(d) and Treasury Regulation 1.132-5(m).

Business Luncheon Club The Named Executives are entitled to Company-paid memberships at business luncheon clubs for the purpose of conducting business on behalf of Macy s. Any meal or other expenses incurred at the clubs that are not business-related are the responsibility of the Named Executive. This benefit provides the Named Executives with access to congenial and helpful settings for business lunches and encourages them to use those locations for business lunches with vendors and other business related meetings.

Additional Executive Discount All regular employees are eligible for a base merchandise discount. The Named Executives are eligible for an additional discount on top of the base discount for a total discount of 40%. They are reimbursed for estimated taxes on imputed income associated with the additional discount.

Company Airplane Mr. Lundgren travels extensively on Company business throughout the fiscal year reviewing the Company s 840 department stores in 45 states, the District of Columbia, Guam and Puerto Rico. The Company also participates in the Corporate Angel program that flies cancer patients to and from their homes and hospitals for treatment. These individuals often accompany Mr. Lundgren on his flights, since they are not able to fly commercially due to the potential risk of infection. Mr. Lundgren is permitted to use Company-owned aircraft for personal flights as well as these business flights. This benefit increases the level of safety and security for Mr. Lundgren and his family. In addition, making the aircraft available to Mr. Lundgren allows him to efficiently and securely conduct business during both business and personal flights. Furthermore, given the delays associated with early check-in requirements, security clearances, baggage claim and the need for additional time to avoid missing a flight due to possible delays at any point in the process, commercial travel has become even more inefficient in recent years, and making the aircraft available to Mr. Lundgren maximizes his availability to conduct business both before and after his flights. Finally, Macy s believes that the value to Mr. Lundgren of making the aircraft available for Mr. Lundgren and his family, in terms of convenience and saving of time, is greater than the incremental cost that Macy s incurs to make the aircraft available and therefore is an efficient form of compensation for him. One other executive is permitted to use Company-owned aircraft for personal flights for up to a total of 25 hours of in-flight time per six-month period, under a former corporate aircraft policy that continues to apply to him. The company reports imputed income for income tax purposes for the value of any personal use based on the Standard Industry Fair Level (SIFL) in accordance with the Internal Revenue Code and Treasury Regulations.

*Fiscal 2009 Action*s: At its March 20, 2009 meeting, the CMD Committee considered a previously announced recommendation by management to discontinue certain of the benefits described above. The CMD Committee acted to eliminate the following benefits that have historically been provided to senior executives, as follows:

The automobile allowance for those executives who received an automobile allowance under the Automobile Program will end as of June 30, 2009. For executives who leased vehicles, the lease program will be phased out over the course of the remaining three years of the lease program as the terms of leases expire;

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Financial counseling and a Company-paid senior life insurance program for executives will end as of December 31, 2009; and

The additional merchandise discount for executives will end as of December 31, 2009.

Also on March 20, 2009, the Board of Directors acted to discontinue the additional merchandise discount for the Non-Employee Directors, effective as of December 31, 2009.

Deductibility

The CMD Committee considers the deductibility for federal income tax purposes under Section 162(m) of the Internal Revenue Code in the design of Macy s compensation programs. Section 162(m) places a limit of $1 million on the amount of compensation that Macy s may deduct in any one year with respect to the Named Executives to whom Section 162(m) applies. There is an exception to the $1 million limitation for performance-based compensation meeting certain requirements defined by the IRS. Annual non-equity incentive plan compensation, stock option awards and performance-based restricted stock awards generally are performance-based compensation meeting those requirements and, as such, are fully deductible. The CMD Committee has taken the necessary actions to maximize the deductibility of payments under Macy s 1992 Bonus Plan and of awards under its two equity plans. However, the CMD Committee may elect to provide compensation that is not deductible in order to achieve its compensation objectives. Consequently, portions of the total compensation program may not be deductible under Section 162(m), including the portion of base pay of some of the Named Executives in excess of $1 million, time-based restricted stock and stock credit awards.

The following table outlines which types of payment retain deductibility when the $1 million threshold is exceeded:

	Deductible	Not Deductible
Base Salary		x
Annual Incentive Bonus	x	
Stock Options	x	
Performance-Based Restricted Stock	x	

Section 409A

Section 409A of the Internal Revenue Code requires that nonqualified deferred compensation arrangements must meet specific requirements. Failure to meet these requirements results in immediate taxation of certain deferred amounts, as well as an additional tax equal to 20% of such deferred amounts and an interest penalty. Macy s believes that its executive compensation plans and arrangements comply with the requirements of Section 409A.

Section 280G

Section 280G and related sections of the Internal Revenue Code provide that executive officers could be subject to significant additional taxes if they receive payments or benefits that exceed certain limits in connection with a change-in-control event. Macy s does not provide any executive officer or director with a commitment to gross-up or reimburse tax amounts that the executive might pay pursuant to Section 280G.

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Accounting

In its financial statements, Macy s records salaries and performance-based compensation incentives as expenses in the amount paid, or to be paid, to the Named Executives. Accounting rules also require Macy s to record an expense in its financial statements for equity-based awards, even though equity awards are not paid as cash to employees. Macy s expenses all equity-based awards in accordance with FAS 123R. Macy s has not implemented any significant changes in its executive compensation program design as a result of FAS 123R.

Change-in-Control Agreements

Macy s equity programs and deferred compensation programs provide for accelerated benefits in the event of a change in control, which affect all participants in those programs as well as the Named Executives. When a change in control occurs, stock options, restricted stock and stock credits issued under the 2006-2007 and 2008-2009 stock credit plans immediately vest for all holders and stock credit units and cash account balances under the deferred compensation plan immediately become payable. This reassures executives that they will receive previously deferred compensation and that prior equity grants will be honored because decisions as to whether to provide these amounts are not left to the management and directors in place following a change in control.

In addition to the above benefits, certain senior executives, including the Named Executives, have change-in-control arrangements. The CMD Committee believes that these arrangements are an important part of the total executive compensation program because they help to attract and retain the caliber of executive that Macy s needs in its most senior positions. The agreements are intended to assist with retention during any rumored or actual change in control where continuity is key to preserving the value of the business. The agreements are also intended to preserve executives neutrality toward a potential change-in-control transaction and keep them focused on minimizing interruptions in business operations by reducing any concerns they may have of being terminated prematurely and without cause during an ownership transition.

The arrangements for the Named Executives provide that if, following a change in control, the executive is terminated for any reason, other than death, disability or for cause, or the executive terminates his or her employment for good reason, then the executive is entitled to benefits described under the heading Compensation of the Named Executives for 2008 Potential Payments upon Termination or Change in Control.

Fiscal 2008 Action: The change-in-control agreements for the Named Executives were set to expire on November 1, 2008. During fiscal 2008, the CMD Committee asked management to continue to explore alternatives for providing change-in-control protection, an initiative that management and Mercer had commenced in fiscal 2007. Since management had not completed its review by the November 1, 2008 expiration date for the agreements, the CMD Committee determined that Macy s should offer to extend the change-in-control agreements for terms of one additional year, to November 1, 2009, to give management time to complete its review and develop a recommendation to the CMD Committee about any alternatives for providing such protection.

The change-in-control agreements define change in control and good reason as described under Compensation of the Named Executives for 2008 Potential Payments upon Termination or Change in Control below.

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Stock Ownership Guidelines For Executives

During fiscal 2006, the Board adopted stock ownership guidelines for certain executives of Macy s, including the Named Executives. Under the guidelines, each corporate officer at the level of Senior Vice President and above and each division principal is required to own Macy s stock, as follows:

Position	Ownership Guideline
Chief Executive Officer	5 x base salary
Vice Chair and Executive Vice President	3 x base salary
Senior Vice President and Division Principal	1 x base salary

Shares counted toward the ownership requirement include:

- any shares beneficially owned by the executive and members of the executive s immediate family;
- stock credits or other stock units credited to an executive s account through deferrals under the Company s deferred compensation program;
- restricted stock before the restrictions have lapsed;
- time-based stock credits issued under the stock credit plans during performance and holding periods;
- performance-based stock credits issued under the stock credit plans during holding periods; and
- the executive s proportionate share of the Macy s common stock fund under the company s 401(k) plan.

Macy s common stock subject to unvested or unexercised stock options does not count toward the ownership requirement. An executive must comply with these guidelines by the later of August 1, 2011 or within five years from the date the executive is employed in one of the positions listed above. Prior to fiscal 2009, stock ownership was measured as of August 1 of a fiscal year. Beginning in fiscal 2009, stock ownership will be measured as of the beginning of the fiscal year.

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COMPENSATION COMMITTEE REPORT

The CMD Committee establishes and administers the compensation practices related to the senior executive officers of Macy s and also ensures appropriate succession plans for the CEO and other key executive positions. All members of the CMD Committee qualify:

- as independent under the applicable listing standards of the NYSE;
- as non-employee directors under Rule 16b-3 of the Securities Exchange Act of 1934; and
- as outside directors under Section 162(m) of the Internal Revenue Code of 1986.

The CMD Committee met six times in fiscal 2008. The CMD Committee regularly meets in executive session without the presence of management.

The CMD Committee has reviewed and discussed the Compensation Discussion & Analysis with Macy s management. Based on the review and discussions referred to above, the CMD Committee recommended to the Board that the Compensation Discussion & Analysis be included in Macy s Annual Report on Form 10-K and proxy statement.

The foregoing report was submitted by the CMD Committee and shall not be deemed to be soliciting material or to be filed with the SEC or subject to Regulation 14A promulgated by the SEC or Section 18 of the Exchange Act.

Respectfully submitted,

Craig E. Weatherup, *Chairperson*

Meyer Feldberg

Sara Levinson

Joseph Neubauer

Joseph A. Pichler

Karl M. von der Heyden

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COMPENSATION OF THE NAMED EXECUTIVES FOR 2008

The following table summarizes the compensation of Macy s principal executive officer, principal financial officer and the three other most highly compensated executive officers of Macy s, collectively referred to as the Named Executives.

2008 SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary ($)	Bonus(1) ($)	Stock Awards(2) ($)	Option Awards(3) ($)	Non-Equity Incentive Plan Compensation ($)	Changes in Pension Value and Nonqualified Deferred Compensation Earnings(4) ($)	All Other Compensation(5) ($)	Total ($)
T. Lundgren	2008	1,500,000	0	(2,485,714)	5,030,732	900,000	0	496,423	5,441,441
Chairman, President and Chief	2007	1,491,667	0	826,710	4,840,013	0	1,218,942	290,945	8,668,277
Executive Officer	2006	1,383,333	0	6,651,653	3,464,675	2,704,800	1,199,550	243,106	15,647,117
K. Hoguet	2008	800,000	0	218,929	1,098,469	240,000	0	80,517	2,437,915
Executive Vice President and CFO(6)	2007	791,667	0	521,825	1,113,982	0	372,011	77,280	2,876,765
	2006	741,667	25,000	1,235,294	877,552	724,500	296,471	79,848	3,980,332
T. Cole	2008	975,000	0	(273,393)	1,242,844	292,500	0	82,482	2,319,433
Vice Chair(6)	2007	962,500	0	376,722	1,283,933	0	808,340	67,579	3,499,074
	2006	883,333	25,000	1,691,762	1,023,142	869,400	444,407	58,045	4,995,089
J. Grove	2008	975,000	0	(271,777)	1,242,844	292,500	0	45,133	2,283,700
Vice Chair	2007	962,500	0	381,975	1,283,933	0	540,547	51,108	3,220,063
	2006	883,333	25,000	1,702,317	1,023,142	869,400	348,355	57,026	4,908,573
S. Kronick	2008	1,100,000	0	(273,154)	1,470,677	330,000	0	66,579	2,694,102
Vice Chair	2007	1,091,667	0	377,286	1,511,766	0	738,738	86,975	3,806,432
	2006	1,042,500	25,000	1,978,004	1,146,552	1,014,300	475,305	58,535	5,740,196

(1) The amounts in this column represent discretionary bonus amounts paid to the Named Executives. Annual performance-based bonus amounts paid to the Named Executives pursuant to the 1992 Bonus Plan are reflected in the Non-Equity Incentive Plan Compensation column.

(2) The amounts in this column for fiscal 2008 reflect the dollar amounts recognized for financial statement reporting purposes for fiscal 2008, in accordance with FAS 123R, for restricted stock awarded under the 1995 Equity Plan and for stock credits awarded under Macy s stock credit plans, and thus include amounts with respect to awards granted in and/or prior to fiscal 2008. In addition, with respect to stock credits, the amounts also reflect variable accounting treatment. The application of variable accounting and FAS 123R resulted in credits to compensation expense in 2008 due to declines in the market price for shares of Macy s common stock subsequent to the end of fiscal 2007. Assumptions used in the calculation of these amounts are included in footnote 16 to Macy s audited financial statements included in the 2008 10-K, in footnotes 1 and 14 to Macy s audited financial statements included in the 2007 10-K and in footnotes 1 and 15 to Macy s audited financial statements included in the 2006 10-K. In all cases, the amounts assume that the Named Executive remains with Macy s until all time-based restrictions have lapsed and that 100% of performance-based stock credits are earned.

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	Restricted Stock				Stock Credits					2008 Total Stock Awards Expense
	Grant Date	Shares (#)	Grant Date FMV ($)	2008 Restricted Stock Expense ($)	Grant Date	Shares (#)	2008 Expense ($)	2008 Dividend Expense ($)	2008 Total Stock Credit Expense/ (Credit) ($)	($)
Lundgren	3/01/07	75,000	44.29	830,438	3/21/08	388,249.0	1,392,711	0	1,392,711	
					3/24/06	261,089.0	(3,790,831)	84,133	(3,706,698)	
					3/26/04	57,372.0	(993,867)	(8,298)	(1,002,165)	(2,485,714)
Hoguet	7/11/06	42,000	36.44	510,160	3/21/08	85,310.0	306,021	0	306,021	
					3/24/06	57,369.7	(390,087)	18,486	(371,601)	
					3/26/04	18,031.0	(223,043)	(2,608)	(225,651)	218,929
Cole	7/11/06	50,000	36.44	607,310	3/21/08	85,310.0	306,021	0	306,021	
					3/24/06	57,369.7	(832,970)	18,486	(814,484)	
					3/26/04	21,310.0	(369,158)	(3,082)	(372,240)	(273,393)
Grove	7/11/06	50,000	36.44	607,310	3/21/08	85,310.0	306,021	0	306,021	
	3/26/04	2,000	25.25	1,616	3/24/06	57,369.7	(832,970)	18,486	(814,484)	
					3/26/04	21,310.0	(369,158)	(3,082)	(372,240)	(271,777)
Kronick	7/11/06	50,000	36.44	607,310	3/21/08	85,310.0	306,021	0	306,021	
					3/24/06	57,369.7	(832,970)	18,486	(814,484)	
					3/26/04	21,310.0	(368,919)	(3,082)	(372,001)	(273,154)

(3) The amounts in this column for fiscal 2008 reflect the dollar amount recognized for financial statement reporting purposes in accordance with FAS 123R for fiscal 2008 for stock options issued pursuant to the 1995 Equity Plan, and thus may include amounts from awards granted in and prior to 2008. Assumptions used in the calculation of these amounts are included in footnote 16 to Macy s audited financial statements included in the 2008 10-K, in footnote 14 to Macy s audited financial statements included in the 2007 10-K, in footnote 15 to Macy s audited financial statements included in the 2006 10-K and in footnote 12 to Macy s audited financial statements included in the 2005 10-K.

Lundgren Grant Date	Options (#)	FMV ($)	2008 Expense ($)	Hoguet Grant Date	Options (#)	FMV ($)	2008 Expense ($)	Cole Grant Date	Options (#)	FMV ($)	2008 Expense ($)
3/21/08	307,261	7.42	474,974	3/21/08	67,515	7.42	104,367	3/21/08	67,515	7.42	104,367
10/26/07	134,000	8.33	344,169	3/23/07	29,444	16.94	124,695	3/23/07	29,444	16.94	124,695
3/01/07	500,000	16.40	2,050,000	7/11/06	125,000	13.67	569,583	7/11/06	150,000	13.67	683,500
3/24/06	177,352	13.58	602,110	3/24/06	38,970	13.58	132,303	3/24/06	38,970	13.58	132,303
3/25/05	550,000	10.50	1,443,750	3/25/05	55,000	10.50	144,375	3/25/05	65,000	10.50	170,625
3/26/04	275,000	10.10	115,729	3/26/04	55,000	10.10	23,146	3/26/04	65,000	10.10	27,354
			5,030,732				1,098,469				1,242,844

Grove Grant Date	Options (#)	FMV ($)	2008 Expense ($)	Kronick Grant Date	Options (#)	FMV ($)	2008 Expense ($)
3/21/08	67,515	7.42	104,367	3/21/08	67,515	7.42	104,367
3/23/07	29,444	16.94	124,695	3/23/07	29,444	16.94	124,695
7/11/06	150,000	13.67	683,500	7/11/06	200,000	13.67	911,333
3/24/06	38,970	13.58	132,303	3/24/06	38,970	13.58	132,303
3/25/05	65,000	10.50	170,625	3/25/05	65,000	10.50	170,625
3/26/04	65,000	10.10	27,354	3/26/04	65,000	10.10	27,354

1,242,844	1,470,677

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(4) Macy s does not pay above-market interest under its deferred compensation plan. The amounts reflected for fiscal 2008 in this column represent the change in fiscal 2008 in the actuarial present value of accumulated pension benefits under the company s cash balance pension plan and supplementary executive retirement plan. The assumptions used in determining the present value of benefits are the same assumptions used for financial reporting purposes. The present value of benefits was determined using a unit credit cost method, a 7.45% discount rate and mortality rates under the RP2000CH table projected to January 1, 2009 using scale AA. Scale AA defines how future mortality improvements are incorporated into the projected mortality tables and is based on a blend of Federal Civil Service and Social Security experiences from 1977 through 1993. The actuarial present value of the pension benefit for the Named Executives decreased, as follows: Mr. Lundgren ($311,461), Mrs. Hoguet ($236,878), Mr. Cole ($278,311), Ms. Grove ($427,142) and Ms. Kronick ($515,850). The decrease in pension value is mainly attributable to the fact that the discount rate increased from 6.25% for fiscal 2007 to 7.45% for fiscal 2008. The assumed retirement age used for these calculations was the normal retirement age of 65, as defined by the plans and each Named Executive was assumed to live to and retire at the normal retirement age.

(5) Included in All Other Compensation for fiscal 2008 is the incremental cost to Macy s of the following perquisites made available to the Named Executives:

Name	Aircraft Usage(a) ($)	Financial Counseling ($)	Car Programs(b) ($)	Additional Executive Merchandise Discount ($)	Gross up(c) ($)	401(k) Matching Contribution/ Insurance Premiums ($)	Total
Lundgren	117,406	16,700	297,958	28,542	29,224	6,593	496,423
Hoguet	0	16,700	10,901	31,625	14,698	6,593	80,517
Cole	0	16,700	15,372	30,058	13,759	6,593	82,482
Grove	0	16,700	9,965	5,887	5,988	6,593	45,133
Kronick	0	16,700	10,479	22,425	12,107	4,868	66,579

(a) The amount shown for aircraft usage represents a ratio of flight hours for personal flights divided by total flight hours on all company planes. The ratio was applied against total airplane cost (excluding depreciation, real estate taxes, insurance, rent and other fixed operating costs).

Total flight hours equal the total number of hours for every flight flown.

Flights were deemed business or personal based on the primary purpose for the flight.

If a trip was deemed personal, ferry flight hours, if any, were included as personal.

If a trip included an intermediary personal stop, only the difference between a direct flight and the indirect flight was considered personal.

If a trip was exclusively personal except for a one-day business stop, all miles were treated as personal less an adjustment for the flight hours to and from the originating airport to the business location.

For a more detailed description of Macy s policies with respect to personal use of company airplanes, see the Benefits discussion in the Compensation Discussion & Analysis.

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(b) For the Named Executives other than Mr. Lundgren, the amount shown reflects the product of (i) the percentage of miles the Named Executive used the vehicle for non-business reasons multiplied by (ii) the actual costs incurred to provide the vehicle, including the costs of the lease, fuel, parking and insurance, reduced by any personal contributions made by the Named Executive. For Mr. Lundgren, the amount reflects the costs relating to the use of a car and driver service that the Company makes available to him for safety reasons pursuant to the recommendation of a third-party security study.

(c) The amount shown reflects gross up payments made in December 2008 on the executive discount for the period from November 2007 through October 2008, and for Mr. Lundgren, the amount also includes a gross up payment for imputed income on personal use of a Company airplane during the 2008 calendar year.

(6) In connection with the restructuring of its management team as a result of the expansion of its My Macy s localization initiative, the titles of Mrs. Hoguet and Mr. Cole were changed to Chief Financial Officer and Chief Administrative Officer, respectively, effective as of February 20, 2009.

Plan-Based Awards

The following table sets forth certain information regarding the annual incentive plan and stock options and other equity awards granted during fiscal 2008 to each of the Named Executives.

2008 GRANTS OF PLAN-BASED AWARDS

			Estimated Future Payouts Under Non-Equity Incentive Plan Awards(1)						
Name	**Plan Name**	**Grant Date**	**Threshold ($)**	**Target ($)**	**Maximum ($)**	**All Other Stock Awards: Number of Shares of Stock or Units (#)(2)**	**All Other Option Awards: Number of Securities Underlying Options (#)(3)**	**Exercise or Base Price of Option Awards ($/sh)**	**Grant Date Fair Value of Stock and Option Awards ($)(4)**
Lundgren	1992 Bonus Plan	3/21/08	600,000	2,250,000	4,500,000				
	1995 Equity Plan	3/21/08					307,261	24.85	2,279,877
	2008-2009 Stock Credit Plan	3/21/08				388,249			9,647,988
Hoguet	1992 Bonus Plan	3/21/08	160,000	600,000	1,200,000				
	1995 Equity Plan	3/21/08					67,515	24.85	500,961
	2008-2009 Stock Credit Plan	3/21/08				85,310			2,119,954
Cole	1992 Bonus Plan	3/21/08	195,000	731,250	1,462,500				
	1995 Equity Plan	3/21/08					67,515	24.85	500,961
	2008-2008 Stock Credit Plan	3/21/08				85,310			2,119,954
Grove	1992 Bonus Plan	3/21/08	195,000	731,250	1,462,500				
	1995 Equity Plan	3/21/08					67,515	24.85	500,961
	2008-2009 Stock Credit Plan	3/21/08				85,310			2,119,954
Kronick	1992 Bonus Plan	3/21/08	220,000	825,000	1,650,000				
	1995 Equity Plan	3/21/08					67,515	24.85	500,961
	2008-2009 Stock Credit Plan	3/21/08				85,310			2,119,954

(1) The Named Executives are eligible for an annual cash incentive award under Macy s 1992 Bonus Plan, which is deemed a non-equity incentive plan under SEC rules. Bonus awards are interpolated for performance that falls between Threshold and Target and between Target and Maximum. If corporate EBIT performance exceeds plan by more than a predetermined amount, the Named Executives may receive a bonus in excess of the maximum amount reflected in the

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table. The actual bonus amount earned, if any, under the 1992 Bonus Plan is reported in the Non-Equity Incentive Plan Compensation column of the 2008 Summary Compensation Table. For a more detailed discussion of the 1992 Bonus Plan, see the Annual Performance-Based Bonus discussion in the Compensation Discussion & Analysis.

(2) The numbers in this column represent performance-based core and My Macy s/Consolidation stock credits granted to the Named Executives under Macy s 2008-2009 Stock Credit Plan.

(3) The numbers reflected in this column represent the number of stock options granted to the Named Executives under Macy s 1995 Equity Plan.

(4) Stock options were valued as of the grant date using the Black-Scholes option pricing model in accordance with FAS 123R, using the following assumptions:

	3/21/08 Grant
Dividend yield:	2.2%
Expected volatility:	36.2%
Risk-free interest rate:	2.7%
Expected life:	5.3 years
Black-Scholes value:	7.42

Stock credits were valued for purposes of this table based on the closing price of Macy s common stock on the grant date ($24.85 per share).

Stock Options. The CMD Committee may grant stock options from the 1995 Equity Plan and the 1994 Stock Plan, each of which has been approved by Macy s shareholders. The exercise price of stock options may not be less than the market price of the underlying Macy s common stock on the grant date (which, among other ways, is defined in the plans as the closing price of Macy s common stock on the NYSE on the trading day prior to the grant date). The options vest over time, typically in 25% installments on the first through fourth anniversaries of the grant date, and have ten year terms. The plans do not provide for the granting of reload options and prohibit the repricing of previously granted options.

The stock option agreements provide that options become immediately exercisable in full, and remain exercisable until the end of their term, in the event of (i) a change in control of the Company, (ii) the executive s permanent and total disability, (iii) the executive s death while still employed by the Company, or (iv) the executive s death following retirement under a Company-sponsored IRS qualified retirement plan at or after attaining age 62 with a minimum of 10 years of service. Option shares continue to become exercisable following retirement if the executive retires under a Company-sponsored IRS qualified retirement plan at or after attaining the age of 62 with a minimum of 10 years of service. The stock option agreements also provide that options automatically terminate if, among other events, the executive retires under a Company-sponsored IRS qualified retirement plan at or after attaining the age of 55 with a minimum of 10 years of service, is a party to an employment agreement with the Company immediately prior to retirement, and renders personal services to a competing business within one year of the date retirement commenced. All stock options granted to the Named Executives in fiscal 2008 were granted from the 1995 Equity Plan. See also the Stock Options discussion in the Compensation Discussion & Analysis.

Restricted Stock. The CMD Committee grants shares of restricted stock from time to time for retention and performance reasons. Restricted stock grants may be granted from either the 1995 Equity Plan or the 1994 Stock Plan and can be either time-based or performance-based. Time-based restricted stock will generally be forfeited by the executive if the executive s employment with Macy s ends prior to the vesting date. Shares may vest 100% on the third anniversary of the grant date or in installments over a number of years following the first anniversary of the grant date. Time-based restricted stock may not fully vest in under three years. Performance-based restricted stock is subject to forfeiture if performance criteria applicable to the shares are not satisfied and/or if the executive s employment with Macy s ends prior to the vesting date. Performance-based restricted stock may not fully vest in less than one year. Depending upon satisfaction of the performance criteria, shares may vest up to 100% on the first anniversary of the grant date or in installments over a number of years following the first anniversary of the grant date. To the extent performance criteria are not satisfied, shares are forfeited. None of the Named Executives received a restricted stock grant in fiscal 2008.

Stock Credits. The CMD Committee authorized a stock credit plan in fiscal 2004 for the fiscal 2004-2005 performance period. The final payment of the value of stock credits awarded under that plan was made shortly after the end of fiscal 2008 when a three-year holding period for the stock credits expired. The CMD Committee authorized a stock credit plan in fiscal 2006 for the fiscal 2006-2007 performance period and in fiscal 2008 for the fiscal 2008-2009 performance period. The CMD Committee granted stock credits to the Named Executives in each of fiscal 2006 and fiscal 2008. It did not grant any stock credits in fiscal 2007 and will not grant any stock credits in fiscal 2009 to the Named Executives. Stock credits issued under either plan may be time-based or performance-based, with performance objectives tied to the company s Four Priorities and, with respect to the plan authorized in 2006, to certain merger-related synergies, and with respect to the plan authorized in 2008, to the My Macy s initiative and certain division consolidation synergies.

At the end of a two-year performance period, the CMD Committee evaluates performance against the performance criteria applicable to the stock credits to determine the percent (from 0% to 100%) of the performance-based stock credits earned by the Named Executives. The performance-based stock credits earned by the Named Executives and the time-based stock credits, if any, held by them are then subject to two- and three-year holding periods. The value of one-half of the stock credits, including dividend equivalents paid during the holding period, is paid in cash at the end of the two-year holding period and the value of the other half, including such dividend equivalents, is paid in cash at the end of the three-year holding period. In each case, the value is determined on the basis of the average closing price of Macy s common stock as reported on the NYSE for the 20 business days preceding the payment date.

With respect to stock credits awarded under the 2006-2007 stock credit plan, following the conclusion of fiscal 2007, the CMD Committee determined that 95% of the core performance-based stock credits and 100% of the merger performance-based stock credits had been earned by participants, including the Named Executives. Those stock credits and the time-based stock credits awarded to them under the 2006-2007 stock credit plan are now subject to two- and three-year holding periods that expire on February 1, 2010 and January 31, 2011, respectively.

Participants who leave the Company during the performance period will forfeit their stock credits unless they retire at or after age 62 with at least 10 years of vesting service or if they are terminated by Macy s other than for cause, in which case their payments will be prorated for the number of months of completed service during the performance period divided by 24. Their payments will be made at the same time and in the same manner as payments to actively employed participants. In the event that a participant dies or becomes totally and permanently disabled during the performance period, the participant (in the event of disability) or the participant s estate (in the event of death) will receive a lump sum payment, discounted to present value, of the prorated portion of their time-based stock credits.

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Participants who leave the Company during a holding period will:

- forfeit their stock credit balances if they leave the Company voluntarily or if their employment is terminated for cause;
- receive the stock credits they have earned if they retire at or after age 62 with at least 10 years of vesting service or if they are terminated by Macy s for other than cause, payable at the same time and in the same manner as payments to actively employed participants;
- receive a pro-rata payment of their stock credit balance if they retire between the ages of 55 and 62 with at least 10 years of vesting service, payable at the same time and in the same manner as payments to actively employed participants; and
- receive a lump sum payment of the discounted present value of the total account in case of death or total and permanent disability.

All stock credit balances in the 2006-2007 and 2008-2009 stock credit plans vest and become immediately payable upon a change in control of the Company. See Outstanding Equity Interests below and the Stock Credits discussion in the Compensation Discussion & Analysis.

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Outstanding Equity Interests

The following table sets forth certain information regarding the total number and aggregate value of options, stock credits and restricted stock held by each of the Named Executives at January 31, 2009. The dollar amount shown for stock credits and restricted stock is calculated by multiplying the number of stock credits or shares of restricted stock, as applicable, by the closing price of Macy s common stock ($ 8.95) on the last trading day of fiscal 2008.

2008 OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

		Option Awards				Stock Awards			
Name	Grant Date	Number of Securities Underlying Unexercised Options (#) Exercisable (1)	Number of Securities Underlying Unexercised Options (#) Unexercisable (1)	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)(2)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)
Lundgren	2/25/00	600,000	0	16.2187	2/25/10				
	6/08/01	306,976	0	21.5000	6/08/11				
	3/22/02	500,000	0	21.3400	3/22/12				
	2/24/03	500,000	0	12.7900	2/24/13				
	3/26/04	275,000	0	25.0050	3/26/14				
	3/25/05	412,500	137,500	30.5350	3/25/15				
	3/24/06	88,676	88,676	36.2600	3/24/16				
	3/01/07	0	500,000	44.6700	3/01/17				
	10/26/07	33,500	100,500	46.1500	3/23/17				
	3/21/08	0	307,261	24.8500	3/21/18				
						75,000(3)	671,250		
						318,461(4)	2,850,226	388,249	3,474,829
Hoguet	2/25/00	46,000	0	16.2187	2/25/10				
	3/23/01	46,000	0	21.4250	3/23/11				
	6/08/01	153,488	0	21.5000	6/08/11				
	3/22/02	60,000	0	21.3400	3/22/12				
	3/28/03	110,000	0	14.2850	3/28/13				
	3/26/04	55,000	0	25.0050	3/26/14				
	3/25/05	41,250	13,750	30.5350	3/25/15				
	3/24/06	19,485	19,485	36.2600	3/24/16				
	7/11/06	0	125,000	36.5100	7/11/16				
	3/23/07	7,361	22,083	46.1500	3/23/17				
	3/21/08	0	67,515	24.8500	3/21/18				
						42,000(3)	375,900		
						75,400.7(4)	674,836	85,310	763,525

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Name	Grant Date	Option Awards: Number of Securities Underlying Unexercised Options (#) Exercisable (1)	Number of Securities Underlying Unexercised Options (#) Unexercisable (1)	Option Exercise Price ($)	Option Expiration Date	Stock Awards: Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#) (2)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)
Cole	3/23/01	36,000	0	21.4250	3/23/11				
	6/08/01	164,930	0	21.5000	6/08/11				
	3/22/02	72,000	0	21.3400	3/22/12				
	3/26/04	65,000	0	25.0050	3/26/14				
	3/25/05	48,750	16,250	30.5350	3/25/15				
	3/24/06	19,485	19,485	36.2600	3/24/16				
	7/11/06	0	150,000	36.5100	7/11/16				
	3/23/07	7,361	22,083	46.1500	3/23/17				
	3/21/08	0	67,515	24.8500	3/21/18				
						50,000(3)	447,500		
						78,679.7(4)	704,183	85,310	763,525
Grove	2/25/00	72,000	0	16.2187	2/25/10				
	3/23/01	36,000	0	21.4250	3/23/11				
	6/08/01	159,348	0	21.5000	6/08/11				
	3/22/02	72,000	0	21.3400	3/22/12				
	3/26/04	65,000	0	25.0050	3/26/14				
	3/25/05	48,750	16,250	30.5350	3/25/15				
	3/24/06	19,485	19,485	36.2600	3/24/16				
	7/11/06	0	150,000	36.5100	7/11/16				
	3/23/07	7,361	22,083	46.1500	3/23/17				
	3/21/08	0	67,515	24.8500	3/21/18				
						50,000(3)	447,500		
						78,679.7(4)	704,183	85,310	763,525
Kronick	3/23/01	72,000	0	21.4250	3/23/11				
	6/08/01	207,232	0	21.5000	6/08/11				
	3/22/02	72,000	0	21.3400	3/22/12				
	3/28/03	97,500	0	14.2850	3/28/13				
	3/26/04	65,000	0	25.0050	3/26/14				
	3/25/05	48,750	16,250	30.5350	3/25/15				
	3/24/06	19,485	19,485	36.2600	3/24/16				
	7/11/06	0	200,000	36.5100	7/11/16				
	3/23/07	7,361	22,083	46.1500	3/23/17				
	3/21/08	0	67,515	24.8500	3/21/18				
						50,000(3)	447,500		
						78,679.7(4)	704,183	85,310	763,525

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(1) Options vest/vested as follows, with full vesting upon a change in control of the Company:

Grant Date	Vesting Schedule
2/25/00	25% on each of 3/24/01, 3/24/02, 3/24/03 and 3/24/04.
3/23/01	25% on each of 3/23/02, 3/23/03, 3/23/04 and 3/23/05.
6/08/01	100% on 6/01/05.
3/22/02	25% on each of 3/22/03, 3/22/04, 3/22/05 and 3/22/06.
2/24/03	25% on each of 2/24/04, 2/24/05, 2/24/06 and 2/24/07.
3/28/03	25% on each of 3/28/04, 3/28/05, 3/28/06 and 3/28/07.
3/26/04	25% on each of 3/26/05, 3/26/06, 3/26/07 and 3/26/08.
3/25/05	25% on each of 3/25/06, 3/25/07, 3/25/08 and 3/25/09.
3/24/06	25% on each of 3/24/07, 3/24/08, 3/24/09 and 3/24/10.
7/11/06	100% on 7/11/09.
3/01/07	100% on 2/28/11.
3/23/07	25% on each of 3/23/08, 3/23/09, 3/23/10 and 3/23/11.
10/26/07	25% on each of 3/23/08, 3/23/09, 3/23/10 and 3/23/11.
3/21/08	25% on each of 3/21/09, 3/21/10, 3/21/11 and 3/21/12.

(2) Performance-based stock credits vest following the conclusion of fiscal 2008 and 2009, subject to the satisfaction of performance criteria. Shares that vest are then subject to the holding periods described in the Stock Credits discussion in the Compensation Discussion & Analysis.

(3) Time-based restricted stock. For Mr. Lundgren, the shares vest on 2/28/11. For Mrs. Hoguet, Mr. Cole, Ms. Grove and Ms. Kronick, the shares vest on 7/11/09.

(4) Time-based and vested performance-based stock credits are subject to satisfaction of holding periods that expired or will expire as follows:

	Holding Period Expiration Date		
	1/31/09	2/1/10	1/31/11
Lundgren	57,372	130,544.5	130,544.5
Hoguet	18,031	28,684.85	28,684.85
Cole	21,310	28,684.85	28,684.85
Grove	21,310	28,684.85	28,684.85
Kronick	21,310	28,684.85	28,684.85

The following table sets forth certain information regarding the value realized by each of the Named Executives during fiscal 2008 upon the exercise of stock options, the vesting of restricted stock and the vesting of stock credits granted under the 2004-2005 stock credit plan.

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2008 OPTION EXERCISES AND STOCK VESTED

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise (#)	Value Realized Upon Exercise(1) ($)	Number of Shares Acquired on Vesting(2) (#)	Value Realized on Vesting ($)
Lundgren	0	0	57,372	575,441
Hoguet	0	0	18,031	180,851
Cole	0	0	21,310	213,739
Grove	0	0	21,810	226,394
Kronick	0	0	21,310	213,739

(1) The amounts realized from option exercises reflect the appreciation on the date of exercise (based on the excess of the fair market value of the shares on the date of exercise over the exercise price). However, because the Named Executives may keep the shares they acquire upon the exercise of the option (or sell them at different prices), these amounts do not necessarily reflect cash actually realized upon the exercise of those options.

(2) For Ms. Grove, the number represents 500 shares of restricted stock that vested on March 26, 2008 and 21,310 stock credits from the 2004-2005 stock credit plan for which the three-year holding period expired at the end of fiscal 2008. For the other Named Executives, the number represents stock credits from the 2004-2005 stock credit plan for which the three-year holding period expired at the end of fiscal 2008. In addition to the amounts shown, the Named Executives also received the following amounts with respect to dividend equivalents accrued on the stock credits during the holding period: Mr. Lundgren, $37,841; Mrs. Hoguet, $11,892; and Mr. Cole, Ms. Grove and Ms. Kronick, $14,055 each. See also the Stock Credits discussion in the Compensation Discussion & Analysis.

Post Retirement Compensation

Retirement Plans

Macy s retirement program, referred to as the Retirement Program, consists of defined benefit plans and a defined contribution plan. As of January 1, 2009, approximately 120,000 employees, including the Named Executives, participated in the Retirement Program.

Defined Benefit Plans. Macy s has two defined benefit plans covering the Named Executives a cash account pension plan, referred to as the CAPP, and a supplementary executive retirement plan, referred to as the SERP. The following table shows the actuarial present value of each of the Named Executive s accumulated benefit under each plan, calculated as of the end of fiscal 2008. Macy s determined the present value using the same assumptions used for financial reporting purposes a unit credit cost method, a 7.45% discount interest rate, and a normal retirement age of 65 (as defined by the plans).

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2008 PENSION BENEFITS

Name	Plan Name	Number of years of credited service (#)	Present Value of Accumulated Benefit ($)
Lundgren	CAPP	27	144,762
	SERP	27	7,034,346
Hoguet	CAPP	26	163,793
	SERP	26	1,766,643
Cole	CAPP	36	423,082
	SERP	36	4,873,467
Grove	CAPP	35	341,158
	SERP	35	4,212,190
Kronick	CAPP	35	290,474
	SERP	35	4,627,476

Cash Account Pension Plan. Under the CAPP, a participant retiring at a normal retirement age is eligible to receive the amount credited to his or her pension account or the monthly benefit payments determined actuarially based on the amount credited to his or her pension account. Amounts credited to a participant s account consist of:

- an opening cash balance for participants in the plan at December 31, 1996, equal to the single sum present value, using stated actuarial assumptions, of the participant s accrued normal retirement benefit earned at December 31, 1996, under the applicable predecessor pension plan;

- pay credits (generally, a percentage of eligible compensation credited annually based on length of service); and

- interest credits (credited quarterly, based on the 30-Year Treasury Bond rate for the November prior to each calendar year, with a guaranteed minimum rate of 5.25%).

In addition, if a participant had attained at least age 55 by December 31, 1996 and had completed 10 or more years of vesting service by December 31, 2001, the pension benefit payable in an annuity form, other than a single life annuity, will not be less than that which would have been payable from the predecessor pension plan under which such participant was covered on December 31, 1996.

Supplementary Executive Retirement Plan. To allow the Retirement Program to provide benefits based on a participant s total compensation, Macy s adopted the SERP, which is a nonqualified unfunded plan. All benefits under the SERP are payable out of the general corporate assets of Macy s. It provides retirement benefits to eligible executives based on all eligible compensation, including compensation in excess of Internal Revenue Code maximums, as well as on amounts deferred under Macy s Executive Deferred Compensation Plan, referred to as the EDCP, in each case employing a formula that is based on the participant s years of vesting service and final average compensation, taking into consideration the participant s balance in the CAPP, the participant s Prior Plan Credits (defined below) and Social Security benefits. As of January 1, 2009, approximately 700 employees were eligible to receive benefits under the terms of the SERP. Macy s has reserved the right to suspend or terminate supplemental payments as to any category of employee or former employee, or to modify or terminate any other element of the Retirement Program, in accordance with applicable law.

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Eligible compensation for this purpose includes amounts reflected in the 2008 Summary Compensation Table under the headings Salary and Non-Equity Incentive Plan Compensation but excludes amounts reflected in other columns of such table and excludes bonus amounts that exceed 100% (160% for Mr. Lundgren) of salary.

In addition to the CAAP and the SERP, Macy s Retirement Program includes a profit sharing plan, the Macy s Profit Sharing 401(k) Investment Plan (the 401(k) Plan). The 401(k) Plan permits executives to contribute up to 8% of compensation (up to maximum amounts established from time to time by the Internal Revenue Code) each year. Macy s matches contributions of up to 5% of eligible compensation each year. The matching rate is discretionary, but in accordance with the terms of the 401(k) Plan is not less than 33 ^{1} /3% of matchable contributions. In February 2009, Macy s announced that it had amended the 401(k) Plan to provide that the matching rate for fiscal 2009 will be 10% of matchable contributions. The executive may choose any of several investment funds for investment of the executive s balances, and may change those elections daily. Benefits may be paid out at termination of employment. Executives may borrow portions of their investment balances while employed. Company contributions to the Named Executives under the 401(k) Plan are reported in the All Other Compensation column of the 2008 Summary Compensation Table.

Prior to the adoption of the 401(k) Plan, Macy s primary means of providing retirement benefits to employees was through defined contribution profit sharing plans. An employee s accumulated retirement profit sharing interests in the profit sharing plans (the Prior Plan Credits) which accrued prior to the adoption of the 401(k) Plan continue to be maintained and invested as a part of the 401(k) Plan until retirement, at which time they are distributed.

Non-qualified Deferred Compensation Plans

Macy s provides the opportunity for executives to defer compensation through the Executive Deferred Compensation Plan, referred to as the EDCP. Under the EDCP, eligible executives may elect to defer a portion of their compensation each year as either stock credits or cash credits. Stock credit accounts reflect common stock equivalents and dividend equivalents. Common stock equivalents are the number of full shares of Macy s common stock for each calendar quarter that could be purchased based on the dollars deferred, and dividend equivalents are determined by multiplying the dividends payable upon a share of common stock to a shareholder of record during such calendar quarter by the number of stock equivalents in the participant s stock credit account at the beginning of each quarter, less the number of shares distributable or withdrawn during each quarter in which the credit is being made. Total value of the stock credits is determined at the end of each quarter based on the closing price of the Company s common stock as of the last day of the quarter. Cash credit accounts reflect dollars deferred plus interest equivalents determined by applying to 100% of such participant s cash credits at the beginning of each quarter, less amounts distributable or withdrawn during such quarter, an interest rate equal to one quarter of the interest rate payable on U.S. 5-year Treasury Notes as of the last day of each quarter. Deferred compensation is distributed in the fiscal year following the fiscal year in which termination of employment occurs.

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2008 NONQUALIFIED DEFERRED COMPENSATION

Name	Plan Name	Executive Contributions in last FY ($)	Registrant Contributions in last FY ($)	Aggregate Earnings in last FY(1) ($)	Aggregate Withdrawals/ Distributions ($)	Aggregate Balance at Last FYE(2) ($)
Lundgren	EDCP	0	0	0	0	0
Hoguet	EDCP	0	0	0	0	0
Cole	EDCP	0	0	931	0	16,208
Grove	EDCP	0	0	6,758	0	117,567
Kronick	EDCP	0	0	0	0	0

(1) These amounts are not included in the Summary Compensation Table.

(2) The compensation deferred by both Mr. Cole and Ms. Grove is deferred as stock credits. The portion of these amounts representing Mr. Cole s and Ms. Grove s contributions was reported as compensation to them in Summary Compensation Tables for the fiscal years in which the compensation was earned.

Potential Payments Upon Termination or Change in Control

Termination Payments under Employment Agreements

Upon certain types of terminations of employment (other than a termination following a change in control of the company, which is addressed below) severance benefits may be paid to the Named Executives. The severance benefits payable to each of the Named Executives are addressed in their employment agreements, and they would receive the benefits provided under those agreements.

Mr. Terry Lundgren. In March 2007, Macy s entered into a new employment agreement with Mr. Lundgren with an expiration date of February 28, 2011. Pursuant to this agreement, Mr. Lundgren s base salary increased to $1,500,000 on March 1, 2007. Mr. Lundgren s employment agreement provides that if Macy s terminates his employment for reasons other than cause or if Mr. Lundgren terminates his employment for good reason he would be entitled to receive all salary and target annual bonuses until the expiration of the employment agreement. Under the terms of his agreement, cause is defined generally to include:

- willful and material breaches of duties;
- habitual neglect of duties; or
- the final conviction of a felony.

Generally, cause does not include bad judgment or negligence, any act or omission believed by Mr. Lundgren in good faith to have been in or not opposed to the interests of Macy s or any act or omission in respect of which a determination could properly have been made by the Board that Mr. Lundgren met the applicable standard of conduct prescribed for indemnification or reimbursement under the By-Laws or the laws of the State of Delaware.

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Under the terms of his employment agreement, good reason is defined generally to include:

- assignment of any duties materially inconsistent with Mr. Lundgren s position, authority, duties or responsibilities, or any other action by Macy s which results in a material diminution in such position, authority, duties or responsibilities;
- any material failure by Macy s to comply with any of the provisions of the agreement;
- failure of Mr. Lundgren to be reelected Chairman of the Board of Macy s or to be reelected to membership on the Board; or
- any purported termination by Macy s of Mr. Lundgren s employment otherwise than as expressly permitted by the agreement.

In addition, Mr. Lundgren s agreement contains non-compete, non-solicitation and mitigation clauses.

Other Named Executives. Macy s has also entered into employment agreements with each of the other Named Executives. The current term of the agreements for Mrs. Hoguet, Mr. Cole and Ms. Grove expire on June 30, 2011. The current term of the agreement for Ms. Kronick expires on January 31, 2010. The agreements provide that in the event that Macy s terminates the executive other than for cause the executive would be entitled to receive base salary until the end of the term of the agreement. The term cause has the same definition as previously described above in the discussion of Mr. Lundgren s agreement. In addition, the agreements contain similar non-compete, non-solicitation and mitigation clauses.

Termination Payments under Change-in-Control Agreements

Macy s entered into a change-in-control agreement, referred to collectively as the CIC Agreements, with Mr. Lundgren and Mrs. Hoguet on March 22, 2002 and with Mr. Cole, Ms. Grove and Ms. Kronick on March 22, 2003. The term of each CIC Agreement ended November 1, 2008. On November 1, 2008, each of the Named Executives and the Company extended the term of each applicable CIC Agreement one year, to November 1, 2009. See the Change-in-Control Agreements discussion in Compensation Discussion & Analysis.

These agreements are intended to provide for continuity of management in the event of a change in control of Macy s. The agreements provide that covered executive officers could be entitled to certain severance benefits following a change in control of Macy s. If, following a change in control, the executive officer is terminated for any reason, other than death, disability or for cause, or if the executive officer terminates his or her employment for good reason, then the executive is entitled to:

- a cash severance payment (generally paid in the form of a lump sum) that will be equal to three times the sum of:
  - the executive officer s base pay (at the higher of the rate in effect at the change in control or the average rate over the last three years), and
  - the higher of target annual bonus for the year of termination or the highest annual bonus received for any year in the three full calendar years immediately preceding the change in control; plus

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- a lump sum payment of any performance-based stock credit awards under Macy s stock credit plans, at target, prorated to the date of termination; plus
- a lump sum payment of an annual bonus for the year of termination, at target, prorated to the date of termination (this feature applies to all executives in the 1992 Bonus Plan); plus
- release of any restrictions on restricted stock, including performance restricted stock upon the change in control (this feature applies to all participants with restricted stock granted under the 1995 Equity Plan or the 1994 Stock Plan); plus
- acceleration of any unvested stock options upon the change in control (this feature applies to all participants with stock options granted under the 1995 Equity Plan or the 1994 Stock Plan); plus
- a lump sum payment of all deferred compensation (this feature applies to all participants in the deferred compensation plan); plus
- a lump sum payment of all retirement, supplementary retirement and 401(k) benefits upon termination or retirement (this feature applies to all participants in the retirement, supplementary retirement and 401(k) plans); plus
- a lump sum payment of retirement, supplementary retirement and 401(k) benefits the executive would have earned over the three years after termination; plus
- continuation of certain fringe benefits for 36 months after termination, including:
  - life insurance coverage,
  - medical, vision and dental coverage, and
  - use of a company car; plus
- a retiree discount for life if at least 55 years of age with 15 years of service at termination (this feature applies generally to all associates).

All of the above severance benefits would be paid to the executive in accordance with, and at times permitted by Section 409A of the Internal Revenue Code.

A change in control occurs in any of the following events:

- Macy s is merged, consolidated or reorganized into or with another corporation and, as a result of or immediately following such merger, consolidation or reorganization, less than a majority of the voting power of the other corporation immediately after the transaction is held in the aggregate by the holders of the voting stock of Macy s immediately prior to the transaction; or

Macy s sells or otherwise transfers all or substantially all of its assets to another corporation and, as a result of or immediately following such sale or transfer, less than a majority of the voting power of the then-outstanding securities of the other corporation immediately after such sale or transfer is held in the aggregate by the holders of voting stock of Macy s immediately before the transaction; or

a person discloses that the person has become the beneficial owner of securities representing 25% or more of the combined voting power of Macy s; or

Macy s discloses that a change in control of the Company has occurred or will occur in the future pursuant to any then-existing contract or transaction; or

if, in any two-year period, individuals who, at the beginning of the period, constitute the directors of Macy s cease for any reason to constitute at least a majority of the Board.

A change in control will not occur under either the third or fourth bullet point above if Macy s, an entity controlled by Macy s or an employee benefit plan of Macy s or any entity controlled by Macy s discloses that it beneficially owns securities, whether more than 25% or otherwise.

Good reason under the CIC Agreements means:

the failure to elect or reelect the executive in the office or the position, or a substantially equivalent office or position, of or with Macy s which the executive held immediately prior to the change in control; or

a significant adverse change in the nature or scope of the authorities, powers, functions, responsibilities or duties attached to the position which the executive held immediately prior to the change in control; or

a reduction in the aggregate amount of the executive s combined base pay and incentive pay receivable from the Company, taken as a whole; or

the termination or denial of the executive s rights to employee benefits or a reduction in the scope or value thereof (except for any such termination or denial or reduction in the scope or value of any employee benefits applicable generally to all recipients of or participants in such employee benefits); or

a determination by the executive (which determination will be conclusive and binding upon the parties, provided it has been made in good faith and in all events will be presumed to have been made in good faith unless otherwise shown by Macy s by clear and convincing evidence) that a change in circumstances has occurred following a change-in-control, including without limitation a change in the scope of the business or other activities for which the executive was responsible immediately prior to the change in control, which has rendered the executive substantially unable to carry out, has substantially hindered the executive s performance of, or has caused the executive to suffer a substantial reduction in, any of the authorities, powers, functions, responsibilities, or duties attached to the position held by the executive immediately prior to the change in control, which situation is not remedied within 10 calendar days after written notice to the company from the executive; or

the liquidation, dissolution, merger, consolidation or reorganization of Macy s or transfer of all or substantially all of its business and/or assets, unless the successor shall have assumed all duties and obligations of Macy s under the CIC Agreement; or

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- Macy s requires the executive to change the executive s principal location of work to any location which is in excess of 25 miles from the location thereof immediately prior to the change in control or requires the executive to travel away from the executive s office in the course of discharging the executive s responsibilities or duties at least 20% more than was required in any of the three full calendar years immediately prior to the change in control; or

- any material breach of the CIC Agreement by Macy s.

The cash severance benefit payable under the CIC Agreements would be reduced by all amounts actually paid by Macy s to the executive pursuant to any other employment or severance agreement or plan to which the executive and Macy s are parties or in which the executive is a participant. In addition, the severance benefits under the CIC Agreements are subject to reduction in certain circumstances if the excise tax imposed under 280G of the Internal Revenue Code would reduce the net after-tax amount received by the executive.

The following tables summarize the amounts payable to the Named Executives upon termination under certain circumstances, assuming that:

- the executive s employment terminated January 31, 2009;

- the executive s salary continues as it existed on January 31, 2009;

- the executive s employment contract and term as of January 31, 2009 applies; and

- the stock price for Macy s common stock is $8.95 per share (the closing price as of the last business day of fiscal 2008).

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Payments and Benefits upon Termination as of the end of Fiscal 2008 ($)

T. Lundgren	Voluntary	Involuntary Without Cause	Involuntary With Cause	After Change in Control	Death	Disability
Severance and accelerated benefits						
Salary and target bonus (to the end of contract term)	0	7,818,750	0	0	0	0
Cash severance benefit (3 x salary plus bonus calculated per the CIC Agreement)	0	0	0	12,614,400	0	0
Non-equity based incentive awards (2008 bonus)	0	900,000	0	900,000	900,000	900,000
Equity Based incentive awards						
a. Vesting of unvested stock options(a)	0	0	0	0	0	0
b. Vesting of time-based restricted stock	0	671,250	0	671,250	671,250	671,250
c. Vesting of unvested stock credits	0	2,496,856	0	4,234,271	759,442	759,442
Cash balance pension lump sum equivalent	0	0	0	85,511	0	0
401(k) plan equivalent	0	0	0	18,000	0	0
Supplementary retirement plan lump sum equivalent	0	0	0	3,957,204	0	0
Other fringe benefits(b)	0	(b)	0	1,211,130	0	0
Total of severance and accelerated benefits:	0	11,886,856	0	23,691,766	2,330,692	2,330,692
Previously vested equity and benefits						
Equity Based incentive awards						
a. Previously vested stock options(a)	0	0	0	0	0	0
b. Previously vested stock credits	2,152,741	2,152,741	575,436	2,152,741	2,152,741	2,152,741
Vested cash balance pension benefit	144,762	144,762	144,762	144,762	144,762	144,762
Vested 401(k) plan balance	167,149	167,149	167,149	167,149	167,149	167,149
Vested supplementary retirement plan benefit	7,034,346	7,034,346	7,034,346	7,034,346	7,034,346	7,034,346
Other fringe benefits	200,000	200,000	0	200,000	0	200,000
Deferred compensation balance previously vested	0	0	0	0	0	0
Total of previously vested equity and benefits:	9,698,998	9,698,998	7,921,693	9,698,998	9,498,998	9,698,998
Full Walk-Away Value:	9,698,988	21,585,854	7,921,693	33,390,764	11,829,690	12,029,690

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K. Hoguet	Voluntary	Involuntary Without Cause		Involuntary With Cause	After Change in Control	Death	Disability
Severance and accelerated benefits							
John H. Howland (6) Former President & Chief Operating Officer of the Company and the Bank	2011	$ 67,692	$ —	$ —	$ —	$188 (4)	$67,880

(1) Mr. Greco was hired as CEO of the Company, the Bank and SCB on October 24, 2011. Mr. Greco, who has served as a Class II Director of the Company, the Bank and SCB since November 15, 2011, does not receive any additional compensation for his services as a director of the Company, the Bank and SCB.

(2) Represents the dollar value of the use of an automobile provided by the Bank and the dollar value of group term life insurance premiums paid by the Bank.

(3) Mr. Pallan was promoted to President of the Company and the Bank effective April 2011 and Senior Loan Officer of the Bank effective September 2012. Prior to his promotion to Senior Loan Officer of the Bank, Mr. Pallan had served as Chief Credit Officer of the Bank.

(4) Represents the dollar value of group term life insurance premiums paid by the Bank.

(5) Includes the dollar value of 1,000 shares of common stock held by Stephen V. Ciancarelli which vested on May 5, 2011. The market price of the common stock on May 5, 2011 was $4.15.

(6) Mr. Howland resigned as President and COO of the Company and the Bank effective April 2011.

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Employment Agreements

From October 24, 2011 to February 28, 2012, Joseph J. Greco served as Chief Executive Officer without an employment agreement at an annual base salary of $245,000. He was also entitled to the use of a vehicle owned by the Bank and other customary benefits associated with the hiring of employees by the Bank. Following regulatory approval of his proposed employment agreement, the Company and the Bank entered into an employment agreement with Joseph J. Greco effective as of February 28, 2012. The Company and Mr. Greco also entered into a restricted stock agreement dated as of February 28, 2012.

Under the employment agreement, Mr. Greco will serve as Chief Executive Officer of the Company and the Bank from the date of the employment agreement through December 31, 2014, unless the Company and the Bank terminate the employment agreement earlier under the terms of the employment agreement. Mr. Greco will also serve as a director of the Company and the Bank.

Mr. Greco will earn an annual base salary of $245,000 over the term of the employment agreement and be entitled to receipt of incentive compensation at the end of each calendar year during the term in an amount up to 10% of his base salary for achieving individual or corporate goals established by the Board of Directors of the Company or the Bank. In addition, Mr. Greco has been granted 112,371 shares of restricted common stock of the Company pursuant to the restricted stock agreement. Under the restricted stock agreement, the 112,371 shares of restricted common stock vests as follows: 37,457 shares as of the date of the restricted stock agreement, 37,457 shares as of July 2, 2012 and 37,457 shares as of January 2, 2013.

During the term, Mr. Greco will be entitled to benefits including, but not limited to, comprehensive health insurance and major medical and dental coverage, participation in any long-term disability insurance plan and pension plan maintained by the Company or the Bank, supplemental disability insurance such that the monthly disability benefit payable to Mr. Greco is equal to 70% of his monthly base salary, use of a Bank-owned vehicle with a purchase price of up to $40,000, and term life insurance in an amount not less than $300,000.

If Mr. Greco is terminated for “Cause” or voluntarily terminates his employment other than for “Good Reason,” he will only be entitled to base salary accrued through the date of his termination. If Mr. Greco’s employment is terminated by reason of “Disability,” he will receive disability benefits under any long-term disability plan maintained by the Company or the Bank. In the event of Mr. Greco’s death, his beneficiary(ies) or estate will be paid Mr. Greco’s base salary for a period of six months following his death. If Mr. Greco is terminated for any reason other than for “Cause” or “Disability” or if Mr. Greco voluntarily terminates his employment for “Good Reason,” then he will be entitled to receive (i) twelve months of base salary and (ii) his individual and/or family health benefits coverage for a period of twelve months following his termination (or such other period prescribed by the then applicable COBRA law), with Mr. Greco paying the same portion of the cost of such coverage as existed at the time of termination; provided, however, that no payments will be made to Mr. Greco if such payments would constitute a “golden parachute payment” and is made after the occurrence of certain events specified under regulations promulgated by the Federal Deposit Insurance Corporation (the “FDIC”), including the determination by the FDIC that the Bank is in “troubled condition.” Any lump sum payment made to Mr. Greco is also subject to claw back by the Company and the Bank if it is later determined he committed or is substantially responsible for certain acts or omissions prohibited under regulations promulgated by the FDIC.

Effective as of January 1, 2011, the Company and the Bank entered into an employment agreement with Mr. Pallan to serve as Senior Vice President and Chief Credit Officer of the Bank through December 31, 2012, unless the Bank terminates the employment agreement earlier under the terms of the employment agreement. Mr. Pallan was subsequently promoted to President of the Company and the Bank in April 2011, while maintaining his position as Chief Credit Officer. The annual base salary payable under the employment agreement was increased from $140,000 to $175,000 when Mr. Pallan was promoted to President of the Company and the Bank. All other terms and conditions of Mr. Pallan’s employment agreement remained unchanged. In addition to base salary, Mr. Pallan will be eligible for salary increases and other merit bonuses at the discretion of the Company’s Board of Directors.

Mr. Pallan will be provided with health and life insurance comparable to coverage provided to other officers of the Bank, will be reimbursed for certain business expenses, and will be eligible to participate in the profit sharing or 401(k) plan of the Company (or its subsidiaries).

If Mr. Pallan's employment is terminated as a result of a "Business Combination" (as such term is defined in the employment agreement), Mr. Pallan will, subject to certain conditions, be entitled to receive a lump sum payment in an amount equal to two times the total of his then current base annual salary plus the amount of any bonus for the prior calendar year in the event that (i) Mr. Pallan is not offered a position with the remaining entity at his then current base annual salary (subject to the remaining entity having a reasonable opportunity to remedy the situation), (ii) Mr. Pallan determines in his sole discretion that the position offered by the remaining entity is inconsistent with his current position (subject to the remaining entity having a reasonable opportunity to remedy the situation), (iii) Mr. Pallan's office is relocated more than 25 miles from its location as of the date of the employment agreement or (iv) Mr. Pallan is terminated (other than for certain specified events that constitute cause or as the result of his death or disability) or his office is relocated, within two years following a "Business Combination." In any such event, Mr. Pallan will also be entitled to (a) an acceleration of vesting of all stock options and restricted stock previously granted to him and (b) a continuation of benefits under the employment agreement for the balance of the unexpired term of his employment, which will be paid at his option as a lump sum payment or ratably over the balance of the unexpired term.

On January 29, 2013, the Company and the Bank entered into an employment agreement with Mr. Pallan effective January 1, 2013.

Under the employment agreement, Mr. Pallan will serve as President of the Company and the Bank and Senior Loan Officer of the Bank for the period from January 1, 2013 to December 31, 2013, unless the employment agreement is terminated earlier in accordance with its terms. Mr. Pallan will be paid a base salary at the annual rate of $175,000 and be eligible for salary increases and bonuses reflecting job performance achievements at the discretion of the Board of Directors of the Company and the Bank. In addition, he will be provided with group life insurance and comprehensive health insurance, including major medical coverage, comparable to the coverage provided to officers generally. Mr. Pallan will also be eligible to participate in any profit sharing plan or 401(k) plan in accordance with their terms.

The employment agreement may be terminated prior to December 31, 2013 as a result of Mr. Pallan engaging in certain specified acts that constitute cause or the death or disability of Mr. Pallan. In addition, in the event (i) the Company and the Bank enter into a “Business Combination” as defined in the employment agreement and (ii) Mr. Pallan (a) is not offered the same position at his current base salary with the surviving entity, (b) determines in his sole discretion that the position offered by the surviving entity is inconsistent with his current position, including diminution in title, authority, duties or responsibilities, (c) has his office relocated more than 25 miles from its current location or (d) is terminated within 2 years following the “Business Combination,” Mr. Pallan will be entitled to receipt of a lump sum payment equal to his then current base salary; provided, however, that no payment will be made to Mr. Pallan if such payment would constitute a “golden parachute payment” and is made after the occurrence of certain events specified under regulations promulgated by the FDIC, including the determination by the FDIC that the Bank is in “troubled condition.” Any lump sum payment made to Mr. Pallan is also subject to claw back by the Company and the Bank if it is later determined that he committed or is substantially responsible for certain acts or omissions prohibited under regulations promulgated by the FDIC.

On December 17, 2010, the Company and its subsidiary, the Bank, entered into an employment agreement with Stephen V. Ciancarelli effective January 1, 2011. Under the employment agreement, Mr. Ciancarelli will serve as the Senior Vice President and Chief Financial Officer of the Company through December 31, 2012, unless the Company terminates the employment agreement pursuant to the terms thereof. Mr. Ciancarelli will receive an annual base salary of $165,000 from January 1, 2011 to December 31, 2012. Mr. Ciancarelli will be eligible for salary increases and other merit bonuses at the discretion of the Company’s Board of Directors.

Mr. Ciancarelli will be provided with health and life insurance, will be reimbursed for certain business expenses, and will be eligible to participate in the profit sharing or 401(k) plan of the Company (or its subsidiaries).

If Mr. Ciancarelli's employment is terminated as a result of a "Business Combination" (as such term is defined in the employment agreement), Mr. Ciancarelli will, subject to certain conditions, be entitled to receive a lump sum payment in an amount equal to two times the total of his then current base annual salary plus the amount of any bonus for the prior calendar year in the event that (i) Mr. Ciancarelli is not offered a position with the remaining entity at his then current base annual salary (subject to the remaining entity having a reasonable opportunity to remedy the situation), (ii) Mr. Ciancarelli determines in his sole discretion that the position offered by the remaining entity is inconsistent with his current position (subject to the remaining entity having a reasonable opportunity to remedy the situation), (iii) Mr. Ciancarelli's office is relocated more than 25 miles from its location as of the date of the employment agreement or (iv) Mr. Ciancarelli is terminated (other than for certain specified events that constitute cause or as the result of his death or disability) or his office is relocated, within two years following a "Business Combination". In either such event, Mr. Ciancarelli will also be entitled to (a) an acceleration of vesting of all stock options and restricted stock previously granted to him and (b) a continuation of benefits under the employment agreement for the balance of the unexpired term of his employment, which will be paid at his option as a lump sum payment or ratably over the balance of the unexpired term.

On January 29, 2013, the Company and the Bank entered into an employment agreement with Mr. Ciancarelli effective January 1, 2013.

Under the employment agreement, Mr. Ciancarelli will serve as Senior Vice President and Chief Financial Officer of the Company and the Bank for the period from January 1, 2013 to December 31, 2013, unless the employment agreement is terminated earlier in accordance with its terms. Mr. Ciancarelli will be paid a base salary at the annual rate of $165,000 and be eligible for salary increases and bonuses reflecting job performance achievements at the discretion of the Board of Directors of the Company and the Bank. In addition, Mr. Ciancarelli will be provided with group life insurance and comprehensive health insurance, including major medical coverage, comparable to the coverage provided to officers generally. He will also be eligible to participate in any profit sharing plan or 401(k) plan in accordance with their terms.

The employment agreement may be terminated prior to December 31, 2013 as a result of Mr. Ciancarelli engaging in certain specified acts that constitute cause or the death or disability of Mr. Ciancarelli. In addition, in the event (i) the Company and the Bank enter into a “Business Combination” as defined in the employment agreement and (ii) Mr. Ciancarelli (a) is not offered the same position at his current base salary with the surviving entity, (b) determines in his sole discretion that the position offered by the surviving entity is inconsistent with his current position, including diminution in title, authority, duties or responsibilities, (c) has his office relocated more than 25 miles from its current location or (d) is terminated within 2 years following the “Business Combination,” Mr. Ciancarelli will be entitled to receipt of a lump sum payment equal to his then current base salary; provided, however, that no payment will be made to him if such payment would constitute a “golden parachute payment” and is made after the occurrence of certain events specified under regulations promulgated by the FDIC, including the determination by the FDIC that the Bank is in “troubled condition.” Any lump sum payment made to Mr. Ciancarelli is also subject to claw back by the Company and the Bank if it is later determined that he committed or is substantially responsible for certain acts or omissions prohibited under regulations promulgated by the FDIC.

On December 17, 2010, the Company and the Bank entered into an employment agreement with John H. Howland effective January 1, 2011. Under the employment agreement, Mr. Howland served as the President and Chief Operating Officer of the Company through the date of his resignation from the Company and the Bank in April 2011. Mr. Howland was to receive an annual base salary of $200,000 from January 1, 2011 to December 31, 2012. Mr. Howland was eligible for salary increases and other merit bonuses at the discretion of the Company’s Board of Directors. In addition, he was provided with health and life insurance, was reimbursed for certain business expenses, and was eligible to participate in the profit sharing or 401(k) plan of the Company (or its subsidiaries).

DIRECTOR COMPENSATION

The following is the directors' compensation table for the year ended December 31, 2012.

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($)	Option Awards ($)	All Other Compensation ($)	Total ($)
Carl R. Borrelli (1)	$ 30,100	$ —	$ —	$ —	$ 30,100
James S. Brownstein, Esq.	23,100	—	—	—	23,100
Elmer F. Laydon (2)	16,200	—	—	—	16,200
Alfred J. Ranieri, Jr., M.D.	22,650	—	—	—	22,650
Joshua H. Sandman, Ph.D.	20,700	—	—	—	20,700
Alphonse F. Spadaro, Jr.	38,600	—	—	—	38,600
Janette J. Parker	17,400	—	—	—	17,400

(1) Carl R. Borelli served as Vice Chairman of the Board and a director of the Company, the Bank and SCB until his death on December 13, 2012.

(2) Elmer F. Laydon retired as Chairman of the Board and as a director of the Company, the Bank and SCB on March 20, 2012.

During 2012, directors of the Company and the Bank, who are not employees of the Company or the Bank, receive compensation in cash as follows: the Chairman and Vice Chairman of the Board receive $600 and $400 per month, respectively; each director receive $300 for each board meeting attended, $400 for each board committee meeting chaired, $300 for each board committee meeting attended and $300 for each executive committee meeting attended. Directors who sit on the Company and Bank boards are compensated for only one meeting where a meeting of both boards or more than one committee is held jointly. Directors of SCB, who are not employees of the Company, SCB or the Bank, receive no compensation for the SCB board or SCB board committee meetings attended. Each Bank director received an annual stipend of $7,500 for 2012.

Effective January 1, 2013, each Bank director received an annual stipend of $12,500 in 2013.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END TABLE

The following table sets forth information concerning outstanding restricted stock and stock options as of December 31, 2012 held by the named executive officers.

	Option Awards			Stock Awards	
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock that have not Vested (#)	Market Value of Shares or Units of Stock that have not Vested ($)
Joseph J. Greco	—	$ —	—	37,457	$ 58,058
Sunil Pallan	500	$ 7.08	12/31/2015	—	$ —

As of December 31, 2012, non-employee directors have the following outstanding stock option awards:

Name	Option Awards (#)
Alfred J. Ranieri, Jr., M.D.	18,538
Joshua H. Sandman, Ph.D.	14,938
Alphonse F. Spadaro, Jr.	14,203
Janette J. Parker	7,054

Elmer F. Laydon retired as Chairman of the Board and as a director of the Company, the Bank and SCB on March 20, 2012. Mr. Laydon has 47,345 outstanding stock options that vested while he served as the Chairman of the Board and as director of the Company and the Bank.

Carl R. Borelli served as Vice Chairman of the Board and a director of the Company, the Bank and SCB until his death on December 13, 2012. Mr. Borelli’s estate is entitled to 21,276 outstanding stock options that vested while Mr. Borelli served as the Vice Chairman of the Board and as director of the Company and the Bank.

The Company maintains directors’ and officers’ liability insurance and the Company’s by-laws provide for mandatory indemnification of directors and officers to the fullest extent permitted by Connecticut law. In addition, the Company’s certificate of incorporation limits the liability of directors to the Company or its shareholders for breaches of directors’ fiduciary duties to the fullest extent permitted by Connecticut law.

The 2005 Stock Option and Award Plan

The Company adopted the Southern Connecticut Bancorp, Inc. 2005 Stock Option and Award Plan (the "2005 Stock Plan"). The purpose of the 2005 Stock Plan is to provide equity-based incentives to employees, officers and directors of the Company in order to attract them to, give them a proprietary interest in, and encourage them to remain in the employ or service of the Company. An aggregate of 150,000 shares of the Company's Common Stock is reserved for issuance upon the exercise of both incentive stock options and nonqualified stock options granted by the Company under the 2005 Stock Plan. All eligible employees and directors of the Company or any subsidiary of the Company, including the Bank, are eligible to receive options under the 2005 Stock Plan. The exercise price for each share for an incentive stock option may not be less than the fair market value of a share of the Company's Common Stock on the date of grant. Although the Plan does not prescribe a minimum option price for non-qualified stock options, it is the current intention of the Compensation Committee to grant non-qualified stock options at or above fair market value of a share of the Company's Common Stock on the date of grant. Options under the 2005 Stock Plan have a term of 10 years unless otherwise determined at the time of grant. As of December 31, 2012 there were 4,820 outstanding options under the 2005 Stock Plan.

The Compensation Committee has broad authority under the 2005 Stock Plan with respect to awards granted under the 2005 Stock Plan, including, without limitation, the authority to:

- authorize the granting of shares of common stock or options under the 2005 Stock Plan;
- determine and designate the employees and directors of the Company to receive awards under the 2005 Stock Plan;
- determine the type, number, price, vesting requirements and other features and conditions of individual stock awards and options under the 2005 Stock Plan; and
- interpret the 2005 Stock Plan and the various written agreements made in connection with grants of shares of common stock or options thereunder.

The 2002 Stock Option Plan

The Company adopted the Southern Connecticut Bancorp, Inc. 2002 Stock Option Plan (the "2002 Plan"). The purpose of the 2002 Plan is to attract and retain the continued services of employees and directors of the Company and the Bank, encourage employees and directors to obtain or increase their stock ownership in the Company, and provide incentive compensation programs competitive with those of other similarly situated companies. An aggregate of 383,250 shares of the Company's Common Stock were reserved for issuance upon the exercise of both incentive stock options and nonqualified stock options granted by the Company under the 2002 Plan, which number has been adjusted to reflect a 10% stock dividend declared in January 2004 and a 5% stock dividend declared in April 2005. All eligible employees and directors of the Company or any subsidiary of the Company, including the Bank, are eligible to receive options under the 2002 Plan. The exercise price for each share covered by an option may not be less than the fair market value of a share of the Company's Common Stock on the date of grant. Options under the 2002 Plan have a term of 10 years unless otherwise determined at the time of grant. On December 22, 2005, the Compensation Committee of the Board of Directors approved the acceleration of all unvested options outstanding as of December 31, 2005 that were granted under the 2002 Plan. Pursuant to this acceleration of all unvested options, options to purchase 197,571 shares of the Company's Common Stock became immediately exercisable as of December 31, 2005. As of December 31, 2012, there were 145,072 outstanding options under the 2002 Plan. The 2002 Plan expired on May 14, 2012.

The 2001 Stock Option Plan

The Company adopted the Southern Connecticut Bancorp, Inc. 2001 Stock Option Plan (the "2001 Option Plan") in 2001 and it was approved by the sole shareholder of the Company in 2001. Under the 2001 Option Plan, an aggregate of 90,000 shares of the Company's Common Stock was reserved for issuance upon the exercise of options granted under the 2001 Option Plan. The Compensation Committee of the Board administers the 2001 Option Plan. The Board voted to terminate the 2001 Option Plan, except for outstanding options previously granted under the 2001 Option Plan, effective as of May 15, 2002. As of December 31, 2012, there were no outstanding options under the 2001 Option Plan.

Warrant Plan

The Company adopted a 2001 Warrant Plan and 2001 Supplemental Warrant Plan (collectively, the “Warrant Plans”) on April 11, 2001 and October 16, 2001. Under the Warrant Plans, each non-employee director of the Company and each director of the Bank who was not a director of the Company, as of the initial public offering of the Company in July 2001, received a warrant to purchase one share of the Company’s Common Stock for each four shares purchased in the offering by such director or members of such director’s immediate family. Under the 2001 Supplemental Warrant Plan, certain organizers of the Company who are not directors, officers or employees of the Company or the Bank but who made contributions to the Company or the Bank received a warrant to purchase one share of the Company’s Common Stock for each five shares purchased in the offering by such person or member of such person’s immediate family. The warrants have a term of ten years. The exercise price of the warrants is $10.39, the price at which the Company’s Common Stock was sold in the initial public offering, as adjusted for the January 2004 10% stock dividend and the April 2005 5% stock dividend. They became exercisable as to 40%, 30% and 30% of the shares covered thereby on the first, second and third anniversary of the closing of the initial public offering of the Company, respectively. All warrants issued under the Warrant Plans expired in November 2011.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Equity Compensation Plan Information. The following schedule provides information with respect to the compensation plans (including individual compensation arrangements) under which equity securities of the Company are authorized for issuance as of December 31, 2012:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available forfuture issuance under equity compensation plans (excluding securities reflected in column (a))
Equity Compensation Plans approved by security holders	145,072	$ 7.62	48,209
Equity Compensation Plan not approved by security holders (1)	—	—	—
Total	145,072	$ 7.62	48,209

(1) The Company adopted a 2001 Warrant Plan and 2001 Supplemental Warrant Plan (collectively, the “Warrant Plans”) on April 11, 2001 and October 16, 2001, respectively. The Warrant Plans were not approved by security holders. Under the Warrant Plans, each director of the Company, other than Mr. Joseph V. Ciaburri (who served as the Chairman of the board of directors of the Company at the time), and each director of the Bank who is not a director of the Company, as of the initial public offering of the Company in July 2001, received a warrant to purchase one share of the Company common stock for each four shares purchased in the offering by such director or members of such director’s immediate family. Under the 2001 Supplemental Warrant Plan, certain organizers of the Company who are not directors, officers or employees of the Company or the Bank but who made contributions to the Company’s

enterprise received a warrant to purchase one share of the Company common stock for each five shares purchased in the offering by such person or member of such person's immediate family. The warrants have a term of ten years. The exercise price of the warrants is $10.39, the price at which the Company's common stock was sold in the initial public offering, as adjusted for subsequent stock dividends. All warrants issued under the Warrant Plans expired in November 2011.

Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information concerning the ownership of the Company's Common Stock as of March 15, 2013 by the Company's directors and named executive officers. Except as otherwise indicated, all shares are owned directly, and the named person possesses sole voting and sole investment power with respect to all such shares. No shares are pledged as collateral. Shares not outstanding but deemed beneficially owned because a person or member of a group has a right to acquire them within 60 days after March 15, 2013 are treated as outstanding only when determining the amount and percent owned by such person or group.

Name and Address of Beneficial Owner the Company Incumbent Directors	Amount and Nature of Beneficial Ownership		Percent of Class (1)	
Class I				
Alphonse F. Spadaro, Jr., Chairman of the Company, the Bank and SCB	33,203	(2)	1.18	%
Managing Principal				
Levitsky & Berney, PC				
100 Bradley Road				
Woodbridge, CT 06525				
Joshua H. Sandman, Ph.D., Director of the Company and the Bank	27,034	(3)	0.96	%
Vice President				
Deitsch Plastic Co., Inc.				
14 Farwell Street				
West Haven, CT 06516				
Class II				
James S. Browstein, Esq., Director of the Company, the Bank and SCB	8,715	(4)	*	
Law Offices of James S. Brownstein, LLC				
One Bradley Road, Suite 305				
Woodbridge, CT 06525				
Joseph J. Greco	112,371		4.00	%
Director and Chief Executive Officer of the Company, the Bank and SCB				
215 Church Street				
New Haven, CT 06510				

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Class III				
Alfred J. Ranieri, Jr., M.D., Vice Chairman of the Company and the Bank	58,583	(5)	2.08	%
1455 Chapel Street				
New Haven, CT 06511				
Janette J. Parker, Director of the Company and the Bank	8,352	(6)	*	
215 Church Street				
New Haven, CT 06510				
Non-Director Executive Officers of the Company and the Bank				
Sunil Pallan	500	(7)	*	
Director of Bank, President of the Company and the Bank and Senior Loan Officer of the Bank				
215 Church Street				
New Haven, CT 06510				
Stephen V. Ciancarelli	5,000		*	
Senior Vice President and Chief Financial Officer of the Company, the Bank and SCB				
215 Church Street				
New Haven, CT 06510				
All the Company directors, director nominees and the executive officers, as a group (8 persons)	253,758	(8)	9.03	%

* Less than 1%

(1) Percentages are based on a total of 2,810,273 shares of Common Stock outstanding on March 15, 2013. For holders of options and warrants exercisable within 60 days after March 15, 2013, the number of shares so exercisable by such holder has been added to the denominator for purposes of calculating such holder's percentage ownership.

(2) Includes 14,203 shares that may be acquired within 60 days by the exercise of options.

(3) Includes an aggregate of 7,823 shares of stock held by Mr. Sandman’s children, as well as 4,273 shares of stock held by the Sandman Family Trust, LLC, of which Mr. Sandman and his spouse are principals. Also includes 14,938 shares that may be acquired within 60 days by the exercise of options.

(4) Includes 1,207 shares of stock held in trust by Mr. Brownstein’s spouse for the benefit of his son.

(5) Includes 18,538 shares that may be acquired within 60 days by the exercise of options.

(6) Includes 7,054 shares that may be acquired within 60 days by the exercise of options.

(7) Represents 500 shares of stock that may be acquired within 60 days by the exercise of options.

(8) Includes 55,233 shares that may be acquired within 60 days by the exercise of options.

The following table sets forth certain information concerning those persons known to the Company who own more than five percent of the Company's Common Stock as of March 15, 2013.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class (1)
Gardner Lewis Asset Management, L.P. 285 Wilmington West Chester Pike Chadds Ford, PA 19317	286,741 (2)	10.20 %
DellaCamera Capital Master Fund, Ltd. 200 Park Avenue, Suite 3300 New York, NY 10166	259,400 (3)	9.23 %
Wellington Management Company, LLP 280 Congress Street Boston, MA 02210	231,725 (4)	8.25 %
Elmer F. Laydon President Elmer F. Laydon Construction Corp. 69 Wheeler Street New Haven, CT 06512	177,326 (5)	6.31 %
Rangeley Capital, LLC 3 Forest Street New Canaan, CT 06840	161,987 (6)	5.76 %

(1) Percent of class beneficially owned is based on an aggregate of 2,810,273 shares of the Company's Common Stock outstanding as of March 15, 2013. If a shareholder owns options and warrants exercisable within 60 days after March 15, 2013, the number of shares so exercisable by such shareholder has been added to the denominator for purposes of calculating such shareholder's percentage ownership.

(2) Information with respect to Gardner Lewis Asset Management, L.P. is derived from the Schedule 13G filed with the SEC on February 8, 2013 by Gardner Lewis Asset Management, L.P. ("Gardner Lewis"). All 286,741 of the reported shares were owned directly by Gardner Lewis, which has the sole power to vote, and to direct the vote, and sole power to dispose, and to direct the disposition of, such shares.

(3) Information with respect to DellaCamera Capital Master Fund, Ltd. is derived from the Schedule 13D/A filed with the SEC on June 27, 2007 by DellaCamera Capital Master Fund, Ltd. (the "Master Fund"), DellaCamera Capital Fund, Ltd. (the "Offshore Fund"), DellaCamera Capital Management, LLC ("DCM"), Ralph DellaCamera, Jr., Andrew Kurtz and Vincent Spinnato. The Master Fund is the direct owner of the 259,400 shares of the Company's Common Stock. The Offshore Fund is the controlling shareholder of the Master Fund. The Master Fund, the Offshore Fund, DCM, Ralph DellaCamera, Jr., Andrew Kurtz and Vincent Spinnato have shared power to vote, and to direct the vote, and shared power to dispose, and to direct the disposition of, the 259,400 shares of the Company's Common Stock held by the Master Fund.

(4) Information with respect to Wellington Management Company, LLP is derived from the Schedule 13G/A filed with the SEC on February 14, 2013 by Wellington Management Company, LLP ("Wellington"). Wellington, in its capacity as investment adviser, may be deemed to beneficially own 231,725 shares of the Company which are held of record by clients of Wellington. These clients have the right to receive, or the power to direct the receipt of, dividends from, or the proceeds from the sale of, such securities. No such client is known to have such right or power with respect to more than five percent of the Company's Common Stock. Wellington has shared voting power over 231,725 shares.

(5) Information with respect to Elmer Laydon is derived from the Schedule 13D filed with the SEC on April 19, 2012 by Elmer Laydon. Mr. Laydon was a director of the Board for the Company since 2000 and served as Chairman of the Board for the Company, the Bank and SCB from July 1, 2007 until his retirement on March 20, 2012. Mr. Laydon is the direct owner of 129,981 shares of the Company and 47,345 shares that may be acquired within 60 days by the exercise of options. Mr. Laydon has sole power to vote and dispose the 129,981 shares of the Company and 47,345 shares that may be acquired within 60 days by the exercise of options.

(6) Information with respect to Rangeley Capital, LLC is derived from the Schedule 13G filed with the SEC on January 11, 2013 by Rangeley Capital, LLC ("Rangeley Capital"), Rangeley Capital Partners, LP ("Rangeley Capital Partners") and Christopher DeMuth, Jr. All 161,987 of the reported shares are beneficially owned by Rangeley Capital, Rangeley Capital Partners and Christopher DeMuth, Jr., who have shared power to vote, and to direct the vote, and shared power to dispose, and to direct the disposition of, such shares.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

Certain Relationships and Related Transactions

In the normal course of business, the Bank and SCB may grant loans to executive officers, directors, and members of their immediate families and to entities in which these individuals have more than ten percent (10%) equity ownership. As of December 31, 2012, the total amount of loans outstanding to officers and directors was $1,092,277 In the opinion of the Board of Directors, all such loans were made in the ordinary course of business of the Bank and SCB on substantially the same terms, including interest rates and collateral requirements, as those then prevailing for comparable transactions with other persons not related to the Bank and SCB and do not involve more than the normal risk of collectability or present other unfavorable features. The Bank has in place policies and procedures for identifying and handling transactions with related persons.

Information regarding transactions involving related persons is assessed by independent directors of the entity considering the loan. Related persons include directors and executive officers as well as immediate family members of directors and officers. If the independent directors approve or ratify a material transaction involving a related person, then the transaction would be disclosed in accordance with the SEC rules. If the related person is a director, or a family member of a director, then that director would not participate in those discussions.

Director Independence

All of our non-employee directors except Mr. James S. Brownstein are “independent directors” as defined in Section 803A of the NYSE MKT Company Guide.

Family Relationships

There are no family relationships among members of the Board of Directors of the Company and the executive officers of the Company, the Bank or SCB.

Item 14. Principal Accountant Fees and Services.

McGladrey LLP provides audit, audit-related and tax advisory and tax return preparation services for the Company and The Bank of Southern Connecticut. The following table summarizes the fees for services provided in 2012 and 2011, respectively:

	2012	2011
Audit fees	$175,451	$167,849
Tax fees	12,665	12,150

Audit fees consist of fees for professional services rendered for the audit of the consolidated financial statements, review of consolidated financial statements included in quarterly reports on Form 10-Q and annual reports on Form 10-K, and services connected with statutory and regulatory filings or engagements. Tax service fees consist of fees for tax return preparation for the Company. There were no audit related fees or other fees for either period.

The audit committee of the Company's Board of Directors has established policies and procedures for the engagement of the independent registered public accounting firm to provide non-audit services, including a requirement for approval in advance of all non-audit services to be provided by the independent auditor. To ensure that this does not restrict access to the independent registered public accounting firm by management on matters where the advice and consultation of the independent registered public accounting firm is sought by management and such advice or consultation, in the opinion of management, cannot practically be delayed pending pre-approval by the audit committee, the committee authorizes management to use their judgment and retain the independent auditor for such matters and consider such services to be pre-approved provided the estimated cost of such services does not exceed 5% of the annual fees paid to the independent registered public accounting firm and such services are formally approved by the audit committee at its next meeting.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) Financial Statements and Schedules:

The following Financial Statements and Supplementary Data are filed as part of this annual report:

Report of Independent Registered Public Accounting Firm
Consolidated Balance Sheets
Consolidated Statements of Operations
Consolidated Statements of Comprehensive Loss
Consolidated Statements of Shareholders' Equity
Consolidated Statements of Cash Flows
Notes to Consolidated Financial Statements

All financial statement schedules are omitted because they are either inapplicable or not required, or because the required information is included in the Consolidated Financial Statements or notes thereto.

(b) Exhibits (numbered in accordance with Item 601 of Regulation S-K):

Exhibit No.	Description
2.1	Agreement and Plan of Merger, dated as of January 16, 2013, by and among Liberty Bank and Southern Connecticut Bancorp, Inc. and The Bank of Southern Connecticut (incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on January 16, 2013)
3(i)	Amended and Restated Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3(i) to the Registrant's Quarterly Report on Form 10-QSB filed on August 14, 2002)
3(ii)	By-Laws of the Registrant (incorporated by reference to Exhibit 3(ii) to the Registrant's Current Report on Form 8-K filed on March 6, 2007)
10.1	Lease, dated as of August 17, 2000, between 215 Church Street, LLC and the Registrant (incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form SB-2 filed on April 30, 2001)
10.2	Letter agreement dated January 3, 2001 amending the Lease between 215 Church Street, LLC and the Registrant (incorporated by reference to Exhibit 10.2 to the Registrant's Registration Statement on Form SB-2 filed on April 30, 2001)
10.3	First Amendment to Lease dated March 30, 2001 between 215 Church Street, LLC and the Registrant (incorporated by reference to Exhibit 10.3 to the Registrant's Registration Statement on Form SB-2 filed on April 30, 2001)

10.4	Second Amendment to Lease dated March 31, 2001 between 215 Church Street, LLC and the Registrant (incorporated by reference to Exhibit 10.4 to the Registrant's Registration Statement Form SB-2 filed on April 30, 2001)
10.5	Assignment of Lease dated April 11, 2001 between the Registrant and The Bank of Southern Connecticut (incorporated by reference to Exhibit 10.5 to the Registrant's Registration Statement on Form SB-2 filed on April 30, 2001)
10.6	Lease dated August 2, 2002 between 469 West Main Street LLC and The Bank of Southern Connecticut (incorporated by reference to Exhibit 10.17 to the Registrant's Annual Report on Form 10-KSB filed on March 30, 2004)
10.7	Registrant's 2001 Stock Option Plan (incorporated by reference to Exhibit 10.8 to the Registrant's Registration Statement on Form SB-2 filed on April 30, 2001) #
10.8	Registrant's 2001 Warrant Plan (incorporated by reference to Exhibit 10.9 to the Registrant's Registration Statement on Form SB-2 filed on April 30, 2001) #
10.9	Registrant's 2001 Supplemental Warrant Plan (incorporated by reference to Exhibit 10.12 to the Registrant's Annual Report on Form 10-KSB filed on March 29, 2002) #
10.10	Registrant's 2002 Stock Option Plan (incorporated by reference to Appendix B to the Registrant's Definitive Proxy Statement filed on April 18, 2002) #
10.11	Form of Stock Option Agreement for Non-qualified Stock Option granted under the Registrant's 2002 Stock Option Plan (incorporated by reference to Exhibit 10.18 to the Registrant's Quarterly Report on Form 10-QSB filed on November 15, 2004) #
10.12	Form of Stock Option Agreement for Incentive Stock Option granted under the Registrant's 2002 Stock Option Plan (incorporated by reference to Exhibit 10.19 to the Registrant's Quarterly Report on Form 10-QSB filed on November 15, 2004) #
10.13	Employment Agreement, effective as of January 1, 2011, by and between Southern Connecticut Bancorp, Inc. and its subsidiary, The Bank of Southern Connecticut, and Sunil Pallan covering the period from January 1, 2011 to December 31, 2012 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on April 8, 2011) #
10.14	Employment Agreement, effective January 1, 2011, by and among the Registrant and The Bank of Southern Connecticut and Stephen V. Ciancarelli covering the period from January 1, 2011 to December 31, 2012 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on December 22, 2010) #
10.15	Employment Agreement, effective as of February 28, 2012, by and between Southern Connecticut Bancorp, Inc. and its subsidiary, The Bank of Southern Connecticut, and Joseph J. Greco (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on March 1, 2012) #
10.16	Restricted Stock Agreement, dated as of February 28, 2012, by and between Southern Connecticut Bancorp, Inc. and Joseph J. Greco (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on March 1, 2012) #

10.17	Employment Agreement, effective as of January 1, 2013, by and between Southern Connecticut Bancorp, Inc., The Bank of Southern Connecticut and Sunil Pallan covering the period from January 1, 2013 to December 31, 2013 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on January 29, 2013) #
10.18	Employment Agreement, effective as of January 1, 2013, by and between Southern Connecticut Bancorp, Inc., The Bank of Southern Connecticut and Stephen V. Ciancarelli covering the period from January 1, 2013 to December 31, 2013 (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on January 29, 2013) #

10.19	2005 Stock Option and Award Plan (incorporated by reference to Exhibit 99.1 to the Registrant's Form S-8 filed on January 13, 2006) #
10.20	Form of Common Stock Award Agreement for Restricted Stock Awards granted under the 2005 Stock Option and Award Plan (incorporated by reference to Exhibit 99.2 to the Registrant's Form S-8 filed on January 13, 2006) #
10.21	Change of Control Agreement, effective as of June 21, 2012, by and between The Bank of Southern Connecticut and David Oliver (incorporated by reference to Exhibit 10.1 to the Registrant's Form 10-Q/A filed on September 13, 2012) #
10.22	Consent Order, dated July 3, 2012, between The Bank of Southern Connecticut, the Federal Deposit Insurance Corporation and the State of Connecticut Department of Banking (incorporated by reference to Exhibit 99.1 to the Registrant's Form 8-K filed on July 6, 2012)
10.23	Stipulation and Consent to the Issuance of a Consent Order, dated July 2, 2012, between The Bank of Southern Connecticut, the Federal Deposit Insurance Corporation and the State of Connecticut Department of Banking (incorporated by reference to Exhibit 99.2 to the Registrant's Form 8-K filed on July 6, 2012)
14	Code of Ethics (incorporated by reference to Exhibit 14 to the Registrant's Annual Report on Form 10-KSB filed on March 30, 2004)
21	Subsidiaries (filed herewith)
23	Consent of McGladrey LLP (filed herewith)
31.1	Rule 13(a)-14(a)/15(d)-14(a) Certification by Chief Executive Officer (filed herewith)
31.2	Rule 13(a)-14(a)/15(d)-14(a) Certification by Senior Vice President and Chief Financial Officer (filed herewith)
31.3	Rule 13(a)-14(a)/15(d)-14(a) Certification by Vice President and Chief Accounting Officer (filed herewith)
32.1	Section 1350 Certification by Chief Executive Officer (filed herewith)
32.2	Section 1350 Certification by Senior Vice President and Chief Financial Officer (filed herewith)
32.3	Section 1350 Certification by Vice President and Chief Accounting Officer (filed herewith)
101.INS	XBRL Instance Document* (filed herewith)
101.SCH	XBRL Taxonomy Extension Schema Document* (filed herewith)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document* (filed herewith)
101.LAB	XBRL Taxonomy Extension Label Linkbase Document* (filed herewith)

101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document* (filed herewith)
101.DEF	Taxonomy Extension Definitions Linkbase Document* (filed herewith)

\# Management contract or compensatory plan or arrangement.

* As provided in Rule 406T of Regulation S-T, this information is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SOUTHERN CONNECTICUT BANCORP, INC.
(Registrant)

By:	/s/ JOSEPH J. GRECO Name: Joseph J. Greco Title: Chief Executive Officer Date: April 8, 2013

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in capacities and on the dates indicated.

/s/ Joseph J. Greco Joseph J. Greco Chief Executive Officer	April 8, 2013 Date
/s/ Stephen V. Ciancarelli Stephen V. Ciancarelli Senior Vice President and Chief Financial Officer	April 8, 2013 Date
/s/ Alphonse F. Spadaro, Jr. Alphonse F. Spadaro, Jr. Chairman and Director	April 8, 2013 Date
/s/ Alfred J. Ranieri, Jr. Alfred J. Ranieri, Jr. Vice Chairman and Director	April 8, 2013 Date
/s/ James S. Brownstein, Esq. James S. Brownstein, Esq. Director	April 8, 2013 Date
/s/ Joshua H. Sandman, Ph.D. Joshua H. Sandman, Ph.D. Director	April 8, 2013 Date
/s/ Anthony M. Avellani Anthony M. Avellani Vice President, Chief Accounting Officer	April 8, 2013 Date

FINANCIAL STATEMENTS

December 31, 2012 and 2011

CONTENTS

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders
Southern Connecticut Bancorp, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Southern Connecticut Bancorp, Inc. and Subsidiaries (the "Company") as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive loss, shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southern Connecticut Bancorp, Inc. and Subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As described in Note 19, the Company has entered into an Agreement and Plan of Merger with another institution, pursuant to which the Company will merge into the other institution. Our opinion is not modified with respect to this matter.

/s/ McGladrey LLP

New Haven, Connecticut
March 28, 2013

Item 1. Financial Statements.

SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
December 31, 2012 and December 31, 2011

ASSETS	December 31, 2012	December 31, 2011
Cash and due from banks (Note 2)	$ 6,913,610	$ 18,167,794
Short term investments	4,674,556	6,764,409
Cash and cash equivalents	11,588,166	24,932,203
Interest bearing certificates of deposit	655,278	99,426
Available for sale securities (at fair value) (Note 3)	1,249,925	3,849,847
Federal Home Loan Bank stock (Note 7)	60,600	66,100
Loans receivable (Note 4)		
Loans receivable	105,508,771	113,943,767
Allowance for loan losses	(2,229,334)	(2,299,625)
Loans receivable, net	103,279,437	111,644,142
Accrued interest receivable	397,497	434,302
Premises and equipment (Note 5)	1,928,353	2,014,665
Other real estate owned	582,911	374,211
Other assets held for sale (Note 17)	315,000	315,000
Other assets	1,389,394	2,240,009
Total assets	$ 121,446,561	$ 145,969,905
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits (Note 6)		
Noninterest bearing deposits	$ 29,906,051	$ 31,003,581
Interest bearing deposits	78,345,187	101,627,100
Total deposits	108,251,238	132,630,681
Repurchase agreements	—	68
Capital lease obligations (Note 8)	1,152,509	1,161,938
Accrued expenses and other liabilities	495,122	631,285
Total liabilities	109,898,869	134,423,972
Commitments and Contingencies (Notes 7, 8 and 13)		
Shareholders' Equity		
Preferred stock, no par value; shares authorized: 500,000; none issued	—	—
Common stock, par value $.01; shares authorized: 5,000,000; shares issued and outstanding: 2012 2,772,816; 2011 2,697,902	27,728	26,979
Additional paid-in capital	22,742,914	22,569,489
Accumulated deficit	(11,222,875)	(11,050,382)
Accumulated other comprehensive loss - net unrealized loss on available for sale securities	(75)	(153)
Total shareholders' equity	11,547,692	11,545,933
Total liabilities and shareholders' equity	$ 121,446,561	$ 145,969,905

See Notes to Consolidated Financial Statements

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SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
For the Years Ended December 31, 2012 and 2011

	December 31, 2012	2011
Interest Income:		
Interest and fees on loans	$ 5,974,297	$ 7,045,527
Interest on securities	1,260	470
Interest on short-term and other investments	40,876	91,611
Total interest income	6,016,433	7,137,608
Interest Expense:		
Interest expense on deposits (Note 6)	907,079	1,778,005
Interest expense on capital lease obligations	165,370	171,504
Interest expense on repurchase agreements and other borrowings	202	809
Total interest expense	1,072,651	1,950,318
Net interest income	4,943,782	5,187,290
Provision for loan losses (Note 4)	472,848	3,036,340
Net interest income after provision for loan losses	4,470,934	2,150,950
Noninterest Income:		
Service charges and fees	326,923	359,405
Loan prepayment fees	91,516	—
Insurance Proceeds	35,899	—
Change in fair value of derivative	9,723	86,434
Other noninterest income	175,508	133,519
Total noninterest income	639,569	579,358
Noninterest Expenses:		
Salaries and benefits	2,925,930	2,654,370
Occupancy and equipment	602,096	660,985
Professional services	437,216	425,679
Data processing and other outside services	269,350	390,211
FDIC Insurance	222,460	214,509
Directors fees	169,500	298,300
Insurance	123,448	84,987
Loan collection expenses	99,579	160,416
Telephone & Communications	81,499	86,832
Other real estate owned expenses	480	93,409
Loss on sale of other real estate owned	—	51,141
Other operating expenses	351,438	347,386
Total noninterest expenses	5,282,996	5,468,225
Net loss	$ (172,493)	$ (2,737,917)
Basic and diluted loss per share	$ (0.06)	$ (1.01)

See Notes to Consolidated Financial Statements

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SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
For the Years Ended December 31, 2012 and 2011

	December 31, 2012	2011
Net loss	$ (172,493)	$ (2,737,917)
Other comprehensive income, net of taxes:		
Net change in unrealized holding gain on available for sale securities	78	121
Comprehensive loss	$ (172,415)	$ (2,737,796)

See Notes to Consolidated Financial Statements

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SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2012 and 2011

	Number of Common Shares	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Other Comprehensive (Loss) Income	Total
Balance, December 31, 2010	2,696,902	$ 26,969	$ 22,567,146	$ (8,312,465)	$ (274)	$ 14,281,376
Net loss	—	—	—	(2,737,917)	—	(2,737,917)
Other comprehensive income	—	—	—	—	121	121
Restricted stock compensation	1,000	10	2,343	—	—	2,353
Balance, December 31, 2011	2,697,902	$ 26,979	$ 22,569,489	$ (11,050,382)	$ (153)	$ 11,545,933
Balance, December 31, 2011	2,697,902	$ 26,979	$ 22,569,489	$ (11,050,382)	$ (153)	$ 11,545,933
Net Loss	—	—	—	(172,493)	—	(172,493)
Other comprehensive income	—	—	—	—	78	78
Restricted stock compensation	74,914	749	173,425	—	—	174,174
Balance, December 31, 2012	2,772,816	$ 27,728	$ 22,742,914	$ (11,222,875)	$ (75)	$ 11,547,692

See Notes to Consolidated Financial Statements

SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2012 and 2011

	2012	2011
Cash Flows From Operations		
Net loss	$ (172,493)	$ (2,737,917)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for loan losses	472,848	3,036,340
Depreciation and amortization	229,826	258,763
Share based compensation	174,174	2,353
Loss on disposal of assets	4,848	—
Increase in cash surrender value of life insurance	(39,345)	(39,973)
Change in fair value of derivative	(9,723)	(86,434)
(Gain) loss on sale of other real estate owned	(1,147)	51,141
Amortization and accretion of premiums and discounts on investments, net	—	(7)
Write-down of other real estate owned	5,701	94,630
Write-down of other assets held for sale	—	57,758
Changes in assets and liabilities:		
Decrease in other assets	899,683	71,647
Decrease in accrued interest receivable	36,805	70,404
Decrease in deferred loan fees	(24,763)	(2,582)
Decrease in accrued expenses and other liabilities	(136,163)	(156,071)
Net cash provided by operating activities	1,440,251	620,052
Cash Flows From Investing Activities		
Proceeds from maturities of available for sale securities	21,430,000	23,100,000
Purchases of available for sale securities	(18,830,000)	(25,199,993)
Net decrease in loans receivable	7,480,297	9,096,232
Proceeds from the sale of other real estate owned	223,069	137,859
Redemptions of Federal Home Loan Bank stock	5,500	—
Purchases of interest bearing certificates of deposit	(555,852)	—
Purchases of premises and equipment	(148,362)	(59,196)
Capitalized costs related to other real estate owned	—	(7,375)
Net cash provided by investing activities	9,604,652	7,067,527
Cash Flows From Financing Activities		
Net decrease in certificates of deposit	(12,203,137)	(14,953,830)
Net (decrease) increase in demand, savings and money market deposits	(12,176,306)	11,763,052
Principal repayments on capital lease obligations	(9,429)	(7,016)
Net decrease in repurchase agreements	(68)	(395,342)
Net cash used in financing activities	(24,388,940)	(3,593,136)
Net (decrease) increase in cash and cash equivalents	(13,344,037)	4,094,443
Cash and cash equivalents		
Beginning	24,932,203	20,837,760
Ending	$ 11,588,166	$ 24,932,203

See Notes to Consolidated Financial Statements

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SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued
For the Years Ended December 31, 2012 and 2011

		2012		2011
Supplemental Disclosures of Cash Flow Information:				
Cash paid for:				
Interest	$	1,229,908	$	1,973,780
Income taxes	$	—	$	750
Supplemental Disclosures of Non-Cash Investing and Financing Activities:				
Transfer of loans receivable to other real estate owned	$	436,323	$	956,513
Transfer of loans receivable to other assets	$	—	$	559,895
Financing of sale of other real estate owned	$	—	$	433,500
Unrealized holding gains on available for sale securities arising during the period	$	78	$	121

See Notes to Consolidated Financial Statements

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SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

NoteNature of Operations and Summary of Significant Accounting Policies
1.

Southern Connecticut Bancorp, Inc. (the "Company") is a bank holding company headquartered in New Haven, Connecticut that was incorporated on November 8, 2000. The Company's strategic objective is to serve as a bank holding company for a community-based commercial bank serving primarily New Haven County (the "Greater New Haven Market"). The Company owns 100% of the capital stock of The Bank of Southern Connecticut (the "Bank"), a Connecticut-chartered bank with its headquarters in New Haven, Connecticut, and 100% of the capital stock of SCB Capital, Inc. The Company and its subsidiaries focus on meeting the financial service needs of consumers and small to medium-sized businesses, professionals and professional corporations, and their owners and employees in the Greater New Haven Market.

The Bank operates branches at four locations, including downtown New Haven, the Amity/Westville section of New Haven, Branford and North Haven. The Bank's branches have a consistent, attractive appearance. Each location has an open lobby, comfortable waiting area, offices for the branch manager and a loan officer, and a conference room. The design of the branches complements the business development strategy of the Bank, affording an appropriate space to deliver personalized banking services in professional, confidential surroundings.

The Bank focuses on serving the banking needs of small to medium-sized businesses, professionals and professional corporations, and their owners and employees in the Greater New Haven Market. The Bank's target commercial customer has between \$1.0 and \$30.0 million in revenues, 15 to 150 employees, and borrowing needs of up to \$3.0 million. The primary focus on this commercial market makes the Bank uniquely qualified to move deftly in responding to the needs of its clients. The Bank has been successful in winning business by offering a combination of competitive pricing for its services, responsive decision making and a high level of personalized, "high touch" customer service.

On January 16, 2013, the Company and the Bank entered into an Agreement and Plan of Merger (the "Merger Agreement") with Liberty Bank, a Connecticut-chartered mutual savings bank with its main office in Middletown, Connecticut ("Liberty"), pursuant to which a to-be-formed wholly-owned subsidiary of Liberty will be merged with and into the Company with the Company being the surviving entity, immediately followed by the merger of the Company with and into Liberty with Liberty being the surviving entity (collectively, the "Merger"), and immediately followed by the merger of the Bank with and into Liberty with Liberty being the surviving bank, as decribed in Note 19.

Principles of consolidation and basis of financial statement presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, and have been prepared in accordance with accounting principles generally accepted in the United States of America and general practices within the banking industry. All significant intercompany balances and transactions have been eliminated. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities as of the date of the balance sheet and the reported amounts of income and expenses for the reporting period. Actual results could differ from those estimates.

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Significant group concentrations of credit risk

Most of the Company's activities are with customers located within New Haven County, Connecticut. Note 3 discusses the types of securities in which the Company invests and Note 4 discusses the types of lending in which the Company engages. The Company does not have any significant concentrations in any one industry or customer.

The following is a summary of the Company's significant accounting policies.

Cash and cash equivalents and statement of cash flows

Cash and due from banks and short-term investments are recognized as cash equivalents in the statements of cash flows. For purposes of reporting cash flows, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Cash flows from loans, deposits, and short-term borrowings are reported net. The Company maintains amounts due from banks which, at times, may exceed Federally insured limits. The Company has not experienced any losses from such concentrations.

Interest-bearing certificates of deposit

Interest-bearing certificates of deposit are carried at cost. At December 31, 2012, the balance in interest-bearing cerificates of deposit was approximately $655,000, which consisted of fixed rate certificate of deposits which will mature between January 2013 and January 2015.

Investments in debt and marketable equity securities

Management determines the appropriate classification of securities at the date individual investment securities are acquired, and the appropriateness of such classification is reassessed at each balance sheet date.

Debt securities that management has the positive intent and ability to hold to maturity, if any, are classified as "held to maturity" and recorded at amortized cost. "Trading" securities, if any, are carried at fair value with unrealized gains and losses recognized in earnings. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income, net of taxes. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

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The Company evaluates securities for other-than-temporary impairment on a regular basis. The evaluation considers several factors, including the amount of the unrealized loss and the period of time the security has been in a loss position. When the Company does not intend to sell the security, and it is more-likely-than-not that the Company will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment loss of a debt security in earnings, and the remaining portion in other comprehensive income. For held-to-maturity debt securities, the amount of an other-than-temporary impairment loss recorded in other comprehensive income for the noncredit loss component of a previous other-than-temporary impairment is amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as estimated based on cash flow projections discounted at the applicable original yield of the security. There were no other-than-temporarily impaired debt securities at December 31, 2012 or 2011.

For equity securities, the entire decline in the value that is considered other-than-temporary is recognized in earnings. There were no equity securities held at December 31, 2012 or 2011.

In estimating other-than-temporary impairment losses, management considered (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

The sale of a held-to-maturity security within three months of its maturity date or after collection of at least 85% of the principal outstanding at the time the security was acquired is considered a maturity for purposes of classification and disclosure.

Loans held for sale

Loans held for sale, if any, are primarily the guaranteed portions of SBA loans the Company has the intent to sell in the foreseeable future, and are carried at the lower of aggregate cost or market value. Gains and losses on sales of loans are determined by the difference between the sales proceeds and the carrying value of the loans.

Transfers of financial assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company – put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and no condition both constrains the transferee from taking advantage of that right and provides more than a trivial benefit for the transferor, and (3) the transferor does not maintain effective control over the transferred assets through either (a) an agreement that both entitles and obligates the transferor to repurchase or redeem the assets before maturity or (b) the ability to unilaterally cause the holder to return specific assets, other than through a cleanup call.

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Servicing

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Generally, purchased servicing rights are capitalized at the cost to acquire the rights. For sales of loans, a portion of the original cost of the loan is allocated to the servicing right, and if the pass-through rate to the investor is less than the note rate, to an interest-only strip, based on relative fair value. Fair value is based on a valuation model that calculates the present value of estimated future net servicing and interest income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing and interest income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Capitalized servicing assets are reported in other assets and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Interest only strips are also reported in other assets and are amortized into other noninterest income under the same method as servicing assets.

Servicing assets and interest-only strips are evaluated for impairment based upon the fair value of the assets as compared to amortized cost. Impairment is determined by stratifying the assets into tranches based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Company later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal, or a fixed amount per loan, and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income, and the amortization of interest-only strips is netted against other noninterest income.

Loans receivable

Loans that the Company has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for unearned income, the allowance for loan losses, and any unamortized deferred fees or costs.

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Interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and amortized as a level yield adjustment over the respective term of the loan.

The accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the loan is well-secured and in process of collection. Consumer installment loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. Loans are considered to be past due when one payment is missed. In all cases, loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual status or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis method until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for loan losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management’s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are considered impaired. For such impaired loans, an allowance is established when the discounted cash flows (or observable market price or collateral value if the loan is collateral dependent) of the impaired loan is lower than the carrying value of that loan. The general component covers all other loans, segregated generally by loan type (and further segregated by risk rating), and is based on historical loss experience with adjustments for qualitative factors which are made after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss data.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and real estate loans by either the present value of expected future cash flows discounted at the loan’s effective interest rate, the loan’s observable market price, or the fair value of the collateral if the loan is collateral dependent.

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Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer loans for impairment disclosures, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

Impaired loans also include loans modified in troubled debt restructurings where concessions have been granted to borrowers either experiencing financial difficulties or absent such concession, it is probable the borrower would experience financial difficulty complying with the original terms of the loan. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.

A modified loan is considered a troubled debt restructuring ("TDR") when two conditions are met: (1) the borrower is experiencing documented financial difficulty and (2) concessions are made by the Company that would not otherwise be considered for a borrower with similar credit characteristics. The most common types of modifications include interest rate reductions and/or maturity extensions. Modified terms are dependent upon the financial position and needs of the individual borrower, as the Bank does not employ modification programs for temporary or trial periods. All modifications are permanent. The modified loan does not revert back to its original terms, even if the modified loan agreement is violated. The Company's workout committee continues to monitor the modified loan and if a re-default occurs, the loan is classified as a re-defaulted TDR and collection is pursued through liquidation of collateral, from guarantors, if any, or through other legal action.

Most TDRs are placed on nonaccrual status at the time of restructuring, and continue on nonaccrual status until they have performed under the revised terms of the modified loan agreement for a minimum of six months. In certain instances, for TDRs that are on accrual status at the time the loans are restructured, the Bank may continue to classify the loans as accruing loans based upon the terms and conditions of the restructuring. At December 31, 2012, the Bank had two commercial and industrial loans and one commercial loan secured by real estate classified as TDRs on nonaccrual status and two commercial loans secured by real estate and one commercial and industrial loan classified as TDRs on accrual status. TDRs are classified as impaired loans and remain as TDRs for the remaining life of the loan. At December 31, 2012, all TDRs have been performing in accordance with the restructured terms.

Impairment analysis is performed on a loan by loan basis for all modified commercial loans, residential mortgages and consumer loans that are deemed to be TDRs, and related charge-offs are recorded or specific reserves are established as appropriate. Commercial loans include loans categorized as commercial loans secured by real estate, commercial loans, and construction and land loans. Impairment is measured by the present value of expected future cash flows discounted at the loan's effective interest rate. The original contractual interest rate for the loan is used as the discount rate for fixed rate loan modifications. The current rate is used as the discount rate when the loan's interest rate floats with a specified index. A change in terms or payments would be included in the impairment calculation.

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The allowances established for losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the borrower’s ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed by the credit department, in consultation with the loan officers, for all commercial loans. Specific valuation allowances are determined by analyzing the borrower’s ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower’s industry, among other things.

General valuation allowances are calculated based on the historical loss experience of specific types of loans. A valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of loans in the pool. The Company’s pools of similar loans includes analogous risk-rated groups of commercial and industrial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

Due to the relatively small asset size and loans outstanding of the Company, the Company uses readily available data from the FDIC regarding the loss experience of national banks with assets between $100 million and $300 million and combines this data with the Company’s actual loss experience to develop average loss factors by weighting the national banks’ loss experience and the Company’s loss experience. In reviewing the performance and trends of the Company’s loan portfolio during the year ended December 31, 2012 compared to the year ended December 31, 2011, management determined to update the methodology relating to the calculation of the general reserve by reducing the historical loss period to three years from the four year loss period utilized during the year ended December 31, 2011, which is considered more representative of average annual losses inherent in the Bank’s loan portfolio. The Company returned to the use of the three year loss period at December 31, 2012 after considering trends in loan loss activity, current loan portfolio quality and present economic, political and regulatory conditions. The three year average loss experience of the Bank and nationwide commercial banks continue to be weighted equally. The general reserve decreased by $66,000 to $2,229,000 at December 31, 2012 compared to $2,295,000 at December 31, 2011. The general reserve decreased by $328,000 due to a $12.6 million decline in gross loans and changes in the composition of loans subject to the general reserve, which was partially offset by a $262,000 increase in the reserve based upon changes in the general reserve formula based factors. The general reserve increased by approximately $94,000 due to the impact of revisions to the qualitative factors used to determine the general reserve and $168,000 due to the impact of the increase in the quantitative factors relating to the change to use of a three year average loss experience for the Bank and nationwide commercial banks with assets from $100 million to $300 million. For the year ended December 31, 2012, the provision for loan losses was $260,000 higher due to the impact of these changes. During the year ended December 31, 2012, the total provision for loan losses decreased by $2.6 million, primarily due to a significant decrease in loan charge-offs in 2012 compared to 2011.

General valuation allowances are based on general economic conditions and other qualitative risk factors, both internal and external, to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Bank’s lending management and staff; (ii) the effectiveness of the Company’s loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; and (vi) the impact of national and local economic trends and conditions. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, moderate or low degree of risk. The results are then entered into a general allocation matrix to determine an appropriate general valuation allowance.

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Other real estate owned

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in operations. Costs relating to the development and improvement of the property are capitalized, subject to the limit of fair value of the collateral. Gains or losses are included in operations upon disposal.

Derivative financial instruments

All derivative financial instruments are recognized as assets at their fair value on the balance sheet with the changes in the fair value reported in current-period earnings. These instruments are classified on the balance sheet as other assets and the change in the fair value is recorded in the Consolidated Statement of Operations as change in fair value of derivatives. For the years ended December 31, 2012 and 2011, the Company recognized a gain from the change in fair value of $9,723 and $86,434, respectively, on these instruments. During the year ended December 31, 2012, the Company exercised its derivative financial instruments and sold the underlying equity securities which resulted in a loss on the sale of $435.

Premises and equipment

Premises and equipment are stated at cost for purchased assets, and, for assets under capital lease, at the lower of fair value or the net present value of the minimum lease payments required over the term of the lease, net of accumulated depreciation and amortization. Leasehold improvements are capitalized and amortized over the shorter of the terms of the related leases or the estimated economic lives of the improvements. Depreciation is charged to operations using the straight-line method over the estimated useful lives of the related assets which range from 3 to 20 years. Gains and losses on dispositions are recognized upon realization. Maintenance and repairs are expensed as incurred and improvements are capitalized.

Impairment of long-lived assets

Long-lived assets, including premises and equipment, which are held and used by the Company, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If impairment is indicated by that review, the asset is written down to its estimated fair value through a charge to noninterest expense.

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Repurchase agreements

Repurchase agreements, which are classified as secured borrowings, generally mature within one to three days from the transaction date, and are reflected at the amount of cash received in connection with the transaction. The Company may be required to provide additional collateral based on the fair value of the underlying securities.

Income taxes

The Company files consolidated federal and state income tax returns. The Company recognizes income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

When tax returns are filed, it is highly certain that some positions taken will be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. The evaluation of a tax position taken is considered by itself and not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit more than fifty percent likely of being realized upon settlement with the applicable taxing authority. The Company recognizes a liability for any tax position deemed less likely than not to be sustained under examination by the relevant taxing authorities. The Company has no liabilities for uncertain income tax positions at December 31, 2012 or 2011. The Company’s open tax years that remain subject to examination by the relevant taxing authorities are 2009, 2010 and 2011.

Interest and penalties related to income taxes, if any, are recorded within the provision for income taxes.

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Share-based compensation

The Company accounts for share-based compensation transactions at fair value and recognizes the related expense in the consolidated statement of operations. Compensation cost has been measured using the fair value of an award on the grant dates and is recognized over the service period, which is usually the vesting period.

Related party transactions

Directors and officers of the Company and the Bank and their affiliates have been customers of and have had transactions with the Bank, and it is expected that such persons will continue to have such transactions in the future. Management believes that all deposit accounts, loans, services and commitments comprising such transactions were made in the ordinary course of business, and on substantially the same terms, including interest rates, as those prevailing at the time for comparable transactions with other customers who are not directors or officers. In the opinion of management, the transactions with related parties did not involve more than normal risks of collectibility or favored treatment or terms, or present other unfavorable features. Note 15 contains details regarding related party transactions.

Comprehensive income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the shareholders' equity section of the balance sheets, such items, along with net income or loss, are components of comprehensive income.

Segment Reporting

The Company has three reporting segments for purposes of reporting business line results, Community Banking, Mortgage Brokerage and the Holding Company. The Community Banking segment is defined as all operating results of the Bank. The Mortgage Brokerage segment is defined as the results of mortgage brokerage activities offered through the Bank, and the Holding Company segment is defined as the results of Southern Connecticut Bancorp on an unconsolidated or standalone basis. The Company uses an internal reporting system to generate information by operating segment. Estimates and allocations are used for noninterest expenses.

Fair value

The Company uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in certain instances, there are no quoted market prices for certain assets or liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the asset or liability.

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Fair value measurements focus on exit prices in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment.

The Company's fair value measurements are classified into a fair value hierarchy based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The three categories within the hierarchy are as follows:

Level 1 Quoted prices in active markets for identical assets and liabilities.

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities in active markets, quoted prices in markets that are not active; and model-based valuation techniques for which all significant inputs are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to determining the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

See Note 17 for additional information regarding fair value.

Recent Accounting Pronouncements

In April 2011, the FASB amended its guidance relating to repurchase agreements. The amendments change the effective control assessment by removing the criterion that required the transferor to have the ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. Instead, the amendments focus the assessment of effective control on the transferor's rights and obligations with respect to the transferred financial assets and not whether the transferor has the practical ability to perform in accordance with those rights or obligations. The amended guidance became effective for the Company as it relates to transactions or modifications of existing transactions that occur in interim and annual periods beginning with the quarter ended March 31, 2012. These amendments did not have an impact on the Company's consolidated financial statements.

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In May 2011, the FASB issued Accounting Standards Update (ASU) 2011-04, Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRs, (ASU 2011-04). ASU 2011-04 converges the fair value measurement guidance in U.S. GAAP and International Financial Reporting Standards (IFRSs). Some of the amendments clarify the application of existing fair value measurement requirements, while other amendments change a particular principle in existing guidance. In addition, ASU 2011-04 requires additional fair value disclosures. The amendments are to be applied prospectively and are effective for interim and annual periods beginning after December 15, 2011. The Company adopted the methodologies prescribed by this ASU during the quarter ended March 31, 2012. Adoption of this guidance did not have a material effect on the Company's financial statements.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This ASU eliminated the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company adopted this guidance effective for the quarter ended March 31, 2012. The adoption of this guidance did not impact the Company's financial position, results of operations or cash flows and only impacted the presentation of other comprehensive income in the financial statements.

In February 2013, the FASB issued ASU 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This ASU requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. Non-public companies are required to comply with the requirements of ASU 2013-02 for all reporting periods (interim and annual) beginning after December 15, 2013. The Company is currently evaluating the impact of this guidance on its consolidated financial statements.

Reclassifications

Certain amounts included in the 2011 consolidated financial statements have been reclassified to conform with the 2012 presentation. Such reclassifications had no impact on net loss.

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Note 2. Restrictions on Cash and Cash Equivalents

The Company is required to maintain reserves against its transaction accounts and non-personal time deposits. At December 31, 2012 and 2011, the Company was required to have cash and liquid assets of approximately $642,000 and $582,000, respectively, to meet these requirements. In addition, at December 31, 2012 and 2011, the Company was required to maintain $650,000 and $125,000, respectively, in the Federal Reserve Bank for clearing purposes.

Note 3. Available for Sale Securities

The amortized cost, gross unrealized gains, gross unrealized losses and approximate fair values of available for sale securities at December 31, 2012 and 2011 were as follows:

December 31, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury Bills	$1,250,000	$ —	$(75)	$1,249,925

December 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury Bills	$ 3,850,000	$ —	$ (153)	$ 3,849,847

The following tables present the Company's available for sale securities' gross unrealized losses and fair value, aggregated by the length of time the individual securities have been in a continuous loss position, at December 31, 2012 and 2011:

	Less Than 12 Months		12 Months or More		Total	
December 31, 2012	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury Bills	$1,249,925	$75	$ —	$ —	$1,249,925	$75

	Less Than 12 Months		12 Months or More		Total	
December 31, 2011	Value	Loss	Value	Loss	Value	Loss
U.S. Treasury Bills	$3,849,847	$153	$ —	$ —	$3,849,847	$153

At December 31, 2012 and 2011, the Company had two and five available for sale securities in an unrealized loss position, respectively. Management believes that none of the unrealized losses on available for sale securities are other than temporary because all of the unrealized losses in the Company's investment portfolio are due to market interest rate changes on debt securities issued by U.S. Government agencies. Management considers the issuers of the securities to be financially sound and the Company expects to receive all contractual principal and interest related to these investments. Because the Company does not intend to sell the investments, and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2012.

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SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

The amortized cost and fair value of available for sale debt securities at December 31, 2012 by contractual maturity are presented below.

	Amortized Cost	Fair Value
Maturity:		
Within one year	$1,250,000	$1,249,925

At December 31, 2012 and 2011, available for sale securities with a carrying value of $1,249,925 and $2,349,906, respectively, were pledged as collateral to secure public deposits. At December 31, 2011, available for sale securities with a carrying value of $1,499,941 were pledged as collateral under repurchase agreements with Bank customers. At December 31, 2012, there was no collateral required to meet pledge obligations under repurchase agreements with Bank customers.

There were no sales of investment securities during the years ended December 31, 2012 or 2011.

NoteLoans Receivable and Allowance for Loan Losses
4.

A summary of the Company's loan portfolio at December 31, 2012 and December 31, 2011 is as follows:

	2012	2011
Commercial loans secured by real estate	$ 64,677,545	$ 67,248,165
Commercial	25,911,897	31,719,229
Residential mortgages	13,182,841	12,565,428
Construction and land	1,441,740	2,309,600
Consumer	403,581	234,941
Total loans	105,617,604	114,077,363
Net deferred loan fees	(108,833)	(133,596)
Allowance for loan losses	(2,229,334)	(2,299,625)
Loans receivable, net	$ 103,279,437	$ 111,644,142

The Company services certain loans that it has sold without recourse to third parties. The aggregate of loans serviced for others approximated $6,961,000 and $13,143,000 as of December 31, 2012 and 2011, respectively.

The balance of capitalized servicing rights, included in other assets at December 31, 2012 and 2011, was $6,012 and $7,991, respectively. No impairment charges related to servicing rights were recognized during the years ended December 31, 2012 and 2011.

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SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

The following tables detail the period end loan balances and the period end allowance for loan losses balances by portfolio segment that were collectively and individually evaluated for impairment as of December 31, 2012 and 2011.

December 31, 2012	Commercial Loans Secured by Real Estate	Commercial	Residential Mortgages	Construction and Land	Consumer	Total
Period-end loan balances:						
Loans collectively evaluated for impairment	$ 60,179,921	$ 22,347,966	$ 12,322,319	$ 98,445	$ 403,581	$ 95,352,232
Loans individually evaluated for impairment	4,497,624	3,563,931	860,522	1,343,295	—	10,265,372
Total	$ 64,677,545	$ 25,911,897	$ 13,182,841	$ 1,441,740	$ 403,581	$ 105,617,604
Period-end allowance amount allocated to:						
Loans collectively evaluated for impairment	$ 1,150,619	$ 844,347	$ 225,601	$ 2,062	$ 6,705	$ 2,229,334
Loans individually evaluated for impairment	—	—	—	—	—	—
Balance at end of period	$ 1,150,619	$ 844,347	$ 225,601	$ 2,062	$ 6,705	$ 2,229,334

December 31, 2011	Commercial Loans Secured by Real Estate	Commercial	Residential Mortgages	Construction and Land	Consumer	Total
Period-end loan balances:						
Loans collectively evaluated for impairment	$ 65,146,824	$ 28,112,167	$ 12,010,750	$ 889,444	$ 233,481	$ 106,392,666
Loans individually evaluated for impairment	2,101,341	3,607,062	554,678	1,420,156	1,460	7,684,697
Total	$ 67,248,165	$ 31,719,229	$ 12,565,428	$ 2,309,600	$ 234,941	$ 114,077,363

Period-end allowance amount allocated to:						
Loans collectively evaluated for impairment	$ 1,122,699	$ 961,581	$ 187,224	$ 20,431	$ 3,292	$ 2,295,227
Loans individually evaluated for impairment	—	4,398	—	—	—	4,398
Balance at end of period	$ 1,122,699	$ 965,979	$ 187,224	$ 20,431	$ 3,292	$ 2,299,625

SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

The following table details activity in the allowance for loan losses by portfolio segment for the year ended December 31, 2012 and 2011. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories:

December 31, 2012	Commercial Loans Secured by Real Estate	Commercial	Residential Mortgages	Construction and Land	Consumer	Total
Balance at beginning of year	$ 1,122,699	$ 965,979	$ 187,224	$ 20,431	$ 3,292	$ 2,299,625
Provision for loan losses	23,050	245,502	216,293	(18,369)	6,372	472,848
Loans charged-off	(24,243)	(455,696)	(177,916)	—	(2,959)	(660,814)
Recoveries of loans previously charged-off	29,113	88,562	—	—	—	117,675
Net recoveries (charge-offs)	4,870	(367,134)	(177,916)	—	(2,959)	(543,139)
Balance at end of period	$ 1,150,619	$ 844,347	$ 225,601	$ 2,062	$ 6,705	$ 2,229,334
Period-end amount allocated to:						
Loans collectively evaluated for impairment	$ 1,150,619	$ 844,347	$ 225,601	$ 2,062	$ 6,705	$ 2,229,334
Loans individually evaluated for impairment	—	—	—	—	—	—
Balance at end of period	$ 1,150,619	$ 844,347	$ 225,601	$ 2,062	$ 6,705	$ 2,229,334

December 31, 2011	Commercial Loans Secured by Real Estate	Commercial	Residential Mortgages	Construction and Land	Consumer	Total
Balance at beginning of year	$ 1,587,196	$ 821,981	$ 316,146	$ 55,182	$ 6,136	$ 2,786,641
Provision for (credit to) loan losses	1,278,615	1,724,164	63,782	(34,751)	4,530	3,036,340
Loans charged-off	(1,743,112)	(1,590,419)	(192,704)	—	(9,675)	(3,535,910)
Recoveries of loans previously charged-off	—	10,253	—	—	2,301	12,554
Net charge-offs	(1,743,112)	(1,580,166)	(192,704)	—	(7,374)	(3,523,356)
	$ 1,122,699	$ 965,979	$ 187,224	$ 20,431	$ 3,292	$ 2,299,625

Balance at end of period						
Period-end amount allocated to:						
Loans collectively evaluated for impairment	$ 1,122,699	$ 961,581	$ 187,224	$ 20,431	$ 3,292	$ 2,295,227
Loans individually evaluated for impairment	—	4,398	—	—	—	4,398
Balance at end of period	$ 1,122,699	$ 965,979	$ 187,224	$ 20,431	$ 3,292	$ 2,299,625

Impaired Loans. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the fair value of the collateral if the loan is collateral dependent.

SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

The following tables relate to impaired loans as of December 31, 2012 and as of December 31, 2011:

December 31, 2012	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
Commercial loans secured by real estate	$ 4,610,747	$ 4,497,624	$ —	$ 4,497,624	$ —
Commercial	4,880,211	3,563,931	—	3,563,931	—
Construction and land	1,343,295	1,343,295	—	1,343,295	—
Residential mortgages	1,074,313	860,522	—	860,522	—
Consumer	—	—	—	—	—
Total	$ 11,908,566	$ 10,265,372	$ —	$ 10,265,372	$ —

December 31, 2011	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
Commercial loans secured by real estate	$ 2,354,430	$ 2,101,341	$ —	$ 2,101,341	$ —
Commercial	4,664,485	1,707,720	1,899,342	3,607,062	4,398
Construction and land	1,420,156	1,420,156	—	1,420,156	—
Residential mortgages	706,472	554,678	—	554,678	—
Consumer	1,460	1,460	—	1,460	—
Total	$ 9,147,003	$ 5,785,355	$ 1,899,342	$ 7,684,697	$ 4,398

The following tables relate to interest income recognized by class of impaired loans for the years ended December 31, 2012 and 2011:

	Year Ended December 31,			
	2012		2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Commercial loans secured by real estate	$2,206,518	$ 39,698	$2,740,115	$ 109,506
Commercial	3,697,995	70,939	1,562,758	27,612
Construction and land	1,395,207	—	1,147,704	—
Residential mortgages	700,380	9,148	717,762	18,538
Consumer	286	14	225	—
Total	$8,000,386	$ 119,799	$6,168,564	$ 155,656

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SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Interest income collected and recognized on impaired loans was $120,174 and $155,656 in 2012 and 2011, respectively. If nonaccrual loans had been current throughout their terms, additional interest income of $343,910 and $461,754 would have been recognized in 2012 and 2011, respectively. The Company has no commitments to lend additional funds to borrowers whose loans are impaired.

The Company's lending activities are conducted principally in New Haven County of Connecticut. The Company grants commercial and residential real estate loans, commercial business loans and a variety of consumer loans. In addition, the Company may grant loans for the construction of residential homes, residential developments and land development projects. All residential and commercial mortgage loans are collateralized by first or second mortgages on real estate. The ability and willingness of borrowers to satisfy their loan obligations is dependent in large part upon the status of the regional economy and regional real estate market. Accordingly, the ultimate collectability of a substantial portion of the loan portfolio and the recovery of a substantial portion of any resulting real estate acquired is susceptible to changes in market conditions.

The Company has established credit policies applicable to each type of lending activity in which it engages, evaluates the creditworthiness of each customer on an individual basis and, when deemed appropriate, obtains collateral. Collateral varies by each borrower and loan type. The market value of collateral is monitored on an ongoing basis and additional collateral is obtained when warranted. Important types of collateral include business assets, real estate, commercial vehicles, equipment, automobiles, marketable securities and time deposits. While collateral provides assurance as a secondary source of repayment, the Company ordinarily requires the primary source of repayment to be based on the borrower's ability to generate continuing cash flows.

Loan Origination/Risk Management. Management and the Board of Directors have adopted policies and procedures which dictate the guidelines for all loan originations for the Company. All loan originations are either approved by the Board of Directors or by a management committee comprised of the CEO, the President and Senior Loan Officer and the senior loan officers of the Company. Any loans approved by the management committee are reviewed and ratified by the Board of Directors.

The Company underwrites commercial and industrial loans, loans secured by commercial real estate, loans secured by residential real estate, loans related to commercial and residential development, and loans to consumers. The principal requirement of any borrower is the demonstrated ability to service the interest and principal payments of the loan as structured.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and generate the cash flow necessary to repay the loan as agreed with respect to principal and interest. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and require a personal guarantee. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

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Like commercial and industrial loans, commercial real estate loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and generate the cash flow necessary to repay the loan as agreed with respect to principal and interest. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk rating.

While the Company does have a small number of loans to individual borrowers to finance their primary residence, the majority of the Company's loans secured by residential real estate are made in connection with a commercial loan for which residential real estate is offered as collateral. These loans are underwritten to the same standards as commercial real estate loans.

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Company may originate from time to time, the Company requires the borrower to have a proven record of success, and typically requires a personal guarantee from all the principals of the project. Construction loans are underwritten utilizing independent appraisal reviews and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project.

The Company originates consumer loans on a limited basis. Applications for consumer loans are analyzed on an individual basis based on the borrower's ability to repay the loan. Where available, collateral is used to secure consumer loans.

Not less than annually, the Company utilizes an independent loan review company to review and validate the credit risk program. Results of these reviews are presented to management and reported to the Board of Directors. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

Nonaccrual and Past Due Loans. The accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the loan is well-secured and in process of collection. Consumer installment loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual status or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis method until the loans qualify for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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At December 31, 2012 and December 31, 2011, the unpaid principal balances of loans placed on nonaccrual status were $5,179,441 and $5,785,355, respectively. At December 31, 2012, three commercial real estate loans with an aggregate principal balance of $3,700,848 and three commercial loans with an aggregate principal balance of $1,876,105 were considered to be troubled debt restructurings. There are no further commitments to lend funds to these borrowers. There were no loans past due 90 days or more and still accruing interest at December 31, 2012 or December 31, 2011.

Non-accrual loans segregated by class of loans as of December 31, 2012 and 2011 were as follows:

	2012	2011
Commercial loans secured by real estate	$1,040,453	$2,101,341
Commercial	1,935,171	1,707,720
Construction and land	1,343,295	1,420,156
Residential mortgages	860,522	554,678
Consumer	-	1,460
	$5,179,441	$5,785,355

An age analysis of past due loans, segregated by class of loans, as of December 31, 2012 and December 31, 2011 was as follows:

December 31, 2012	Loans 30-89 Days Past Due	Loans 90 Days or More Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial loans secured by real estate	$ 363,284	$ 1,040,453	$ 1,403,737	$ 63,273,808	$ 64,677,545	$ —
Commercial	608,612	1,935,171	2,543,783	23,368,114	25,911,897	—
Residential mortgages	—	860,522	860,522	12,322,319	13,182,841	—
Construction and land	—	1,343,295	1,343,295	98,445	1,441,740	—
Consumer	26,273	—	26,273	377,308	403,581	—
	$ 998,169	$ 5,179,441	$ 6,177,610	$ 99,439,994	$ 105,617,604	$ —

December 31, 2011	Loans 30-89 Days Past Due	Loans 90 Days or More Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial loans secured by real estate	$128,384	$2,101,341	$2,229,725	$65,018,440	$67,248,165	$ —
Commercial	1,052,990	1,707,720	2,760,710	28,958,519	31,719,229	—
Residential mortgages	211,562	554,678	766,240	11,799,188	12,565,428	—
Construction and land	—	1,420,156	1,420,156	889,444	2,309,600	—
Consumer	—	1,460	1,460	233,481	234,941	—

$1,392,936	$5,785,355	$7,178,291	$106,899,072	$114,077,363	$ —

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SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

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Troubled Debt Restructurings. The recorded investment balance of TDRs, net of charge-offs, as of December 31, 2012 and December 31, 2011 was $5,577,000 and $3,213,000, respectively. At December 31, 2012, this recorded investment balance included $941,000 for a commercial and industrial loan which returned to accrual status during the year ended December 31, 2012, as it had performed in accordance with the terms and conditions of its restructuring agreement for a period of one year. At December 31, 2011, there was a $4,398 specific reserve related to one TDR. There was no such reserve at December 31, 2012. For the years ended December 31, 2012 and 2011, the Bank charged off a total of $109,000 and $129,000, respectively, relating to the portion of TDRs deemed to be uncollectible. There were no additional funds committed to borrowers in TDR status at December 31, 2012.

The following table provides information on loans modified as TDRs during the year ended December 31, 2012:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Coupon Rate
Commercial loans secured by real estate	1	$ 2,686,863	$ 2,686,863	4.69 %
Commercial	2	428,228	428,228	1.12 %
Total	3	$ 3,115,091	$ 3,115,091	4.20 %

The following table provides information on how loans were modified as TDRs during the year ended December 31, 2012:

	2012
Extended maturity	$79,617
Adjusted interest rates	3,035,474
Total	$3,115,091

There were no loans previously modified as a TDR for which there was a payment default during the year ended December 31, 2012.

Credit Quality Indicators. Oversight of the credit quality of the Company’s loan portfolio is managed by members of senior management and a committee of the Board of Directors. This group meets not less than monthly to review all impaired loans, any loans identified by management as potential problem loans, and all loans that are past due. The Company’s loan portfolio is comprised principally of loans to commercial entities, but the Company offers consumer loans as well. The Company employs different methodologies for monitoring credit risk in commercial loans and consumer loans.

SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

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Commercial Loans. The Company employs a risk rating system to identify the level of risk inherent in commercial loans. The risk rating system assists management in monitoring and overseeing the loan portfolio by providing indications of credit trends, serving as a basis for pricing, and being a part of the quantitative determination of the allowance for loan losses.

All commercial relationships, including loans categorized as commercial and industrial loans, commercial real estate loans, commercial loans secured by residential real estate, and construction loans, are included in this risk rating system. Under the Company’s internal risk rating system, the Company has risk rating categories of 0 through 5 that fall into the federal regulatory risk rating of “Pass.” A risk rating of 0 is assigned to those loans that are secured by readily marketable assets (including deposits at the bank); risk ratings increase from 1 to 5 in incremental increases of risk inherent in the relationship, with a loan that is rated 5 representing moderate risk. In addition, the Company identifies criticized loans as “special mention,” “substandard,” “doubtful” or “loss,” by employing a numerical risk rating system of 6, 7, 8 and 9, respectively, which correspond with the federal regulatory risk rating definitions of special mention, substandard, doubtful and loss, respectively.

Risk ratings assigned to loans are recommended by management and approved by the Company’s loan committee. The loan officer presents a proposed risk rating based on the underlying loan and the proposal is reviewed for accuracy and confirmed by the credit department. Risk ratings take into account a variety of commonly employed financial metrics, both quantitative and qualitative, which serve to measure risk. As part of the determination, all ratings of 5 or better (which are collectively considered “Pass” ratings by the Company) require that the customers have furnished timely financial information and other data pertinent to the relationships. Cash flow is reviewed and analyzed over a period of two to five years, but particular emphasis is placed on recent data in the event of a material change in performance, particularly a downward trend. New companies are generally considered riskier than established entities and length of time in business is factored into the risk rating decision. As part of the risk rating system, the health of the overall industry in which the company operates is also considered. Risk ratings are reviewed not less than annually.

Consumer Residential Mortgage Loans. The Company does not assign risk ratings to consumer residential mortgage loans. Consumer residential mortgage loans are considered “Pass loans until such time that it is determined that the loan is impaired. For our consumer residential real estate loans, the Company orders an appraisal at 90 days past due. In the event there is a collateral shortfall, the Company records partial or full charge-offs of the loan balances, typically immediately.

Consumer Loans. The Company does not assign risk ratings to consumer loans. Consumer loans are considered “Pass” loans until such time that it is determined that the loan is impaired. In the event a consumer loan becomes impaired, the entire balance of the loan is typically charged off immediately.

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The following table presents credit risk ratings by class of loan as of December 31, 2012 and December 31, 2011:

December 31, 2012	Commercial Loans Secured by Real Estate	Commercial	Construction and Land	Residential Mortgages	Consumer	Total
Risk Rating:						
Pass	$ 50,805,961	$ 19,325,262	$ 98,445	$ 12,176,580	$ 403,581	$ 82,809,829
Special Mention	8,006,881	2,616,278	—	145,739	—	10,768,898
Substandard	5,864,703	3,970,357	1,343,295	860,522	—	12,038,877
Total	$ 64,677,545	$ 25,911,897	$ 1,441,740	$ 13,182,841	$ 403,581	$ 105,617,604

December 31, 2011	Commercial Loans Secured by Real Estate	Commercial	Construction and Land	Residential Mortgages	Consumer	Total
Risk Rating:						
Pass	$ 60,201,549	$ 26,578,102	$ 889,444	$ 12,010,750	$ 233,481	$ 99,913,326
Special Mention	4,945,275	269,222	—	—	—	5,214,497
Substandard	2,101,341	4,871,905	1,420,156	554,678	1,460	8,949,540
Total	$ 67,248,165	$ 31,719,229	$ 2,309,600	$ 12,565,428	$ 234,941	$ 114,077,363

Note 5. Premises and Equipment

At December 31, 2012 and 2011, premises and equipment consisted of the following:

	2012	2011
Land	$255,766	$255,766
Premises under capital lease	1,192,036	1,192,036
Buildings and improvements	681,142	681,142
Leasehold improvements	1,020,889	1,027,390
Furniture and fixtures	551,023	527,969
Equipment	811,703	996,259
Software	92,108	92,495
	4,604,667	4,773,057
Less accumulated depreciation and amortization	(2,676,314)	(2,758,392)
	$ 1,928,353	$ 2,014,665

For the years ended December 31, 2012 and 2011, depreciation and amortization expense related to premises and equipment totaled $229,807 and $258,763, respectively.

SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

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Premises under capital lease of $1,192,036, and related accumulated amortization of $642,107 and $582,505 as of December 31, 2012 and 2011, respectively, are included in premises and equipment.

Note 6. Deposits

At December 31, 2012 and 2011, deposits consisted of the following:

	2012	2011
Noninterest bearing	$ 29,906,051	$ 31,003,581
Interest bearing:		
Checking	5,110,736	5,149,535
Money Market	36,649,525	47,728,069
Savings	2,877,303	2,838,736
Time certificates, less than $100,000 (1)	10,873,751	19,657,059
Time certificates, $100,000 or more (2)	22,833,872	26,253,701
Total interest bearing	78,345,187	101,627,100
Total deposits	$ 108,251,238	$ 132,630,681

(1) Included in time certificates of deposit, less than $100,000, at December 31, 2012 and December 31, 2011were brokered deposits totaling $469,037 and $3,976,764, respectively.

(2) Included in time certificates of deposit, $100,000 or more, at December 31, 2012 and December 31, 2011were brokered deposits totaling $4,049,919 and $5,119,113, respectively.

Brokered deposits at December 31, 2012 and December 31, 2011 were as follows:

	2012	2011
Bank customer time certificates of deposit placed through CDARS to ensure FDIC coverage	$279,382	$2,180,568
Time certificates of deposit purchased by the Bank through CDARS	4,049,919	4,161,974
Other brokered time certificates of deposit	189,655	2,753,335
Total brokered deposits	$4,518,956	$9,095,877

As a result of the Consent Order, described in Note 14, the Bank does not intend to renew or accept brokered deposits without obtaining prior regulatory approval during the period in which the Consent Order is in place.

Contractual maturities of time certificates of deposit as of December 31, 2012 are summarized below:

Due within:	
1 year	$21,142,539
1-2 years	4,734,023
2-3 years	4,399,614
3-4 years	3,062,601

4-5 years	368,846
	$33,707,623

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Interest expense on certificates of deposit in denominations of $100,000 or more was $331,025 and $656,309 for the years ended December 31, 2012 and 2011, respectively.

Note 7. Commitments and Contingencies

Federal Home Loan Bank borrowings and stock

The Bank is a member of the Federal Home Loan Bank of Boston (“FHLB”). At December 31, 2012, the Bank had the ability to borrow from the FHLB based on a certain percentage of the value of the Bank’s qualified collateral, as defined in the FHLB Statement of Products Policy, at the time of the borrowing. In accordance with an agreement with the FHLB, the qualified collateral must be free and clear of liens, pledges and encumbrances. There were no borrowings outstanding with the FHLB at December 31, 2012.

The Bank is required to maintain an investment in capital stock of the FHLB in an amount that is based on a percentage of its outstanding residential first mortgage loans. The stock is bought from and sold to the Federal Home Loan Bank based upon its $100 par value. The stock does not have a readily determinable fair value and as such is classified as restricted stock, carried at cost and evaluated for impairment. The stock’s value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and the length of time this situation persists; (b) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to its operating performance; (c) the impact of legislative and regulatory changes on the customer base of the FHLB; and (d) the liquidity position of the FHLB. Management evaluated the stock and concluded that the stock was not impaired for the periods presented herein.

Employment agreements

On February 28, 2012, the Company and the Bank entered into an employment agreement with the Chief Executive Officer effective as of February 28, 2012. The Company and the Chief Executive Officer also entered into a restricted stock agreement dated as of February 28, 2012.

Under the employment agreement, the individual will serve as Chief Executive Officer of the Company and the Bank from the date of the employment agreement through December 31, 2014, unless the Company and the Bank terminate the employment agreement earlier under the terms of the agreement. The Chief Executive Officer will also serve as a director of the Company and the Bank.

The Chief Executive Officer will earn an annual base salary over the term of the employment agreement and be entitled to receipt of incentive compensation at the end of each calendar year during the term in an amount up to 10% of the Chief Executive Officer’s base salary for achieving individual or corporate goals established by the Board of Directors of the Company or the Bank. In addition, the Chief Executive Officer has been granted 112,371 shares of restricted common stock of the Company pursuant to the restricted stock agreement. Under the restricted stock agreement, the 112,371 shares of restricted common stock vests as follows: 37,457 shares as of the date of the restricted stock agreement, 37,457 shares as of July 2, 2012 and 37,457 shares as of January 2, 2013.

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During the term, the Chief Executive Officer will be entitled to benefits including, but not limited to, comprehensive health insurance and major medical and dental coverage, participation in any long-term disability insurance plan and pension plan maintained by the Company or the Bank, supplemental disability insurance such that the monthly disability benefit payable to the Chief Executive Officer is equal to 70% of the Chief Executive Officer monthly base salary, use of a Bank-owned vehicle with a purchase price of up to $40,000, and term life insurance in an amount not less than $300,000.

If the Chief Executive Officer is terminated for “Cause” or voluntarily terminates the Chief Executive Officer’s employment other than for “Good Reason,” the Chief Executive Officer will only be entitled to base salary accrued through the date of the Chief Executive Officer’s termination. If the Chief Executive Officer’s employment is terminated by reason of “Disability,” the Chief Executive Officer will receive disability benefits under any long-term disability plan maintained by the Company or the Bank. In the event of the Chief Executive Officer’s death, the Chief Executive Officer’s beneficiary(ies) or estate will be paid the Chief Executive Officer’s base salary for a period of six months following the Chief Executive Officer’s death. If the Chief Executive Officer is terminated for any reason other than for “Cause” or “Disability” or if the Chief Executive Officer voluntarily terminates the Chief Executive Officer’s employment for “Good Reason,” then the Chief Executive Officer will be entitled to receive (i) twelve months of base salary and (ii) the Chief Executive Officer’s individual and/or family health benefits coverage for a period of twelve months following the Chief Executive Officer’s termination (or such other period prescribed by the then applicable COBRA law), with the Chief Executive Officer paying the same portion of the cost of such coverage as existed at the time of termination; provided, however, that no payment will be made to the Chief Executive Officer if such payment would constitute a “golden parachute payments” and is made after the occurrence of certain events specified under regulations promulgated by the Federal Deposit Insurance Corporation (the “FDIC”), including the determination by the FDIC that the Bank is in “troubled condition.” Any lump sum payment made to the Chief Executive Officer is also subject to claw back by the Company and the Bank if it is later determined that the Chief Executive Officer committed or is substantially responsible for certain acts or omissions prohibited under regulations promulgated by the FDIC.

On January 29, 2013, the Company and the Bank entered into an employment agreement with the President and Senior Loan Officer effective January 1, 2013.

Under the employment agreement, the individual will serve as President of Bancorp and the Bank and Senior Loan Officer of the Bank for the period from January 1, 2013 to December 31, 2013, unless the employment agreement is terminated earlier in accordance with its terms. The President and Senior Loan Officer will be paid a base salary at the annual rate of $175,000 and be eligible for salary increases and bonuses reflecting job performance achievements at the discretion of the Board of Directors of the Company and the Bank. In addition, the President and Senior Loan Officer will be provided with group life insurance and comprehensive health insurance, including major medical coverage, comparable to the coverage provided to officers generally. The President and Senior Loan Officer will also be eligible to participate in any profit sharing plan or 401(k) plan in accordance with their terms.

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The employment agreement may be terminated prior to December 31, 2013 as a result of the President and Senior Loan Officer engaging in certain specified acts that constitute cause or the death or disability of the President and Senior Loan Officer. In addition, in the event (i) the Company and the Bank enter into a “Business Combination” as defined in the employment agreement and (ii) the President and Senior Loan Officer (a) is not offered the same position at the President and Senior Loan Officer’s current base salary with the surviving entity, (b) determines in the President and Senior Loan Officer’s sole discretion that the position offered by the surviving entity is inconsistent with the President and Senior Loan Officer’s current position, including diminution in title, authority, duties or responsibilities, (c) has the President and Senior Loan Officer’s office relocated more than 25 miles from its current location or (d) is terminated within 2 years following the “Business Combination,” the President and Senior Loan Officer will be entitled to receipt of a lump sum payment equal to the President and Senior Loan Officer’s then current base salary; provided, however, that no payment will be made to the President and Senior Loan Officer if such payment would constitute a “golden parachute payment” and is made after the occurrence of certain events specified under regulations promulgated by the FDIC, including the determination by the FDIC that the Bank is in “troubled condition.” Any lump sum payment made to the President and Senior Loan Officer is also subject to claw back by the Company and the Bank if it is later determined that the President and Senior Loan Officer committed or is substantially responsible for certain acts or omissions prohibited under regulations promulgated by the FDIC.

On January 29, 2013, the Company and the Bank entered into an employment agreement with the Senior Vice President and Chief Financial Officer effective January 1, 2013.

Under the employment agreement, the individual will serve as Senior Vice President and Chief Financial Officer of the Company and the Bank for the period from January 1, 2013 to December 31, 2013, unless the employment agreement is terminated earlier in accordance with its terms. The Senior Vice President and Chief Financial Officer will be paid a base salary at the annual rate of $165,000 and be eligible for salary increases and bonuses reflecting job performance achievements at the discretion of the Board of Directors of the Company and the Bank. In addition, the Senior Vice President and Chief Financial Officer will be provided with group life insurance and comprehensive health insurance, including major medical coverage, comparable to the coverage provided to officers generally. The Senior Vice President and Chief Financial Officer will also be eligible to participate in any profit sharing plan or 401(k) plan in accordance with their terms.

The employment agreement may be terminated prior to December 31, 2013 as a result of the Senior Vice President and Chief Financial Officer engaging in certain specified acts that constitute cause or the death or disability of the Senior Vice President and Chief Financial Officer. In addition, in the event (i) the Company and the Bank enter into a “Business Combination” as defined in the employment agreement and (ii) the Senior Vice President and Chief Financial Officer (a) is not offered the same position at the Senior Vice President and Chief Financial Officer’s current base salary with the surviving entity, (b) determines in the Senior Vice President and Chief Financial Officer’s sole discretion that the position offered by the surviving entity is inconsistent with the Senior Vice President and Chief Financial Officer’s current position, including diminution in title, authority, duties or responsibilities, (c) has the Senior Vice President and Chief Financial Officer’s office relocated more than 25 miles from its current location or (d) is terminated within 2 years following the “Business Combination,” the Senior Vice President and Chief Financial Officer will be entitled to receipt of a lump sum payment equal to the Senior Vice President and Chief Financial Officer’s then current base salary; provided, however, that no payment will be made to the Senior Vice President and Chief Financial Officer if such payment would constitute a “golden parachute payment” and is made after the occurrence of certain events specified under regulations promulgated by the FDIC, including the determination by the FDIC that the Bank is in “troubled condition.” Any lump sum payment made to the Senior Vice President and Chief Financial Officer is also subject to claw back by the Company and the Bank if it is later determined that the Senior Vice President and Chief Financial Officer committed or is substantially responsible for certain acts or omissions prohibited under regulations promulgated by the FDIC.

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On January 29, 2013, the Company and the Bank entered into an employment agreement with the First Vice President, Human Resources Director and Corporate Secretary effective January 1, 2013.

Under the employment agreement, the individual will serve as First Vice President, Human Resources Director and Corporate Secretary of the Company and the Bank for the period from January 1, 2013 to December 31, 2013, unless the employment agreement is terminated earlier in accordance with its terms. The First Vice President, Human Resources Director and Corporate Secretary will be paid a base salary at the annual rate of $82,000 and be eligible for salary increases and bonuses reflecting job performance achievements at the discretion of the Board of Directors of the Company and the Bank. In addition, the First Vice President, Human Resources Director and Corporate Secretary will be provided with group life insurance and comprehensive health insurance, including major medical coverage, comparable to the coverage provided to officers generally. The First Vice President, Human Resources Director and Corporate Secretary will also be eligible to participate in any profit sharing plan or 401(k) plan in accordance with their terms.

The employment agreement may be terminated prior to December 31, 2013 as a result of the First Vice President, Human Resources Director and Corporate Secretary engaging in certain specified acts that constitute cause or the death or disability of the First Vice President, Human Resources Director and Corporate Secretary. In addition, in the event (i) the Company and the Bank enter into a “Business Combination” as defined in the employment agreement and (ii) the First Vice President, Human Resources Director and Corporate Secretary (a) is not offered the same position at the First Vice President, Human Resources Director and Corporate Secretary’s current base salary with the surviving entity, (b) determines in the First Vice President, Human Resources Director and Corporate Secretary’s sole discretion that the position offered by the surviving entity is inconsistent with the First Vice President, Human Resources Director and Corporate Secretary’s current position, including diminution in title, authority, duties or responsibilities, (c) has the First Vice President, Human Resources Director and Corporate Secretary’s office relocated more than 25 miles from its current location or (d) is terminated within 2 years following the “Business Combination,” the First Vice President, Human Resources Director and Corporate Secretary will be entitled to receipt of a lump sum payment equal to the First Vice President, Human Resources Director and Corporate Secretary’s then current base salary; provided, however, that no payment will be made to the First Vice President, Human Resources Director and Corporate Secretary if such payment would constitute a “golden parachute payment” and is made after the occurrence of certain events specified under regulations promulgated by the FDIC, including the determination by the FDIC that the Bank is in “troubled condition.” Any lump sum payment made to the First Vice President, Human Resources Director and Corporate Secretary is also subject to claw back by the Company and the Bank if it is later determined that the First Vice President, Human Resources Director and Corporate Secretary committed or is substantially responsible for certain acts or omissions prohibited under regulations promulgated by the FDIC.

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Change in Control Agreement

Effective June 21, 2012, the Bank entered into a change in control agreement with its Senior Vice President of Retail Banking.

The agreement provides that in the event of (i) a "Change in Control" (as defined in the agreement) and (ii) the termination within twelve months of such "Change in Control" of the Senior Vice President of Retail Banking's employment (a) for any reason other than for "Cause" (as defined in the agreement), death or "Disability" (as defined in the agreement) or (b) as result of his resignation for "Good Reason" (as defined in the agreement) following the cure period specified in the agreement, the Senior Vice President of Retail Banking will be entitled to receipt of an amount equal to one times his annual base salary immediately prior to his termination of employment or the "Change in Control," whichever is higher. The Senior Vice President of Retail Banking will also be entitled to receipt of accrued but unpaid compensation and vacation time as well as an amount equal to one year's medical and dental insurance premiums totaling approximately $20,000.

The agreement further provides that notwithstanding anything to the contrary contained in the agreement, unless all necessary regulatory approvals are obtained, no "Change in Control" payments will be made to the Senior Vice President of Retail Banking if such payments would constitute a "golden parachute payment" under regulations promulgated by the FDIC. If required, any payments may be suspended, prevented or subject to claw back in whole or in part when warranted to ensure that payments contrary to the intent of federal law and regulations promulgated by the FDIC are not made. In this regard, any payments made to the Senior Vice President of Retail Banking are subject to claw back by the Bank if it is later determined that the Senior Vice President of Retail Banking committed or is substantially responsible for certain acts or omissions prohibited under regulations promulgated by the FDIC.

Litigation

At December 31, 2012, neither the Company nor any subsidiary was involved in any pending legal proceedings believed by management to be material to the Company's financial condition or results of operations. Periodically, there have been various claims and lawsuits against the Company, such as claims to enforce liens, condemnation proceedings on properties in which the Bank holds a security interest, claims involving the making and servicing of real property loans and other issues incident to the Company's business. However, neither the Company nor any subsidiary is a party to any pending legal proceedings that management believes would have a material adverse effect on the Company's financial condition, results of operations or cash flows.

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Directors Retirement Plan

Effective March 3, 2011, the Bank adopted a Director Retirement Plan (the "Director Plan") for each non-employee director of the Bank. Under the Director Plan, each non-employee director of the Bank who Retires (as defined below) from the Board of Directors of the Bank (the "Bank Board") with a minimum of five years of service on the Bank Board shall be entitled to receipt of a one-time payment of $50,000 upon his or her Retirement (as defined below). The years of service began accruing on March 3, 2011, the date of adoption of the Director Plan, and will not include any periods in which the person was an employee of the Bank. "Retire" and "Retirement" means termination of service as a director of the Bank and all its subsidiaries for any reason other than death, Disability (as defined in the Director Plan) or Specially-Defined Cause (as defined in the Director Plan). In addition, the one-time payment of $50,000 will also become due and payable to the non-employee directors of the Bank regardless of their number of years of service on the Bank Board in the event of (i) a change in control of the Bank (as may be defined by the Bank Board), (ii) the death of a director, (iii) the Disability (as defined in the Director Plan) of a director or (iv) the failure of a director to stand for reelection due to any age restriction.

Based upon actuarial calculations completed in March 2011, the Company anticipated incurring a net periodic cost for the year ended December 31, 2011 of $47,493. The five-year projection of the net periodic cost for the Director Plan was $333,147.

On October 18, 2011, the Bank terminated the Director Plan for each non-employee director of the Bank effective September 30, 2011. As noted above, the Director Plan was initially adopted on March 3, 2011, and there have been no payments made under the Director Plan prior to the date that the Director Plan was terminated. During the third quarter of 2011, the Bank reversed the $33,000 of retirement benefits expense that had been accrued during 2011 related to the Director Plan.

NoteLease and Subleases
8.

The Company leases the Bank's main and Branford branch offices under twenty-year capital leases that have terms, including renewal periods, through 2021 and 2022, respectively. Under the terms of the leases, the Bank will pay all executory costs including property taxes, utilities and insurance. In 2006, the Company entered into an operating lease for its North Haven branch. The Company also leases the driveway to its main office and certain equipment under non-cancelable operating leases.

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At December 31, 2012, future minimum lease payments to be made under these lease by year and in the aggregate, were as follows:

Year	Capital Leases	Operating Leases
2013	$219,204	$47,408
2014	219,204	46,751
2015	219,204	46,751
2016	236,393	48,782
2017	243,998	49,788
2018 and thereafter	893,169	408,663
	2,031,172	$648,143
	(878,663)	
Less amount representng interest Present value of future minimum lease payments - capital lease obligation	$1,152,509	

Total rent expense charged to operations under the operating leases approximated $67,500 and $54,900 for the years ended December 31, 2012 and 2011, respectively. Rental income under subleases, and a lease of space in premises owned, approximated $31,200 and $13,600 for the years ended December 31, 2012 and 2011, respectively.

Note 9. Income Taxes

A reconciliation of the anticipated income tax benefit (computed by applying the statutory Federal income tax rate of 34% to the loss before income taxes) to the amount reported in the statement of operations for the years ended December 31, 2012 and 2011 is as follows:

	2012	2011
Benefit for income taxes at statutory Federal rate	$(58,648)	$(930,892)
State taxes, net of Federal benefit	(8,538)	(135,527)
Increase in valuation allowance	77,607	1,080,474
Other	(10,421)	(14,055)
	$ —	$ —

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	2012	2011
Deferred tax assets:		
Allowance for loan losses	$868,326	$895,704
Net operating loss carryforwards	3,343,119	3,261,268
Unrealized gain on available for sale securities	29	60
Interest on non accruing loans	133,953	179,853
Capital lease obligation	238,948	234,813
Other	324,741	261,040
Gross deferred tax assets	4,909,116	4,832,738
Less valuation allowance	(4,464,091)	(4,386,515)
Deferred tax assets - net of valuation allowance	445,025	446,223
Deferred tax liabilities:		
Tax bad debt reserve	445,025	446,223
Gross deferred tax liabilities	445,025	446,223
Net deferred taxes	$ —	$ —

As of December 31, 2012, the Company had net operating loss carryforwards of approximately $8,700,000 and $8,440,000 available to reduce future Federal and state taxable income, respectively, which expire in 2022 through 2032.

The net changes in the valuation allowance for 2012 and 2011 were increases of $77,607 and $1,080,474, respectively. The changes in the valuation allowance have been allocated between operations and equity to adjust the deferred tax asset to an amount considered by management more likely than not to be realized. The portion of the change in the valuation allowance allocated to equity is to eliminate the tax benefit related to the unrealized losses on available for sale securities.

During 2007, the Company had a tax deduction for compensation related to the shares issued to the former Chairman that exceeded the book compensation recorded for such shares and predecessor stock options. The tax benefit for this excess tax deduction is typically recorded as an increase to shareholders' equity. However, because the Company is in a net operating loss position for tax purposes and has a full valuation allowance recorded for its net deferred tax asset, the Company did not record the tax benefit of this deduction in 2007, and will not record such benefit until the Company's net operating losses are fully utilized. At both December 31, 2012 and 2011, approximately $140,000 of net operating losses resulting from this deduction, and related tax benefit of approximately $55,000, have been excluded from the calculation of deferred tax assets.

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Note 10. Shareholders' Equity

Loss per share

The Company is required to present basic loss per share and diluted loss per share in its statements of operations. Basic and diluted loss per share are computed by dividing net loss by the weighted average number of common shares outstanding. Diluted per share amounts assume exercise of all potential common stock instruments unless the effect is to reduce the loss or increase the income per share.

Year Ended December 31,		12/31/2012			12/31/2011	
	Net Loss	Weighted Average Shares	Amount Per Share	Net Loss	Weighted Average Shares	Amount Per Share
Basic Loss Per Share						
Loss available to common shareholders	$(172,493)	2,748,254	$(0.06)	$(2,737,917)	2,697,902	$(1.01)
Effect of Dilutive Securities						
Warrants/Restricted Stock/Stock Options outstanding	—	—	—	—	—	—
Loss available to common shareholders plus assumed conversions	$(172,493)	2,748,254	$(0.06)	$(2,737,917)	2,697,902	$(1.01)

For the years ended December 31, 2012 and 2011, common stock equivalents of 44,212 shares and 370 shares, respectively, have been excluded in the computation of net loss per share because the inclusion of such common stock equivalents is anti-dilutive.

Share-based plans

The Company has adopted three share-based plans, the 2001 Stock Option Plan (the "2001 Plan"), the 2002 Stock Option Plan (the "2002 Plan"), and the 2005 Stock Option and Award Plan (the "2005 Plan"), under which an aggregate of 193,281 shares of the Company's common stock are reserved for issuance of the Company's common stock, or upon the exercise of incentive options, nonqualified options and restricted stock granted under the share-based plans.

Under all three plans, the exercise price for each share covered by an option may not be less than the fair market value of a share of the Company's common stock on the date of grant. For incentive options granted to a person who owns more than 10% of the combined voting power of the Company or any subsidiary ("ten percent shareholder"), the exercise price cannot be less than 110% of the fair market value on the date of grant.

Options under all three plans have a term of ten years unless otherwise determined at the time of grant, except that incentive options granted to any ten percent shareholder will have a term of five years unless a shorter term is fixed. Under the 2001 and 2002 plans, unless otherwise fixed at the time of grant, 40% of the options become exercisable one year from the date of grant, and 30% of the options become exercisable at each of the second and third anniversaries from the date of grant. Under the 2005 plan, the vesting terms of the awards is determined at the date of grant. Dividends are not paid on unexercised options.

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Also, under the 2005 Plan, awards in the form of the Company's common stock may be granted. The vesting terms of the awards are determined at the time of the grant.

Upon adoption of the 2002 Option Plan in May 2002, the Company determined that no additional options will be granted under the 2001 Option Plan. The 2002 Option Plan expired in May 2012.

A summary of the status of the stock options at December 31, 2012 and changes during the year then ended, is as follows:

	2012			
	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Granted	158,388	$ 7.76	2.2	
Exercised	—	—		
Exchanged	—	—		
Expired	(8,316)	10.39		
Forfeited	(5,000)	7.42		
Outstanding at end of year	145,072	$ 7.62	1.3	$ —
Vested at end of year	145,072	$ 7.62	1.3	$ —
Exercisable at end of year	145,072	$ 7.62	1.3	$ —

There were no stock options granted in 2012 and 2011. In addition, there were no stock options excercised in 2012 and 2011.

A summary of the status of the Company's nonvested restricted stock at December 31, 2012 and changes during the year then ended, is as follows:

	2012	
	Number of Shares	Weighted-Average Grant-Date Fair Value
Nonvested restricted stock at beginning of the year	—	$ —
Granted	112,371	1.55
Vested and issued	(74,914)	1.55
Forfeited	—	—
Nonvested restricted stock at December 31, 2012	37,457	$ 1.55

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As of December 31, 2012, there was no unrecognized compensation cost relating to the option plans or restricted stock. During the years ended December 31, 2012 and 2011, expenses of $174,174 and $2,353 for restricted stock was recognized as compensation cost, respectively.

Stock warrants

The Company adopted the 2001 Warrant Plan and the 2001 Supplemental Warrant Plan (the “Warrant Plans”), under which an aggregate of 77,184 shares of the Company’s common stock were reserved for issuance upon the exercise of warrants granted to non-employee directors of the Company and the Bank, and certain other individuals involved in the organization of the Bank. All warrants under the Warrant Plans expired on November 15, 2011.

Warrants under the Warrant Plans had a term of ten years. Forty percent of the warrants became exercisable one year from the date of grant, and 30% of the warrants became exercisable at each of the second and third anniversaries from the date of grant.

Note 11.Other Comprehensive Income

Under guidance relating to reporting comprehensive income, certain transactions and other economic events that bypass the Company’s income statement must be displayed as other comprehensive income. The Company’s other comprehensive income, which is comprised solely of the change in unrealized gains on available for sale securities, was as follows:

	Amount	Taxes	Amount
Unrealized holding gain arising during period	$78	$(30)	$48
Reclassification adjustment for amounts recognized in net loss	—	—	—
Reduction in deferred tax valuation allowance allocated to equity	—	30	30
Unrealized holding gains on available for sale securities, net of taxes	$78	$ —	$78

	Twelve Months Ended December 31, 2011		
	Before-Tax Amount	Taxes	Net-of-Tax Amount
Unrealized holding gains arising during period	$121	$(47)	$74
Reclassification adjustment for amounts recognized in net loss	—	—	—
Reduction in deferred tax valuation allowance allocated to equity	—	47	47
Unrealized holding gains on available for sale securities, net of taxes	$121	$ —	$121

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Note 12. 401(k) Profit Sharing Plan

The Bank's employees are eligible to participate in The Bank of Southern Connecticut 401(k) Profit Sharing Plan (the "Plan") under Section 401(k) of the Internal Revenue Code. The Plan covers substantially all employees of the Bank. Under the terms of the Plan, participants can contribute a discretionary percentage of compensation, with total annual contributions subject to Federal limitations. The Bank may make discretionary contributions to the Plan. Participants are immediately vested in their contributions and become fully vested in employer contributions after three years of service. There were no contributions made by the Company in 2012 or 2011.

Note 13. Segment Reporting

The Company has three reporting segments for purposes of reporting business line results: Community Banking, Mortgage Brokerage and the Holding Company. The Community Banking segment is defined as all operating results of the Bank. The Mortgage Brokerage segment is defined as mortgage brokerage activities through the Bank, and the Holding Company segment is defined as the results of Southern Connecticut Bancorp on an unconsolidated or standalone basis. The Company uses an internal reporting system to generate information by operating segment. Estimates and allocations are used for noninterest expenses.

Information about the reporting segments and reconciliation of such information to the consolidated financial statements is as follows:

Year Ended December 31, 2012

	Community Banking	Mortgage Brokerage	Holding Company	Elimination Entries	Consolidated Total
Net interest income	$4,939,393	$3,840	$549	$ —	$4,943,782
Provision for loan losses	472,848	—	—	—	472,848
Net interest income after provision for loan losses	4,466,545	3,840	549	—	4,470,934
Noninterest income	608,849	—	30,720	—	639,569
Noninterest expense	5,108,618	198	174,180	—	5,282,996
Net (loss) income	(33,224)	3,642	(142,911)	—	(172,493)
Total assets as of December 31, 2012	120,922,463	45,068	11,567,942	(11,088,912)	121,446,561

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Year Ended December 31, 2011

	Community Banking	Mortgage Brokerage	Holding Company	Elimination Entries	Consolidated Total
Net interest income	$5,158,838	$26,303	$2,149	$ —	$5,187,290
Provision for loan losses	3,036,340	—	—	—	3,036,340
Net interest income after provision for loan losses	2,122,498	26,303	2,149	—	2,150,950
Noninterest income	565,758	—	13,600	—	579,358
Noninterest expense	5,313,613	2,030	152,582	—	5,468,225
Net (loss) income	(2,625,357)	24,273	(136,833)	—	(2,737,917)
Total assets as of December 31, 2011	145,325,773	42,389	11,558,084	(10,956,341)	145,969,905

Note 14. Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business, the Company is a party to financial instruments with off-balance-sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the financial statements. The contractual amounts of these instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The contractual amounts of commitments to extend credit represents the amounts of potential accounting loss should the contract be fully drawn upon, the customer defaults, and the value of any existing collateral become worthless. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments and evaluates each customer’s creditworthiness on a case-by-case basis.

Management believes that the Company controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral that it deems necessary.

Financial instruments whose contract amounts represent credit risk were as follows at December 31, 2012 and December 31, 2011:

	2012	2011
Commitments to extend credit:		
Future loan commitments	$3,025,000	$1,565,000
Unused lines of credit	15,629,121	17,569,186
Financial standby letters of credit	1,954,807	3,083,828
Undisbursed construction loans	450,000	508,827

	$21,058,928	$22,726,841

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Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments to extend credit generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. Since these commitments could expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counter-party. Collateral held varies, but may include residential and commercial property, deposits and securities.

Standby letters of credit are written commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Guarantees that are not derivative contracts have been recorded on the Company's consolidated balance sheet at their fair value at inception. The liability related to guarantees recorded at December 31, 2012 and 2011 was not significant.

NoteRegulatory Matters
15.

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2012, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. While the Bank met the capital ratio requirements to be classified as a "well capitalized" financial institution as of December 31, 2012, the Bank is currently classified as "adequately capitalized" as a result of the Consent Order entered into by the Bank in July 2012 with the Federal Deposit Insurance Corporation and the State of Connecticut Department of Banking, which is described below in the following paragraphs. As an "adequately capitalized" financial institution, the Bank may not accept brokered deposits without first obtaining a waiver from the Federal Deposit Insurance Corporation. With such a waiver, the Bank generally may not pay an interest rate on the brokered deposits in excess of 75 basis points above interest rates in its normal market area or the national interest rate on deposits outside of its normal market area. The Federal Deposit Insurance Corporation insurance assessment also increases when a financial institution falls below the "well capitalized" classification. In addition, financial institutions that are not "well capitalized," such as the Bank, may have more difficulty obtaining certain regulatory approvals (including for acquisitions of other financial institutions and opening of new branches).

On July 2, 2012, the Bank entered into a stipulation and consent to the Issuance of a Consent Order with the FDIC and the State of Connecticut Department of Banking ("Connecticut Department of Banking"). Thereafter, on July 3, 2012, the Bank entered into a Consent Order (the "Consent Order") with the FDIC and the Connecticut Department of Banking.

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By entering into the Consent Order, the Bank has agreed to take certain measures in a number of areas, including, without limitation, the following: (i) having and retaining qualified management and reviewing and revising its assessment of senior management; (ii) maintaining minimum specified capital levels and developing and submitting a capital plan in the event any of its capital ratios fall below such minimum specified capital levels; (iii) formulating and submitting a profit and budget plan consisting of goals and strategies consistent with sound banking practices and implementing such plan; (iv) formulating and submitting a plan to reduce classified assets and implementing such plan; (v) reviewing and improving the loan and credit risk management policies and procedures; (vi) developing and implementing action plans addressing all other recommendations identified within its most recent Report of Examination; (vii) complying with the Interagency Policy Statement on Internal Audit Function and its Outsourcing; and (viii) not accepting, renewing or rolling over any brokered deposits unless the Bank is in compliance with regulations governing the solicitation and acceptance of brokered deposits. The Consent Order also provides that the Bank will obtain prior regulatory approval before the payment of any dividends. The Bank has already adopted and implemented many of the actions prescribed in the Consent Order.

The Consent Order requires the Bank to maintain a minimum Tier 1 leverage ratio of at least 8.0%, a Tier 1 risk-based capital ratio of at least 9% and a total risk-based capital ratio of at least 10%. At December 31, 2012, the Bank's capital ratios exceeded such minimums set forth in the Consent Order. In September 2012, the Bank also submitted a revised capital plan outlining its strategy for increasing its capital amounts and ratios to the Federal Deposit Insurance Corporation and the State of Connecticut Department of Banking for their approval. The capital plan included a profit and budget plan and a plan to reduce classified assets. In October 2012, the Bank received regulatory approval for its revised capital plan. Further regulatory action is possible if the Bank does not continue to maintain the minimum capital ratios set forth in the Consent Order.

The Bank has an Oversight Committee that is responsible for supervising the implementation of the Consent Order. The Oversight Committee meets monthly and is currently composed of the Company's Chairman of the Board, two additional directors, the Chief Executive Officer, the President and Senior Loan Officer and the Chief Financial Officer.

The Consent Order is the result of ongoing discussions between the Bank's regulatory agencies and the Bank based on a regulatory examination conducted in early 2012. The Consent Order will remain in effect until it is modified or terminated by the FDIC and the Connecticut Department of Banking. The Bank's customer deposits remain fully insured to the highest limit set by the FDIC.

SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

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The Company's actual capital amounts and ratios at December 31, 2012 and December 31, 2011 were (dollars in thousands):

December 31, 2012	Actual			For Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio		Amount	Ratio		Amount	Ratio
Total Capital to Risk-Weighted Assets	$12,863	12.33	%	$8,343	8.00	%	N/A	N/A
Tier 1 Capital to Risk-Weighted Assets	11,548	11.07	%	4,171	4.00	%	N/A	N/A
Tier 1 (Leverage) Capital to Average Assets	11,548	9.31	%	4,960	4.00	%	N/A	N/A

December 31, 2011	Actual			For Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio		Amount	Ratio		Amount	Ratio
Total Capital to Risk-Weighted Assets	$13,057	10.88	%	$9,601	8.00	%	N/A	N/A
Tier 1 Capital to Risk-Weighted Assets	11,546	9.62	%	4,800	4.00	%	N/A	N/A
Tier 1 (Leverage) Capital to Average Assets	11,546	7.41	%	6,236	4.00	%	N/A	N/A

The Bank's actual capital amounts and ratios at December 31, 2012 and December 31, 2011 were (dollars in thousands):

December 31, 2012	Actual			For Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
Total Capital to Risk-Weighted Assets	$ 12,057	11.60	%	$ 8,313	8.00	%	$ 10,391	10.00	%
Tier 1 Capital to Risk-Weighted Assets	10,747	10.34	%	4,156	4.00	%	6,235	6.00	%
Tier 1 (Leverage) Capital to Average Assets	10,747	8.70	%	4,939	4.00	%	6,174	5.00	%

To Be Well

December 31, 2011	Actual		For Capital Adequacy Purposes		Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk-Weighted Assets	$ 12,283	10.28 %	$ 9,555	8.00 %	$ 11,943	10.00 %
Tier 1 Capital to Risk-Weighted Assets	10,780	9.03 %	4,777	4.00 %	7,166	6.00 %
Tier 1 (Leverage) Capital to Average Assets	10,780	6.95 %	6,206	4.00 %	7,758	5.00 %

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Restrictions on dividends, loans or advances

The Company's ability to pay cash dividends is dependent on the Bank's ability to pay dividends to the Company. However, certain restrictions exist regarding the ability of the Bank to transfer funds to the Company in the form of cash dividends, loans or advances. Regulatory approval is required to pay cash dividends in excess of the Bank's net earnings retained in the current year plus retained net earnings for the preceding two years. The Bank is also prohibited from paying dividends that would reduce its capital ratios below minimum regulatory requirements, and the Federal Reserve Board may impose further dividend restrictions on the Company. No such dividends were declared in 2012 or 2011.

Under Federal Reserve regulation, the Bank is also limited to the amount it may loan to the Company, unless such loans are collateralized by specified obligations. Loans or advances to the Company by the Bank are limited to 10% of the Bank's capital stock and surplus on a secured basis. During the years ended December 31, 2012 and 2011, no loans or advances were made to the Company by the Bank.

Note 16. Related Party Transactions

In the normal course of business, the Company may grant loans to executive officers, directors and members of their immediate families, as defined, and to entities in which these individuals have more than a 10% equity ownership. Such loans are transacted at terms including interest rates, similar to those available to unrelated customers.

	2012	2011
Balance, at beginning of year	$2,026,960	$1,526,974
Additional loans	836,534	2,089,199
Repayments	(715,262)	(1,589,213)
Other	(1,055,955)	—
	$1,092,277	$2,026,960

Other transactions represent loans to related parties who ceased to be related parties during the year.

Related party deposits aggregated approximately $1,115,662 and $3,908,313 as of December 31, 2012 and 2011, respectively.

Included in professional services for the years ended December 31, 2012 and 2011 were approximately $113,200 and $114,100, respectively, in professional fees incurred for services provided by an accounting firm ($0 in 2012 and $5,700 in 2011) and a law firm ($113,200 in 2012 and $108,400 in 2011), principals of which are directors of the Company. During 2011, the Company paid approximately $5,400 for capital expenditures and maintenance to certain companies, principals of which were directors of the Company. There were no such expenditures paid in 2012.

SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

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NoteFair Value and Interest Rate Risk
17.

As described in Note 1, the Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. A description of the valuation methodologies used for assets and liabilities recorded at fair value, and for estimating fair value for financial and non-financial instruments not recorded at fair value, is set forth below.

Cash and due from banks, short-term investments, interest bearing certificates of deposit, accrued interest receivable, accrued interest payable and repurchase agreements

The carrying amount is a reasonable estimate of fair value. The Company does not record these assets at fair value on a recurring basis. Cash and due from banks, short-term investments, interest bearing certificates of deposit, accrued interest receivable, accrued interest payable and repurchase agreements are classified as Level 1 within the fair value hierarchy.

Federal Home Loan Bank stock

The Bank is a member of the Federal Home Loan Bank ("FHLB") of Boston and is required to maintain an investment in capital stock of the FHLB. The carrying amount is a reasonable estimate of fair value. The Company does not record this asset at fair value on a recurring basis. Based on redemption provisions, the stock of the FHLB has no quoted market value and is carried at cost. FHLB stock is classified as Level 3 within the fair value hierarchy.

Available for sale securities

These financial instruments are recorded at fair value in the financial statements on a recurring basis. Where quoted prices are available in an active market, the securities are classified within Level 1 of the valuation hierarchy. If quoted prices are not available, then fair values are estimated by using pricing models (i.e., matrix pricing) or quoted prices of securities with similar characteristics and the securities are classified within Level 2 of the valuation hierarchy. Examples of such instruments include government agency bonds and mortgage-backed securities and common stock. Securities classified within Level 3 of the valuation hierarchy are securities for which significant unobservable inputs are utilized. Available for sale securities are recorded at fair value on a recurring basis.

The Company's available for sale securities, comprised of U.S. Treasury securities, are classified as Level 1 in the fair value hierarchy, as quoted prices are available in an active market.

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Loans receivable

For variable rate loans that reprice frequently and have no significant change in credit risk, carrying values are a reasonable estimate of fair values, adjusted for credit losses inherent in the loan portfolio. The fair value of fixed rate loans is estimated by discounting the future cash flows using estimated period end market rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, adjusted for credit losses inherent in the loan portfolio. The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for credit losses is established. The specific reserves for collateral dependent impaired loans are based on the fair value of collateral less estimated costs to sell. The fair value of collateral is determined based on appraisals. In some cases, adjustments are made to the appraised values due to various factors including age of the appraisal, age of comparables included in the appraisal, and known changes in the market and in the collateral. When significant adjustments are based on unobservable inputs, the resulting fair value measurement is categorized as a Level 3 measurement.

At December 31, 2012 and 2011, the Company's collateral dependent loans receivable considered impaired that were newly measured for fair value purposes during such periods, were categorized as Level 3 within the fair value hierarchy, and the balances, net of related specific reserves, were $3,448,058 and $3,678,296, respectively. The remaining balance of loans receivable was classified as Level 2 within the fair value hierarchy.

Servicing assets

The fair value is based on market prices for comparable servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The Company does not record these assets at fair value on a recurring basis. Servicing assets are classified as Level 2 within the fair value hierarchy.

Other assets held for sale and other real estate owned

Other assets held for sale, representing real estate that is not intended for use in operations and real estate acquired through foreclosure, are recorded at fair value on a nonrecurring basis. Fair value is based upon appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company classifies the fair value measurement as Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company classifies the fair value measurement as Level 3. The Company classified the other assets held for sale and other real estate owned as Level 2 within the fair value hierarchy, as the fair value of these assets was based upon current appraisals.

Other assets – derivative financial instruments

Derivative financial instruments represent an equity warrant asset held by the Bank which entitled the Bank to acquire stock in the issuer, a publicly traded company. The Bank held this asset for prospective investment gains. The Bank did not use it to hedge any economic risks nor does it use other derivative instruments to hedge economic risks. The equity warrant asset was recorded at fair value and classified as a derivative asset, which is a component of other assets, on the Company's consolidated balance sheet at December 31, 2011. The Company classified the other assets –

derivative financial instruments as Level 2 within the fair value hierarchy.

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Interest only strips

The fair value is based on a valuation model that calculates the present value of estimated future cash flows. The Company does not record these assets at fair value on a recurring basis. Interest only strips are classified as Level 2 within the fair value hierarchy.

Deposits

The fair value of demand deposits, savings and money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposit is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities, estimated using local market data, to a schedule of aggregated expected maturities of such deposits. The Company does not record deposits at fair value on a recurring basis. Demand deposits, savings and money market deposits are classified as Level 1 within the fair value hierarchy. Certificates of deposit are classified as Level 2 within the fair value hierarchy.

Off-balance-sheet instruments

Fair values for the Company's off-balance-sheet instruments (lending commitments) are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The Company does not record its off-balance-sheet instruments at fair value on a recurring basis. Off-balance-sheet instruments are classified as Level 3 within the fair value hierarchy.

The following tables detail the financial asset amounts that were carried at fair value and measured at fair value on a recurring basis as of December 31, 2012 and 2011, and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value:

	Balance as of December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasury Bills	$1,249,925	$1,249,925	$ —	$ —

	Balance as of December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

U.S. Treasury Bills	$	3,849,847	$	3,849,847	$	—	$	—
Other assets - derivatives	$	86,434			$	86,434	$	—

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The following tables detail the financial instruments carried at fair value and measured at fair value on a nonrecurring basis as of December 31, 2012 and 2011, and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value:

	Balance as of December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets held at fair value				
Impaired loans (1)	$3,448,058	$ —	$ —	$ 3,448,058

	Balance as of December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets held at fair value				
Impaired loans (1)	$3,678,296	$ —	$ —	$ 3,678,296

(1) Represents carrying value and related write-downs for which adjustments are based on appraised value. Management makes adjustments to the appraised values as necessary to consider declines in real estate values since the time of the appraisal. Such adjustments are based on management's knowledge of the local real estate markets.

The following tables detail the nonfinancial assets carried at fair value and measured at fair value on a nonrecurring basis as of December 31, 2012 and 2011, and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value:

	Balance as of December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Other assets held for sale	$315,000	$ —	$315,000	$ —

Other real estate owned	$582,911	$ —	$ —	$ 582,911

	Balance as of December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Other assets held for sale	$315,000	$ —	$315,000	$ —
Other real estate owned	$374,211	$ —	$ —	$ 374,211

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The Company discloses fair value information about financial instruments, whether or not recognized in the statement of financial condition, for which it is practicable to estimate that value. Certain financial instruments are exluded from disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The estimated fair value amounts as of December 31, 2012 and 2011 have been measured as of their respective year-ends and have not been reevaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than amounts reported at each year-end.

The information presented should not be interpreted as an estimate of the fair value of the Company as a whole since a fair value calculation is only required for a limited portion of the Company’s assets and liabilities. Due to the wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company’s disclosures and those of other companies may not be meaningful.

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The following is a summary of the recorded book balances and estimated fair values of the Company's financial instruments at December 31, 2012 and 2011, in thousands:

	Fair Value Hierarachy Level	December 31, 2012 Recorded Book Balance	December 31, 2012 Fair Value	December 31, 2011 Recorded Book Balance	December 31, 2011 Fair Value
Financial Assets:					
Cash and due from banks	Level 1	$ 6,913,610	$ 6,913,610	$ 18,167,794	$ 18,167,794
Short-term investments	Level 1	4,674,556	4,674,556	6,764,409	6,764,409
Interest bearing certificates of deposit	Level 1	655,278	655,278	99,426	99,426
Available for sale securities	Level 1	1,249,925	1,249,925	3,849,847	3,849,847
Federal Home Loan Bank stock	Level 3	60,600	60,600	66,100	66,100
Loans receivable, net:					
Observable inputs	Level 2	98,099,996	99,788,559	105,858,787	108,656,645
Unobservable inputs	Level 3	5,179,441	5,179,441	5,785,355	5,785,355
Accrued interest receivable	Level 1	397,497	397,497	434,302	434,302
Servicing rights	Level 2	6,012	15,106	7,991	20,079
Interest only strips	Level 2	7,769	12,531	10,364	16,717
Derivative financial instruments	Level 2	—	—	86,434	86,434
Financial Liabilities:					
Noninterest-bearing deposits	Level 1	29,906,051	29,906,051	31,003,581	31,003,581
Interest bearing checking accounts	Level 1	5,110,736	5,110,736	5,149,535	5,149,535
Money market deposits	Level 1	36,649,525	36,649,525	47,728,069	47,728,069
Savings deposits	Level 1	2,877,303	2,877,303	2,838,736	2,838,736
Time certificates of deposits	Level 2	33,707,623	34,357,000	45,910,760	46,787,000
Repurchase agreements	Level 1	—	—	68	68
Accrued interest payable	Level 1	46,764	46,764	204,021	204,021

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Unrecognized financial instruments

Loan commitments on which the committed interest rate is less than the current market rate were insignificant at December 31, 2012 and 2011.

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, fair values of the Company's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent management believes necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and by investing in securities with terms that mitigate the Company's overall interest rate risk.

NoteProperty Held for Sale
18.

In June 2005, the Company purchased a one acre improved site with two buildings in Clinton, Connecticut for the primary purpose of establishing a branch office of the Bank. During 2007, the Bank determined that it would not establish a branch at this location and subsequently retained a commercial real estate broker to represent the Company with respect to the sale of the property. The property is classified as other assets held for sale as of December 31, 2012 and 2011.

In December 2011, the Company entered into an agreement to lease one of the two buildings located in Clinton, Connecticut. The lease is for an initial term of five years, with two successive five-year option periods. Base rent is $26,400 annually until December 15, 2016. The base rent for the option periods increases and is fixed in the lease. The tenant has a right of first refusal to purchase the property. The tenant is responsible for all costs to maintain the building, other than structural repairs and real estate taxes. Prior to December 2011, the Company had a lease agreement in place under similar terms and conditions with a different tenant. The Company and the former tenant mutually agreed to terminate the lease agreement in August 2011. The Company received approximately $31,200 and $13,600 in rent for this Clinton, Connecticut property in 2012 and 2011, respectively.

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Note 19. Subsequent Events

On January 16, 2013, the Company and the Bank entered into an Agreement and Plan of Merger (the "Merger Agreement") with Liberty Bank, a Connecticut-chartered mutual savings bank with its main office in Middletown, Connecticut ("Liberty"), pursuant to which a to-be-formed wholly-owned subsidiary of Liberty will be merged with and into the Company with the Company being the surviving entity, immediately followed by the merger of the Company with and into Liberty with Liberty being the surviving entity (collectively, the "Merger"), and immediately followed by the merger of the Bank with and into Liberty with Liberty being the surviving bank.

Subject to the terms and conditions of the Merger Agreement, upon consummation of the Merger, each outstanding share of common stock of the Company will be converted into the right to receive cash consideration in the amount of $3.76. In addition, each outstanding option to acquire shares of common stock of the Company will be cancelled and converted into the right to receive cash equal to the product of (i) the positive difference, if any, between $3.76 and the exercise price of such option multiplied by (ii) the number of shares of common stock of the Company underlying such option.

The Merger Agreement contains representations, warranties and covenants of the Company, the Bank and Liberty. Among other customary covenants, each of the Company and the Bank has agreed that it (i) will conduct its business in the ordinary course and consistent with past banking practices during the period between the execution of the Merger Agreement and the consummation of the Merger and (ii) will not engage in certain kinds of transactions during such period unless it obtains the prior written consent of Liberty. The Company has also agreed to not, subject to certain exceptions generally related to the Company's Board of Directors' evaluation and exercise of its fiduciary duties, (i) solicit proposals relating to alternative business combination transactions or (ii) enter into discussions or negotiations or provide confidential information in connection with any proposals for alternative business combination transactions. The Merger Agreement also provides that Liberty will establish an advisory board for the Greater New Haven, Connecticut market area and invite each director of the Company to serve on such advisory board.

The Merger Agreement provides certain termination rights for both the Company and Liberty, and further provides that upon termination of the Merger Agreement under certain circumstances, the Company will be obligated to pay Liberty a termination fee of up to $450,000.

Completion of the Merger is subject to various conditions, including (i) receipt of the requisite approval of the shareholders of the Company, (ii) the absence of any law or order prohibiting the closing and (iii) receipt of regulatory approvals. In addition, each party's obligation to consummate the Merger is subject to certain other conditions, including the accuracy of the representations and warranties of the other party, compliance by the other party with its covenants in all material respects and the receipt of all material permits, authorizations, consents, waivers or approvals required to be obtained by the other party. If these conditions are satisfied, the Merger is expected to be completed in the second quarter of 2013.