EXECUTIVE COMPENSATION: HOW MUCH IS TOO MUCH?

HEARING

BEFORE THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

OCTOBER 28, 2009

Serial No. 111–35

Printed for the use of the Committee on Oversight and Government Reform

Available via the World Wide Web: http://www.gpoaccess.gov/congress/index.html
http://www.house.gov/reform

U.S. GOVERNMENT PRINTING OFFICE

54–553 PDF WASHINGTON : 2009

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EXECUTIVE COMPENSATION: HOW MUCH IS TOO MUCH?

WEDNESDAY, OCTOBER 28, 2009

HOUSE OF REPRESENTATIVES,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The committee met, pursuant to notice, at 11:03 a.m., in room 2157, Rayburn House Office Building, Hon. Edolphus Towns (chairman of the committee) presiding.

Present: Representatives Towns, Issa, Maloney, Cummings, Kucinich, Tierney, Clay, Connolly, Quigley, Kaptur, Van Hollen, Cuellar, Murphy, Welch, Foster, Speier, Driehaus, Chu, Burton, Souder, McHenry, Bilbray, Jordan, Flake, Luetkemeyer and Cao.

Staff present: Brian Eiler and Brian Quinn, investigative counsels; Jean Gosa, clerk; Adam Hodge, deputy press secretary; Carla Hultberg, chief clerk; Marc Johnson, assistant clerk; Mike McCarthy, deputy staff director; Steven Rangel, senior counsel; Jenny Rosenberg, director of communications; Joanne Royce, senior investigative counsel; Leneal Scott, IT specialist; Ron Stroman, staff director; Alex Wolf, professional staff member; Gerri Willis, special assistant; David Rothany, counsel; Lawrence Brady, minority staff director; John Cuaderes, minority deputy staff director; Ron Borden, minority general counsel; Jennifer Safavian, minority chief counsel for oversight and investigations; Adam Fromm, minority chief clerk and Member liaison; Kurt Bardella, minority press secretary; Seamus Kraft and Benjamin Cole, minority deputy press secretarys; Christopher Hixon, minority senior counsel; Hudson Hollister, minority counsel; and Brien Beattie and Mark Marin, minority professional staff members.

Chairman TOWNS. The committee will come to order.

Good morning. Before we begin, I would like to extend a warm welcome to a new member of the committee on the majority side, Representative Judy Chu from the 32nd District of the great State of California, which includes East Los Angeles. Dr. Chu is a longtime elected official at the State and local level, so she brings that experience to our committee. She also holds a Ph.D. in psychology—now, you know we need her; we need her desperately—which also may be useful on this committee.

I yield to the ranking member, then, and, of course, after that, I would like to yield some time to Dr. Chu.

Congressman Issa.

Mr. ISSA. Well, I would like to join with the chairman in welcoming my colleague both to the committee and obviously as a fellow Californian. I might only comment that perhaps if your degree was in child psychology, it would be more useful in Congress. But we look forward to your comments.

Yield back.

Chairman TOWNS. We will take any degree.

Dr. Chu.

Ms. CHU. Well, thank you, Chairman Towns and Ranking Member Issa, for that very, very warm welcome. Well, actually, it is Judy Chu.

But I am so grateful to be the newest member of the Committee on Oversight and Government Reform. This jurisdiction will allow us to delve into the major issues of the day that affect our constituents in our Nation, such as foreclosures, the financial crisis, and Government waste, fraud, and abuse. The economic downturn has hit my district hard. The number of foreclosure filings in California are very, very high and in L.A. County has hit 12.7 percent. Yet, we have read for the past year how well CEOs and bank executives are doing, and compensation levels are at an all-time high. So today's topic couldn't be more timely and I look forward to hearing more in today's hearing as a member of this committee.

Thank you and I yield back.

Chairman TOWNS. Thank you very much, Dr. Chu. We welcome you to the committee.

There is little doubt that executive compensation schemes were a contributing factor in the Wall Street meltdown. Top executives had grown accustomed to receiving enormous bonuses on top of fat salaries, regardless of how their companies performed. When their companies did well, they received big, big bonuses. And when their companies did poorly, they still received big, big bonuses. Even the chairman of Goldman Sachs has admitted that the perverse incentives created by these schemes helped send the industry into the brink.

It is not surprising that the taxpayers were outraged when they realized that their money was being used to bail out companies that still planned to pay their executives millions of dollars, even though the company was not doing well. If it were not for taxpayer bailouts, these companies would no longer be in existence. We wouldn't be reviewing their salary plans, we would be reviewing their liquidation plans.

After these bailouts, and after the outrage last spring, you would think that the top brass would have recognized there was a problem with excessive compensation.

The Obama administration made a good decision when they appointed a special master, Mr. Ken Feinberg, to review executive compensation at companies receiving taxpayer bailouts. Mr. Feinberg performed the first review of compensation for the highest paid employees of the seven companies which received the most TARP dollars. He found what many feared: the top brass still does not understand. Another way to put it, they still don't get it.

Despite record losses and near bankruptcies, the executives at these companies were still planning to cash in and continue to do business as usual. I am happy to say that Mr. Feinberg ordered substantial cuts in their pay. No doubt there is howling in the executive suites, but I don't think the taxpayers are going to be shedding any tears over this.

These huge pay packages are offensive during these difficult times and Americans are angry about it. I hear the anger in church, on the street, and wherever average Americans congregate you hear from them as to how angry they are about what is going on.

Some on Wall Street have justified their huge pay packages by comparing themselves to superstar athletes. But Tiger Woods and A-Rod didn't crash the economy. They haven't asked for any Government bailouts, either. And let me be clear. The issue today is not whether the Government should dictate how much people should be allowed to earn. The issue today is whether banks, that were saved from bankruptcy only by taking billions of dollars in taxpayer money, should be rewarded with salaries that give new meaning to the word "generous."

It is a shame to have Government get involved in bank compensation issues, but Wall Street can no longer be trusted to control themselves. Some constraints on these companies are necessary to protect the safety and soundness of the entire financial system. We need more than just a special master; we need to give the shareholders a way to get this under control.

Today we welcome Mr. Feinberg, who will testify about his efforts to ensure that our tax dollars are not being squandered on excessive compensation.

I want to also thank Professor Black and Professor Roberts, who will likewise share their insight on executive compensation. I look forward to hearing their testimony.

I am certain that most of you know the American people are really angry about what is really going on.

[The prepared statement of Chairman Edolphus Towns follows:]

OPENING STATEMENT OF CHAIRMAN EDOLPHUS TOWNS

Hearing: "Executive Compensation: How Much is Too Much?"

October 28, 2009

Good morning and thank you all for being here.

There is little doubt that executive compensation schemes were a contributing factor in the Wall Street meltdown.

Top executives had grown accustomed to receiving enormous bonuses on top of fat salaries, regardless of how their companies performed.

When their companies did well they received big bonuses. And when their companies did poorly, they still received big bonuses.

Even the Chairman of Goldman Sachs has admitted that the perverse incentives created by these schemes helped send the industry over the brink.

It's not surprising, then, that the taxpayers were outraged when they realized that their money was being used to bail out companies that still planned to pay their executives millions of dollars.

If it weren't for taxpayer bailouts, these companies would no longer be here. We wouldn't be reviewing their salary plans – we'd be reviewing their liquidation plans.

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These huge pay packages are offensive during these difficult times and Americans are angry about it. I hear the anger in church, on the street, and wherever average Americans meet.

And I think we saw more evidence of people's outrage at the protests at the American Banker's Association meeting in Chicago yesterday.

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I want to also thank Professors Black and Roberts who will likewise share their insight on executive compensation.

I look forward to their testimony.

Chairman TOWNS. I now yield 5 minutes to the committee's ranking member, Darrell Issa, of California, for his opening statement.

Mr. ISSA. Thank you, Mr. Chairman. Mr. Chairman, I ask unanimous consent that mine and all Members' opening statements be placed in the record in their entirety.

Chairman TOWNS. Without objection, so ordered.

Mr. ISSA. Mr. Chairman, I will be brief and paraphrase my opening statements.

I join with you in the comment you made in your opening statement that we need to empower the stockholders of public companies to better manage the package of pay and incentive packages of their key executives.

I also would say that, in 1992, the word "perverse" perhaps would be based on the efforts by this Congress to rein in pay by simply saying compensation for more than $1 million, if it is not tied to performance, would be double taxable.

Although well meaning, clearly what we have done is we have created an environment in which a board, acting on behalf of their stockholders, is not able to link whatever amount of money they would like to pay in a long and perhaps deferred compensation way but, rather, begin by saying, for their key executives, how do we work around that law? How do we link it to performance?

There is an entire industry that has built up over the last almost two decades of people who in fact helped key executives get more money into their incentive plans, then proceed to advise boards as to whether those plans are reasonable, and the upward spiral has continued.

I would say that we pay, often, more than we need to as stockholders for the work done by key executives. But, Mr. Chairman, that is not the issue before us today. The issue before us today is do the American people have a stake in seeing that compensation is limited by these seven companies in order to ensure timely repayment of as much or all of what we have loaned to these companies as possible.

Mr. Chairman, I would say that these seven companies are very different. Mr. Chairman, AIG will in all likelihood not return anywhere close to 100 cents on the dollars to the American people. On the other hand, it is likely that Bank of America, Goldman Sachs and others quickly returning to the money and, in fact, perhaps returning it sooner if we were not concerned about the ongoing stability of our economy, would soon be likely to return the money and, as such, in my opinion, we would no longer have a legitimate right to oversee their pay and compensation.

Notwithstanding that, Mr. Chairman, since this committee has had a keen interest for a period of time in executive compensation and whether in fact the stockholders are being well represented, I would join with you gladly to continue the process of looking at whether or not public companies currently meet the obligation of ensuring that the compensation is a compensation that best is in line with the interest of the stockholders and whether or not those stockholders, if fully informed, would validate that pay.

Mr. Chairman, I believe that is the reform that we have an ongoing nature for, not necessarily any one person's pay today. I look forward to hearing from our witness and our panel to follow on whether or not we in fact are making the link between the $700 billion TARP and the moneys that have been loaned and the American people getting paid back.

I hope that we all will leave today's hearing realizing that if we go too far, we endanger the American people's system of capitalism and limited free market that has allowed us to be the envy of the world. Yes, we do prevent antitrust; yes, we do have rules of the road; and, yes, we do have controls over public companies. But, Mr. Chairman, the successes of the past in America should not in fact be wiped away because of the sins of a few on Wall Street who, perhaps, realizing that bulls and bears were both making money, decided to become pigs.

Mr. Chairman, I yield back the balance of my time.

[The prepared statement of Hon. Darrell E. Issa follows:]

EDOLPHUS TOWNS, NEW YORK
CHAIRMAN

DARRELL E. ISSA, CALIFORNIA
RANKING MINORITY MEMBER

ONE HUNDRED ELEVENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
2157 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6143

Majority (202) 225–5051
Minority (202) 225–5074

Statement of Rep. Darrell Issa, Ranking Member

"Executive Compensation: How Much is Too Much?"

October 28, 2009

Chairman Towns, thank you for holding today's hearing on the Obama Administration's efforts to control executive compensation in the private sector.

The American people are angry and they have a right to be. They're angry that Wall Street executives who made reckless bets with other people's money and were bailed out by the taxpayers while many of those same taxpayers lost their jobs.

Corporate greed and corruption isn't a sound business strategy. Bear Stearns, Lehman Brothers, and Countrywide are all examples of firms where greed for profit led to their ultimate downfall.

While the American people are angry at Wall Street, they're also angry at us. Why?

There's a saying about greed on Wall Street that once rang true: "Bulls and bears get rich, but pigs go broke."

Under the new order, pigs get a government bail out.

President Bush, President Obama, Hank Paulson, Ben Bernanke, Tim Geithner, and the United States Congress failed in their solemn responsibility to the American people. TARP is the biggest giveaway of taxpayer dollars in American history – $700 billion of taxpayer money was handed over to a bunch of companies that balked at facing the consequences for their greed and bad decisions.

Mr. Chairman, I believe in capitalism. Although it is not perfect, the American brand of capitalism has enabled the production of more wealth, spread among more people, than any system of economic organization in the history of man. Just as government bailouts of failed firms are misguided, so to are efforts to place a cap on the rewards of true innovation and success.

The rewards of success in business incentivize managers and investors to make good decisions, and the fear of failure discourages bad decisions. If you take away the freedom to fail, the entire system goes out of balance.

The series of bailout decisions made by both the Bush and Obama Administrations have insulated Big Business from the fear of failure. We have subsidized failure and mortgaged our future to do so, and it has to stop.

Building on these bad decisions, the Obama Administration has appointed a "Special Master for Compensation" who is commonly referred to as the "Pay Czar." While I appreciate the Special Master's appearance before the Committee today, I am deeply concerned that this position is an example of this Administration yet again outsourcing responsibility to unaccountable czars. According to news reports, the Special Master's rulings are final and unreviewable. He rarely consults with Secretary Geithner, and he is purposefully insulated from oversight from the White House.

While distancing themselves from the Special Master's activities may be politically expedient for President Obama and Secretary Geithner, this position represents a fundamental shirking of their responsibility to the American people. The American people have a right to know how the Pay Czar can exercise such unprecedented and unchecked power in a free society.

Before we had a pay czar and before Federal bailouts were commonplace, the United States had a system known as bankruptcy whereby failed firms could have debts dissolved, salaries of executives slashed, and in extreme cases, the firms could actually be dissolved. Executive pay was also controlled by boards of directors and shareholders.

In knowing that the existing regulatory structure failed in its responsibilities to protect shareholders, the right way to address the problem is to fix the underlying regulatory system rather than appoint a pay czar.

While I appreciate that Mr. Feinberg is concerned that taxpayer dollars aren't used to fund excessive executive compensation, I also hope he'll understand my position: we need to address problems in our financial system and get to a place where we don't need a pay czar as quickly as possible.

Mr. Chairman, those in Washington who bailed out these companies had the arrogance to say, "We know what's best. We have the special knowledge and the right to take money out of the taxpayers' pockets and give it to those who should have borne the consequences for their bad decisions." I say nothing gives us that right.

We have made these firms too big to fail. We have given them access to the public purse. And we continue to travel down the road to crony capitalism by relying on unaccountable czars to micromanage salaries at firms we should have never protected from failure in the first place.

Thank you, Mr. Chairman.

Chairman TOWNS. Thank you very much. I thank the gentleman for his statement.

Today's hearing will consist of two panels. Our first panel witness is Mr. Kenneth R. Feinberg, who serves as the special master for TARP Executive Compensation. Mr. Feinberg has just completed a report regarding the compensation proposal of the 25 highest paid employees of the seven recipients of exceptional assistance under TARP.

We welcome, you, Mr. Feinberg, and I want to thank you for all your hard work. I can only imagine how difficult it was to balance the competing interests. I know you did not make many friends with your rulings. I understand that.

It is committee policy that all witnesses are sworn in, so if you would stand and raise your right hand.

[Witness sworn.]

Chairman TOWNS. Let the record reflect that Mr. Feinberg responded in the affirmative.

We generally move forward with the lights on—it starts at green and then it goes to yellow and then turns to red—but we want you to go without the lights. We are just so anxious and eager to hear what you have to say, so why don't you just begin and, of course, try to do it within 10 minutes.

STATEMENT OF KENNETH R. FEINBERG, SPECIAL MASTER FOR TARP EXECUTIVE COMPENSATION

Mr. FEINBERG. You may regret that, Mr. Chairman.

First of all, I want to thank you, Mr. Chairman, for inviting me, and the ranking minority member for inviting me. It is an honor and a privilege to be here today, the first time I have addressed a committee here in the Congress on my recent report of last week.

I just want to mention at the outset, Mr. Chairman, I want to thank you and the ranking minority member once again for how much you helped me 8 years ago, during my administration of the 9/11 Victim Compensation Fund. The two of you and other members of this committee were extraordinarily helpful to me in meeting with the families and discussing with them the benefits of the 9/11 Fund, and I thank both of you really again for your help in that regard.

I now have a new challenge, executive compensation. I should say at the outset, one reason that this committee hearing room is so crowded is virtually my entire staff is here. I don't think anybody is working today at Treasury from the Office of the Special Master, and I am grateful for their hard work and help.

For the last 5 months I had a narrow mandate under the law, and that was to determine pay compensation packages for the top 25 officials in just seven companies that received the most TARP assistance—Citigroup, AIG, Bank of America, General Motors, GMAC, Chrysler, and Chrysler Financial. That is the limit of my jurisdiction. I have no authority, no mandatory jurisdiction to determine pay for any other than these seven companies. And even as to these seven companies, only the top 25 officials in each of those companies.

The report, which I have submitted, which is now public, and which I have attached to my testimony, is a comprehensive report that explains in great detail the method I used and the conclusions I reached strictly following the statute passed by Congress and the accompanying Treasury regulations.

In your letter of invitation you raised three questions for me to respond to in the course of this testimony, and I will summarize my response. My more detailed response is found in my written testimony.

First, you asked what principles guided me in my decisions. The principles that guided me were the legal principles laid out in the statute and the accompanying regulations—"Mr. Special Master, make sure that these companies, as the ranking minority member mentioned, make sure these companies stay in business with compensation packages that will make them thrive, hopefully, and, above all, will help them return to the taxpayers the money that was loaned to them initially."

But the law also spells out that, in establishing these compensation packages, I should consider various other factors: one, let's avoid guaranteed contracts, retention payments, salaries, bonuses, commissions, long-term severance packages; etc.; let's tie, as best we can, compensation to performance; let's encourage executive officials to stay on the job and continue to work at these companies; let's establish compensation packages that will avoid excessive risk taking.

These were all principles laid out in the statute that guided me in my work. And my simple summary answer to the principles and the terms and the conditions that I used in reaching my conclusions are found in the public law and the public regulations, and I did my best to enforce the law and the regulations without fear and without favor.

The second question you asked is how did you go about determining the compensation packages; what was the process; how did it work; where did you find the companies acceptable, where did you find their recommendations flawed.

I requested and received comprehensive submissions from each of the seven companies explaining their view of what they thought they needed for their 25 top officials in the way of a comprehensive package. I examined those submissions with the utmost care and scrutiny, and I concluded that in six of the seven submissions the information requested, the compensation packages urged on me by these companies were contrary to the statute, contrary to the regulations, and contrary to the public interest. They were contrary because each of the submissions, or six of the seven, wanted too much cash guaranteed salary; they wanted stock that would be immediately, on the day it is issued, transferrable; they wanted to tie their salary and their compensation to vague, ambiguous performance standards; they made no mention, or insufficient mention, of the perks that were part of their overall salary—private airfare, golf club dues, country club dues, etc.—and they demanded, as part of their submission, that I honor all old prior grand-fathered contracts for compensation that were entered into with officials long before this law was passed and long before I arrived on the scene as the special master.

So what did we do in this report? We evaluated the submissions and then we made some, what I think, material changes in the overall program. First, we greatly reduced the amount of cash that would be made available to these senior officials. We reduced that cash by approximately 90 percent.

Now, I read with great interest in today's newspaper an article that implied or stated that I had actually raised cash base salaries with a number of these officials. It all depends what you mean by cash base salaries. If somebody is getting cash salary, guaranteed last year, of $3 million, and now they are getting, under my program, $300,000 in cash, that sounds to me like a 90 percent reduction. The article today cited one example of a Citi official where the base salary for that official, according to the article, was raised by the special master to $475,000, an increase of 111 percent. What the article does not point out is, last year, that same official received from Citi $13 million in cash. And under my report that cash was reduced by 98 percent.

So I am very comfortable in defending my report and saying that, overall, one of our primary objectives succeeded in this report for these seven companies was to reduce absolute guaranteed cash by 90 percent.

Second, we required, in addition to the cash salaries, that when we issue stock in the company that is salarized stock, that is part of the salary, that stock may not be cashed out for up to 4 years. The stock can be cashed after 2 years one-third, 3 years another third, and 4 years the last third. We want to keep people on the job with a vested interest in the company. If you want salarized stock, the value of that stock is tied to the performance of the company and the goal—the ranking minority member couldn't have said it better—the goal is keeping the company moving so that the taxpayers get their money back.

Third, we said no more unlimited perks. No more private jets, no more golf club dues, no more country club dues. Perks, under the report, are limited to $25,000 per individual. Anything more than $25,000 you have to come back to the special master for approval and monitoring of those requested excessive perks.

Finally, what did we say with these companies about these old grand-fathered contracts that are purportedly in the hundreds of millions of dollars? Well, we worked with the seven companies. They were very, very cooperative. Very cooperative. And in almost every case we worked out a system whereby any grand-fathered amounts that were due and owing as compensation would be voluntarily rolled over into prospective stock under our rules, 4 years before it totally vests, and we removed almost all of those grand-fathered valid contracts and got the companies to voluntarily agree that it would be ill advised, unwise to demand payment on those old contracts. And, instead, in almost every case we mutually agreed that those grand-fathered amounts should be rolled over prospectively into future stock with a vested interest in the company.

That is what we did, spelled out in some detail in the report.

Finally, your letter of invitation, Mr. Chairman, asked me to comment on any recommendations I might have going forward in dealing with executive compensation. I should remind the committee that my first obligation, right now underway, under the law is to design a compensation structure for officials 26 to 100 in each of these seven companies. Right now we are actively doing that. By the end of this year we will have designed and implemented not individual pay packages for 26 to 100, but overall compensation structure for employees 26 to 100 in these seven companies. Then, if the Secretary of the Treasury so requests, I will turn my attention immediately in January to compensation packages for 2010 for these same seven companies and the 25 individuals in 2010 that are covered by the statute.

So those two objectives—26 to 100, 2010—the law spells out expressly. Those are part of my ongoing obligations.

I want to just finally address a point that the ranking minority member just made. I do not believe that this law should be extended to encompass other companies. The law was enacted to deal with the taxpayers of this country as creditors of these seven companies, and whatever one might think about whether or not it is a good idea or a bad idea for the Federal Government to be involved in setting compensation for private companies, I suggest that what Congress was stating was that this is an exception. These seven companies are owned by the taxpayers and the taxpayers, as creditors, are asking these companies to rein in compensation and come up with compensation packages that will maximize the likelihood, first and foremost, that the taxpayers will get their money back; and that is my primary objective.

I do not believe, as the administration has stated elsewhere, that we should be micromanaging other companies in the private sector. I am hoping that the report that I issued and the recommendations that I have made as to these seven companies will have some effect, voluntarily, in influencing how the private sector goes about establishing compensation practices, and one of my objectives is, hopefully, that, with my recommendations, other companies on Wall Street and elsewhere will take to heart what I have suggested, what is mandated for these seven companies, and hopefully the model that is created in my report will trickle and expand beyond these seven companies.

But I agree with the minority member that I am perfectly comfortable, thank you, limited to these seven companies. That is enough work for me and I am hopeful that the committee will find my report helpful and useful.

I am prepared to answer any questions and, frankly, I am prepared, in the weeks and months ahead, to work with this committee, to consult with the committee as the committee deems appropriate.

Thank you, Mr. Chairman, for this summary.

[The prepared statement of Mr. Feinberg follows:]

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

TESTIMONY OF
KENNETH R. FEINBERG

Special Master for TARP Executive Compensation
House Committee on Oversight and Government Reform

October 28, 2009

Mr. Chairman:

I thank you and the Committee for the opportunity to testify today. The subject of executive compensation continues to be a top priority of the American people and the international business community, so I welcome your invitation and look forward to participating in this hearing.

As you know, in June of this year, I was asked to serve as Special Master for TARP Executive Compensation by the Secretary of the Treasury. In that capacity, I have a number of responsibilities under the relevant statutory[1] and regulatory[2] authority. These responsibilities include interpreting the regulations, and evaluating and making determinations regarding compensation payments to, and compensation structures for, certain employees of TARP recipients receiving exceptional financial assistance.

In these capacities, I have spent the past five months carefully considering the terms and conditions of the 2009 executive compensation for senior executives at those seven corporations that received exceptional financial assistance from the federal government: AIG, Bank of America, Citigroup, Chrysler, Chrysler Financial, General Motors and GMAC. These executives include five "senior executive officers" and the twenty "most highly compensated employees." My mandatory jurisdiction under the regulations is limited to the senior executives at these seven companies and <u>only</u> these seven companies. Although I do have interpretive authority under the Standards, and advisory authority under the law to make recommendations and nonbinding

[1] *See* Section 111 of the Emergency Economic Stabilization Act of 2008, *as amended by* the American Recovery and Reinvestment Act of 2009.

[2] *See* TARP Standards for Compensation and Corporate Governance, 31 C.F.R. § 30.1 *et seq.*

determinations as to officials of other companies who received TARP financial assistance, I have no legal authority to make final determinations pertaining to executive compensation for any companies other than these seven.

Mr. Chairman, I refer you and the Members of the Committee to the Report of the Special Master for TARP Executive Compensation: 2009 Executive Compensation Determinations for the TARP Exceptional Assistance Recipients, dated October 22, 2009, a copy of which is included with my prepared testimony. This Report includes my compensation determinations concerning senior executives at each of the seven companies referenced above, and provides a comprehensive explanation and analysis of the reasoning which underlies such determinations. I welcome any inquiries you may have concerning my Report.

In your letter of October 15, 2009, inviting me to testify, you raised three questions for me to focus on during my appearance here today. I treat these questions in the order you presented them in your letter.

I. What standards and considerations are you using to evaluate employee compensation at the seven companies that submitted such plans for review?

I was guided by the rules and principles in the statute and the Treasury regulations in evaluating employee compensation at the seven companies. For example, the Treasury regulations expressly make clear that I must consider competitive market forces in determining compensation levels that will permit the seven companies to remain in business, to thrive financially, and to eventually repay the taxpayers for TARP financial assistance. These companies must be able to attract sufficient talent to prosper. At the same time, however, the law requires me to take into account whether the terms and conditions of compensation are performance-based and tie compensation to the companies' prospective performance and financial success. In addition, the regulations make clear that my compensation determinations should be made in such a way that considers whether senior executives are provided incentives to avoid taking excessive risks to receive greater amounts of compensation. The law also anticipates that a portion of compensation be tied to the repayment of TARP financial assistance, and requires companies to "claw back" incentive compensation that is based upon inaccurate financial statements or performance metrics.

In sum, the standards and considerations I used in evaluating employee compensation at the seven companies can be found in the statute and the accompanying Treasury regulations: in these laws, Congress and the Treasury provided me the guidance needed to make my final determinations. Based on this guidance, I determined that a new compensation regimen should be implemented at these seven companies: guaranteed compensation is to be replaced by performance-based compensation designed to tie individual executives' financial opportunities to the long term overall financial success of each company. Short-term profits must give way to longer-term financial stability and success.

II. What specific proposals have been received from the seven companies and what specific actions have you taken with respect to those proposals?

Mr. Chairman, I refer you and the Members of the Committee to my Report (attached) which details the individual submissions made by each of the seven companies, and also describes in comprehensive fashion my response to each of these submissions. The general conclusions I reached after careful evaluation and analysis of the submissions were the same for six of the seven companies—I concluded, pursuant to the statute and the Treasury regulations, that each submission would result in payments contrary to the "Public Interest Standard," and should, therefore, be rejected. The "Public Interest Standard" is the term I used in my Report to describe the regulatory standards that I am required to apply in making determinations. Instead, as my Report spells out, I made important revisions to the submissions as a precondition to approving compensation structures and payments for each individual covered executive at these six TARP recipients. (Chrysler Financial has unique circumstances, and I determined that its proposal was appropriate in light of them.)

I can summarize the flaws in the six individual company submissions as follows:

1. The companies requested excessive guaranteed cash – salaries and bonuses – for company executives;

2. The companies requested that stock issued to these executives be either immediately redeemable or redeemable without a sufficient waiting period;

3. Many of the companies did not sufficiently tie compensation to performance-based benchmarks and metrics;

4. Many of the companies did not sufficiently limit or restrict financial "perks," such as private airplane transportation, country club dues, golf outings, etc., and in some cases provided excessive levels of severance and executive retirement benefits;

5. The companies did not make sufficient effort to fold guaranteed compensation contracts – entered into prior to the enactment of the current compensation regulations – into 2009 performance-based compensation.

In modifying these six submissions in order to satisfy the "Public Interest Standard," I made important changes designed to tie compensation to prospective company performance:

1. I greatly reduced the amount of 2009 guaranteed cash compensation made available to senior executives. On the whole, cash (which, in the past, included cash base salaries and cash bonuses) was reduced by approximately 90%. Overall total compensation was reduced by approximately 50%.

2. In place of cash, I substituted "stock salary" which, in accordance with Treasury regulations, vests immediately upon issuance but may only be

redeemed in three equal, annual installments beginning in 2011, with each installment redeemable one year early if TARP obligations are repaid. The objectives are clear – to tie individual compensation to longer-term performance metrics, and to encourage senior executives to remain at the company for a period of years to maximize their personal benefit from the overall profitability of the company itself. The value of "stock salary" will depend on the companies' financial success in coming years. At the same time, I also permitted incentive payments of "long-term restricted stock." This long-term incentive stock vests only if executives remain employed for three years after grant, and it can be cashed in only in 25% increments for each 25% of TARP obligations repaid by their employer. Again, the goal is to tie individual compensation to the overall financial success of the company.

3. By implementing the ideas of "stock salary" and "long-term restricted stock," only redeemable after multiple years of company performance, I tied individual compensation to long-term company success.

4. I reined in "perks" by expressly requiring that any such perks beyond $25,000 per individual must first receive the approval of the Office of the Special Master. No longer will senior executives be entitled to excessive use of private planes and other compensation-related financial benefits. I also prohibited additional company contributions to executive retirement programs.

5. I succeeded in almost all cases in getting the companies to agree to restructure guaranteed contracts and other forms of guaranteed compensation into prospective, performance-based compensation packages. These companies agreed, in almost all cases, to transfer guaranteed forms of compensation – entered into with company officials before the enactment of current legal requirements – into "stock salary." I am very reluctant to even attempt to invalidate the sanctity of contracts

entered into well before enactment of the current law; however, I did work closely with the companies in an attempt, cooperatively, to restructure these "grandfathered" financial guarantees by making them part of my 2009 final compensation determinations.

Mr. Chairman, I refer you and the Members of the Committee, to my Report which spells out in further detail how we modify company submissions to comply with the "Public Interest Standard."

III. What recommendations do you have for oversight of TARP recipient employee compensation schemes in the future?

The Treasury regulations speak quite clearly to this question.

First, the Standards require that the Office of the Special Master now turn its attention to reviewing compensation structures for the remaining executive officers, and 75 next most highly compensated employees, in each of the seven companies. The regulations do not require the Special Master to make individual compensation determinations for these individuals; instead, the regulations require that the Special Master approve the compensation structure for these individuals. The law affords me 60 days to do this from the time that I deem the company submissions with respect to these individuals "substantially complete." I have received all of these pertinent submissions from each of the seven companies but have not yet concluded that they are "substantially complete," thereby triggering the 60-day limitation.

Second, the Office of the Special Master must soon turn its attention to the process for determining the 2010 compensation for the senior executives at each of the seven TARP exceptional assistance companies. I believe we have made important progress in this regard as a result of completed efforts at 2009 compensation. Nevertheless, there will undoubtedly be new compensation issues which will confront us in 2010. (For example, we anticipate dealing once again with claims of "grandfathered" retention contracts and other guaranteed forms of compensation which will have to be considered by the Special Master as part of 2010 submissions for the senior executives; in addition, it is anticipated that the list of senior executives for each Company will undergo some modification, requiring a new evaluation of certain individual compensation packages submitted by each company.)

Finally, I do not recommend that my responsibilities related to compensation determinations for senior executives, as currently defined by Treasury regulations, be expanded beyond the current seven companies receiving exceptional TARP financial assistance. I believe Congress and the Treasury have already spoken with respect to the compensation restrictions that apply beyond this group of firms. My limited mandatory jurisdiction involving just these seven companies is justified by the fact that the American taxpayers have a vested interest as particularly significant stakeholders in these seven companies. But, the federal government should not enter the business of micromanaging compensation practices beyond these seven companies by expanding my jurisdiction or broadening my discretionary authority. Hopefully, the individual final compensation determinations I make may yet be used, in whole or in part, by other companies in modifying their individual compensation practices. I believe the final compensation determinations I make and discuss in my Report are a useful model to guide others in the private marketplace. But that is where my authority should end. I do not believe it necessary or wise to broaden my jurisdiction or make my legal authority more pervasive.

Mr. Chairman, this concludes my formal written statement, and I welcome any questions from you and the Members of this distinguished Committee.

Thank you.

**REPORT
OF**

**THE SPECIAL MASTER
FOR TARP EXECUTIVE COMPENSATION**

**DETERMINATION DECISIONS
FOR THE
SEVEN EXCEPTIONAL ASSISTANCE TARP RECIPIENTS**

October 22, 2009

Special Master for Executive Compensation
2009 Executive Compensation Decisions
for the TARP Exceptional Assistance Companies

1. **American International Group, Inc.**
2. **Bank of America, Corp.**
3. **Chrysler Group, LLC**
4. **Chrysler Financial**
5. **Citigroup, Inc.**
6. **General Motors Company**
7. **General Motors Acceptance Corporation Financial Services**

1. American International Group, Inc.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 22, 2009

Mr. Robert Benmosche
President and Chief Executive Officer
American International Group, Inc.
70 Pine Street
27th Floor
New York, NY 10270

Re: Proposed Compensation Payments and Structures for Senior Executive Officers and Most Highly Compensated Employees

Dear Mr. Benmosche:

Pursuant to the Department of the Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance, the Office of the Special Master has completed its review of your 2009 compensation submission on behalf of the senior executive officers and most highly compensated employees of American International Group, Inc. ("AIG"). Attached as ***Annex A*** is a Determination Memorandum (accompanied by ***Exhibits I*** and ***II***) providing the determinations of the Special Master with respect to 2009 compensation for those employees. 31 C.F.R. § 30.16(a)(3).

Pursuant to the Interim Final Rule, the Special Master is required to determine whether the compensation structure for each senior executive officer and certain most highly compensated employees "will or may result in payments inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." *Id.* § 30.16(a)(3). The Special Master has determined that, to satisfy this standard, 2009 compensation for AIG's senior executive officers and most highly compensated employees generally must comport with the following important standards:

- Base salary paid in cash should not exceed $500,000 per year, except in appropriate cases for good cause shown. Such good cause will not exist in any case in which the employee is to be paid a substantial cash amount pursuant to a previously existing agreement between AIG and the employee. Overall, cash compensation must be significantly reduced from cash amounts paid in 2008. In AIG's case, cash compensation for these employees will decrease 91% from 2008 levels.

- Rather than cash, the majority of each individual's base salary will be paid in the form of stock units reflecting the value of a "basket" of four AIG insurance subsidiaries that the Company, the Federal Reserve Bank of New York, and the Department of the Treasury have identified as critical to the future of the company. These units will immediately vest, in accordance with the Interim Final Rule, but will only be redeemable in three equal, annual installments beginning on the second anniversary of the date they are earned, with each installment redeemable one year early if AIG repays its TARP obligations. This structure encourages employees to remain employed by AIG and to maximize the value of the businesses most important to its long-term stability while avoiding incentives for unnecessary risk-taking. Other terms and conditions of these stock units, including any alterations to the structure of the "basket" to maintain appropriate incentives for employees, will be determined by the AIG, subject to the Special Master's approval.

- Total compensation for each individual must be appropriate when compared with total compensation provided to persons in similar positions or roles at similar entities. Overall, total compensation must be significantly reduced from the amounts paid in 2008. In AIG's case, total compensation for these employees will decrease 58% from 2008 levels.

- If—and only if—the employee achieves objective performance metrics developed and reviewed in consultation with the Office of the Special Master, the employee may be eligible for long-term incentive awards. These awards, however, must be payable in the form of restricted stock that will be forfeited unless the employee stays with AIG for at least three years following grant, and may only be redeemed in 25% installments for each 25% of AIG's TARP obligations that are repaid. Such long-term incentive awards may not exceed one third of total annual compensation.

- Employees of AIG Financial Products will receive only cash base salaries through the balance of 2009. Employees who pledged to return amounts paid pursuant to previously existing retention awards must immediately repay the pledged amount.

- Any and all incentive compensation will be subject to recovery or "clawback" if the payments are based on materially inaccurate financial statements, any other materially inaccurate performance metrics, or if the employee is terminated due to misconduct that occurred during the period in which the incentive was earned.

- Any and all "other" compensation and perquisites will not exceed $25,000 for each employee (absent exceptional circumstances for good cause shown to the satisfaction of the Special Master).

- No severance benefit to which an employee becomes entitled in the future may take into account a cash salary increase, or any payment of stock salary, that the Special Master has approved for 2009.

- No additional amounts in 2009 may be accrued under supplemental executive retirement plans or credited by the company to other "non-qualified deferred compensation" plans after the date of the Determination Memorandum.

The Special Master has also determined that, in order for the approved compensation structures to satisfy the standards of 31 C.F.R. § 30.16(a)(3), AIG must adopt policies applicable to these executive officers and employees as follows:

- The achievement of any performance objectives must be certified by the Compensation and Management Resources Committee of AIG's Board of Directors, which is composed solely of independent directors, as part of AIG's securities filings. These performance objectives must be reviewed and approved by the Office of the Special Master.

- The employees will be prohibited from engaging in any hedging, derivative or other transactions that have an equivalent economic effect that would undermine the long-term performance incentives created by their compensation structures.

- AIG may not provide a tax "gross up" of any kind to these employees.

- At least once every year, the Compensation and Management Resources Committee must provide to the Department of the Treasury a narrative description identifying each compensation plan for its senior executive officers, and explaining how the plan does not encourage the senior executive officers to take unnecessary and excessive risks that threaten AIG's value.

These requirements are described in further detail in the attached Determination Memorandum.

The Special Master's review has been guided by a number of considerations, including each of the principles articulated in the Interim Final Rule. *Id.* § 30.16(b)(1). The following principles were of particular importance to the Special Master in his determinations with respect to AIG's compensation structures:

- *Performance-based compensation.* The overwhelming majority of approved compensation depends on AIG's performance, and ties the financial incentives of AIG employees to the overall performance of the company. A majority of the salary paid to employees under these structures will be paid in the form of stock units reflecting the value of four subsidiaries critical to AIG's long-term stability; and, because the stock will only be redeemable in equal, one-third installments beginning on the second anniversary of the date the stock salary is earned (in each case subject to acceleration by one year if AIG repays its TARP obligations), the ultimate value realized by the employee will depend on AIG's performance over the long term. Guaranteed amounts payable in cash, in contrast, are generally rejected. *Id.* § 30.16(b)(1)(iv).

- *Taxpayer return.* The compensation structures approved by the Special Master reflect the need for AIG to remain a competitive enterprise and, ultimately, to be able to repay TARP obligations. The Special Master has determined that these approved compensation structures are competitive when compared with those provided to persons in similar positions or roles at similar entities. *Id.* § 30.16(b)(1)(ii).

- *Appropriate allocation.* The total compensation payable to AIG employees is weighted heavily towards long-term structures that are tied to AIG's performance and are easily understood by shareholders. As a general principle, guaranteed income is rejected. Fixed compensation payable to AIG employees should consist only of cash salaries at sufficient levels to attract and retain employees and provide them a reasonable level of liquidity.

Pursuant to the Interim Final Rule, AIG may, within 30 days of the date hereof, request in writing that the Special Master reconsider the determinations set forth in ***Annex A***. If AIG does not request reconsideration within 30 days, these initial determinations will be treated as final determinations. *Id.* § 30.16(c)(1).

Very truly yours,

Kenneth R. Feinberg
Office of the Special Master
TARP Executive Compensation

Attachment

cc: Anastasia D. Kelly, Esquire
Marc R. Trevino, Esquire

ANNEX A
DETERMINATION MEMORANDUM

I. INTRODUCTION

The Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009 ("EESA"), requires the Secretary of the Treasury to establish standards related to executive compensation and corporate governance for financial institutions receiving financial assistance under the Troubled Asset Relief Program ("TARP"). Through the Department of the Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance (the "Rule"), the Secretary delegated to the Office of the Special Master for TARP Executive Compensation (the "Office of the Special Master" or, the "Office") responsibility for reviewing compensation structures of certain employees at financial institutions that received exceptional financial assistance under the TARP ("Exceptional Assistance Recipients"). 31 C.F.R. § 30.16(a); *id.* § 30.16(a)(3). For these employees, the Special Master must determine whether the compensation structure will or may result in payments "inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." *Id.*

American International Group, Inc. ("AIG," or the "Company"), one of seven Exceptional Assistance Recipients, has submitted to the Special Master proposed compensation structures for review pursuant to Section 30.16(a)(3) of the Rule. These compensation structures apply to three employees that the Company has identified as senior executive officers (the "Senior Executive Officers," or "SEOs") for purposes of the Rule, and nine employees the Company has identified as among the most highly compensated employees of the Company for purposes of the Rule (the "Most Highly Compensated Employees," and, together with the SEOs, the "Covered Employees").

The Special Master has completed the review of the Company's proposed compensation structures pursuant to the principles set forth in the Rule. This Determination Memorandum sets forth the determinations of the Special Master, pursuant to Section 30.16(a)(3) of the Rule, with respect to the Covered Employees.

II. BACKGROUND

On June 15, 2009, the Department of the Treasury ("Treasury") promulgated the Rule, creating the Office of the Special Master and delineating its responsibilities. Immediately following that date, the Special Master, and Treasury employees working in the Office of the Special Master, conducted extensive discussions with AIG officials and Company counsel. During these discussions, the Office of the Special Master informed AIG about the nature of the Office's work and the authority of the Special Master under the Rule. These discussions continued for a period of months, during which the Special Master and AIG explored potential compensation structures for the Covered Employees.

The Rule requires that each Exceptional Assistance Recipient submit proposed compensation structures for each Senior Executive Officer and Most Highly Compensated Employee no later than August 14, 2009. 31 C.F.R. § 30.16(a)(3). On July 20, 2009, the Special Master requested from each Exceptional Assistance Recipient, including AIG, certain data and documentary information necessary to facilitate the Special Master's review of the Company's compensation structures. The request required AIG to submit data describing its proposed compensation structures, and the payments that would result from the structures, concerning each Covered Employee.

In addition, the Rule authorizes the Special Master to request information from an Exceptional Assistance Recipient "under such procedures as the Special Master may determine." *Id.* § 30.16(d). AIG was required to submit competitive market data indicating how the amounts payable under AIG's proposed compensation structures relate to the amounts paid to persons in similar positions or roles at similar entities. AIG was also required to submit a range of documentation, including information related to proposed performance metrics, internal policies designed to curb excessive risk, and certain previously existing compensation plans and agreements.

AIG submitted this information to the Office of the Special Master on August 14, 2009. Following a preliminary review of the submission, and the submission of certain additional information, on August 31, 2009, the Special Master determined that AIG's submission was substantially complete for purposes of the Rule. *Id.* § 30.16(a)(3). The Office of the Special Master then commenced a formal review of AIG's proposed compensation structures for the Covered Employees. The Rule provides that the Special Master is required to issue a compensation determination within 60 days of a substantially complete submission. *Id.*

The Office of the Special Master's review of the Company's proposals was aided by analysis from a number of internal and external sources, including:

- Treasury personnel detailed to the Office of the Special Master, including executive compensation specialists with significant experience in reviewing, analyzing, designing and administering executive compensation plans, and attorneys with experience in matters related to executive compensation;

- Competitive market data provided by the Company in connection with its submission to the Office of the Special Master;

- External information on comparable compensation structures extracted from the *U.S. Mercer Benchmark Database-Executive*;

- External information on comparable compensation structures extracted from Equilar's *ExecutiveInsight* database (which includes information drawn from publicly filed proxy statements) and Equilar's *Top 25 Survey Summary Report* (which includes information from a survey on the pay of highly compensated employees);

- Consultation with Lucian A. Bebchuk, a world-renowned expert in executive compensation and the William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance and Director of the Program on Corporate Governance at Harvard Law School; and

- Consultation with Kevin J. Murphy, a world-renowned expert in executive compensation and the Kenneth L. Trefftzs Chair in Finance in the department of finance and business economics at the University of Southern California's Marshall School of Business.

The Special Master considered these views, in light of the statutory and regulatory standards described in Part III below, when evaluating the Company's proposed compensation structures for the Covered Employees for 2009.

III. STATUTORY AND REGULATORY STANDARDS

The Rule requires that the Special Master determine for each of the Covered Employees whether AIG's proposed compensation structure, including amounts payable or potentially payable under the compensation structure, "will or may result in payments that are inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." 31 C.F.R. § 30.16(a)(3) (as applied to Covered Employees of Exceptional Assistance Recipients, the "Public Interest Standard"). Regulations promulgated pursuant to the Rule require that the Special Master consider six principles when making these compensation determinations:

(1) *Risk.* The compensation structure should avoid incentives that encourage employees to take unnecessary or excessive risks that could threaten the value of the Exceptional Assistance Recipient, including incentives that reward employees for short-term or temporary increases in value or performance; or similar measures that may undercut the long-term value of the Exceptional Assistance Recipient. Compensation packages should be aligned with sound risk management. *Id.* § 30.16(b)(1)(i).

(2) *Taxpayer return.* The compensation structure and amount payable should reflect the need for the Exceptional Assistance Recipient to remain a competitive enterprise, to retain and recruit talented employees who will contribute to the recipient's future success, so that the Company will ultimately be able to repay its TARP obligations. *Id.* § 30.16(b)(1)(ii).

(3) *Appropriate allocation.* The compensation structure should appropriately allocate the components of compensation such as salary and short-term and long-term performance incentives, as well as the extent to which compensation is provided in cash, equity, or other types of compensation such as executive pensions, or other benefits, or perquisites, based on the specific role of the employee and other relevant circumstances, including the nature and amount of current compensation,

deferred compensation, or other compensation and benefits previously paid or awarded. *Id.* § 30.16(b)(1)(iii).

(4) *Performance-based compensation.* An appropriate portion of the compensation should be performance-based over a relevant performance period. Performance-based compensation should be determined through tailored metrics that encompass individual performance and/or the performance of the Exceptional Assistance Recipient or a relevant business unit taking into consideration specific business objectives. Performance metrics may relate to employee compliance with relevant corporate policies. In addition, the likelihood of meeting the performance metrics should not be so great that the arrangement fails to provide an adequate incentive for the employee to perform, and performance metrics should be measurable, enforceable, and actually enforced if not met. *Id.* § 30.16(b)(1)(iv).

(5) *Comparable structures and payments.* The compensation structure, and amounts payable where applicable, should be consistent with, and not excessive taking into account, compensation structures and amounts for persons in similar positions or roles at similar entities that are similarly situated, including, as applicable, entities competing in the same markets and similarly situated entities that are financially distressed or that are contemplating or undergoing reorganization. *Id.* § 30.16(b)(1)(v).

(6) *Employee contribution to TARP recipient value.* The compensation structure and amount payable should reflect the current or prospective contributions of an employee to the value of the Exceptional Assistance Recipient, taking into account multiple factors such as revenue production, specific expertise, compliance with company policy and regulation (including risk management), and corporate leadership, as well as the role the employee may have had with respect to any change in the financial health or competitive position of the recipient. *Id.* § 30.16(b)(1)(vi).

The Rule provides that the Special Master shall have discretion to determine the appropriate weight or relevance of a particular principle depending on the facts and circumstances surrounding the compensation structure or payment for a particular employee. *Id.* § 30.16(b). To the extent two or more principles may appear inconsistent in a particular situation, the Rule requires that the Special Master exercise his discretion in determining the relative weight to be accorded to each principle. *Id.*

The Rule provides that the Special Master may, in the course of applying these principles, take into account other compensation structures and other compensation earned, accrued, or paid, including compensation and compensation structures that are not subject to the restrictions of section 111 of EESA. For example, the Special Master may consider payments obligated to be made by the Company pursuant to certain legally binding rights under valid written employment contracts entered into prior to enactment of the statute and the accompanying Rule. *Id.* § 30.16(a)(3).

IV. COMPENSATION STRUCTURES AND PAYMENTS

A. AIG Proposals

AIG has provided the Office of the Special Master with detailed information concerning its proposed 2009 compensation structures for the Covered Employees, including amounts proposed to be paid under the compensation structure for each Covered Employee (the "Proposed Structures").

AIG supported its proposal with detailed assessments of each Covered Employee's tenure and responsibilities at the Company (or its applicable subsidiary) and historical compensation structure. The submission also included market data that, according to the Company, indicated that the amounts potentially payable to each employee were comparable to the compensation payable to persons in similar positions or roles at a "peer group" of entities selected by the Company.

1. AIG Corporate and Operating Units

AIG has proposed compensation structures for each of three Senior Executive Officers, as well as for four Most Highly Compensated Employees, each of whom serves as an executive in AIG's corporate offices or as a senior executive at an AIG subsidiary.[1]

AIG's proposed compensation structures for each of the seven executives in this group generally emphasized increases in cash base salary and substantial base salary paid in the form of vested AIG stock and did not include any compensation payable on the basis of individual performance.

a. Cash Salary and Cash "Retention" Awards

AIG generally proposed to increase cash base salaries for employees in this group. AIG's submission asserted that these base salaries could be justified by reference to the compensation of persons in similar positions or roles at similar entities.

AIG also proposed to pay "retention" awards to three of these employees, in amounts ranging from $1,500,000 to $2,400,000, that AIG argued were due under agreements providing for legally binding rights under valid written employment contracts, *see* 31 C.F.R. § 30.10(e)(2), and thus were not subject to the review of the Special Master.

[1] On August 16, 2008, AIG entered into a Letter Agreement with Robert H. Benmosche pursuant to which Mr. Benmosche was appointed Chief Executive Officer of AIG. The Special Master separately reviewed the Letter Agreement and determined that the compensation structure under the Letter Agreement was consistent with the Public Interest Standard. *See* Office of the Special Master, Letter to Compensation and Management Resources Committee, American International Group, Oct. 2, 2009, *available at* http://www.financialstability.gov/docs/RobertBenmoscheDeterminationLetter.pdf. Accordingly, Mr. Benmosche's compensation package is not addressed in this Determination Memorandum.

b. Stock Salary

AIG proposed that employees in this group receive substantial compensation in the form of vested AIG common stock delivered on the Company's payroll schedule. AIG proposed that 50% of the stock be transferable *immediately* by the employee. AIG proposed to deliver stock salary in amounts ranging from $250,000 to $4,600,000 to employees in this group.

c. Annual Long-Term Incentive Awards

AIG did not propose that employees in this group be granted any compensation subject to the achievement of performance measures. Specifically, AIG's Proposed Structures did not include grants of long-term incentive awards granted in compliance with the requirements of the Rule.

d. "Other" Compensation and Perquisites

AIG's submission included payments of "other" compensation as well as perquisites to the Covered Employees. The proposed payments varied in value.

e. Supplemental Executive Retirement Plans and Non-Qualified Deferred Compensation

AIG also proposed that certain Covered Employees receive compensation in the form of accruals under a "non-qualified deferred compensation" plan.

f. Severance Plans

AIG's submission to the Office of the Special Master also indicated that, in some cases, the Proposed Structures would result in increases in amounts payable to these employees pursuant to severance arrangements.

2. Covered Employees at AIG Financial Products

AIG has also proposed compensation structures for five Covered Employees employed by AIG Financial Products, a subsidiary of the Company. AIG's proposed compensation structure for each of these five employees included significant increases in cash base salary, accompanied by a promise, secured by a segregated pool of cash, to pay the employees substantial amounts based on their performance. In summary, AIG's proposed compensation structures for these employees included the following principal elements:

- Cash base salaries, delivered on a *nunc pro tunc* basis effective January 1, 2009, ranging from $285,000 to $950,000.
- Payments from the segregated cash pool ranging from $1,115,000 to $2,612,182.

- Total proposed 2009 compensation for five employees of $13,200,000.

In addition, in the course of discussions with the Office of the Special Master, AIG acknowledged that certain employees of AIG Financial Products had pledged to repay amounts paid in early 2009 in connection with certain bonuses. AIG had further acknowledged that four of these five employees made such pledges and failed, as of the date of AIG's submission to the Office of the Special Master, to honor those pledges. The remaining Covered Employee at AIG Financial Products did not pledge to return any of the amounts received in early 2009.

B. <u>Determinations of the Special Master</u>

The Special Master has reviewed the Proposed Structures in detail by application of the principles set forth in the Rule and described in Part III above. In light of this review and analysis, the Special Master has determined that both the structural design of AIG's proposals and the amounts potentially payable to Covered Employees under the proposals would be inconsistent with the Public Interest Standard, and, therefore, require modification.

The Special Master has determined, in light of the considerations that follow, that the compensation structures described in ***Exhibits I*** and ***II*** to this Determination Memorandum will not, by virtue of either their structural design or the amounts potentially payable under them, result in payments inconsistent with the Public Interest Standard.

1 AIG Corporate and Operating Units

a. <u>Cash Salary and Cash "Retention" Awards</u>

The Special Master reviewed AIG's proposal with respect to cash salary and "retention" awards in light of the principle that compensation structures should generally be comparable to "compensation structures and amounts for persons in similar positions or roles at similar entities," *id.* § 30.16(b)(1)(v). AIG's cash salary proposals for these employees generally exceeded the 50th percentile of amounts paid to persons in similar positions or roles at similar entities. The Special Master has concluded that, for Covered Employees at Exceptional Assistance Recipients, cash salaries generally should target the 50th percentile as compared to persons in similar positions or roles at similar entities because such levels of cash salaries balance the need to attract and retain talented employees with the need for compensation structures that reflect the circumstances of Exceptional Assistance Recipients. Accordingly, the Special Master has concluded that AIG's proposed cash salaries are inconsistent with the Public Interest Standard, because the proposed amounts cannot be supported by reference to amounts payable to persons in similar positions or roles at similar entities.

The Special Master also reviewed AIG's proposed cash salaries in light of the principle that an "appropriate portion of...compensation should be performance-based over a relevant performance period." *Id.* § 30.16(b)(1)(iv). AIG proposed that cash salaries constitute significant proportions of total compensation, although cash salaries are not performance-based. The Special Master has concluded that performance-based compensation should constitute the primary portion of these employees total compensation packages, and therefore that AIG's proposed salaries are inconsistent with the Public Interest Standard because the proposed cash amounts would have constituted too significant a proportion of the employee's total pay.

In addition, the Special Master may take into account compensation structures, such as legally binding rights under valid employment contracts, that are not subject to review by the Special Master. *Id.* § 30.16(a)(3). AIG proposed cash salaries for three employees that, AIG asserted, were also entitled to substantial cash payments in 2009 pursuant to previously existing "retention" awards. Although the Office of the Special Master negotiated for the restructuring of similar arrangements at other Exceptional Assistance Recipients, discussions with AIG officials did not lead to an agreed upon restructuring of these "retention" awards. After consulting with officials at the Federal Reserve Bank of New York and officials at Treasury, and considering their opinions, the Special Master has concluded that, due to the unique circumstances currently found to exist at AIG, and the need to retain the services of these three employees who are deemed to be particularly critical to AIG's long-term financial success, restructuring these "retention" contracts would not be consistent with the Public Interest Standard. Instead, the Special Master has considered these retention awards when determining an appropriate reduction in proposed 2009 cash salaries for these employees.

The Special Master has determined that cash salaries of less than $500,000 are generally consistent with the Public Interest Standard. In particular, the cash salaries of the three employees receiving payments pursuant to previously existing "retention" awards must not exceed this amount. The cash salaries that the Special Master has determined to be consistent with the Public Interest Standard for these employees are described in further detail in ***Exhibits I*** and ***II***.

b. Stock Salary

First, the Special Master reviewed the amounts of compensation to be granted in the form of stock salary in light of the principle that compensation structures should generally be comparable to "compensation structures and amounts for persons in similar positions or roles at similar entities," *id.* § 30.16(b)(1)(v). In general, the Special Master has concluded that AIG's proposed amounts are consistent with the Public Interest Standard. These amounts, adjusted to reflect each employee's responsibilities and role with respect to any change in the financial health or competitive position of AIG, *id.* § 30.16(b)(1)(v), are described in further detail in ***Exhibits I*** and ***II***.

Second, the Special Master reviewed the structure of AIG's stock salary proposal in light of the principle that compensation structures should align performance incentives with long-term value creation rather than short-term profits. *See id.* § 30.16(b)(1)(i). The Special Master has concluded that AIG's proposal, which contemplates that 50% of stock salary will be transferable *immediately* by the employee, does not provide sufficient alignment with long-term value creation.

The Special Master also reviewed the structure of AIG's stock salary proposal in light of the principle that an appropriate portion of compensation should be "performance-based over a relevant performance period," *id.* § 30.16(b)(1)(iv). Stock salary that is transferable immediately permits an employee to liquidate his or her investment in the stock immediately rather than over a period designed to reflect performance.

Accordingly, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard would not permit immediate transferability or sale of stock salary. Instead, stock salary may only be redeemable in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year early if AIG repays its TARP obligations.

Finally, the Special Master reviewed AIG's proposed stock salary in light of the principle that AIG must be able to maintain and attract the necessary employees to remain competitive in the marketplace. *See id.* § 30.16(b)(1)(ii). During this review, the Special Master consulted with officials at the Federal Reserve Bank of New York and officials at Treasury and considered their views. Based on this input, the Special Master has determined that the compensation structures consistent with the Public Interest Standard shall include stock units reflecting the value of a "basket" of four AIG insurance subsidiaries: American International Assurance Co. Ltd., American Life Insurance Co., Chartis, and AIG Domestic Life & Retirement Services Group. The value of each subsidiary, and therefore of the units, is to be determined on the basis of an adjusted book value measure that will exclude extraordinary events and give employees incentives to focus their efforts on the earnings generated by these critical businesses. Other terms and conditions of the "basket" units, including any alterations to the structure of the "basket" to maintain appropriate incentives for employees, will be determined by AIG subject to the approval of the Office of the Special Master.[2] The units are described in further detail in ***Exhibits I*** and ***II***.

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[2] The Covered Employees generally may not be paid a "bonus," or receive payments pursuant to an "incentive plan," except in limited circumstances prescribed by the Rule. The provisions of the Rule addressing compensation in the form of salary paid in property (such as stock) indicate that such payments will not constitute an "incentive plan" for purposes of the Rule if the payments are made pursuant to "an arrangement under which an employee receives a restricted stock unit that is analogous to TARP recipient stock." 31 C.F.R. § 30.1. Under the Rule, "a unit is analogous to stock if...the term 'TARP recipient stock' with respect to a particular employee recipient means the stock of a corporation...that is an 'eligible issuer of service recipient stock'" for purposes of certain federal taxation regulations. *id.* The Rule also provides that "[t]he Special Master shall have responsibility for interpreting" the Rule. *Id.* § 30.16(a)(1). AIG's proposed "basket" units are designed to reflect the value of businesses that comprise over 90% of AIG's overall value, and to give employees incentives, in AIG's unique circumstances, to maximize the value of those businesses and thus the value of the Company as a whole, while avoiding incentives for excessive risk taking. Accordingly, under these limited, unique circumstances, and without determining whether the "basket" units comprise "stock of a corporation...that is an 'eligible issuer of service recipient stock'" under the Rule, the Special Master has concluded that AIG's proposed subsidiary "basket" units constitute "restricted stock unit[s] that are analogous to TARP recipient stock" for purposes of the Rule. *Id.* § 30.1.

c. Annual Long-Term Incentive Awards

The Special Master also reviewed AIG's proposals in light of the principle that an "appropriate portion of the compensation should be performance-based," *id.* § 30.16(b)(1)(iv), and based on "performance metrics [that are] measurable, enforceable, and actually enforced if not met." *Id.* AIG's proposals did not include any amounts payable to employees in this group on the basis of the achievement of performance measures. As described in ***Exhibits I*** and ***II***, the structures the Special Master has determined to be consistent with the Public Interest Standard include an annual long-term incentive award payable only upon the achievement of specified, objective performance criteria developed and reviewed in consultation with the Office of the Special Master.

The Special Master also evaluated AIG's proposals in light of recently adopted international standards providing that incentive compensation should generally be payable over a period of three years, as well as the principle in the Rule providing that performance-based compensation should be payable "over a relevant performance period," *id.* Accordingly, the Special Master has concluded that, to meet the Public Interest Standard, restricted stock granted in connection with these awards should not vest unless the employee remains employed until the third anniversary of grant. Finally, as required by the Rule, these awards may only be redeemed in 25% installments for each 25% of AIG's TARP obligations that are repaid. These awards are described in further detail in ***Exhibits I*** and ***II***.

d. "Other" Compensation and Perquisites

AIG has proposed substantial payments of "other" compensation, as well as perquisites, to the Covered Employees. (AIG's submission included proposed payments of "other" compensation exceeding $1,500,000 and perquisites exceeding $900,000 to certain employees.) The Special Master has concluded that, absent special justification, employees—not the Company—generally should be responsible for paying personal expenses, and that significant portions of compensation structures should not be allocated to such perquisites and "other" compensation. *See id.* §30.16(b)(1)(iii).

The Rule requires that each Exceptional Assistance Recipient annually disclose to Treasury any perquisites where the total value for any Senior Executive Officer or Most Highly Compensated Employee exceeds $25,000. An express justification for offering these benefits must also be disclosed. Accordingly, as described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard provide no more than $25,000 in "other" compensation and perquisites to each of these employees. Any exceptions to this limitation will require that the Company provide to the Office of the Special Master an independent justification for the payment that is satisfactory to the Special Master. To the extent that payments exceeding this limitation have already been made to a Covered Employee in 2009, those amounts should be promptly returned to the Company.

e. Supplemental Executive Retirement Plans and Non-Qualified Deferred Compensation

AIG proposed that certain Covered Employees receive compensation in the form of accruals under a "non-qualified deferred compensation" plan. In such plans, employers periodically credit employees with an entitlement to post-retirement payments. Over time, these credits accumulate and employees may become entitled to substantial cash guarantees payable on retirement—in addition to any payments provided under retirement plans maintained for employees generally.

The Special Master has concluded that the primary portion of a Covered Employee's compensation package should be allocated to compensation structures that are "performance-based over a relevant performance period." *Id.* § 30.16(b)(1)(iv). Payments under the Company's "non-qualified deferred compensation" plans do not depend upon "individual performance and/or the performance of the [Company] or a relevant business unit," *id.*; instead, such accruals are simply guaranteed cash payments from the Company in the future. In addition, these payments can make it more difficult for shareholders to readily ascertain the full amount of pay due a top employee upon leaving the Company.

Covered Employees should fund their retirements using wealth accumulated based on Company performance while they are employed, rather than being guaranteed substantial retirement benefits by the Company regardless of Company performance during and after their tenures. Accordingly, as described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard prohibit further 2009 accruals for Covered Employees under supplemental retirement plans or Company credits to other "non-qualified deferred compensation" plans following the date of this Determination Memorandum.

f. Severance Plans

The Special Master has concluded that an increase in the amounts payable under these arrangements would be inconsistent with the principle that compensation should be performance-based, *id.* § 30.16(b)(1)(iv), and that payments should be appropriately allocated among the elements of compensation, *id.* § 30.16(b)(1)(iii). Accordingly, for the compensation structures described in ***Exhibits I*** and ***II*** to be consistent with the Public Interest Standard, the Company must ensure that 2009 compensation structures for these employees do not result in an increase in the amounts payable pursuant to these arrangements.

2. Covered Employees at AIG Financial Products

The Office of the Special Master evaluated AIG's proposed compensation structures for these employees in light of the principle that compensation structures should, where appropriate, reflect "the role [an] employee may have had with respect to any change in the financial health or competitive position of the TARP recipient," *id.* § 30.16(b)(1)(vi). The performance of AIG Financial Products has contributed significantly to the deterioration in AIG's financial health. Accordingly, the Special Master has determined that AIG's proposed compensation structures for these employees are inconsistent with the Public Interest Standard, because they do not adequately reflect the role of AIG Financial Products in the change in the financial health and competitive position of AIG.

In addition, the Special Master may take into account compensation structures, such as legally binding rights under valid employment contracts, that are not subject to review by the Special Master. *Id.* § 30.16(a)(3). These employees received significant bonus payments in early 2009 notwithstanding AIG Financial Products' role in the events necessitating taxpayer intervention. Accordingly, taking into account the payments made to these employees in early 2009, as well as the other principles set forth in the Rule, the Special Master has concluded that only the payment of these employees' base salaries as in effect on December 31, 2008, and no further amounts of any kind, is consistent with the Public Interest Standard. These amounts are described in further detail in ***Exhibits I*** and ***II***.

The Office of the Special Master is engaged in ongoing discussions with the Company with respect to these employees. These discussions have emphasized the importance of the repayment of the entire pledged amount by each Covered Employee who pledged to return bonus amounts paid in 2009. Until the Special Master's consideration of those matters is complete, no payments of compensation in 2009 to these employees, other than continuation of the cash salaries in effect on December 31, 2008, would be consistent with the Public Interest Standard.

3. Departed Employees

Thirteen employees that would have been Covered Employees had they remained employed are no longer employed by the Company. With respect to those employees, the Special Master has determined that cash salaries through the date of the termination of employment, and payment of up to $25,000 in perquisites and "other" compensation are consistent with the Public Interest Standard. No other payments to these employees of any kind would be consistent with the Public Interest Standard. Any exceptions to this limitation will require that the Company provide to the Office of the Special Master an independent justification for the payment that is satisfactory to the Special Master.

V. CORPORATE GOVERNANCE

As noted in Part III, above, the Rule requires the Special Master to consider the extent to which compensation structures are "performance-based over a relevant performance period." 31 C.F.R. § 30.16(b)(iv). In light of the importance of this principle, AIG must take certain additional corporate governance steps, including those required by the Rule, to ensure that the compensation structures for the Covered Employees, and the amounts payable or potentially payable under those structures, are consistent with the Public Interest Standard.

A. Requirements Relating to Compensation Structures

In order to ensure that objective compensation performance criteria are "measurable, enforceable, and actually enforced if not met," *id.* § 30.16(b)(1)(iv), long-term incentive awards may not be granted unless the AIG Compensation and Management Resources Committee determines to grant such an award in light of the employee's performance as measured against objective performance criteria that the Committee has developed and reviewed in consultation with the Office of the Special Master. This evaluation must be disclosed to shareholders in, and certified by the Committee as part of, AIG's securities filings. In addition, the Committee must retain discretion with respect to each employee, to reduce (but not to increase) the amount of any incentive award on the basis of its overall evaluation of the employee's or AIG's performance (notwithstanding full or partial satisfaction of the performance criteria).

In addition, as noted in Part IV, above, and described in ***Exhibits I*** and ***II***, the structures determined by the Special Master to be consistent with the Public Interest Standard include grants of stock in AIG. It is critical that these compensation structures achieve the Rule's objective of "appropriate[ly] allocat[ing] the components of compensation [including] long-term incentives, as well as the extent to which compensation is provided in...equity," *id.* § 30.16(b)(iii).

The Company must have in effect a policy that would prohibit an employee from engaging in hedging, derivative or other transactions that have an economically similar effect that would undermine the incentives created by the compensation structures set forth in ***Exhibits I*** and ***II***. Such transactions would be contrary to the principles set forth in the Rule.

B. Additional Requirements

In addition to the requirements set forth above, pursuant to the requirements of the Rule, AIG is required to institute the following corporate governance reforms:

(1) *Compensation Committee: Risk Review.* AIG must maintain a compensation committee comprised exclusively of independent directors. Every six months, the committee must discuss, evaluate, and review with AIG's senior risk officers any risks that could threaten the value of AIG. In particular, the committee must meet every six months to discuss, evaluate, and review the terms of each employee compensation plan to identify and limit the features in (1) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that threaten the value of AIG; (2) the SEO or other employees' compensation plans that could encourage behavior focused on short-term results and not on long-term value creation; and (3) the employee compensation plans that could encourage the manipulation of AIG's reported earnings to enhance the compensation of any of the employees. *Id.* § 30.4; *id.* § 30.5.

(2) *Disclosure with Respect to Compensation Consultants.* The compensation committee must disclose to Treasury an annual narrative description of whether

AIG, its Board of Directors, or the committee has engaged a compensation consultant during the past three years. If so, the compensation committee must detail the types of services provided by the compensation consultant or any affiliate, including any "benchmarking" or comparisons employed to identify certain percentile levels of compensation. *Id.* § 30.11(c).

(3) *Disclosure of Perquisites.* As noted in Part IV, AIG must provide to Treasury an annual disclosure of any perquisite whose total value for AIG's fiscal year exceeds $25,000 for each of the Covered Employees. AIG must provide a narrative description of the amount and nature of these perquisites, the recipient of these perquisites, and a justification for offering these perquisites (including a justification for offering the perquisite, and not only for offering the perquisite with a value that exceeds $25,000). *Id.* § 30.11(b).

(4) *Clawback.* AIG must ensure that any incentive award paid to a Covered Employee is subject to a clawback if the award was based on materially inaccurate financial statements (which includes, but is not limited to, statements of earnings, revenues, or gains) or any other materially inaccurate performance metric criteria. AIG must exercise its clawback rights except to the extent that it is unreasonable to do so. *Id.* § 30.8.

(5) *Say-on-Pay.* AIG must permit a separate shareholder vote to approve the compensation of executives, as required to be disclosed pursuant to the federal securities laws (including the compensation discussion and analysis, the compensation tables, and any related material). *Id.* § 30.13. AIG conducted its first such vote in July 2009.

(6) *Policy Addressing Excessive or Luxury Expenditures.* AIG was required to adopt an excessive or luxury expenditures policy, provide that policy to Treasury, and post it on AIG's website. If AIG's board of directors makes any material amendments to this policy, within ninety days of the adoption of the amended policy, the board of directors must provide the amended policy to Treasury and post the amended policy on the company website. *Id.* § 30.12.

(7) *Prohibition on Tax Gross-Ups.* Except as explicitly permitted under the Rule, AIG is prohibited from providing (formally or informally) tax gross-ups to any of the Covered Employees. *Id.* § 30.11(d).

(8) *CEO and CFO Certification.* AIG's chief executive officer and chief financial officer must provide to the Securities and Exchange Commission written certification of the Company's compliance with the various requirements of section 111 of EESA. The precise nature of the required certification is identified in the Rule. *Id.* § 30.15 Appx. A.

VI. Conclusion

The Special Master has reviewed the Proposed Structures for the Covered Employees for 2009 in light of the principles set forth at 31 C.F.R. § 30.16(b). On the basis of that review, the Special Master has determined that the Proposed Structures submitted by AIG require modification in order to meet the Public Interest Standard.

The Special Master has separately reviewed the compensation structures set forth in ***Exhibits I*** and ***II*** in light of the principles set forth at 31 C.F.R. § 30.16(b). Pursuant to the authority vested in the Special Master by the Rule, and in accordance with Section 30.16(a)(3) thereof, the Special Master hereby determines that the compensation structures set forth in ***Exhibits I*** and ***II***, including the amounts payable or potentially payable under such compensation structures, will not result in payments that are inconsistent with the purposes of section 111 of EESA or the TARP, and will not otherwise be contrary to the public interest.

Pursuant to the Interim Final Rule, AIG may, within 30 days of the date hereof, request in writing that the Special Master reconsider the determinations set forth in this Determination Memorandum. The request for reconsideration must specify a factual error or relevant new information not previously considered, and must demonstrate that such error or lack of information resulted in a material error in the initial determinations. If AIG does not request reconsideration within 30 days, the determinations set forth herein will be treated as final determinations. 31 C.F.R. § 30.16(c)(1).

The foregoing determinations are limited to the compensation structures described in ***Exhibits I*** and ***II***, and shall not be relied upon with respect to any other employee. The determinations are limited to the authority vested in the Special Master by Section 30.16(a)(3) of the Rule, and shall not constitute, or be construed to constitute, the judgment of the Office of the Special Master or Treasury with respect to the compliance of any compensation structure with any other provision of the Rule. Moreover, this Determination Memorandum has relied upon, and is qualified in its entirety by, the accuracy of the materials submitted by the Company to the Office of the Special Master, and the absence of any material misstatement or omission in such materials.

Finally, the foregoing determinations are limited to the compensation structures described herein, and no further compensation of any kind payable to any Covered Employee without the prior approval of the Special Master would be consistent with the Public Interest Standard.

EXHIBIT I

COVERED EMPLOYEES

2009 Compensation

Company Name: American International Group, Inc.

Employee ID	**Cash Salary** (Rate going forward.)	**Stock Salary** (Performance based: The stock vests at grant and is redeemable in three equal annual installments beginning on the 2nd anniversary of grant.)	**Long-Term Restricted Stock** (Performance based: Awarded based on achievement of objective performance goals. Vests after 3 years of service. Transferability dependent on TARP repayment.)	**Total Direct Compensation** (Cash salary paid to date plus two months at new run rate + stock salary + long-term restricted stock.)
1	$3,000,000	$4,000,000	$3,500,000	$10,500,000
110	$350,000	$100,000	$225,000	$675,000
137	$125,000	$0	$0	$125,000
145	$177,799	$0	$0	$177,799
150	$425,000	$0	$0	$425,000
157	$125,000	$0	$0	$125,000
163	$350,000	$3,104,167	$833,333	$4,558,333
182	$144,000	$0	$0	$144,000
188	$100,000	$0	$0	$100,000
206	$450,000	$4,691,667	$2,000,000	$7,600,000
209	$425,000	$0	$0	$425,000
255	$450,000	$0	$0	$450,000
267	$375,000	$3,566,666	$1,750,000	$6,108,333

Comparison of 2009 compensation to Prior Years: 2007 & 2008 Compensation

2008 Cash decreased by $34.4M or 90.8%
Total Direct Compensation decreased by $28.4M or 57.8%

2007 Cash decreased by $29.0M or 89.2%
Total Direct Compensation decreased by $26.3M or 55.7%

Note: 1: Amounts reflected in this Exhibit do not include amounts the Company has asserted to be payable pursuant to legally binding rights under valid employment contracts. see 31 C.F.R. § 30.10(e)(2).
Note: 2: The total number of Covered Employees may be less than 25 because of terminations, departures and retirements after January 1, 2009.
Note: 3: The terms and conditions of the stock salary and long-term restricted stock to be awarded to Employee 1, the Chief Executive Officer, differ from those described in these Exhibits. See *supra* Determination Memorandum note 1.

EXHIBIT II
TERMS AND CONDITIONS OF PAYMENTS AND STRUCTURES CONSISTENT WITH THE PUBLIC INTEREST STANDARD

The following general terms and conditions shall govern the compensation structures described in ***Exhibit I***. The Special Master's determination that those structures are consistent with the Public Interest Standard is qualified in its entirety by the Company's adherence to these terms and conditions.

- ***Cash base salary***. Cash base salaries reflect the go-forward rate for the employee effective as of November 1, 2009. Compensation paid in the form of cash base salary prior to that date in accordance with the terms of employment as of June 14, 2009 shall be permitted unless otherwise noted. 31 C.F.R. § 30.16(a)(3)(iii).

- ***Stock salary***. As described in Part IV, stock salary will be granted in the form of stock units reflecting the value of a "basket" of four AIG insurance subsidiaries: American International Assurance Co. Ltd., American Life Insurance Co., Chartis, and AIG Domestic Life & Retirement Services Group. The value of each subsidiary, and therefore of the units, will be determined on the basis of an adjusted book value measure that will exclude extraordinary events. The units will immediately vest, in accordance with the Interim Final Rule, but will only be redeemable in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year early if AIG repays its TARP obligations. Other terms and conditions of the "basket" units, including any alterations to the structure of the "basket" to maintain appropriate incentives for employees, will be determined by AIG subject to the approval of the Office of the Special Master.

  Rates of stock salary grants reflect full-year values. Because this is a new compensation element, the amounts are payable on a *nunc pro tunc* basis effective January 1, 2009. Stock salary must be determined as a dollar amount through the date salary is earned, be accrued at the same time or times as the salary would otherwise be paid in cash, and vest immediately upon grant, with the number of shares or units based on the fair market value of a share on the date of award.

- ***Long-term restricted stock***. Long-term restricted stock may be granted upon the achievement of specified, objective performance criteria that have been developed and reviewed in consultation with the Office of the Special Master and certified by the Compensation and Management Resources Committee of AIG's Board of Directors. Any such stock may vest only if the employee remains employed by the Company on the third anniversary of grant (or, if earlier, upon death or disability). The stock shall be transferable only in 25% increments for each 25% of TARP obligations repaid by the Company.

- ***Other compensation and perquisites***. No more than $25,000 in total other compensation and perquisites may be provided to any Covered Employee, absent exceptional circumstances for good cause shown, as defined by pertinent SEC regulations.

- ***Supplemental executive retirement plans and non-qualified deferred compensation plans***. Following the date of the Determination Memorandum, no additional amounts may be accrued under supplemental executive retirement plans, and no Company contributions may be made to other "non-qualified deferred compensation" plans, as defined by pertinent SEC regulations.

- ***Qualified Plans***. For the avoidance of doubt, the Special Master has determined that participation by the Covered Employees in tax-qualified retirement, health and welfare, and similar plans is consistent with the Public Interest Standard.

2. Bank of America Corporation

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 22 2009

Mr. J. Steele Alphin
Chief Administrative Officer
Bank of America Corporation
100 N. Tyron Street
NCI-007-58-22
Charlotte, North Carolina 28255-001

Re: ***Proposed Compensation Payments and Structures for Senior Executive Officers and Most Highly Compensated Employees***

Dear Mr. Alphin:

Pursuant to the Department of the Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance, the Office of the Special Master has completed its review of your 2009 compensation submission on behalf of the senior executive officers and certain most highly compensated employees of Bank of America Corporation ("BofA"). Attached as ***Annex A*** is a Determination Memorandum (accompanied by ***Exhibits I*** and ***II***,) providing the determinations of the Special Master with respect to 2009 compensation for those employees. 31 C.F.R. § 30.16(a)(3).

The Interim Final Rule requires the Special Master to determine whether the compensation structure for each senior executive officer and certain most highly compensated employees "will or may result in payments inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." *Id.* § 30.16(a)(3). The Special Master has determined that, to satisfy this standard, 2009 compensation for senior executive officers and certain most highly compensated employees of BofA generally must comport with the following standards:

- There can be no guarantee of any "bonus" or "retention" awards among the compensation structures approved by the Special Master. Cash guarantees payable in 2009 pursuant to previously existing agreements must be restructured to be payable in stock awards that may only be liquidated over time.

- Rather than cash, the majority of each individual's base salary will be paid in the form of stock. This stock will immediately vest, in accordance with the Interim Final Rule, but will only be redeemable in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year earlier if BofA repays its TARP obligations.

- Base salary paid in cash should not exceed $500,000 per year, except in appropriate cases for good cause shown. Overall, cash compensation must be significantly reduced from cash amounts paid in 2008. In BofA's case, cash compensation for these employees will decrease 94% from 2008 levels

- Total compensation for each individual must both reflect the individual's value to BofA and be appropriate when compared with total compensation provided to persons in similar positions or roles at similar entities. Overall, total direct compensation must be significantly reduced from 2008 amounts. In BofA's case, total direct compensation for these employees will decrease 62% from 2008 levels. *Id.* § 30.16(a)(3)(i).

- If—and only if—the employee achieves objective performance metrics developed and reviewed in consultation with the Office of the Special Master, employee may be eligible for long-term incentive awards. These awards, however, must be payable in the form of restricted stock that will be forfeited unless the employee stays with BofA for at least three years following grant, and may only be redeemed in 25% installments for each 25% installment of BofA's TARP obligations that are repaid. Such long-term incentive awards may not exceed one-third of total annual compensation.

- Any and all incentive compensation paid to employees will be subject to recovery or "clawback" if the payments are based on materially inaccurate financial statements or any other materially inaccurate performance metrics, or if the employee is terminated due to misconduct that occurred during the period in which the incentive was earned.

- Any and all "other" compensation and perquisites will not exceed $25,000 for each employee (absent exceptional circumstances for good cause shown).

- No severance benefit to which an employee becomes entitled in the future may take into account a cash salary increase, or any payment of stock salary, that the Special Master has approved for 2009.

- No additional amounts in 2009 may be accrued under supplemental executive retirement plans or credited by the company to other "non-qualified deferred compensation" plans after the date of the Determination Memorandum.

The Special Master has also determined that, in order for the approved compensation structures to satisfy the standards of 31 C.F.R. § 30.16(a)(3), BofA must adopt policies applicable to these employees as follows:

- The achievement of any performance objectives must be certified by the Compensation and Benefits Committee of BofA's Board of Directors, which is composed solely of independent directors. These performance objectives must be reviewed and approved by the Office of the Special Master.

- The employees will be prohibited from engaging in any hedging or derivative transactions involving BofA stock that would undermine the long-term performance incentives created by the compensation structures.

- BofA may not provide a tax "gross up" of any kind to these employees.

- At least once every year, the Compensation and Benefits Committee of BofA's Board of Directors must provide to the Department of the Treasury a narrative description identifying each compensation plan for its senior executive officers, and explaining how the plan does not encourage the senior executive officers to take unnecessary and excessive risks that threaten BofA's value.

These requirements are described in further detail in the attached Determination Memorandum.

The Special Master's review has been guided by a number of considerations, including each of the principles articulated in the Interim Final Rule. *Id.* § 30.16(b)(1). The following principles were of particular importance to the Special Master in his determinations with respect to BofA's compensation structures:

- *Performance-based compensation.* The overwhelming majority of approved compensation depends on BofA's performance, and ties the financial incentives of BofA employees to the overall performance of the company. A majority of the salary paid to employees under these structures will be paid in the form of stock; and, because the stock salary will become transferable only in three equal, annual installments beginning on the second anniversary of the date the salary stock is earned (with each installment redeemable one year earlier if BofA repays its TARP obligations), the ultimate value realized by the employee will depend on BofA's performance over the long term. Guaranteed amounts payable in cash, in contrast, are generally rejected. *Id.* § 30.16(b)(1)(iv).

- *Taxpayer return.* The compensation structures approved by the Special Master reflect the need for BofA to remain a competitive enterprise and, ultimately, to be able to repay TARP obligations. The Special Master has determined that the approved compensation structures are competitive when compared to those provided to similarly situated employees of similarly situated companies. Overall, the compensation structures generally provide for total compensation packages that target the 50th percentile when compared to other executive officers and employees. Id. § 30.16(b)(1)(ii).

- *Appropriate Allocation.* The total compensation payable to BofA employees is weighted heavily toward long-term structures that are tied to BofA's performance and are easily understood by shareholders. As a general principle, guaranteed income is rejected. Fixed compensation payable to BofA employees should consist only of cash salaries at sufficient levels to attract and retain employees and provide them a reasonable level of liquidity.

Pursuant to the Interim Final Rule, the Company may, within 30 days of the date hereof, request in writing that the Special Master reconsider the determinations set forth in the Determination Memorandum. If the Company does not request reconsideration within 30 days, these initial determinations will be treated as final determinations. *Id.* § 30.16(c)(1).

Very truly yours,

Kenneth R. Feinberg
Office of the Special Master
for TARP Executive Compensation

Attachments

cc: Mr. Thomas M. Ryan
Jana J. Litsey, Esquire
Mr. Mark Behnke

ANNEX A
DETERMINATION MEMORANDUM

I. INTRODUCTION

The Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009 ("EESA"), requires the Secretary of the Treasury to establish standards related to executive compensation and corporate governance for financial institutions receiving financial assistance under the Troubled Asset Relief Program ("TARP"). Through the Department of the Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance (the "Rule"), the Secretary delegated to the Office of the Special Master for TARP Executive Compensation (the "Office of the Special Master" or "the Office") responsibility for reviewing compensation structures of certain employees at financial institutions that received exceptional financial assistance under the TARP ("Exceptional Assistance Recipients"). 31 C.F.R. § 30.16(a); *id.* § 30.16(a)(3). For these employees, the Special Master must determine whether the compensation structure will or may result in payments "inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." *Id.*

Bank of America Corporation ("BofA" or the "Company"), one of seven Exceptional Assistance Recipients, has submitted to the Special Master proposed compensation structures for review pursuant to Section 30.16(a)(3) of the Rule. These compensation structures apply to 3 employees that the Company has identified as Senior Executive Officers (the "Senior Executive Officers," or "SEOs") for purposes of the Rule, and 11 employees the Company has identified as among the most highly compensated employees of the Company for purposes of the Rule (the "Most Highly Compensated Employees," and, together with the SEOs, the "Covered Employees").

The Special Master has completed the review of the Company's proposals for the Covered Employees pursuant to the principles set forth in the Rule. *Id.* § 30.16(b)(1). This Determination Memorandum sets forth the determinations of the Special Master, pursuant to Section 30.16(a)(3) of the Rule, with respect to the Covered Employees.

II. BACKGROUND

On June 15, 2009, the Department of the Treasury ("Treasury") promulgated the Rule, creating the Office of the Special Master and delineating its responsibilities. Immediately following that date, the Special Master, and Treasury employees working in the Office of the Special Master, conducted extensive discussions with BofA officials. During these discussions, the Office of the Special Master informed BofA about the nature of the Office's work and the authority of the Special Master under the Rule. These discussions continued for a period of months, during which the Special Master and BofA explored potential compensation structures for the Covered Employees.

The Rule required that each Exceptional Assistance Recipient submit proposals for each Senior Executive Officer and Most Highly Compensated Employee no later than

August 14, 2009. *Id.* § 30.16(a)(3). On July 20, 2009, the Special Master requested from each Exceptional Assistance Recipient, including BofA, certain data and documentary information necessary to facilitate the Special Master's review of the Company's compensation structures. The request required BofA to submit data describing its proposals, and the payments that would result from the proposals concerning each Covered Employee.

In addition, the Rule authorizes the Special Master to request information from an Exceptional Assistance Recipient "under such procedures as the Special Master may determine." *Id.* § 30.16(d). BofA was required to submit competitive market data indicating how the amounts payable under BofA's proposals relate to the amounts paid to similarly situated employees at similarly situated financial institutions. BofA was also required to submit a range of documentation, including information related to proposed performance metrics, internal policies designed to curb excessive risk, and certain previously existing compensation plans and agreements.

BofA submitted this information to the Office of the Special Master on August 14, 2009. Following a preliminary review of the submission, and the submission of certain additional information, on August 31, 2009, the Special Master determined that BofA's submission was substantially complete for purposes of the Rule. *Id.* § 30.16(a)(3). The Office of the Special Master then commenced a formal review of BofA's proposals for the Covered Employees. The Rule provides that the Special Master is required to issue a compensation determination within 60 days of a substantially complete submission. *Id.* § 30.16(a)(3).

The Office of the Special Master's review of the Company's proposals was aided by analysis from a number of internal and external sources, including:

- Treasury personnel detailed to the Office of the Special Master, including executive compensation specialists with significant experience in reviewing, analyzing, designing and administering executive compensation plans, and attorneys with experience in matters related to executive compensation;

- Competitive market data provided by the Company in connection with its submission to the Office of the Special Master;

- External information on comparable compensation structures extracted from the *U.S. Mercer Benchmark Database-Executive*;

- External information on comparable compensation structures extracted from Equilar's *ExecutiveInsight* database (which includes information drawn from publicly filed proxy statements) and Equilar's *Top 25 Survey Summary Report* (which includes information from a survey on the pay of highly compensated employees);

- Consultation with Lucian A. Bebchuk, a world-renowned expert in executive compensation and the William J. Friedman and Alicia Townsend Friedman

Professor of Law, Economics, and Finance and Director of the Program on Corporate Governance at Harvard Law School; and

- Consultation with Kevin J. Murphy, a world-renowned expert in executive compensation and the Kenneth L. Trefftzs Chair in Finance in the department of finance and business economics at the University of Southern California's Marshall School of Business.

The Special Master considered these views, in light of the statutory and regulatory standards described in Part II below, when evaluating the Company's proposals for the Covered Employees for 2009.

III. STATUTORY AND REGULATORY STANDARDS

The Rule requires that the Special Master determine for each of the Covered Employees whether BofA's proposed compensation structures, including amounts payable or potentially payable under the compensation structure, "will or may result in payments that are inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." 31 C.F.R. § 30.16(a)(3) (as applied to Covered Employees of Exceptional Assistance Recipients, the "Public Interest Standard"). Regulations promulgated pursuant to the Rule require that the Special Master consider six principles when making these compensation determinations:

(1) *Risk.* The compensation structure should avoid incentives which encourage employees to take unnecessary or excessive risks that could threaten the value of the Exceptional Assistance Recipient, including incentives that reward employees for short-term or temporary increases in value or performance; or similar measures that may undercut the long-term value of the Exceptional Assistance Recipient. Compensation packages should be aligned with sound risk management. *Id.* § 30.16(b)(1)(i).

(2) *Taxpayer return.* The compensation structure and amount payable should reflect the need for the Exceptional Assistance Recipient to remain a competitive enterprise, to retain and recruit talented employees who will contribute to the recipient's future success, so that the Company will ultimately be able to repay its TARP obligations. *Id.* § 30.16(b)(1)(ii).

(3) *Appropriate allocation.* The compensation structure should appropriately allocate the components of compensation such as salary and short-term and long-term performance incentives, as well as the extent to which compensation is provided in cash, equity, or other types of compensation such as executive pensions, or other benefits, or perquisites, based on the specific role of the employee and other relevant circumstances, including the nature and amount of current compensation, deferred compensation, or other compensation and benefits previously paid or awarded. *Id.* § 30.16(b)(1)(iii).

(4) *Performance-based compensation.* An appropriate portion of the compensation should be performance-based over a relevant performance period. Performance-based compensation should be determined through tailored metrics that encompass individual performance and/or the performance of the Exceptional Assistance Recipient or a relevant business unit taking into consideration specific business objectives. Performance metrics may relate to employee compliance with relevant corporate policies. In addition, the likelihood of meeting the performance metrics should not be so great that the arrangement fails to provide an adequate incentive for the employee to perform, and performance metrics should be measurable, enforceable, and actually enforced if not met. *Id.* § 30.16(b)(1)(iv).

(5) *Comparable structures and payments.* The compensation structure and amount payable should be consistent with, and not excessive taking into account, compensation structures and amounts for persons in similar positions or roles at similar entities that are similarly situated, including, as applicable, entities competing in the same markets and similarly situated entities that are financially distressed or that are contemplating or undergoing reorganization. *Id.* § 30.16(b)(1)(v).

(6) *Employee contribution to TARP recipient value.* The compensation structure and amount payable should reflect the current or prospective contributions of an employee to the value of the Exceptional Assistance Recipient, taking into account multiple factors such as revenue production, specific expertise, compliance with company policy and regulation (including risk management), and corporate leadership, as well as the role the employee may have had with respect to any change in the financial health or competitive position of the recipient. *Id.* § 30.16(b)(1)(vi).

The Rule provides that the Special Master shall have discretion to determine the appropriate weight or relevance of a particular principle depending on the facts and circumstances surrounding the compensation structure or payment for a particular employee. *Id.* § 30.16(b). To the extent two or more principles may appear inconsistent in a particular situation, the Rule requires that the Special Master exercise his discretion in determining the relative weight to be accorded to each principle. *Id.*

The Rule provides that the Special Master may, in the course of applying these principles, take into account other compensation structures and other compensation earned, accrued, or paid, including compensation and compensation structures that are not subject to the restrictions of section 111 of EESA. For example, the Special Master may consider payments obligated to be made by the Company pursuant to certain legally binding rights under valid written employment contracts entered into prior to enactment of the statute and the accompanying Rule. *Id.* § 30.16(a)(3).

IV. COMPENSATION STRUCTURES AND PAYMENTS

A. BofA Proposals

BofA has provided the Office of the Special Master with detailed information concerning its proposed 2009 compensation structures for the Covered Employees, including amounts potentially payable under the compensation structure for each Covered Employee (the "Proposed Structures").

BofA supported its proposal with detailed assessments of each Covered Employee's tenure and responsibilities at the Company (or its applicable subsidiary) and historical compensation structure. The submission also included market data that, according to the Company, indicated that the amounts potentially payable to each employee were comparable to the compensation payable to similarly situated employees at a "peer group" of entities selected by the Company.

1. Covered Employees Generally

The following structures were proposed by BofA for the Covered Employee generally, with the exception of BofA's Chief Executive Officer (" CEO") and an employee with an existing arrangement that provides a cash guarantee; each of those employees are addressed separately.

a. Cash Salary

Except for the Company's CEO, BofA proposed increasing the cash salary of each Covered Employee to annualized amounts of either $700,000 or $950,000. The Company's proposal asserted that cash salaries at such levels could be justified by reference to the compensation of similarly situated employees at similarly situated companies.

b. Stock Salary

BofA proposed that Covered Employees receive substantial "stock salary," in annualized amounts ranging from $1,966,667 to $19,050,000. Stock salary would be delivered on the Company's regular payroll dates in the form of fully vested stock units, which would then "settle" into regular shares and become transferable 40% on the first anniversary of grant and 30% each on the second and third anniversaries.

c. Annual Long-Term Incentive Awards

BofA proposed that the Covered Employees be eligible in 2009 for substantial grants of annual long-term incentive awards, with total potential values ranging from $1,333,334 to $10,000,000. Under the proposal, the amount of an employee's award would be calculated based on achievement of corporate and/or business unit financial goals. Awards would be paid in the form of long-term restricted stock with vesting subject to the employee providing two years of service from the date of award, and actual payment in 25% installments for each 25% repayment of the Company's TARP obligations.

After submitting the Proposed Structures, the Company informed the Office of the Special Master that neither the CEO nor any of his direct reports who were serving in leadership positions at either legacy BofA or Merrill Lynch during 2008 (including those among the Covered Employees) would be eligible for an annual long-term incentive award in 2009.

d. "Other" Compensation and Perquisites

BofA proposed payments of "other" compensation, as well as perquisites, to the Covered Employees. These proposed payments varied in value.

e. Non-Qualified Deferred Compensation

BofA also proposed that certain Covered Employees receive compensation in the form of accruals under a "non-qualified deferred compensation" plan.

2. Certain other Covered Employees

a. Covered Employee with a Cash Guarantee

BofA included a proposal with respect to a Covered Employee who is party to an agreement with the Company providing for a substantial guaranteed cash payment in 2009 BofA believed this agreement created a legally binding right under a valid written employment contract, *see* 31 C.F.R. § 30.10(e)(2). BofA proposed that the amount of cash that would otherwise be delivered to this Covered Employee be instead delivered as a $700,000 cash salary, with the remainder of the guaranteed amount paid in salary stock provided on the same terms that BofA proposed for salary stock generally. The Covered Employee agreed to waive his right to the guaranteed cash payment in exchange for the proposed structure.

b. CEO

As initially submitted by BofA, the Proposed Structure for the CEO included cash salary of $950,000 (reduced from his 2008 salary of $1,500,000), stock salary of $7,050,000 and eligibility for an annual long-term incentive award of up to $4,000,000.

On September 30, 2009, the CEO announced his retirement from the Company, effective December 31, 2009. Following this announcement, the Company proposed instead that the CEO be paid no stock salary or long-term incentive award for 2009 and a prospective cash salary of $0 from the date of this Determination Memorandum through his last day of employment.

B. <u>Determinations of the Special Master</u>

The Special Master has reviewed the Proposed Structures in detail by application of the principles set forth in the Rule and described in Part II above. In light of this review and analysis, the Special Master has determined that both the structural design of BofA's proposals and the amounts potentially payable to Covered Employees under the proposals would be inconsistent with the Public Interest Standard and, therefore, require modification.

The Special Master has determined, in light of the considerations that follow, that the compensation structures described in ***Exhibits I*** and ***II*** to this Determination Memorandum will not, by virtue of either their structural design or the amounts potentially payable under them, result in payments inconsistent with the Public Interest Standard.

1. Covered Employees Generally

a. <u>Cash Salary</u>

The Special Master has reviewed the cash salary proposals in light of the principle that compensation structures should generally be comparable to "compensation structures and amounts for persons in similar positions or roles at similar entities." *Id.* § 30.16(b)(1)(v). The Special Master has concluded generally that, for Covered Employees at Exceptional Assistance Recipients, cash salaries should generally target the 50th percentile. Such levels of cash salaries balance the need to attract and retain talent with the need for compensation structures that reflect the circumstances of Exceptional Assistance Recipients

In conducting the review of the proposed amounts of cash salaries, the Special Master made use of the resources described in Part II. Based on this review, the Special Master has concluded that BofA's proposed cash salaries are inconsistent with the Public Interest Standard because the amounts potentially payable to certain Covered Employees cannot be supported by comparison to cash salaries provided to similarly situated employees of similar companies.

In addition, the Special Master has considered whether BofA's proposed salaries reflect the current or prospective contributions of an employee to the value of the [company]," *id.* § 30.16(b)(1)(vi). Under the BofA proposal, each Covered Employee would receive either a $700,000 or $950,000 cash salary. The Special Master has concluded that the proposed salaries are inconsistent with the Public Interest Standard because they do not differentiate among employees in a manner that reflects their individual values to the Company.

Finally, because cash salaries do not create incentives for employees to pursue long-term value creation or financial stability, the amount of cash salary provided to a Covered Employee must be considered in comparison to the portion of compensation that is "performance-based over a relevant period." *Id.* § 30.16(b)(1)(iv). The Special Master has concluded that the portion of the Covered Employee's compensation that may be allocated to cash salary should in most cases not exceed $500,000. See *id.* § 30.16(b)(1)(iii).

As described in further detail in ***Exhibits I*** and ***II***, the cash salaries that the Special Master has determined to be consistent with the Public Interest Standard compare appropriately to those paid to similar employees at similar firms, and are generally less than $500,000.

The Special Master has also concluded that, for cash salaries payable to certain employees to be consistent with the Public Interest Standard, further reductions are required in consideration of "other compensation earned, accrued, or paid" by BofA in 2009. *Id.* § 30.16(a)(3). These adjustments apply to certain employees who received cash bonus payments in 2009 that were excessive in light of bonuses provided to "persons in similar positions or roles at similar entities," *id.* § 30.16(b)(1)(v), and the "prospective contributions of [the employee] to the value of the exceptional assistance recipient, taking into account multiple factors such as...corporate leadership, as well as the role the employee may have had with respect to any change in the financial health or competitive position of the recipient." *Id.* § 30.16(b)(1)(vi).[1]

b. Stock Salary

The Special Master has reviewed the amount of stock salary BofA proposed to pay the Covered Employees in light of the principle that compensation structures should generally be comparable to " compensation structures and amounts for persons in similar positions or roles at similar entities." *Id.* § 30.16(b)(1)(v). Based on this review, the Special Master has concluded that the amount of stock salary BofA proposed paying to the Covered Employees is excessive and that the proposals are inconsistent with the Public Interest Standard. The compensation structures that the Special Master has determined are consistent with the Public Interest Standard provide lesser amounts of stock salary, as described in further detail in ***Exhibits I*** and ***II***.

The Special Master also has concluded that, for the amount of stock salary potentially payable to certain employees to be consistent with the Public Interest Standard, further reductions were required in consideration of "other compensation earned, accrued, or paid" by BofA in 2009. *Id.* § 30.16(a)(3). These adjustments apply to certain employees who received cash bonus payments in 2009 that were excessive in light of bonuses provided to "persons in similar positions or roles at similar entities," *id.*

[1] The Special Master's determinations regarding such "other compensation earned, accrued, or paid" considered only the extent to which the amounts of such compensation should be considered in the analysis with respect to whether the amounts potentially payable to the Covered Employees were consistent with the Public Interest Standard. *See* 31 C.F.R. § 30.16(a)(3)(i). The determinations are not, and should not be construed as an analysis, opinion, or determination under any other legal standard applicable to the payment or receipt of such compensation or to any act arising from or relating to such payment or receipt, including, without limitation, the Special Master's authority under 31 C.F.R. § 30.16(a)(3) to review whether such payments were "inconsistent with the purposes of section 111 of EESA or TARP, or otherwise contrary to the public interest." *Id.*

§ 30.16(b)(1)(v), and the "prospective contributions of [the employee] to the value of the exceptional assistance recipient, taking into account multiple factors such as...corporate leadership, as well as the role the employee may have had with respect to any change in the financial health or competitive position of the recipient." *Id.* § 30.16(b)(1)(vi).[2]

The Special Master has also reviewed the structure of BofA's stock salary proposal. The Rule requires that the Special Master consider whether an appropriate portion of an employee's compensation is allocated to long-term incentives. *Id.* § 30.16(b)(1)(iii). Stock salary that can be liquidated too soon would not be performance-based over the relevant performance period to provide such a long-term incentive. *See Id.* § 30.16(b)(1)(iv). Instead, such stock salary could incentivize employees to pursue short-term results instead of long-term value creation by paying excessive benefits to employees for short-term increases in share price. See *Id.* § 30.16(b)(1)(i). Under the Company's proposal, 40% of stock salary would be redeemable one-year after being granted. The Special Master has concluded that a one year holding period is insufficient to provide a long-term incentive and could result in payments that would be inconsistent with the Public Interest Standard.

As described in ***Exhibit I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard require that, at a minimum, stock salary only become redeemable in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year earlier if BofA repays its TARP obligations.

c. Annual Long-Term Incentive Awards

The Special Master has reviewed BofA's proposed annual long-term incentive awards in light of the principle that performance-based compensation should be based on "performance metrics [that are] measurable, enforceable, and actually enforced if not met." *Id.* § 30.16(b)(1)(iv). The Special Master, also has evaluated BofA's proposed awards by application of recently adopted international standards that provide that incentive compensation should generally be payable over a period of three years, as well as the Rule's principle that performance-based compensation should be payable "over a relevant performance period," *id.*

Although BofA proposed individually tailored performance metrics to calculate the size of long-term restricted stock awards, which the Special Master concluded are generally consistent with the Public Interest Standard, the restricted stock would vest after only two years of service. The Special Master has concluded that BofA's proposed annual long-term incentive awards are inconsistent with the Public Interest Standard because a two-year period of service is insufficient.

As described in ***Exhibits I*** and ***II***, the structures the Special Master has determined to be consistent with the Public Interest Standard include an annual long-term incentive award payable only upon the achievement of specified, objective performance

[2] See *supra*, note 1.

criteria that have been developed and reviewed in consultation with the Office of the Special Master, and that will not vest unless the employee remains employed until the third anniversary of grant. In addition, as required by the Rule, these awards may only be redeemed in 25% installments for each 25% of BofA's TARP obligations that are repaid.

d. "Other" Compensation and Perquisites

BofA proposed limited payments of "other" compensation, as well as perquisites, to the Covered Employees. The Special Master has concluded that, absent special justification, employees—not the Company—generally should be responsible for paying personal expenses, and that significant portions of compensation structures should not be allocated to such perquisites and "other" compensation. *See id.* §30.16(b)(1)(iii).

The Rule requires that each Exceptional Assistance Recipient annually disclose to Treasury any perquisites where the total value for any Senior Executive Officer or Most Highly Compensated Employee exceeds $25,000. An express justification for offering these benefits must also be disclosed. Accordingly, as described in ***Exhibits I*** and ***II***, and the compensation structures the Special Master has determined to be consistent with the Public Interest Standard provide no more than $25,000 in "other" compensation and perquisites to each of these employees. Any exceptions to this limitation will require that the Company provide to the Office of the Special Master an independent justification for the payment that is satisfactory to the Special Master. To the extent that payments exceeding this limitation have already been made to a Covered Employee in 2009, those amounts should be promptly returned to the Company.

e. Non-Qualified Deferred Compensation

BofA proposed that certain Covered Employees receive compensation in the form of accruals under a "non-qualified deferred compensation" plan. In such plans, employers periodically credit employees with an entitlement to post-retirement payments. Over time, these credits accumulate and employees may become entitled to substantial cash guarantees payable on retirement—in addition to any payments provided under retirement plans maintained for employees generally.

The Special Master has concluded that the primary portion of a Covered Employee's compensation package should be allocated to compensation structures that are "performance-based over a relevant performance period." *Id.* § 30.16(b)(1)(iv). Payments under the Company's "non-qualified deferred compensation" plans do not depend upon "individual performance and/or the performance of the [Company] or a relevant business unit," *id.*; instead, such accruals are simply guaranteed cash payments from the Company in the future. In addition, these payments can make it more difficult for shareholders to readily ascertain the full amount of pay due a top executive upon leaving the firm.

Covered Employees should fund their retirements using wealth accumulated based on Company performance while they are employed, rather than being guaranteed substantial retirement benefits by the Company regardless of Company performance during and after their tenures. Accordingly, as described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard prohibit further 2009 accruals for Covered Employees under supplemental retirement plans or Company credits to other "non-qualified deferred compensation" plans following the date of this Determination Memorandum.

f. Severance Arrangements

The Special Master has concluded that an increase in the amounts payable under these arrangements would be inconsistent with the principle that compensation should be performance-based, *id.* § 30.16(b)(1)(iv), and that payments should be appropriately allocated among the elements of compensation, *id.* § 30.16(b)(1)(iii). Accordingly, for the compensation structures described in ***Exhibits I*** and ***II*** to be consistent with the Public Interest Standard, the Company must ensure that 2009 compensation structures for these employees do not result in an increase in the amounts payable pursuant to these arrangements.

2. Certain other Covered Employees

The proposals for two Covered Employees were reviewed and analyzed by the Special Master separately because of one employee's existing cash guarantee and the other's unique role in the Company, respectively.

a. Covered Employee with a Cash Guarantee

The Special Master has concluded that guaranteed cash payments are not "performance-based over a relevant performance period," *Id.* § 30.16(b)(1)(iv). Indeed, the principles identified in the Rule are generally inconsistent with the payment of large guaranteed cash amounts. BofA proposed that the Covered Employee's guarantee be restructured into a $700,000 cash salary, with the remainder delivered as a stock salary with the same terms as the stock salary proposal for other Covered Employees.

Such a restructuring would be consistent with the principle that cash guarantees are generally disfavored, but inconsistent with the Special Master's conclusion that the cash portion of a Covered Employee's compensation that is not performance-based generally should not exceed $500,000. See *Id.* § 30.16(b)(1)(iii). As a result, the proposed restructuring is inconsistent with the Public Interest Standard.

The Special Master has determined that, with respect to this employee, a restructuring of the cash guarantee providing a cash salary of less than $500,000, with the remainder of the "guarantee" paid as stock salary, would be consistent with the Public Interest Standard. In addition, the Covered Employee's compensation structures, will also be subject to the limitations described in Parts IV.A.4 ("other" compensation and perquisites), IV.A.5 (non-qualified deferred compensation), and IV.A.6 (severance plans) above.

b. CEO

The CEO has publicly announced his retirement from the Company. In addition, it is anticipated that he will receive a very substantial retirement compensation package consisting of cash, equity and other payments, all agreed upon during the CEO's lengthy tenure with the Company and its predecessors. Accordingly, the Special Master has determined that the payment of any amount of compensation to the CEO for 2009 is inconsistent with the Public Interest Standard.

3. Departed Employees

In addition, eleven employees that would have been Covered Employees had remained employed are no longer employed by the Company. With respect to those employees, the Special Master has determined that cash salaries through the date of the termination of employment, and payment of up to $25,000 in perquisites and "other" compensation are consistent with the Public Interest Standard. No other payments to these employees of any kind would be consistent with the Public Interest Standard. Any exceptions to this limitation will require that the Company provide to the Office of the Special Master an independent justification for the payment that is satisfactory to the Special Master.

V. CORPORATE GOVERNANCE

As noted in Part II above, the Rule requires the Special Master to consider the extent to which compensation structures are "performance-based over a relevant performance period," 31 C.F.R. § 30.16(b)(1)(iv). In light of the importance of this principle, BofA must take certain additional corporate governance steps, including those required by the Rule, to ensure that the compensation structures for the Covered Employees, and the amounts payable or potentially payable under those structures, are consistent with the Public Interest Standard.

A. Requirements Relating to Compensation Structures

In order to ensure that objective compensation performance criteria are "measurable, enforceable, and actually enforced if not met," *id.* § 30.16(b)(1)(iv), long-term incentive awards may not be granted unless the Compensation and Benefits Committee of BofA's Board of Directors determines to grant such an award in light of the employee's performance as measured against objective performance criteria that the Committee has developed and reviewed in consultation with the Office of the Special Master. This evaluation must be disclosed to shareholders in, and certified by the Committee as part of, BofA's securities filings. In addition, the Committee must retain discretion with respect to each employee to reduce (but not to increase) the amount of any incentive award on the basis of its overall evaluation of the employee's or BofA's performance (notwithstanding full or partial satisfaction of the performance criteria).

In addition, the structures determined by the Special Master to be consistent with the Public Interest Standard include grants of stock in BofA. It is critical that these compensation structures achieve the Rule's objective of "appropriate[ly] allocat[ing] the components of compensation [including] long-term incentives, as well as the extent to which compensation is provided in...equity," *id.* § 30.16(b)(iii).

BofA must have in effect a policy that would prohibit an employee from engaging in any hedging, derivative or other transactions that have an equivalent economic effect that would undermine the incentives created by the compensation structures set forth in ***Exhibits I*** and ***II***. Such transactions would be contrary to the principles set forth in the Rule.

B. <u>Additional Requirements</u>

In addition to the requirements set forth above, pursuant to the requirements of the Rule, BofA is required to institute the following corporate governance reforms:

(1) *Compensation Committee; Risk Review*. BofA must maintain a compensation committee comprised exclusively of independent directors. Every six months, the committee must discuss, evaluate, and review with BofA's senior risk officers any risks that could threaten the value of BofA. In particular, the committee must meet every six months to discuss, evaluate, and review the terms of each employee compensation plan to identify and limit the features in (1) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that threaten the value of BofA; (2) SEO or other employee compensation plans that could encourage behavior focused on short-term results and not on long-term value creation; and (3) employees' compensation plans that could encourage the manipulation of BofA's reported earnings to enhance the compensation of any of the employees. *Id.* § 30.4; *id.* § 30.5.

(2) *Disclosure with Respect to Compensation Consultants*. The compensation committee must disclose to Treasury an annual narrative description of whether the Company, its Board of Directors, or the committee has engaged a compensation consultant during the past three years. If so, the compensation committee must detail the types of services provided by the compensation consultant or any affiliate, including any "benchmarking" or comparisons employed to identify certain percentile levels of compensation. *Id.* § 30.11(c).

(3) *Disclosure of Perquisites*. BofA must provide to Treasury an annual disclosure of any perquisite whose total value for BofA's fiscal year exceeds $25,000 for each of the Covered Employees. BofA must provide a narrative description of the amount and nature of these perquisites, the recipient of these perquisites, and a justification for offering these perquisites (including a justification for offering the perquisite, and not only for offering the perquisite with a value that exceeds $25,000). *Id.* § 30.11(b).

(4) *Clawback.* BofA must ensure that any incentive award paid to a Covered Employee is subject to a clawback if the award was based on materially inaccurate financial statements (which includes, but is not limited to, statements of earnings, revenues, or gains) or any other materially inaccurate performance metric criteria. BofA must exercise its clawback rights except to the extent that it is unreasonable to do so. *Id.* § 30.8.

(5) *Say-on-Pay.* BofA must permit a separate shareholder vote to approve the compensation of executives, as required to be disclosed pursuant to the federal securities laws (including the compensation discussion and analysis, the compensation tables, and any related material). *Id.* § 30.13.

(6) *Policy Addressing Excessive or Luxury Expenditures.* BofA was required to adopt an excessive or luxury expenditures policy, provide that policy to Treasury, and post it on the Company's website. If BofA's board of directors makes any material amendments to this policy, within ninety days of the adoption of the amended policy, the board of directors must provide the amended policy to Treasury and post the amended policy on BofA's Internet website. *Id.* § 30.12.

(7) *Prohibition on Tax Gross-Ups.* Except as explicitly permitted under the Rule, BofA is prohibited from providing (formally or informally) tax gross-ups to any of the Covered Employees. *Id.* § 30.11(d).

(8) *CEO and CFO Certification.* BofA's CEO and chief financial officer must provide to the Securities and Exchange Commission written certification of BofA's compliance with the various requirements of section 111 of EESA. The precise nature of the required certification is identified in the Rule. *Id.* § 30.15 Appx. A.

VI. CONCLUSION

The Special Master has reviewed the Proposed Structures for the Covered Employees for 2009 in light of the principles set forth at 31 C.F.R. § 30.16(b). On the basis of that review, the Special Master has determined that the Proposed Structures submitted by BofA require modification in order to meet the Public Interest Standard.

The Special Master has separately reviewed the compensation structures set forth in ***Exhibits I*** and ***II*** in light of the principles set forth at 31 C.F.R. § 30.16(b). Pursuant to the authority vested in the Special Master by the Rule, and in accordance with Section 30.16(a)(3) thereof, the Special Master hereby determines that the compensation structures set forth in ***Exhibits I*** and ***II***, including the amounts payable or potentially payable under such compensation structures, will not result in payments that are inconsistent with the purposes of section 111 of EESA or the TARP, and will not otherwise be contrary to the public interest.

Pursuant to the Interim Final Rule, BofA may, within 30 days of the date hereof, request in writing that the Special Master reconsider the determinations set forth in this

Determination Memorandum. The request for reconsideration must specify a factual error or relevant new information not previously considered, and must demonstrate that such error or lack of information resulted in a material error in the initial determinations. If BofA does not request reconsideration within 30 days, the determinations set forth herein will be treated as final determinations. 31 C.F.R. § 30.16(c)(1).

The foregoing determinations are limited to the compensation structures described in ***Exhibits I*** and ***II***, and shall not be relied upon with respect to any other employee. The determinations are limited to the authority vested in the Special Master by Section 30.16(a)(3) of the Rule, and shall not constitute, or be construed to constitute, the judgment of the Office of the Special Master or Treasury with respect to the compliance of any compensation structure with any other provision of the Rule. Moreover, this Determination Memorandum has relied upon, and is qualified in its entirety by, the accuracy of the materials submitted by BofA to the Office of the Special Master, and the absence of any material misstatement or omission in such materials.

Finally, the foregoing determinations are limited to the compensation structures described herein, and no further compensation of any kind payable to any Covered Employee without the prior approval of the Special Master would be consistent with the Public Interest Standard.

EXHIBIT I

COVERED EMPLOYEES

2009 Compensation

Company Name: Bank of America Corporation

Employee ID	**Cash Salary** (Rate going forward.)	**Stock Salary** (Performance based: The stock vests at grant and is redeemable in three equal annual installments beginning on the 2nd anniversary of grant.)	**Long-Term Restricted Stock** (Performance based: Awarded based on achievement of objective performance goals. Vests after 3 years of service. Transferability dependent on TARP repayment.)	**Total Direct Compensation** (Cash salary paid to date plus two months at new run rate + stock salary + long-term restricted stock.)
1678	$0	$0	$0	$0
1029	$500,000	$1,750,000	$1,125,000	$3,375,000
1055	$403,847	$5,412,180	$2,851,923	$8,555,770
1108	$412,500	$1,914,583	$1,106,250	$3,318,750
1123	$300,000	$4,483,333	$2,350,000	$7,050,000
1143	$500,000	$9,316,667	$0	$9,900,000
1164	$500,000	$5,640,000	$3,001,250	$9,003,750
1227	$352,500	$4,797,917	$2,526,250	$7,578,750
1562	$500,000	$5,250,000	$0	$6,000,000
1564	$412,500	$5,114,583	$2,706,250	$8,118,750
1714	$403,847	$4,612,180	$2,451,923	$7,355,770
1787	$412,500	$2,114,583	$1,206,250	$3,618,750
1850	$500,000	$3,950,000	$0	$4,700,000

Comparison of 2009 Compensation to Prior Years: 2007 & 2008 Compensation

2008 Cash decreased by $89.3M or 94.5%
Total Direct Compensation decreased by $149.2M or 65.5%

2007 Cash decreased by $49.8M or 92.2%
Total Direct Compensation decreased by $112.6M or 63.3%

Note: 1: Amounts reflected in this Exhibit do not include amounts the Company has asserted to be payable pursuant to legally binding rights under valid employment contracts, see 31 C.F.R. § 30.10(e)(2).

Note: 2: The total number of Covered Employees may be less than 25 because of terminations, departures and retirements after January 1, 2009.

EXHIBIT II
TERMS AND CONDITIONS OF PAYMENTS AND STRUCTURES CONSISTENT WITH THE PUBLIC INTEREST STANDARD

The following general terms and conditions shall govern the compensation structures described in ***Exhibit I***. The Special Master's determination that those structures are consistent with the Public Interest Standard is qualified in its entirety by the Company's adherence to these terms and conditions.

- ***Cash base salary.*** Cash base salaries reflect the go-forward rate for the employee effective as of November 1, 2009. Compensation paid in the form of cash base salary prior to that date in accordance with the terms of employment as of June 14, 2009 shall be permitted unless otherwise noted. 31 C.F.R. § 30.16(a)(3)(iii).

- ***Stock salary.*** Rates of stock salary grants reflect full-year values. Because this is a new compensation element, the amounts are payable on a *nunc pro tunc* basis effective January 1, 2009. Stock salary must be determined as a dollar amount through the date salary is earned, be accrued at the same time or times as the salary would otherwise be paid in cash, and vest immediately upon grant, with the number of shares or units based on the fair market value on the date of award. Stock granted as stock salary may only be redeemed in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year early if TARP obligations are repaid.

- ***Long-term restricted stock.*** Long-term restricted stock may be granted upon the achievement of specified, objective performance criteria that have been developed and reviewed in consultation with the Office of the Special Master and certified by the Compensation and Benefits Committee of the Company's Board of Directors. Any such stock may vest only if the employee remains employed by the Company on the third anniversary of grant (or, if earlier, upon death or disability). The stock shall be transferable only in 25% increments for each 25% of TARP obligations repaid by the Company.

- ***Other compensation and perquisites.*** No more than $25,000 in total other compensation and perquisites may be provided to any Covered Employee, absent exceptional circumstances for good cause shown, as defined by pertinent SEC regulations.

- ***Supplemental executive retirement plans and non-qualified deferred compensation plans.*** Following the date of the Determination Memorandum, no additional amounts may be accrued under supplemental executive retirement plans, and no Company contributions may be made to other "non-qualified deferred compensation" plans, as defined by pertinent SEC regulations.

- ***Qualified Plans.*** For the avoidance of doubt, the Special Master has determined that participation by the Covered Employees in tax-qualified retirement, health and welfare, and similar plans is consistent with the Public Interest Standard.

3. Chrysler Group, LLC

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 22, 2009

Ms. Nancy Rae
Executive Vice President, Human Resources
Chrysler Group, LLC
1000 Chrysler Drive
CIMS 485-08-96
Auburn Hills, MI 48326-2766

Re: Proposed Compensation Payments and Structures for Senior Executive Officers and Most Highly Compensated Employees

Dear Ms. Rae:

Pursuant to the Department of the Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance, the Office of the Special Master has completed its review of your 2009 compensation submission on behalf of the senior executive officers and certain most highly compensated employees of Chrysler Group, LLC ("Chrysler"). Attached as ***Annex A*** is a Determination Memorandum (accompanied by ***Exhibits I*** and ***II***) providing the determinations of the Special Master with respect to 2009 compensation for those employees. 31 C.F.R. § 30.16(a)(3).

The Interim Final Rule requires the Special Master to determine whether the compensation structure for each senior executive officer and certain most highly compensated employees "will or may result in payments inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." *Id.* § 30.16(a)(3). The Special Master has determined that, to satisfy this standard, 2009 compensation for Chrysler's senior executive officers and certain most highly compensated employees generally must comport with the following standards:

- There can be no guarantee of any "bonus" or "retention" awards among the compensation structures approved by the Special Master.

- Rather than cash, a significant portion of each individual's base salary will be paid in the form of stock. This stock will immediately vest, in accordance with the Interim Final Rule, but will only be redeemable in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year earlier if Chrysler repays its TARP obligations.

- Base salary paid in cash should not exceed $500,000 per year, except in appropriate cases for good cause shown.

- Total compensation for each individual must both reflect the individual's value to Chrysler and be appropriate when compared with total compensation of persons in similar positions or roles at similar entities, and should generally target the 50th percentile of total compensation for such similarly situated employees.

- Employees may be eligible to vest in long-term incentive awards if—and only if—objective performance metrics developed and reviewed in consultation with the Office of the Special Master are achieved. All such awards must be payable in the form of restricted stock that will be forfeited unless the employee stays with Chrysler for at least three years following grant and may only be redeemed in 25% installments for each 25% installments of Chrysler's TARP obligations that are repaid. Such long-term incentive awards may not exceed one-third of total annual compensation.

- Any and all incentive compensation paid to employees will be subject to recovery or "clawback" if the payments are based on materially inaccurate financial statements or any other materially inaccurate performance metrics, or if the employee is terminated due to misconduct that occurred during the period in which the incentive was earned.

- Any and all "other" compensation and perquisites will not exceed $25,000 for each employee (absent exceptional circumstances for good cause shown).

- No severance benefit to which an employee becomes entitled in the future may take into account a cash salary increase, or any payment of stock salary, that the Special Master has approved for 2009.

- No additional amounts in 2009 may be accrued under supplemental executive retirement plans or credited by the Company to other "non-qualified deferred compensation" plans after the date of the Determination Memorandum.

The Special Master has also determined that, in order for the approved compensation structures to satisfy the standards of 31 C.F.R. § 30.16(a)(3), Chrysler must adopt policies applicable to these employees as follows:

- The achievement of any performance objectives must be certified by the Compensation and Leadership Committee of Chrysler's Board of Directors, which is composed solely of independent directors. These performance objectives must be reviewed and approved by the Office of the Special Master.

- The employees will be prohibited from engaging in any hedging, derivative or other transactions that have an equivalent economic effect that would undermine the long-term performance incentives created by the compensation structures.

- At least once every year, Chrysler's compensation committee must provide to the Department of the Treasury a narrative description identifying each compensation plan for its senior executive officers, and explaining how the plan does not encourage the senior executive officers to take unnecessary and excessive risks that threaten Chrysler's value.

These requirements are described in further detail in the attached Determination Memorandum.

The Special Master's review has been guided by a number of considerations, including each of the principles articulated in the Interim Final Rule. *Id.* § 30.16(b)(1). The following principles were of particular importance to the Special Master in his determinations with respect to Chrysler's compensation structures:

- *Performance-based compensation.* A substantial amount of approved compensation depends on Chrysler's performance, and ties the financial incentives of Chrysler employees to the overall performance of the Company. Portions of the salary paid to employees under these structures will be paid in the form of stock; and, because the stock salary will become transferable only in three equal, annual installments beginning on the second anniversary of the date the stock salary is earned (with each installment redeemable one year earlier if Chrysler repays its TARP obligations), the ultimate value realized by the employee will depend on Chrysler's performance over the long term. Guaranteed amounts payable in cash, in contrast, are generally rejected. *Id.* § 30.16(b)(1)(iv).

- *Taxpayer return.* The compensation structures approved by the Special Master reflect the need for Chrysler to remain a competitive enterprise and, ultimately, to be able to repay TARP obligations. The Special Master has determined that the approved compensation structures are competitive when compared to those provided to similarly situated employees of similarly situated companies. Overall, the compensation structures generally provide for total compensation packages that are well below the 50th percentile when compared to such other executive officers and employees. *Id.* § 30.16(b)(1)(ii).

Pursuant to the Interim Final Rule, Chrysler may, within 30 days of the date hereof, request in writing that the Special Master reconsider the determinations set forth in the Determination Memorandum. If the Chrysler does not request reconsideration within 30 days, these initial determinations will be treated as final determinations. *Id.* § 30.16(c)(1).

Very truly yours,

Kenneth R. Feinberg
Office of the Special Master
for TARP Executive Compensation

Attachments

cc: Holly E. Leese, Esquire
Lawrence Cagney, Esquire

ANNEX A
DETERMINATION MEMORANDUM

I. INTRODUCTION

The Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009 ("EESA"), requires the Secretary of the Treasury to establish standards related to executive compensation and corporate governance for financial institutions receiving financial assistance under the Troubled Asset Relief Program ("TARP"). Through the Department of the Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance (the "Rule"), the Secretary delegated to the Office of the Special Master for TARP Executive Compensation (the "Office of the Special Master" or "the Office") responsibility for reviewing compensation structures of certain employees at financial institutions that received exceptional financial assistance under the TARP ("Exceptional Assistance Recipients"). 31 C.F.R. § 30.16(a); *id.* § 30.16(a)(3). For these employees, the Special Master must determine whether the compensation structure will or may result in payments "inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." *Id.*

Chrysler Group, LLC ("Chrysler" or the "Company"), one of seven Exceptional Assistance Recipients, has submitted to the Special Master proposed compensation structures (the "Proposed Structures") for review pursuant to Section 30.16(a)(3) of the Rule. These compensation structures apply to five employees that the Company has identified as senior executive officers (the "Senior Executive Officers," or "SEOs") for purposes of the Rule, and 20 employees the Company has identified as among the most highly compensated employees of the Company for purposes of the Rule (the "Most Highly Compensated Employees," and, together with the SEOs, the "Covered Employees").

The Special Master has completed the review of the Company's Proposed Structures for the Covered Employees pursuant to the principles set forth in the Rule. *Id.* § 30.16(b)(1). This Determination Memorandum sets forth the determinations of the Special Master, pursuant to Section 30.16(a)(3) of the Rule, with respect to the Covered Employees.

II. BACKGROUND

On June 15, 2009, the Department of the Treasury ("Treasury") promulgated the Rule, creating the Office of the Special Master and delineating its responsibilities. Immediately following that date, the Special Master, and Treasury employees working in the Office of the Special Master, conducted extensive discussions with Chrysler officials. During these discussions, the Office of the Special Master informed Chrysler about the nature of the Office's work and the authority of the Special Master under the Rule. These discussions continued for a period of months, during which the Special Master and Chrysler explored potential compensation structures for the Covered Employees.

The Rule requires that each Exceptional Assistance Recipient submit proposed compensation structures for each Senior Executive Officer and Most Highly Compensated Employee no later than August 14, 2009. 31 C.F.R. § 30.16(a)(3). On July 20, 2009, the Special Master requested from each Exceptional Assistance Recipient, including Chrysler, certain data and documentary information necessary to facilitate the Special Master's review of the Company's compensation structures. The request required Chrysler to submit data describing its proposals, and the payments that would result from the Proposed Structures, concerning each Covered Employee.

In addition, the Rule authorizes the Special Master to request information from an Exceptional Assistance Recipient "under such procedures as the Special Master may determine." *Id.* § 30.16(d). Chrysler was required to submit competitive market data indicating how the amounts payable under Chrysler's Proposed Structures relate to the amounts paid to persons in similar positions or roles at similar entities. Chrysler was also required to submit a range of documentation, including information related to proposed performance metrics, internal policies designed to curb excessive risk, and certain previously existing compensation plans and agreements.

Chrysler submitted this information to the Office of the Special Master on August 14, 2009. Following a preliminary review of the submission, and the submission of certain additional information, on August 31, 2009, the Special Master determined that Chrysler's submission was substantially complete for purposes of the Rule. *Id.* § 30.16(a)(3). The Office of the Special Master then commenced a formal review of Chrysler's proposal for the Covered Employees. The Rule provides that the Special Master is required to issue a compensation determination within 60 days of a substantially complete submission. *Id.* § 30.16(a)(3).

The Office of the Special Master's review of the Company's proposals was aided by analysis from a number of internal and external sources, including:

- Treasury personnel detailed to the Office of the Special Master, including executive compensation specialists with significant experience in reviewing, analyzing, designing and administering executive compensation plans, and attorneys with experience in matters related to executive compensation;

- Competitive market data provided by the Company in connection with its submissions to the Office of the Special Master;

- External information on comparable compensation structures extracted from the *U.S. Mercer Benchmark Database-Executive*;

- External information on comparable compensation structures extracted from Equilar's *ExecutiveInsight* database (which includes information drawn from publicly filed proxy statements) and Equilar's *Top 25 Survey Summary Report* (which includes information from a survey on the pay of highly compensated employees);

- Consultation with Lucian A. Bebchuk, a world-renowned expert in executive compensation and the William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance and Director of the Program on Corporate Governance at Harvard Law School; and

- Consultation with Kevin J. Murphy, a world-renowned expert in executive compensation and the Kenneth L. Trefftzs Chair in Finance in the department of finance and business economics at the University of Southern California's Marshall School of Business.

The Special Master considered these views, in light of the statutory and regulatory standards described in Part III below, when evaluating the Company's proposed compensation structures for the Covered Employees for 2009.

III. Statutory and Regulatory Standards

The Rule requires that the Special Master determine for each of the Covered Employees whether Chrysler's proposals, including amounts payable or potentially payable under the compensation structure, "will or may result in payments that are inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." 31 C.F.R. § 30.16(a)(3) (as applied to Covered Employees of Exceptional Assistance Recipients, the "Public Interest Standard"). Regulations promulgated pursuant to the Rule require that the Special Master consider six principles when making these compensation determinations:

(1) *Risk.* The compensation structure should avoid incentives which encourage executive officers and employees to take unnecessary or excessive risks that could threaten the value of the exceptional assistance recipient, including incentives that reward employees for short-term or temporary increases in value or performance; or similar measures that may undercut the long-term value of the exceptional assistance recipient. Compensation packages should be aligned with sound risk management. *Id.* § 30.16(b)(1)(i).

(2) *Taxpayer return.* The compensation structure and amount payable should reflect the need for the exceptional assistance recipient to remain a competitive enterprise, to retain and recruit talented employees who will contribute to the recipient's future success, so that the Company will ultimately be able to repay its TARP obligations. *Id.* § 30.16(b)(1)(ii).

(3) *Appropriate allocation.* The compensation structure should appropriately allocate the components of compensation such as salary and short-term and long-term performance incentives, as well as the extent to which compensation is provided in cash, equity, or other types of compensation such as executive pensions, or other benefits or perquisites, based on the specific role of the employee and other

relevant circumstances, including the nature and amount of current compensation, deferred compensation, or other compensation and benefits previously paid or awarded. *Id.* § 30.16(b)(1)(iii).

(4) *Performance-based compensation.* An appropriate portion of the compensation should be performance-based over a relevant performance period. Performance-based compensation should be determined through tailored metrics that encompass individual performance and/or the performance of the Exceptional Assistance Recipient or a relevant business unit taking into consideration specific business objectives. Performance metrics may relate to employee compliance with relevant corporate policies. In addition, the likelihood of meeting the performance metrics should not be so great that the arrangement fails to provide an adequate incentive for the employee to perform, and performance metrics should be measurable, enforceable, and actually enforced if not met. *Id.* § 30.16(b)(1)(iv).

(5) *Comparable structures and payments.* The compensation structure, and amount payable where applicable, should be consistent with, and not excessive taking into account, compensation structures and amounts for persons in similar positions or roles at similar entities that are similarly situated, including, as applicable, entities competing in the same markets and similarly situated entities that are financially distressed or that are contemplating or undergoing reorganization. *Id.* § 30.16(b)(1)(v).

(6) *Employee contribution to TARP recipient value.* The compensation structure and amount payable should reflect the current or prospective contributions of an employee to the value of the exceptional assistance recipient, taking into account multiple factors such as revenue production, specific expertise, compliance with company policy and regulation (including risk management), and corporate leadership, as well as the role the employee may have had with respect to any change in the financial health or competitive position of the recipient. *Id.* § 30.16(b)(1)(vi).

The Rule provides that the Special Master shall have discretion to determine the appropriate weight or relevance of a particular principle depending on the facts and circumstances surrounding the compensation structure or payment for a particular employee. *Id.* § 30.16(b). To the extent two or more principles may appear inconsistent in a particular situation, the Rule requires that the Special Master exercise his discretion in determining the relative weight to be accorded to each principle. *Id.*

The Rule provides that the Special Master may, in the course of applying these principles, take into account other compensation structures and other compensation earned, accrued, or paid, including compensation and compensation structures that are not subject to the restrictions of section 111 of EESA. For example, the Special Master may consider payments obligated to be made by the Company pursuant to certain legally binding rights under valid written employment contracts entered into prior to enactment of the statute and the accompanying Rule. *Id.* § 30.16(a)(3).

IV. Compensation Structures and Payments

A. Chrysler Proposals

Chrysler provided the Office of the Special Master with detailed information concerning its proposals for the Covered Employees, including amounts potentially payable under the compensation structure for each Covered Employee.

Chrysler supported its proposal with detailed assessments of each Covered Employee's tenure and responsibilities at the Company and historical compensation structure. The submission also included market data that, according to the Company, indicated that the amounts potentially payable to each employee were comparable to the compensation payable to persons in similar positions or roles at a "peer group" of entities selected by the Company.

1. Chief Executive Officer

Chrysler's chief executive officer (the "CEO") also serves as the chief executive officer of Fiat S.p.A, a minority shareholder of the Company. Fiat, according to the Company's submission, has and will continue to provide for the CEO's 2009 compensation, and Chrysler has not proposed to pay him any compensation whatsoever in 2009.

2. Covered Employees Generally

Chrysler's proposals for this group of Covered Employees, (which excludes the CEO and three departing employees, who are covered separately below), ranged from $311,503 to $719,340 and consisted of three primary components—cash salaries, stock salaries, and annual long-term incentive awards—plus additional payments in the form of "non-qualified deferred compensation" accruals, perquisites, and "other" compensation.

a. Cash Salary

Chrysler proposed increasing the cash salary of these Covered Employees to annualized amounts ranging from $276,672 to $603,000. The Company's proposal asserted that cash salaries at such levels could be justified by reference to the compensation of persons in similar positions or roles at similar entities.

b. Stock Salary

Chrysler proposed that these Covered Employees receive 20% of their total salaries going forward as stock salary, in annualized amounts ranging from $56,000 to $122,000 on an annual basis. On each regular payroll date, Covered Employees would earn fully vested "deferred phantom units," each representing an equal portion of the Company's equity, which would then settle in two tranches of 50% each on the second and third anniversaries of the grant date, respectively.

c. Annual Long-Term Incentive Awards

Chrysler proposed that these Covered Employees be eligible for annual long-term incentive awards equal to one third of total compensation received from and after September 1, 2009, with total potential values ranging from $56,001 to $122,002. Awards would be paid in the form of "long-term restricted stock" with 25% vesting after two years of service and 75% vesting on the later to occur of the second anniversary of the grant date or a public offering by the Company. Actual payment would be made in 25% installments for each 25% repayment of the Company's TARP obligations.

d. "Other" Compensation and Perquisites

Chrysler proposed payments of "other" compensation, as well as perquisites, to the Covered Employees. These proposed payments varied in value.

e. Non-Qualified Deferred Compensation

Chrysler also proposed that certain Covered Employees receive compensation in the form of accruals under a "non-qualified deferred compensation" plan.

B. Determinations of the Special Master

The Special Master has reviewed the Proposed Structures in detail by application of the principles set forth in the Rule and described in Part III above. In light of this review and analysis, the Special Master has determined that both the structural design of Chrysler's proposals and the amounts potentially payable to Covered Employees under the proposals would be inconsistent with the Public Interest Standard and, therefore, require modification.

The Special Master has determined, in light of the considerations that follow, that the compensation structures described in ***Exhibits I*** and ***II*** to this Determination Memorandum will not, by virtue of either their structural design or the amounts potentially payable under them, result in payments inconsistent with the Public Interest Standard.

1. Chief Executive Officer

Because they are provided by a minority shareholder of the company, the proposals for Chrysler's CEO and amounts potentially payable under such structures, which would generally be subject to the Special Master's review and analysis, are instead outside the Special Master's purview. As a result, the Special Master has made no determination as to whether any payments made or proposed to be made to Chrysler's CEO are consistent with the Public Interest Standard. 31 C.F.R. § 30.1.

2. Covered Employees Generally

a. Cash Salary

The Special Master reviewed the cash salary proposals in light of the principle that compensation structures should generally be comparable to "compensation structures and amounts for persons in similar positions or roles at similar entities." *Id.* § 30.16(b)(1)(v). The Special Master has concluded generally that cash salaries for employees at Exceptional Assistance Recipients, cash salaries should generally target the 50th percentile because such levels of cash salaries balance the need to attract and retain talent with the need for compensation structures that reflect the circumstances of Exceptional Assistance Recipients

The Special Master made use of the resources described in Part II and concluded that Chrysler's proposal would generally deliver cash salaries that would place the Covered Executives at or below the 50th percentile of compensation provided to persons in similar positions or roles at similar entities.

In addition, because cash salaries do not create incentives for employees to pursue long-term value creation or financial stability, the amount of cash salary provided to a Covered Employee must be considered in comparison to the portion of compensation that is "performance-based over a relevant performance period." *Id.* § 30.16(b)(1)(iv). The Special Master has concluded that the portion of the Covered Employee's compensation that is not performance-based and should instead be allocated to cash salary should in most cases not exceed $500,000. *See id.* § 30.16(b)(1)(iii).

As described in further detail in ***Exhibits I*** and ***II***, the cash salaries that the Special Master has determined to be consistent with the Public Interest Standard compare appropriately to those paid to persons in similar positions or roles at similar entities, and are generally less than $500,000.

b. Stock Salary

The Special Master reviewed the amount of stock salary Chrysler proposed to pay the Covered Employees. This review was analogous to the comparative review of proposed cash salaries, described above. The Special Master determined that Chrysler's stock salary proposal would convey amounts of equity compensation in 2009 that would place the Covered Employees at or below the 50th percentile of compensation provided to persons in similar positions or roles at similar entities. These amounts are described in further detail in ***Exhibits I*** and ***II.***

The Special Master also reviewed the structure of Chrysler's stock salary proposal. The Rule requires that the Special Master consider whether an appropriate portion of an employee's compensation is allocated to long-term incentives *Id.* § 30.16(b)(1)(iii). Stock salary that can be liquidated too soon would not be performance-based over the relevant performance period to provide such a long-term incentive. See *Id.* § 30.16(b)(1)(iv). Instead, such stock salary could incentivize employees to pursue short-term results instead of long-term value creation by paying excessive benefits to employees for short-term increases in share price. See *Id.* § 30.16(b)(1)(i). Under the Company's proposal, 50% of stock salary would be redeemable by the employee after two years and the remaining 50% of stock salary would be redeemable after three years, which the Special Master has concluded is an insufficient holding period to provide an appropriate long-term incentive and could result in payments that would be inconsistent with the Public Interest Standard. Accordingly, as described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard require that stock salary become redeemable in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year earlier if Chrysler repays its TARP obligations.

c. Annual Long-Term Incentive Awards

The Special Master reviewed Chrysler's proposed annual long-term incentive awards in light of the principle that performance-based compensation should be based on "performance metrics [that are] measurable, enforceable, and actually enforced if not met." *Id.* § 30.16(b)(1)(iv). Although Chrysler's proposal for the vesting condition for 75% of the annual-incentive awards was based on a substantial goal related to the performance of the Company, *id.*, 25% of the awards required only continued employment for two years. A two-year service requirement does not provide Covered Employees with tailored metrics that encompass individual performance. *Id.* In addition, in light of recently adopted international standards providing that incentive compensation should be payable over a period of three years and the Rule's requirement that performance-based compensation be payable "over a relevant performance period," *id.*, the Special Master has concluded that awards of long-term restricted stock should not vest unless the employee remains employed through the third anniversary of grant.

As described in ***Exhibits I*** and ***II***, the structures the Special Master has determined to be consistent with the Public Interest Standard include an annual long-term incentive award payable only upon the achievement of specified, objective performance criteria that have been developed and reviewed in consultation with the Office of the Special Master, and that will not vest unless the employee remains employed until the third anniversary of grant. In addition, as required by the Rule, these awards may only be redeemed in 25% installments for each 25% of Chrysler's TARP obligations that are repaid.

d. "Other" Compensation and Perquisites

Chrysler proposed payments of "other" compensation, as well as perquisites, to the Covered Employees. The Special Master has concluded that, absent special justification, employees—not the Company—generally should be responsible for paying personal expenses, and that significant portions of compensation structures should not be allocated to such perquisites and "other" compensation. *See id.* §30.16(b)(1)(iii).

The Rule requires that each Exceptional Assistance Recipient annually disclose to Treasury any perquisites where the total value for any Senior Executive Officer or Most

Highly Compensated Employee exceeds $25,000. An express justification for offering these benefits must also be disclosed. Accordingly, as described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard provide no more than $25,000 in "other" compensation and perquisites to each of these employees. Any exceptions to this limitation will require that the Company provide to the Office of the Special Master an independent justification for the payment that is satisfactory to the Special Master. To the extent that payments exceeding this limitation have already been made to a Covered Employee in 2009, those amounts should be promptly returned to the Company.

e. Non-Qualified Deferred Compensation

Chrysler also proposed that certain Covered Employees receive compensation in the form of accruals under a "non-qualified deferred compensation" plan. In such plans, employers periodically credit employees with an entitlement to post-retirement payments. Over time, these credits accumulate and employees may become entitled to substantial cash guarantees payable on retirement—in addition to any payments provided under retirement plans maintained for employees generally.

The Special Master has concluded that the primary portion of a Covered Employee's compensation package should be allocated to compensation structures that are "performance-based over a relevant performance period." *Id.* § 30.16(b)(1)(iv). Payments under the Company's "non-qualified deferred compensation" plans do not depend upon "individual performance and/or the performance of the [Company] or a relevant business unit," *id.*; instead, such accruals are simply guaranteed cash payments from the Company in the future.

Covered Employees should fund their retirements using wealth accumulated based on Company performance while they are employed, rather than being guaranteed substantial retirement benefits by the Company regardless of Company performance during and after their tenures. Accordingly, as described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard prohibit further 2009 accruals for Covered Employees under supplemental retirement plans or Company credits to other "non-qualified deferred compensation" plans following the date of this Determination Memorandum.

In addition, Chrysler proposed that amounts already accrued by the Covered Employees in 2009 under executive retirement plans be paid out to the employees in January 2010. Such payments would effectively constitute a short-term cash guarantee that is not "performance-based over a relevant performance period," 31 C.F.R. § 30.16(b)(1)(iv). The Special Master has determined that the proposed timing of the payment of the existing retirement accruals is not consistent with the Public Interest Standard and that modifying the existing retirement accruals to provide for payment on a post-retirement basis would be consistent with the Public Interest Standard.

f. Severance Arrangements

The Special Master has concluded that an increase in the amounts payable under these arrangements would be inconsistent with the principle that compensation should be performance-based, *id.* § 30.16(b)(1)(iv), and that payments should be appropriately allocated among the elements of compensation, *id.* § 30.16(b)(1)(iii). Accordingly, for the compensation structures described in ***Exhibits I*** and ***II***, to be consistent with the Public Interest Standard, the Company must ensure that 2009 compensation structures for these executives do not result in an increase in the amounts payable pursuant to these arrangements.

3. Departing Employees

Chrysler has also proposed that three Covered Employees whose employment will terminate prior to December 31, 2009, should receive only continuation of their existing cash salaries until their date of departure. With respect to two of those employees, the Special Master has determined that cash salaries through the date of the termination of employment, and payment of up to $25,000 in perquisites and "other" compensation are consistent with the Public Interest Standard. No other payments to these employees of any kind would be consistent with the Public Interest Standard. Any exceptions to this limitation will require that the Company provide to the Office of the Special Master an independent justification for the payment that is satisfactory to the Special Master.

With respect to the third Covered Employee, who has an annual cash salary of $2,583,336, the Special Master has determined that, in light of "compensation earned, accrued, or paid" to this employee in 2009, *id.* § 30.16(a)(3), the payment of any additional cash after the date of this Determination Memorandum would be inconsistent with the Public Interest.

V. CORPORATE GOVERNANCE

As noted in Part IV above, the Rule requires the Special Master to consider the extent to which compensation structures are "performance-based over a relevant performance period," 31 C.F.R. § 30.16(b)(1)(iv). In light of the importance of this principle, the Company must take certain additional corporate governance steps, including those required by the Rule, to ensure that the compensation structures for the Covered Employees, and the amounts payable or potentially payable under those structures, are consistent with the Public Interest Standard.

A. **Requirements Relating to Compensation Structures**

In order to ensure that objective compensation performance criteria are "measurable, enforceable, and actually enforced if not met," *id.* § 30.16(b)(1)(iv), long-term incentive awards may not vest unless the Company's compensation committee determines that the applicable level of performance—as measured against objective performance criteria that the compensation committee has developed and reviewed in consultation with the Office of the Special Master—has been met. This determination must be certified by the compensation committee to the Office of the Special Master or, subject to the approval of the Special Master, in such other manner as is determined by the compensation committee.

In addition, as noted in Part IV, above and described in ***Exhibits I*** and ***II***, the structures determined by the Special Master to be consistent with the Public Interest Standard include grants of stock in the Company. It is critical that these compensation structures achieve the Rule's objective of "appropriate[ly] allocat[ing] the components of compensation [including] long-term incentives, as well as the extent to which compensation is provided in...equity," *id.* § 30.16(b)(iii).

The Company must have in effect a policy that would prohibit an employee from engaging in hedging, derivative or other transactions that have an economically similar effect that would undermine the incentives created by the compensation structures set forth in ***Exhibits I*** and ***II***. Such transactions would be contrary to the principles set forth in the Rule.

B. <u>Additional Requirements</u>

In addition to the requirements set forth above, pursuant to the requirements of the Rule, the Company is required to institute the following corporate governance reforms:

(1) *Compensation Committee: Risk Review.* Chrysler must maintain a compensation committee comprised exclusively of independent directors. Every six months, the committee must discuss, evaluate, and review with the Company's senior risk officers any risks that could threaten the value of the Company. In particular, the committee must meet every six months to discuss, evaluate, and review the terms of each employee compensation plan to identify and limit the features in (1) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that threaten the value of the Company; (2) SEO or other employee compensation plans that could encourage behavior focused on short-term results and not on long-term value creation; and (3) employees' compensation plans that could encourage the manipulation of the Company's reported earnings to enhance the compensation of any of the employees. *id.* § 30.4; *id.* § 30.5.

(2) *Disclosure with Respect to Compensation Consultants.* The compensation committee must disclose to Treasury an annual narrative description of whether the Company, its Board of Directors, or the committee has engaged a compensation consultant during the past three years. If so, the compensation committee must detail the types of services provided by the compensation consultant or any affiliate, including any "benchmarking" or comparisons employed to identify certain percentile levels of compensation. *Id.* § 30.11(c).

(3) *Disclosure of Perquisites.* As noted in Part IV, Chrysler must provide to Treasury an annual disclosure of any perquisite whose total value for Chrysler's fiscal year exceeds $25,000 for each of the Covered Employees. Chrysler must

provide a narrative description of the amount and nature of these perquisites, the recipient of these perquisites, and a justification for offering these perquisites (including a justification for offering the perquisite, and not only for offering the perquisite with a value that exceeds $25,000). *Id.* § 30.11(b).

(4) *Clawback.* Chrysler must ensure that any incentive award paid to a Covered Employee is subject to a clawback if the award was based on materially inaccurate financial statements (which includes, but is not limited to, statements of earnings, revenues, or gains) or any other materially inaccurate performance metric criteria. Chrysler must exercise its clawback rights except to the extent that it is unreasonable to do so. *Id.* § 30.8.

(5) *Policy Addressing Excessive or Luxury Expenditures.* Chrysler was required to adopt an excessive or luxury expenditures policy, provide that policy to Treasury, and post it on the Company's website. If Chrysler's board of directors makes any material amendments to this policy, within ninety days of the adoption of the amended policy, the board of directors must provide the amended policy to Treasury and post the amended policy on its Internet website. *Id.* § 30.12.

(6) *Prohibition on Tax Gross-Ups.* Except as explicitly permitted under the Rule, Chrysler is prohibited from providing (formally or informally) tax gross-ups to any of the Covered Employees. *Id.* § 30.11(d).

(7) *CEO and CFO Certification.* Chrysler's CEO and chief financial officer must provide written certification of Chrysler's compliance with the various requirements of section 111 of EESA. The precise nature of the required certification is identified in the Rule. *Id.* § 30.15 Appx. A.

VI. CONCLUSION

The Special Master has reviewed the Proposed Structures for the Covered Employees for 2009 in light of the principles set forth at 31 C.F.R. § 30.16(b). On the basis of that review, the Special Master has determined that the Proposed Structures submitted by Chrysler require modification in order to meet the Public Interest Standard.

The Special Master has separately reviewed the compensation structures set forth in ***Exhibits I*** and ***II***, in light of the principles set forth at 31 C.F.R. § 30.16(b). Pursuant to the authority vested in the Special Master by the Rule, and in accordance with Section 30.16(a)(3) thereof, the Special Master hereby determines that the compensation structures set forth in ***Exhibits I*** and ***II***, including the amounts payable or potentially payable under such compensation structures, will not result in payments that are inconsistent with the purposes of section 111 of EESA or the TARP, and will not otherwise be contrary to the public interest.

Pursuant to the Interim Final Rule, Chrysler may, within 30 days of the date hereof, request in writing that the Special Master reconsider the determinations set forth in this Determination Memorandum. The request for reconsideration must specify a factual error or relevant new information not previously considered, and must demonstrate that such error or lack of information resulted in a material error in the initial determinations. If Chrysler does not request reconsideration within 30 days, the determinations set forth herein will be treated as final determinations. 31 C.F.R. § 30.16(c)(1).

The foregoing determinations are limited to the compensation structures described in ***Exhibits I*** and ***II***, and shall not be relied upon with respect to any other employee. The determinations are limited to the authority vested in the Special Master by Section 30.16(a)(3) of the Rule, and shall not constitute, or be construed to constitute, the judgment of the Office of the Special Master or Treasury with respect to the compliance of any compensation structure with any other provision of the Rule. Moreover, this Determination Memorandum has relied upon, and is qualified in its entirety by, the accuracy of the materials submitted by Chrysler to the Office of the Special Master, and the absence of any material misstatement or omission in such materials.

Finally, the foregoing determinations are limited to the compensation structures described herein, and no further compensation of any kind payable to any Covered Employee without the prior approval of the Special Master would be consistent with the Public Interest Standard.

EXHIBIT I

COVERED EMPLOYEES

2009 Compensation

Company Name: Chrysler Group LLC

Employee ID	**Cash Salary** (Rate going forward.)	**Stock Salary** (Performance based: The stock vests at grant and is redeemable in three equal, annual installments beginning on the 2nd anniversary of grant.)	**Long-Term Restricted Stock** (Performance based: Awarded based on achievement of objective performance goals. Vests after 3 years of service. Transferability dependent on TARP repayment.)	**Total Direct Compensation** (Cash salary paid to date plus two months at new run rate + stock salary + long-term restricted stock.)
TRP001	$0	$0	$0	$0
TRP002	$500,000	$34,001	$102,002	$644,336
TRP003	$0	$0	$0	$2,150,000
TRP004	$485,000	$197,253	$0	$694,756
TRP005	$485,000	$105,000	$107,002	$626,175
TRP006	$455,000	$84,000	$102,002	$620,175
TRP007	$440,000	$29,334	$88,002	$503,169
TRP008	$435,000	$29,001	$87,002	$463,503
TRP009	$410,000	$27,334	$82,002	$490,169
TRP010	$410,000	$27,334	$82,002	$511,003
TRP011	$410,000	$27,334	$82,002	$511,003
TRP012	$405,000	$27,000	$81,001	$508,835
TRP013	$400,000	$0	$0	$391,667
TRP014	$479,300	$25,667	$77,002	$503,393
TRP015	$370,000	$0	$0	$365,833
TRP016	$335,000	$22,334	$67,002	$416,003
TRP017	$315,000	$21,000	$63,001	$394,835
TRP018	$315,000	$21,000	$63,001	$357,341
TRP019	$310,700	$20,714	$62,141	$389,388
TRP020	$310,000	$20,667	$62,002	$380,169
TRP021	$295,000	$19,667	$59,001	$369,501
TRP022	$290,000	$19,334	$58,001	$334,018
TRP023	$280,000	$18,667	$56,001	$350,501
TRP024	$280,000	$18,667	$56,001	$350,501
TRP025	$310,000	$20,667	$62,002	$359,336

Comparison of 2009 Compensation to Prior Years: 2007 & 2008 Compensation

2008 Cash decreased by $1.5M or 17.9%
Total Direct Compensation increasedby $2.1M or 24.2%

2007 Cash increased by $0.9M or 14.0%
Total Direct Compensation increased by $4.5M or 72.3%

Note: 1: Amounts reflected in this Exhibit do not include amounts the Company has asserted to be payable pursuant to legally binding rights under valid employment contracts. see 31 C.F.R. § 30.10(e)(2).

Note: 2: The total number of Covered Employees may be less than 25 because of terminations, departures and retirements after January 1, 2009.

EXHIBIT II
TERMS AND CONDITIONS OF PAYMENTS AND STRUCTURES CONSISTENT WITH THE PUBLIC INTEREST STANDARD

The following general terms and conditions shall govern the compensation structures described in ***Exhibit I***. The Special Master's determination that those structures are consistent with the Public Interest Standard is qualified in its entirety by the Company's adherence to these terms and conditions.

- ***Cash base salary***. Cash base salaries reflect the go-forward rate for the employee effective as of November 1, 2009. Compensation paid in the form of cash base salary prior to that date in accordance with the terms of employment as of June 14, 2009 shall be permitted unless otherwise noted. 31 C.F.R. § 30.16(a)(3)(iii).

- ***Stock salary***. Rates of stock salary grants reflect full-year values. Because this is a new compensation element, the amounts are payable on a *nunc pro tunc* basis effective January 1, 2009. Stock salary must be determined as a dollar amount through the date salary is earned, be accrued at the same time or times as the salary would otherwise be paid in cash, and vest immediately upon grant, with the number of units based on the fair market value on the date of award. Stock granted as stock salary may only be redeemed in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year early if TARP obligations are repaid.

- ***Long-term restricted stock***. Long-term restricted stock may be granted upon the achievement of specified, objective performance criteria that have been developed and reviewed in consultation with the Office of the Special Master and certified by the Company's compensation committee. Any such stock may vest only if the employee remains employed by the Company on the third anniversary of grant (or, if earlier, upon death or disability). The stock shall be transferable only in 25% increments for each 25% of TARP obligations repaid by the Company.

- ***Other compensation and perquisites***. No more than $25,000 in total other compensation and perquisites may be provided to any Covered Employee, absent exceptional circumstances for good cause shown, as defined by pertinent SEC regulations.

- ***Supplemental executive retirement plans and non-qualified deferred compensation plans***. Following the date of the Determination Memorandum, no additional amounts may be accrued under supplemental executive retirement plans, and no Company contributions may be made to other "non-qualified deferred compensation" plans, as defined by pertinent SEC regulations.

- ***Qualified Plans***. For the avoidance of doubt, the Special Master has determined that participation by the Covered Employees in tax-qualified retirement, health and welfare, and similar plans is consistent with the Public Interest Standard.

4. Chrysler Financial

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 22, 2009

Ms. Tracy Hackman, Esquire
Vice President, General Counsel and Secretary
Chrysler Financial
27777 Inkster Road
CIMS 405-27-16
Farmington Hills, MI 48334

Re: ***Proposed Compensation Payments and Structures for Senior Executive Officers and Most Highly Compensated Employees***

Dear Ms. Hackman:

Pursuant to the Department of the Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance, the Office of the Special Master has completed its review of your 2009 compensation submission on behalf of the senior executive officers and certain most highly compensated employees of Chrysler Financial. Attached as ***Annex A*** is a Determination Memorandum (accompanied by ***Exhibits I*** and ***II***) providing the determinations of the Special Master with respect to 2009 compensation for those employees. 31 C.F.R. § 30.16(a)(3).

Pursuant to the Interim Final Rule, the Special Master is required to determine whether the compensation structure for each senior executive officer and certain most highly compensated employees "will or may result in payments inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." *Id.* § 30.16(a)(3). The Special Master has determined that, to satisfy this standard, 2009 compensation for Chrysler Financial's senior executive officers and certain most highly compensated employees generally must comport with the following important standards:

- Base salary paid in cash should not exceed $500,000 per year, except in appropriate cases for good cause shown. Overall, cash compensation must be significantly reduced from cash amounts paid in 2008. In Chrysler Financial's case, cash compensation for these employees will decrease 30% from 2008 levels.

- Total compensation for each individual must be appropriate when compared with total compensation of persons in similar positions or roles at similar entities, and should generally target the 50th percentile of total compensation for comparable employees. Overall, total compensation must be significantly reduced from the amounts paid in 2008. In Chrysler Financial's case, total compensation for these employees will decrease 56% from 2008 levels.

- Any and all "other" compensation and perquisites will not exceed $25,000 for each employee (absent exceptional circumstances for good cause shown to the satisfaction of the Special Master).

- No severance benefit to which an employee becomes entitled in the future may take into account a cash salary increase, or any payment of stock salary, that the Special Master has approved for 2009.

The Special Master has also determined that, in order for the approved compensation structures to satisfy the standards of 31 C.F.R. § 30.16(a)(3), Chrysler Financial must adopt policies applicable to these employees as follows:

- Chrysler Financial may not provide a tax "gross up" of any kind to these employees.

- At least once every year, Chrysler Financial's compensation committee must provide to the Department of the Treasury a narrative description identifying each compensation plan for its senior executive officers, and explaining how the plan does not encourage the senior executive officers to take unnecessary and excessive risks that threaten Chrysler Financial's value.

These requirements are described in further detail in the attached Determination Memorandum.

The Special Master's review has been guided by a number of considerations, including each of the principles articulated in the Interim Final Rule. *Id.* § 30.16(b)(1). The following principle was of particular importance to the Special Master in his determinations with respect to Chrysler Financial's compensation structures:

- *Taxpayer return.* The compensation structures approved by the Special Master reflect the need for Chrysler Financial to remain a competitive enterprise and, ultimately, to be able to repay TARP obligations. The Special Master has determined that these approved compensation structures are competitive when compared with persons in similar positions or roles at similar entities. Overall, the compensation structures provide for total compensation packages that target the 50th percentile when compared to such other executive officers and employees. *Id.* § 30.16(b)(1)(ii).

Pursuant to the Interim Final Rule, Chrysler Financial may, within 30 days of the date hereof, request in writing that the Special Master reconsider the determinations set forth in ***Annex A***. If Chrysler Financial does not request reconsideration within 30 days, these initial determinations will be treated as final determinations. *Id.* § 30.16(c)(1).

Very truly yours,

Kenneth R. Feinberg
Office of the Special Master
for TARP Executive Compensation

Attachments

cc: Thomas F. Gilman

ANNEX A
DETERMINATION MEMORANDUM

I. Introduction

The Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009 ("EESA"), requires the Secretary of the Treasury to establish standards related to executive compensation and corporate governance for financial institutions receiving financial assistance under the Troubled Asset Relief Program ("TARP"). Through the Department of the Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance (the "Rule"), the Secretary delegated to the Office of the Special Master for TARP Executive Compensation (the "Office of the Special Master" or, the "Office") responsibility for reviewing compensation structures of certain employees at financial institutions that received exceptional financial assistance under the TARP ("Exceptional Assistance Recipients"). 31 C.F.R. § 30.16(a); *id.* § 30.16(a)(3). For these employees, the Special Master must determine whether the compensation structure will or may result in payments "inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." *Id.*

Chrysler Financial, one of seven Exceptional Assistance Recipients, has submitted to the Special Master proposed compensation structures for review pursuant to Section 30.16(a)(3) of the Rule. These compensation structures apply to five employees that the Company has identified as Senior Executive Officers (the "Senior Executive Officers," or "SEOs") for purposes of the Rule, and seventeen employees the Company has identified as among the most highly compensated employees of the Company for purposes of the Rule (the "most highly compensated employees," and, together with the SEOs, the "Covered Employees").

The Special Master has completed the review of the Company's proposed compensation structures pursuant to the principles set forth in the Rule. *Id.* Section 30.16(b)(1). This Determination Memorandum sets forth the determinations of the Special Master, pursuant to Section 30.16(a)(3) of the Rule, with respect to the Covered Employees.

II. Background

On June 15, 2009, the Department of the Treasury ("Treasury") promulgated the Rule, creating the Office of the Special Master and delineating its responsibilities. Immediately following that date, the Special Master, and Treasury employees working in the Office of the Special Master, conducted extensive discussions with Chrysler Financial officials and Company counsel. During these discussions, the Office of the Special Master informed Chrysler Financial about the nature of the Office's work and the authority of the Special Master under the Rule. These discussions continued for a period of months, during which the Office of the Special Master and Chrysler Financial explored potential compensation structures for the Covered Employees.

The Rule requires that each Exceptional Assistance Recipient submit proposed compensation structures for each Senior Executive Officer and Most Highly Compensated Employee no later than August 14, 2009. 31 C.F.R. § 30.16(a)(3). In addition, the Rule authorizes the Special Master to request information from an Exceptional Assistance Recipient "under such procedures as the Special Master may determine." *Id.* § 30.16(d). The Rule provides that the Special Master is required to issue a compensation determination within 60 days of a substantially complete submission. *Id.* § 30.16(a)(3).

On July 20, 2009, the Special Master requested from each Exceptional Assistance Recipient, including Chrysler Financial, certain data and documentary information necessary to facilitate the Special Master's review of the Company's compensation structures. The request required Chrysler Financial to submit data describing its proposed compensation structures, and the payments that would result from the proposed structures, concerning each Covered Employee. In addition, Chrysler Financial was required to submit competitive market data indicating how the amounts payable under Chrysler Financial's proposed compensation structures relate to the amounts paid to persons in similar positions or roles at similar entities. Chrysler Financial was also required to submit a range of documentation, including information related to proposed performance metrics, internal policies designed to curb excessive risk, and certain previously existing compensation plans and agreements.

Chrysler Financial submitted this information to the Office of the Special Master on August 13, 2009. Following a preliminary review of the submission, and the submission of certain additional information, the Special Master determined that Chrysler Financial's submission was substantially complete on August 31, 2009. *Id.* § 30.16(a)(3). The Office of the Special Master then commenced a formal review of Chrysler Financial's proposed compensation structures for the Covered Employees. The Rule provides that the Special Master is required to issue a compensation determination within 60 days of a substantially complete submission. *Id.* § 30.16(a)(3).

The Office of the Special Master's review of the Company's proposals was aided by analysis from a number of internal and external sources, including:

- Treasury personnel detailed to the Office of the Special Master, including executive compensation specialists with significant experience in reviewing, analyzing, designing and administering executive compensation plans, and attorneys with experience in matters related to executive compensation;

- Competitive market data provided by the Company in connection with its submission to the Office of the Special Master;

- External information on comparable compensation structures extracted from the *U.S. Mercer Benchmark Database-Executive*;

- External information on comparable compensation structures extracted from Equilar's *ExecutiveInsight* database (which includes information drawn from publicly filed proxy statements) and Equilar's *Top 25 Survey Summary Report* (which includes information from a survey on the pay of highly compensated employees);

- Consultation with Lucian A. Bebchuk, a world-renowned expert in executive compensation and the William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance and Director of the Program on Corporate Governance at Harvard Law School; and

- Consultation with Kevin J. Murphy, a world-renowned expert in executive compensation and the Kenneth L. Trefftzs Chair in Finance in the department of finance and business economics at the University of Southern California's Marshall School of Business.

The Special Master considered these views, in light of the statutory and regulatory standards described in Part III below, when evaluating the Company's proposed compensation structures for the Covered Employees for 2009.

III. Statutory and Regulatory Standards

The Rule requires that the Special Master determine for each of the Covered Employees whether Chrysler Financial's proposed compensation structures, including amounts payable under the compensation structure, "will or may result in payments that are inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." 31 C.F.R. § 30.16(a)(3) (as applied to Covered Employees of Exceptional Assistance Recipients, the "Public Interest Standard"). Regulations promulgated pursuant to the Rule require that the Special Master consider six principles when making these compensation determinations:

(1) *Risk.* The compensation structure should avoid incentives which encourage executive officers and employees to take unnecessary or excessive risks that could threaten the value of the exceptional assistance recipient, including incentives that reward employees for short-term or temporary increases in value or performance; or similar measures that may undercut the long-term value of the Exceptional Assistance Recipient. Compensation packages should be aligned with sound risk management. *Id.* § 30.16(b)(i).

(2) *Taxpayer return.* The compensation structure and amount payable should reflect the need for the Exceptional Assistance Recipient to remain a competitive enterprise, to retain and recruit talented employees who will contribute to the recipient's future success, so that the Company will ultimately be able to repay its TARP obligations. *Id.* § 30.16(b)(ii).

(3) *Appropriate allocation.* The compensation structure should appropriately allocate the components of compensation such as salary and short-term and long-term performance incentives, as well as the extent to which compensation is provided in cash, equity, or other types of compensation such as executive pensions, and other financial benefits or perquisites, based on the specific role of the employee and other relevant circumstances, including the nature and amount of current compensation, deferred compensation, or other compensation and benefits previously paid or awarded. *Id.* § 30.16(b)(iii).

(4) *Performance-based compensation.* An appropriate portion of the compensation should be performance-based over a relevant performance period. Performance-based compensation should be determined through tailored metrics that encompass individual performance and/or the performance of the Exceptional Assistance Recipient or a relevant business unit taking into consideration specific business objectives. Performance metrics may relate to employee compliance with relevant corporate policies. In addition, the likelihood of meeting the performance metrics should not be so great that the arrangement fails to provide an adequate incentive for the employee to perform, and performance metrics should be measurable, enforceable, and actually enforced if not met. *Id.* § 30.16(b)(iv).

(5) *Comparable structures and payments.* The compensation structure, and amount payable where applicable, should be consistent with, and not excessive, taking into account compensation structures and amounts for persons in similar positions or roles at similar entities that are similarly situated, including, as applicable, entities competing in the same markets and similarly situated entities that are financially distressed or that are contemplating or undergoing reorganization. *Id.* § 30.16(b)(v).

(6) *Employee contribution to TARP recipient value.* The compensation structure and amount payable should reflect the current or prospective contributions of an employee to the value of the Exceptional Assistance Recipient, taking into account multiple factors such as revenue production, specific expertise, compliance with company policy and regulation (including risk management), and corporate leadership, as well as the role the employee may have had with respect to any change in the financial health or competitive position of the recipient. *Id.* § 30.16(b)(vi).

The Rule provides that the Special Master shall have discretion to determine the appropriate weight or relevance of a particular principle depending on the facts and circumstances surrounding the compensation structure or payment for a particular employee. *Id.* § 30.16(b). To the extent two or more principles may appear inconsistent in a particular situation, the Rule requires that the Special Master exercise his discretion in determining the relative weight to be accorded to each principle. *Id.*

The Rule provides that the Special Master may, in the course of applying these principles, take into account other compensation structures and other compensation earned, accrued, or paid, including compensation and compensation structures that are not subject to the restrictions of section 111 of EESA. For example, the Special Master may consider payments obligated to be made by the Company pursuant to certain legally binding rights under valid written employment contracts entered into prior to enactment of the statute and the accompanying Rule. *Id.* § 30.16(a)(3).

IV. Compensation Structures and Payments

A. Chrysler Financial Proposals

Chrysler Financial has provided the Office of the Special Master with detailed information concerning its proposed 2009 compensation structures for pertinent executive officers and employees, including amounts proposed to be paid under the compensation structure for each Covered Employee (the "Proposed Structures").

Chrysler Financial supported its proposal with detailed assessments of each Covered Employee's tenure and responsibilities at the Company (or its applicable subsidiary) and historical compensation structure. The submission also included market data that, according to the Company, indicated that the amounts potentially payable to each employee were comparable to the compensation payable to persons in similar positions or roles at a "peer group" of entities selected by the Company.

Chrysler Financial is currently following Treasury's directive to liquidate its business in an orderly fashion. Accordingly, Chrysler Financial is currently pursuing a successful wind-down of its operations by December 31, 2011, and the repayment of its lenders and investors. Chrysler Financial's proposed compensation structures therefore emphasize that the Company's unique business objectives—to wind down, rather than to grow, its operations—render the use of traditional business metrics in the determination of appropriate compensation impractical. Rather, Chrysler Financial's submission asserts that its success in the wind-down of operations and repayment of lenders and investors is largely dependent upon maintaining critical talent to enable the Company to service and manage its portfolio during the wind-down process. The Company also contends that the risk of employee departures must be minimized because Chrysler Financial has publicly stated that it intends to wind-down its operations and will have difficulty attracting new employees.

1. Cash Salary

Chrysler Financial's Proposed Structures included proposed annual cash base salaries ranging from $175,872 to $1,500,000. The proposal reflects cash decreases from 2008 levels for each employee ranging from 10% to 67%.

2. "Other" Compensation and Perquisites

Chrysler Financial also proposed payments of "other" compensation, as well as perquisites, to the Covered Employees. These proposed payments varied in value.

B. <u>Determinations of the Special Master</u>

The Special Master has reviewed the Proposed Structures in detail by application of the principles set forth in the Rule and described in Part III above. In light of this review and analysis, the Special Master has determined that both the structural design of Chrysler Financial's proposals and the amounts potentially payable to Covered Employees under the proposals are consistent with the Public Interest Standard.

The Special Master has determined, in light of the considerations that follow, that the compensation structures described in ***Exhibits I*** and ***II***, to this Determination Memorandum will not, by virtue of either their structural design or the amounts potentially payable under them, result in payments inconsistent with the Public Interest Standard except as noted below.

1. Cash Salary

The Special Master reviewed Chrysler Financial's proposals with respect to cash salary in light of the principle that compensation structures should generally be comparable to "compensation structures and amounts for persons in similar positions or roles at similar entities," 31 C.F.R. § 30.16(b)(1)(v). This review made use of the resources and analysis described in Part II. The Special Master generally has concluded that, for Covered Employees at Exceptional Assistance Recipients, cash salaries should generally target 50th percentile because such levels of cash salaries balance the need to attract and retain talented with the need for compensation structures that reflect the circumstances of Exceptional Assistance Recipients.

In addition, the Special Master reviewed the Company's proposal in light of the • principle that compensation structures must "reflect the need for the TARP recipient to remain a competitive enterprise…and ultimately to be able to repay TARP obligations." *Id.* § 30.16(b)(1)(ii). As noted above, the Company's submission emphasized that its business objectives—including an orderly wind-down of the Company's operations that would permit lenders and investors to be repaid—required cash base salaries that would give employees clear incentives to remain with the firm during this period.

In general, the principles set forth in the Rule emphasize compensation structures that are performance-based, *id.* § 30.16(b)(1)(iv), and payable over the long term, *id.* Unlike other Exceptional Assistance Recipients, however, Chrysler Financial's stated business objective, developed in consultation with Treasury, is to wind down its business in the near term. Under these unique circumstances, providing employees incentives over the appropriate compensation horizon, *see id.* § 30.16(b)(1)(i), may require cash compensation payable in base salary rather than longer-term incentives based on the performance of the Company.

In light of these considerations, the Special Master has concluded that Chrysler Financial's Proposed Structures and the amounts potentially payable under them are consistent with the Public Interest Standard. The amounts payable pursuant to these structures are described in further detail in ***Exhibits I*** and ***II***.

2. "Other" Compensation and Perquisites

Chrysler Financial also proposed payments of "other" compensation, as well as perquisites, to the Covered Employees. The Special Master has concluded that, absent special justification, employees—not the Company—generally should be responsible for paying personal expenses, and that significant portions of compensation structures should not be allocated to such perquisites and "other" compensation. *See id.* §30.16(b)(1)(iii).

The Rule requires that each Exceptional Assistance Recipient annually disclose to Treasury any perquisites where the total value for any Senior Executive Officer or Most Highly Compensated Employee exceeds $25,000. An express justification for offering these benefits must also be disclosed. Accordingly, as described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard provide no more than $25,000 in "other" compensation and perquisites to each of these employees. Any exceptions to this limitation will require that the Company provide to the Office of the Special Master an independent justification for the payment that is satisfactory to the Special Master. To the extent that payments exceeding this limitation have already been made to a Covered Employee in 2009, those amounts should be promptly returned to the Company.

3. Severance Arrangements

The Special Master has concluded that an increase in the amounts payable under these arrangements would be inconsistent with the principle that compensation should be performance-based, *id.* § 30.16(b)(1)(iv), and that payments should be appropriately allocated among the elements of compensation, *id.* § 30.16(b)(1)(iii). Accordingly, for the compensation structures described in ***Exhibits I*** and ***II*** to be consistent with the Public Interest Standard, the Company must ensure that 2009 compensation structures for these employees do not result in an increase in the amounts payable pursuant to these arrangements.

4 Departed Employees

In addition, three employees that would have been Covered Employees had they remained employed are no longer employed by the Company. With respect to these employees, the Special Master has determined that cash salaries through the date of the termination of employment, and payment of up to $25,000 in perquisites and "other" compensation are consistent with the Public Interest Standard. No other payments to these employees of any kind would be consistent with the Public Interest Standard. Any exceptions to this limitation will require that the Company provide to the Office of the

Special Master an independent justification for the payment that is satisfactory to the Special Master.

V. CORPORATE GOVERNANCE

Pursuant to the requirements of the Rule, Chrysler Financial is required to institute the following corporate governance reforms:

(1) *Compensation Committee: Risk Review.* Chrysler Financial must maintain a compensation committee comprised exclusively of independent directors. Every six months, the committee must discuss, evaluate, and review with Chrysler Financial's senior risk officers any risks that could threaten the value of Chrysler Financial. In particular, the committee must meet every six months to discuss, evaluate, and review the terms of each employee's compensation plans to identify and limit the features in (1) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that threaten the value of Chrysler Financial; (2) SEO or other employees' compensation plans that could encourage behavior focused on short-term results and not on long-term value creation; and (3) employees' compensation plans that could encourage the manipulation of Chrysler Financial's reported earnings to enhance the compensation of any of the employees. 31 C.F.R. § 30.4; *id.* § 30.5.

(2) *Disclosure with Respect to Compensation Consultants.* The committee must disclose to Treasury an annual narrative description of whether Chrysler Financial, its Board of Directors, or the committee has engaged a compensation consultant during the past three years. If so, the compensation committee must detail the types of services provided by the compensation consultant or any affiliate, including any "benchmarking" or comparisons employed to identify certain percentile levels of compensation. *Id.* § 30.11(c).

(3) *Disclosure of Perquisites.* As noted in Part IV, Chrysler Financial must provide to Treasury an annual disclosure of any perquisite whose total value for the Company's fiscal year exceeds $25,000 for each of the Covered Employees. Chrysler Financial must provide a narrative description of the amount and nature of these perquisites, the recipient of these perquisites, and a justification for offering these perquisites (including a justification for offering the prerequisite, and not only for offering the perquisite with a value that exceeds $25,000). *Id.* § 30.11(b).

(4) *Clawback.* Chrysler Financial must ensure that any incentive award paid to a Covered Employee is subject to a clawback if the award was based on materially inaccurate financial statements (which includes, but is not limited to, statements of earnings, revenues, or gains) or any other materially inaccurate performance metric criteria. Chrysler Financial must exercise its clawback rights except to the extent that it is unreasonable to do so. *Id.* § 30.8.

(5) *Policy as to excessive or luxury expenditures.* Chrysler Financial must adopt an excessive or luxury expenditure policy, provide that policy to Treasury, and post it on Chrysler Financial's website. If, after adopting an excessive or luxury expenditures policy, Chrysler Financial's board of directors makes any material amendments to this policy, within ninety days of the adoption of the amended policy, the board of directors must provide the amended policy to Treasury and post the amended policy on the Company's Internet website. *Id.* § 30.12.

(6) *Prohibition on tax gross-ups.* Except as explicitly permitted under the Rule, Chrysler Financial is prohibited from providing (formally or informally) tax gross-ups to any of the Covered Employees. *Id.* § 30.11(d).

(7) *CEO and CFO Certification.* Chrysler Financial's chief executive officer and chief financial officer must provide to the Securities and Exchange Commission (the "SEC") written certification of the Company's compliance with the various requirements of section 111 of EESA, including all the requirements listed in this section. The precise nature of the required certification is identified in the Rule. *Id.* § 30.15 Appx. A.

VI. CONCLUSION

The Special Master has reviewed the Proposed Structures for the Covered Employees for 2009 in light of the principles set forth at 31 C.F.R. § 30.16(b). On the basis of that review, the Special Master has determined that the Proposed Structures submitted by Chrysler Financial are generally consistent with the Public Interest Standard.

The Special Master has separately reviewed the compensation structures set forth in ***Exhibits I*** and ***II***, in light of the principles set forth at 31 C.F.R. § 30.16(b). Pursuant to the authority vested in the Special Master by the Rule, and in accordance with Section 30.16(a)(3) thereof, the Special Master hereby determines that the compensation structures set forth in ***Exhibits I*** and ***II***, including the amounts payable or potentially payable under such compensation structures, will not result in payments that are inconsistent with the purposes of section 111 of EESA or the TARP, and will not otherwise be contrary to the public interest.

Pursuant to the Interim Final Rule, Chrysler Financial may, within 30 days of the date hereof, request in writing that the Special Master reconsider the determinations set forth in this Determination Memorandum. The request for reconsideration must specify a factual error or relevant new information not previously considered, and must demonstrate that such error or lack of information resulted in a material error in the initial determinations. If Chrysler Financial does not request reconsideration within 30 days, the determinations set forth herein will be treated as final determinations. 31 C.F.R. § 30.16(c)(1).

The foregoing determinations are limited to the compensation structures described in ***Exhibits I*** and ***II***, and shall not be relied upon with respect to any other employee. The determinations are limited to the authority vested in the Special Master by Section 30.16(a)(3) of the Rule, and shall not constitute, or be construed to constitute, the judgment of the Office of the Special Master or Treasury with respect to the compliance of any compensation structure with any other provision of the Rule. Moreover, this Determination Memorandum has relied upon, and is qualified in its entirety by, the accuracy of the materials submitted by the Company to the Office of the Special Master, and the absence of any material misstatement or omission in such materials.

Finally, the foregoing determinations are limited to the compensation structures described herein, and no further compensation of any kind payable to any Covered Employee without the prior approval of the Special Master would be consistent with the Public Interest Standard.

EXHIBIT I

COVERED EMPLOYEES

2009 Compensation

Company Name: Chrysler Financial

Employee ID	**Cash Salary** (Rate going forward.)	**Stock Salary** (Performance based: The stock vests at grant and is redeemable in three equal, annual installments beginning on the 2nd anniversary of grant.)	**Long-Term Restricted Stock** (Performance based: Awarded based on achievement of objective performance goals. Vests after 3 years of service. Transferability dependent on TARP repayment.)	**Total Direct Compensation** (Cash salary paid to date plus two months at new run rate + stock salary + long-term restricted stock.)
A216G8	$1,500,000	$0	$0	$875,000
A224F7	$216,000	$0	$0	$216,000
A272C1	$800,000	$0	$0	$466,667
A288A8	$400,000	$0	$0	$218,667
A296A7	$432,000	$0	$0	$252,500
B225F8	$1,350,000	$0	$0	$704,167
B233F7	$410,000	$0	$0	$246,753
B241E6	$415,000	$0	$0	$250,767
B249D5	$490,000	$0	$0	$265,167
C250D6	$216,000	$0	$0	$216,000
C258D5	$490,000	$0	$0	$268,587
C298A9	$400,000	$0	$0	$245,667
D203H4	$194,436	$0	$0	$194,436
E212G4	$182,496	$0	$0	$182,496
E220G3	$410,000	$0	$0	$272,083
E236E1	$500,000	$0	$0	$500,003
F245E1	$410,000	$0	$0	$246,533
F253D9	$443,000	$0	$0	$234,263
G206H7	$490,000	$0	$0	$261,667
H207H8	$175,872	$0	$0	$175,872
H231F5	$425,000	$0	$0	$237,833
H279B8	$600,000	$0	$0	$300,000

Comparison of 2009 Compensation to Prior Years: 2007 & 2008 Compensation

2008 Cash decreased by $4.3M or 29.9%
Total Direct Compensation decreased by $8.1M or 56.0%

2007 Company was created August 3, 2007. There is not enough data for a full year 2009 vs 2007 comparison

Note: 1: Amounts reflected in this Exhibit do not include amounts the Company has asserted to be payable pursuant to legally binding rights under valid employment contracts, see 31 C.F.R. § 30.10(e)(2).
Note: 2: The total number of Covered Employees may be less than 25 because of terminations, departures and retirements after January 1, 2009.

EXHIBIT II
TERMS AND CONDITIONS OF PAYMENTS AND STRUCTURES CONSISTENT WITH THE PUBLIC INTEREST STANDARD

The following general terms and conditions shall govern the compensation structures described in ***Exhibit I***. The Special Master's determination that those structures are consistent with the Public Interest Standard is qualified in its entirety by the Company's adherence to these terms and conditions.

- ***Cash base salary.*** Cash base salaries reflect the go-forward rate for the employee effective as of November 1, 2009. Compensation paid in the form of cash base salary prior to that date in accordance with the terms of employment as of June 14, 2009 shall be permitted unless otherwise noted. 31 C.F.R. § 30.16(a)(3)(iii).

- ***Other compensation and perquisites.*** No more than $25,000 in total other compensation and perquisites may be provided to any Covered Employee, absent exceptional circumstances for good cause shown, as defined by pertinent SEC regulations.

- ***Qualified Plans***. For the avoidance of doubt, the Special Master has determined that participation by the Covered Employees in tax-qualified retirement, health and welfare, and similar plans is consistent with the Public Interest Standard.

5. Citigroup, Inc.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 22, 2009

Mr. Michael S. Helfer, Esquire
General Counsel &
Corporate Secretary
Citigroup Inc.
399 Park Avenue
New York, NY 10022

Re: Proposed Compensation Payments and Structures for Senior Executive Officers and Most Highly Compensated Employees

Dear Mr. Helfer:

Pursuant to the Department of the Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance, the Office of the Special Master has completed its review of your 2009 compensation submission on behalf of the senior executive officers and certain most highly compensated employees of Citigroup Inc. ("Citigroup"). Attached as ***Annex A*** is a Determination Memorandum (accompanied by ***Exhibits I*** and ***II***) providing the determinations of the Special Master with respect to 2009 compensation for those employees. 31 C.F.R. § 30.16(a)(3).

Pursuant to the Interim Final Rule, the Special Master is required to determine whether the compensation structure for each senior executive officer and certain most highly compensated employees "will or may result in payments inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." *Id.* § 30.16(a)(3). The Special Master has determined that, to satisfy this standard, 2009 compensation for Citigroup's senior executive officers and certain most highly compensated employees generally must comport with the following important standards:

- There can be no guarantee of any "bonus" or "retention" awards among the compensation structures approved by the Special Master. Cash guarantees payable in 2009 pursuant to previously existing agreements must be restructured to be payable in stock awards that may only be liquidated over time. In Citigroup's case, this will require the restructuring of several agreements between Citigroup and its employees, and the deferral of payments to certain employees of Phibro, LLC until such time as Phibro is no longer a subsidiary of Citigroup.

- Rather than cash, the majority of each individual's base salary will be paid in the form of Citigroup stock. This stock will immediately vest, in accordance with the Interim Final Rule, but will only be redeemable in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year early if Citigroup repays its TARP obligations. This structure encourages employees to remain employed by Citigroup and to maximize its long-term value.

- Base salary paid in cash should not exceed $500,000 per year, except in appropriate cases for good cause shown. Overall, cash compensation must be significantly reduced from cash amounts paid in 2008. In Citigroup's case, cash compensation for these employees will decrease 96% from 2008 levels.

- Where applicable, compensation should reflect the employee's role, if any, with respect to the change in Citigroup's financial health during 2008, and may take into account payments not subject to the review of the Special Master, including payments pursuant to legally binding rights under previously existing valid employment contracts. *Id.* § 30.16(a)(3)(i).

- Total compensation for each individual must be appropriate when compared with the total compensation for to persons in similar positions or roles at similar entities, and should generally target the 50th percentile of total compensation for comparable employees. Overall, total compensation must be significantly reduced from the amounts paid in 2008. In Citigroup's case, total compensation for these employees will decrease 70% from 2008 levels.

- If—and only if—the employee achieves objective performance metrics developed and reviewed in consultation with the Office of the Special Master, the employee may be eligible for long-term incentive awards. These awards, however, must be payable in the form of restricted stock that will be forfeited unless the employee stays with Citigroup for at least three years following grant, and may only be redeemed in 25% installments for each 25% of Citigroup's TARP obligations that are repaid. Such long-term incentive awards may not exceed one third of total annual compensation.

- Any and all incentive compensation paid to these employees will be subject to recovery or "clawback" if the payments are based on materially inaccurate financial statements, any other materially inaccurate performance metrics, or if the employee is terminated due to misconduct that occurred during the period in which the incentive was earned.

- Any and all "other" compensation and perquisites will not exceed $25,000 for each employee (absent exceptional circumstances for good cause shown to the satisfaction of the Special Master).

- No severance benefit to which an employee becomes entitled in the future may take into account a cash salary increase, or any payment of stock salary, that the Special Master has approved for 2009.

- No additional amounts in 2009 may be accrued under supplemental executive retirement plans or credited by the company to other "non-qualified deferred compensation" plans after the date of the Determination Memorandum.

The Special Master has also determined that, in order for the approved compensation structures to satisfy the standards of 31 C.F.R. § 30.16(a)(3), Citigroup must adopt policies applicable to these employees as follows:

- The achievement of any performance objectives must be certified by the Personnel and Compensation Committee of Citigroup's Board of Directors, which is composed solely of independent directors. These performance objectives must be reviewed and approved by the Office of the Special Master.

- The employees will be prohibited from engaging in any hedging, derivative or other transactions that have an equivalent economic effect that would undermine the long-term performance incentives created by the compensation structures.

- Citigroup may not provide a tax "gross up" of any kind to these employees.

- At least once every year, the Personnel and Compensation Committee of Citigroup's Board of Directors must provide to the Department of the Treasury a narrative description identifying each compensation plan for its senior executive officers, and explaining how the plan does not encourage the senior executive officers to take unnecessary and excessive risks that threaten Citigroup's value.

These requirements are described in further detail in the attached Determination Memorandum.

The Special Master's review has been guided by a number of considerations, including each of the principles articulated in the Interim Final Rule. *Id.* § 30.16(b)(1). The following principles were of particular importance to the Special Master in his determinations with respect to Citigroup's compensation structures:

- *Performance-based compensation.* The overwhelming majority of approved compensation depends on Citigroup's performance, and ties the financial incentives of Citigroup employees to the overall performance of the company. A majority of the salary paid to employees under these structures will be paid in the form of stock; and, because the stock will only be redeemable in equal, one-third installments beginning on the second anniversary of the date the stock salary is earned (in each case subject to acceleration by one year if Citigroup repays its TARP obligations), the ultimate value realized by the employee will depend on Citigroup's performance over the long term. Guaranteed amounts payable in cash, in contrast, are generally rejected. *Id.* § 30.16(b)(1)(iv).

- *Taxpayer return.* The compensation structures approved by the Special Master reflect the need for Citigroup to remain a competitive enterprise and, ultimately, to be able to repay TARP obligations. The Special Master has determined that these approved compensation structures are competitive when compared with persons in similar positions or roles at similar entities. Overall, the compensation structures provide for total compensation packages that generally target the 50th percentile when compared to such other executive officers and employees. *Id.* § 30.16(b)(1)(ii).

- *Appropriate allocation.* The total compensation payable to Citigroup employees is weighted heavily toward long-term structures that are tied to Citigroup's performance and are easily understood by shareholders. As a general principle, guaranteed income is rejected. Fixed compensation payable to Citigroup employees should consist only of cash salaries at sufficient levels to attract and retain employees and provide them a reasonable level of liquidity.

Pursuant to the Interim Final Rule, Citigroup may, within 30 days of the date hereof, request in writing that the Special Master reconsider the determinations set forth in ***Annex A***. If Citigroup does not request reconsideration within 30 days, these initial determinations will be treated as final determinations. *Id.* § 30.16(c)(1).

Very truly yours,

Kenneth R. Feinberg
Office of the Special Master
for TARP Executive Compensation

Attachments

cc: Lewis B. Kaden, Esquire
Mr. Paul McKinnon

ANNEX A
DETERMINATION MEMORANDUM

I. Introduction

The Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009 ("EESA"), requires the Secretary of the Treasury to establish standards related to executive compensation and corporate governance for financial institutions receiving financial assistance under the Troubled Asset Relief Program ("TARP"). Through the Department of the Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance (the "Rule"), the Secretary delegated to the Office of the Special Master for TARP Executive Compensation (the "Office of the Special Master" or, the "Office") responsibility for reviewing compensation structures of certain employees at financial institutions that received exceptional financial assistance under the TARP ("Exceptional Assistance Recipients"). 31 C.F.R. § 30.16(a); *id.* § 30.16(a)(3). For these employees, the Special Master must determine whether the compensation structure will or may result in payments "inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." *Id.*

Citigroup Inc. ("Citigroup," or the "Company"), one of seven Exceptional Assistance Recipients, has submitted to the Special Master proposed compensation structures for review pursuant to Section 30.16(a)(3) of the Rule. These compensation structures apply to three employees that the Company has identified as senior executive officers (the "Senior Executive Officers," or "SEOs") for purposes of the Rule, and eighteen employees the Company has identified as among the most highly compensated employees of the Company for purposes of the Rule (the "Most Highly Compensated Employees," and, together with the SEOs, the "Covered Employees").

The Special Master has completed the review of the Company's proposed compensation structures for the Covered Employees pursuant to the principles set forth in the Rule. § 30.16(b)(1). This Determination Memorandum sets forth the determinations of the Special Master, pursuant to Section 30.16(a)(3) of the Rule, with respect to the Covered Employees.

II. Background

On June 15, 2009, the Department of the Treasury ("Treasury") promulgated the Rule, creating the Office of the Special Master and delineating its responsibilities. Immediately following that date, the Special Master, and Treasury employees working in the Office of the Special Master, conducted extensive discussions with Citigroup officials. During these discussions, the Office of the Special Master informed Citigroup about the nature of the Office's work and the authority of the Special Master under the Rule. These discussions continued for a period of months, during which the Special Master and Citigroup explored potential compensation structures for the Covered Employees.

The Rule requires that each Exceptional Assistance Recipient submit proposed compensation structures for each Senior Executive Officer and Most Highly Compensated Employee no later than August 14, 2009. 31 C.F.R. § 30.16(a)(3). On July 20, 2009, the Special Master requested from each Exceptional Assistance Recipient, including Citigroup, certain data and documentary information necessary to facilitate the Special Master's review of the Company's compensation structures. The request required Citigroup to submit data describing its proposed compensation structures, and the payments that would result from the proposals, concerning each Covered Employee.

In addition, the Rule authorizes the Special Master to request information from an Exceptional Assistance Recipient "under such procedures as the Special Master may determine." *Id.* § 30.16(d). Citigroup was required to submit competitive market data indicating how the amounts payable under Citigroup's proposed compensation structures relate to the amounts paid to persons in similar positions or roles at similar entities. Citigroup was also required to submit a range of documentation, including information related to proposed performance metrics, internal policies designed to curb excessive risk, and certain previously existing compensation plans and agreements.

Citigroup submitted this information to the Office of the Special Master on August 14, 2009. Following a preliminary review of the submission, and the submission of certain additional information, on August 31, 2009, the Special Master determined that Citigroup's submission was substantially complete for purposes of the Rule. *Id.* § 30.16(a)(3). The Office of the Special Master then commenced a formal review of Citigroup's proposed compensation structures for the Covered Employees. The Rule provides that the Special Master is required to issue a compensation determination within 60 days of a substantially complete submission. *Id.*

The Office of the Special Master's review of the Company's proposals was aided by analysis from a number of internal and external sources, including:

- Treasury personnel detailed to the Office of the Special Master, including executive compensation specialists with significant experience in reviewing, analyzing, designing and administering executive compensation plans, and attorneys with experience in matters related to executive compensation;

- Competitive market data provided by the Company in connection with its submission to the Office of the Special Master;

- External information on comparable compensation structures extracted from the *U.S. Mercer Benchmark Database-Executive*;

- External information on comparable compensation structures extracted from Equilar's *ExecutiveInsight* database (which includes information drawn from publicly filed proxy statements) and Equilar's *Top 25 Survey Summary Report* (which includes information from a survey on the pay of highly compensated employees);

- Consultation with Lucian A. Bebchuk, a world-renowned expert in executive compensation and the William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance and Director of the Program on Corporate Governance at Harvard Law School; and

- Consultation with Kevin J. Murphy, a world-renowned expert in executive compensation and the Kenneth L. Trefftzs Chair in Finance in the department of finance and business economics at the University of Southern California's Marshall School of Business.

The Special Master considered these views, in light of the statutory and regulatory standards described in Part III below, when evaluating the Company's proposed compensation structures for the Covered Employees for 2009.

III. STATUTORY AND REGULATORY STANDARDS

The Rule requires that the Special Master determine for each of the Covered Employees whether Citigroup's proposed compensation structure, including amounts payable or potentially payable under the compensation structure, "will or may result in payments that are inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." 31 C.F.R. § 30.16(a)(3) (as applied to Covered Employees of Exceptional Assistance Recipients, the "Public Interest Standard"). Regulations promulgated pursuant to the Rule require that the Special Master consider six principles when making these compensation determinations:

(1) *Risk.* The compensation structure should avoid incentives that encourage employees to take unnecessary or excessive risks that could threaten the value of the Exceptional Assistance Recipient, including incentives that reward employees for short-term or temporary increases in value or performance; or similar measures that may undercut the long-term value of the Exceptional Assistance Recipient. Compensation packages should be aligned with sound risk management. *Id.* § 30.16(b)(1)(i).

(2) *Taxpayer return.* The compensation structure and amount payable should reflect the need for the Exceptional Assistance Recipient to remain a competitive enterprise, to retain and recruit talented employees who will contribute to the recipient's future success, so that the Company will ultimately be able to repay its TARP obligations. *Id.* § 30.16(b)(1)(ii).

(3) *Appropriate allocation.* The compensation structure should appropriately allocate the components of compensation such as salary and short-term and long-term performance incentives, as well as the extent to which compensation is provided in cash, equity, or other types of compensation such as executive pensions, or other benefits, or perquisites, based on the specific role of the employee and other relevant circumstances, including the nature and amount of current compensation,

deferred compensation, or other compensation and benefits previously paid or awarded. *Id.* § 30.16(b)(1)(iii).

(4) *Performance-based compensation.* An appropriate portion of the compensation should be performance-based over a relevant performance period. Performance-based compensation should be determined through tailored metrics that encompass individual performance and/or the performance of the Exceptional Assistance Recipient or a relevant business unit taking into consideration specific business objectives. Performance metrics may relate to employee compliance with relevant corporate policies. In addition, the likelihood of meeting the performance metrics should not be so great that the arrangement fails to provide an adequate incentive for the employee to perform, and performance metrics should be measurable, enforceable, and actually enforced if not met. *Id.* § 30.16(b)(1)(iv).

(5) *Comparable structures and payments.* The compensation structure, and amounts payable where applicable, should be consistent with, and not excessive taking into account, compensation structures and amounts for persons in similar positions or roles at similar entities that are similarly situated, including, as applicable, entities competing in the same markets and similarly situated entities that are financially distressed or that are contemplating or undergoing reorganization. *Id.* § 30.16(b)(1)(v).

(6) *Employee contribution to TARP recipient value.* The compensation structure and amount payable should reflect the current or prospective contributions of an employee to the value of the Exceptional Assistance Recipient, taking into account multiple factors such as revenue production, specific expertise, compliance with company policy and regulation (including risk management), and corporate leadership, as well as the role the employee may have had with respect to any change in the financial health or competitive position of the recipient. *Id.* § 30.16(b)(1)(vi).

The Rule provides that the Special Master shall have discretion to determine the appropriate weight or relevance of a particular principle depending on the facts and circumstances surrounding the compensation structure or payment for a particular employee. *Id.* § 30.16(b). To the extent two or more principles may appear inconsistent in a particular situation, the Rule requires that the Special Master exercise his discretion in determining the relative weight to be accorded to each principle. *Id.*

The Rule provides that the Special Master may, in the course of applying these principles, take into account other compensation structures and other compensation earned, accrued, or paid, including compensation and compensation structures that are not subject to the restrictions of section 111 of EESA. For example, the Special Master may consider payments obligated to be made by the Company pursuant to certain legally binding rights under valid written employment contracts entered into prior to enactment of the statute and the accompanying Rule. *Id.* § 30.16(a)(3).

IV. COMPENSATION STRUCTURES AND PAYMENTS

A. Citigroup Proposals

Citigroup has provided the Office of the Special Master with detailed information concerning its proposed 2009 compensation structures for the Covered Employees, including amounts proposed to be paid under the compensation structure for each Covered Employee (the "Proposed Structures").

Citigroup supported its proposal with detailed assessments of each Covered Employee's tenure and responsibilities at the Company (or its applicable subsidiary) and historical compensation structure. The submission also included market data that, according to the Company, indicated that the amounts potentially payable to each employee were comparable to the compensation payable to persons in similar positions or roles at a "peer group" of entities selected by the Company.

1. Citigroup Corporate and Operating Units

Citigroup has proposed compensation structures for each of two Senior Executive Officers,[1] as well as for 11 Most Highly Compensated Employees, each of whom serves as an executive in Citigroup's corporate offices or as a senior executive of a Citigroup subsidiary.[2]

a. Cash Salary

With the exception of the Chief Executive Officer, who has agreed to continue receiving an annual base salary of $1 during 2009, Citigroup generally proposed to increase cash salaries for employees in this group. The proposed increases included cash base salaries as high as $800,000 per year. Citigroup's submission to the Office of the Special Master asserted that base salaries at this level could be justified by reference to the compensation of comparable employees at comparable financial institutions.

b. Stock Salary

Citigroup proposed that employees in this group receive substantial compensation in the form of vested Citigroup stock delivered on the Company's payroll schedule. Citigroup proposed that one-third of the stock be transferable upon grant; one-third be transferable on the first anniversary of the grant date; and one-third be transferable on the

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[1] Citigroup had three Chief Financial Officers during 2009. Because "an individual who served as the [CFO] of a TARP recipient…is a SEO for purposes of that fiscal year," each of these three individuals is included in Citigroup's Covered Employees during 2009. *See* Frequently Asked Questions, Troubled Asset Relief Program Standards for Compensation and Corporate Governance, FAQ #4, *available at* http://www.financialstability.gov/docs/IFrFAQsPartI.pdf.

[2] Compensation for Covered Employees at two specific Citigroup subsidiaries, Citigroup Derivatives Markets, Inc. ("CDMI") and Phibro LLC, are addressed in further detail in Parts IV.A.2. and IV.A.3.

second anniversary of the grant date. Citigroup proposed to deliver annualized amounts ranging from $2,311,667 to $5,525,000 to employees in this group.

c. Annual Long-Term Incentive Awards

Citigroup proposed that employees in this group be eligible, in the discretion of the Company, for grants of substantial incentive awards with total value ranging from under $1,393,333 to $3,000,000. Citigroup proposed that the awards be payable in the form of restricted Citigroup stock that vested if the employee remained employed by Citigroup on the second anniversary of the grant date.

d. "Other" Compensation and Perquisites

Citigroup proposed payments of "other" compensation, as well as perquisites, to the employees in this group. These proposed payments varied in value.

e. Supplemental Executive Retirement Plans and Non-Qualified Deferred Compensation

Citigroup proposed that certain employees in this group receive compensation in the form of accruals under a "non-qualified deferred compensation" plan.

f. Severance Plans

Citigroup's submission to the Office of the Special Master indicated that the Proposed Structures would, in some cases, result in increases in amounts payable to these employees pursuant to severance arrangements. These arrangements generally provide for amounts payable upon termination of employment, including termination in light of the employee's performance.

2. *Covered Employees Party to Certain Agreements* *(Citigroup's CDMI & Investment and Advisory Subsidiaries)*

Citigroup has also proposed compensation structures for six Covered Employees who are party to written employment agreements with Citigroup.[3] Citigroup argued that the agreements provided for legally binding rights under valid employment contracts, *see* 31 C.F.R. § 30.10(e)(2). Under the Rule, amounts payable pursuant to such agreements are generally not subject to the review of the Special Master, although such amounts may be taken into account by the Special Master in connection with determinations with respect to prospective compensation payable to the employee, *id.* § 30.16(a)(3)(i).

Citigroup's proposed compensation structure for each of the six employees in this group emphasized the payment of small cash salaries accompanied by large cash payments reflecting the terms of the existing agreements.

[3] Three of the Covered Employees are employed by Citigroup's CDMI subsidiary. The remaining three employees serve as the senior employees of Citigroup investment and advisory subsidiaries.

3. Covered Employees at Phibro, LLC

Citigroup has also proposed compensation structures for two Covered Employees employed by Phibro, LLC, a subsidiary engaged in commodities trading. In connection with the submission of its proposed compensation structures for these employees, Citigroup provided the Office of the Special Master with a detailed description of the historical compensation practices at this subsidiary. Generally, these practices called for Phibro to establish cash "bonus pools" in amounts based upon Phibro's annual trading profits, and for these pools to be allocated in the discretion of Phibro's Chief Executive Officer.

Each of the two Covered Employees employed by Phibro has historically participated in these bonus pools. As noted above, Citigroup argued that the employees' participation in these bonus pools reflected legally binding rights under valid employment contracts, *see id.* § 30.10(e)(2), and thus were not subject to the review of the Special Master. Accordingly, Citigroup's proposed compensation structure for each of these two employees emphasized the payment of small cash salaries accompanied by large cash payments from Phibro's bonus pools.

B. Determinations of the Special Master

The Special Master has reviewed the Proposed Structures in detail by application of the principles set forth in the Rule and described in Part III above. In light of this review and analysis, the Special Master has determined that both the structural design of Citigroup's proposals and the amounts potentially payable to Covered Employees under the proposals would be inconsistent with the Public Interest Standard and, therefore, require modification.

The Special Master has determined, in light of the considerations that follow, that the compensation structures described in ***Exhibits I*** and ***II*** to this Determination Memorandum will not, by virtue of either their structural design or the amounts potentially payable under them, result in payments inconsistent with the Public Interest Standard.

1. Citigroup Corporate and Operating Units

a. Cash Salary

The Special Master reviewed Citigroup's proposal with respect to cash salary in light of the principle that compensation structures should generally be comparable to "compensation structures and amounts for persons in similar positions or roles at similar entities," *id.* § 30.16(b)(1)(v). The Special Master has concluded generally that, for Covered Employees at Exceptional Assistance Recipients, cash salaries should generally target the 50th percentile because such levels of cash salaries balance the need to attract and retain talented with the need for compensation structures that reflect the circumstances of Exceptional Assistance Recipients. Citigroup proposed annual cash salaries in excess of $800,000 for the three employees in this group. The Special Master has concluded that the proposed cash salaries are inconsistent with the Public Interest Standard because the amounts potentially payable to certain Covered Employees cannot be supported by comparison to cash salaries provided to persons in similar positions or roles at similar entities.

Accordingly, the Special Master has determined that Citigroup's proposed cash base salaries for these employees are inconsistent with the Public Interest Standard. As described in further detail in ***Exhibits I*** and ***II***, the cash salaries for these employees that the Special Master has determined to be consistent with the Public Interest Standard are comparable to those amounts for persons in similar positions or roles at similar entities, and are generally less than $500,000.

b. Stock Salary

First, the Special Master reviewed the amounts of compensation to be granted in the form of stock salary in light of the principle that compensation structures should generally be comparable to "compensation structures and amounts for persons in similar positions or roles at similar entities." *Id.* § 30.16(b)(1)(v). The Special Master has concluded that the proposed amounts to be delivered in stock salary are inconsistent with the Public Interest Standard because the amounts potentially payable to certain Covered Employees cannot be supported by comparison to the compensation payable to persons in similar positions or roles at similar entities. The Special Master has concluded that lesser amounts payable in the form of stock salary are consistent with the Public Interest Standard. These amounts are described in further detail in ***Exhibits I*** and ***II***.

Second, the Special Master reviewed the structure of Citigroup's stock salary proposal in light of the principle that compensation structures should align performance incentives with long-term value creation rather than short-term profits. *See id.* § 30.16(b)(1)(i). The Special Master has concluded that Citigroup's proposal, which contemplates that one third of stock salary will be transferable *immediately* by the employee, does not provide sufficient alignment with long-term value creation.

The Special Master also reviewed the structure of Citigroup's stock salary proposal in light of the principle that an appropriate portion of compensation should be "performance-based over a relevant performance period," *id.* § 30.16(b)(1)(iv). Stock that is immediately transferable permits an employee to liquidate his or her investment in the stock immediately rather than over a period designed to reflect performance. Accordingly, the Special Master has determined that the structure of Citigroup's stock salary proposal is inconsistent with the Public Interest Standard.

Accordingly, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard would not permit immediate transferability or sale of stock salary. Instead, stock salary may only be redeemable in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year early if Citigroup repays its TARP obligations.

c. Annual Long-Term Incentive Awards

The Special Master evaluated Citigroup's proposed annual long-term incentive awards in light of the principle that performance-based compensation should be based on "performance metrics [that are] measurable, enforceable, and actually enforced if not met." *Id.* § 30.16(b)(1)(iv). Citigroup's proposed awards would have been granted in the discretion of the Company rather than based on performance metrics. The Special Master has concluded that the proposed incentive awards are inconsistent with the Public Interest Standard because they could be granted without respect to the achievement of objective, measurable performance metrics.

The Special Master also evaluated Citigroup's proposed awards in light of recently adopted international standards providing that incentive compensation should generally be payable over a period of three years, as well as the principle in the Rule providing that performance-based compensation should be payable "over a relevant performance period," *id.* Restricted stock granted in connection with Citigroup's proposed awards would have vested on the second anniversary of the grant date. Accordingly, the Special Master has concluded that the proposed incentive awards are inconsistent with the Public Interest Standard because they would have vested over a period too short to be relevant to the long-term performance of the Company.

Accordingly, as described in ***Exhibits I*** and ***II***, the structures the Special Master has determined to be consistent with the Public Interest Standard include an annual long-term incentive award payable only upon the achievement of specified, objective performance criteria that have been developed and reviewed in consultation with the Office of the Special Master, and that will not vest unless the employee remains employed until the third anniversary of grant. In addition, as required by the Rule, these awards may only be redeemed in 25% installments for each 25% of Citigroup's TARP obligations that are repaid.

d. "Other" Compensation and Perquisites

Citigroup proposed limited payments of "other" compensation, as well as perquisites, to the Covered Employees. The Special Master has concluded that, absent special justification, employees—not the Company—generally should be responsible for paying personal expenses, and that significant portions of compensation structures should not be allocated to such perquisites and "other" compensation. *See id.* §30.16(b)(1)(iii).

The Rule requires that each Exceptional Assistance Recipient annually disclose to Treasury any perquisites where the total value for any Senior Executive Officer or Most Highly Compensated Employee exceeds $25,000. An express justification for offering these benefits must also be disclosed. Accordingly, as described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard provide no more than $25,000 in "other" compensation and perquisites to each of these employees. Any exceptions to this limitation will require that the Company provide to the Office of the Special Master an independent justification for the payment that is satisfactory to the Special Master. To the extent that payments exceeding this limitation have already been made to a Covered Employee in 2009, those amounts should be promptly returned to the Company.[4]

e. Supplemental Executive Retirement Plans and Non-Qualified Deferred Compensation

Citigroup also proposed that certain Covered Employees receive limited compensation in the form of accruals under a "non-qualified deferred compensation" plan. In such plans, employers periodically credit employees with an entitlement to post-retirement payments. Over time, these credits accumulate and employees may become entitled to substantial cash guarantees payable on retirement—in addition to any payments provided under retirement plans maintained for employees generally.

The Special Master has concluded that the primary portion of a Covered Employee's compensation package should be allocated to compensation structures that are "performance-based over a relevant performance period." *Id.* § 30.16(b)(1)(iv). Payments under the Company's "non-qualified deferred compensation" plans do not depend upon "individual performance and/or the performance of the [Company] or a relevant business unit," *id.*; instead, such accruals are simply guaranteed cash payments from the Company in the future. In addition, these payments can make it more difficult for shareholders to readily ascertain the full amount of pay due a top employee upon leaving the Company.

Covered Employees should fund their retirements using wealth accumulated based on Company performance while they are employed, rather than being guaranteed substantial retirement benefits by the Company regardless of Company performance during and after their tenures. Accordingly, as described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard prohibit further 2009 accruals for Covered Employees under supplemental retirement plans or Company credits to other "non-qualified deferred compensation" plans following the date of this Determination Memorandum.

f. Severance Plans

The Special Master has concluded that an increase in the amounts payable under these arrangements would be inconsistent with the principle that compensation should be performance-based, *id.* § 30.16(b)(1)(iv), and that payments should be appropriately allocated among the elements of compensation, *id.* § 30.16(b)(1)(iii). Accordingly, for the compensation structures described in ***Exhibits I*** and ***II*** to be consistent with the Public Interest Standard, the Company must ensure that 2009 compensation structures for these employees do not result in an increase in the amounts payable pursuant to these arrangements.

[4] Citigroup has, however, identified four employees subject to expatriate arrangements providing for the payment of certain "other" compensation in excess of this limitation. The Special Master has reviewed these arrangements and has concluded that such payments, not to exceed $350,000 per employee, are consistent with the Public Interest Standard.

2. *Covered Employees Party to Certain Agreements*
(Citigroup's CDMI & Investment and Advisory Subsidiaries)

The Special Master reviewed Citigroup's proposed compensation structures for these employees in light of the principle that compensation structures should be "performance-based over a relevant performance period," *id.* § 30.16(b)(1)(iv). Citigroup's proposals for these employees generally provided for the payment of substantial guaranteed minimum cash amounts. The Special Master has concluded that the proposal is inconsistent with the Public Interest Standard because the payment of a large cash lump sum is not adequately linked to the performance of the Company over a relevant performance period.

The Special Master also reviewed the proposals in light of the requirement that compensation structures "avoid incentives to take unnecessary or excessive risks," *id.* §30.16(b)(1)(i). A guaranteed minimum amount provides the employee with little downside risk in the event of poor performance, but potentially unlimited gain in the event that substantial risk-taking leads to significant profits. Accordingly, the Special Master has concluded that the proposal is inconsistent with the Public Interest Standard because the presence of a guaranteed minimum amount may lead to incentives to take unnecessary or excessive risks.

During discussions with the Company, the Office of the Special Master conveyed the view that the proposals were inconsistent with the Public Interest Standard. Citigroup asserted that these payments were to be made under agreements providing for legally binding rights under valid written employment contracts, *see id.* § 30.10(e)(2). Following extensive discussions, all six of the employees in this group agreed to waive their rights to the cash payments reflected in the Company's proposals.

Accordingly, these payments will be restructured to be consistent with the Public Interest Standard and will include the following:

- Cash base salaries no greater than $475,000.

- Grants of vested stock salary redeemable only in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year early if Citigroup repays its TARP obligations.

- Subject to the achievement of objective, specified performance metrics developed in consultation with the Office of the Special Master, an annual long-term incentive award, granted in the form of Citigroup restricted stock that will be forfeited unless the employee stays with Citigroup for at least three years following grant, and may only be redeemed in 25% installments for each 25% of Citigroup's TARP obligations that are repaid. [5]

[5] Stock granted pursuant to such awards, if any, for these three employees may vest if the employee is terminated by Citigroup without "cause" prior to the third anniversary of the grant date.

The compensation structures for these employees will also be subject to the limitations described in Parts IV.B.1.d., ("other" compensation and perquisites), IV.B.1.e. (non-qualified deferred compensation), and IV.B.1.f. (severance plans) above.

3. Covered Employees at Phibro, LLC

The Special Master reviewed the proposals for these two employees in light of the principle that compensation arrangements should not "reward employees for short-term or temporary increases in value," *id.* § 30.16(b)(1)(i). Citigroup's proposal with respect to these employees called for the payment of substantial bonuses based upon Phibro's performance during a fifteen-month period. Accordingly, the Special Master concluded that the proposals were inconsistent with the Public Interest Standard because they could provide substantial rewards for short-lived increases in value.

The Special Master also reviewed the proposals in light of the requirement that compensation structures should "avoid incentives to take unnecessary or excessive risks," *id.* §30.16(b)(1)(i). Citigroup's proposal called for the payment of cash bonuses based on the short-term results of a trading operation involving, according to Citigroup's analysis, long-term risk-taking that could result in losses exceeding several billion dollars. Accordingly, the Special Master concluded that the proposals were inconsistent with the Public Interest Standard because they could provide the employees with incentives to take unnecessary or excessive risks.

In addition, the Special Master reviewed the proposals in light of the principle that "amounts payable...should be consistent with, *and not excessive taking into account*, compensation structures and amounts for persons in similar positions or roles." *Id.* § 30.16(b)(1)(v) (emphasis added). Citigroup's proposal for one of these employees involved the payment of a 2009 bonus in excess of $95,000,000. The Special Master concluded that this amount was excessive taking into account compensation amounts for persons in similar positions or roles at similar entities.

During discussions with the Company, the Office of the Special Master conveyed the view that the proposal was inconsistent with the Public Interest Standard. Citigroup asserted that these payments were to be made under agreements providing for legally binding rights under valid written employment contracts, *see id.* § 30.10(e)(2). During these discussions, and while the proposals were under consideration by the Special Master, Citigroup informed the Special Master that the Company had entered into a definitive agreement providing for the sale of Phibro to Occidental Petroleum, Inc., which has not received assistance under the TARP. Accordingly, the compensation structures of both Covered Employees at Phibro will no longer be subject to the review of the Special Master in 2010.

One of the Covered Employees at Phibro entered into an agreement providing that no amounts will be paid to that employee for 2009 until Phibro is no longer a subsidiary of Citigroup, and that the amounts will not be payable in cash until January 2011. With respect to 2009, the Special Master has concluded that, to be consistent with the Public

Interest Standard, that employee's compensation structure must provide for no compensation of any kind during 2009. Accordingly, amounts paid to the employee prior to the date of this Determination Memorandum shall be repaid to Citigroup.

The second Covered Employee at Phibro was determined not to have a legally binding right to the proposed amounts. *See id.* § 30.10(e)(2). Accordingly, the Office of the Special Master engaged in discussions with the Company to ensure that no payments would be made to this employee that would be inconsistent with the Public Interest Standard. The compensation structures for this employee that the Special Master has determined to be consistent with the Public Interest Standard will be structured in accordance with the conclusions of the Special Master described in Part IV.B.2. above. The compensation structures for this employee will also be subject to the limitations described in Parts IV.B.2.d., ("other" compensation and perquisites), IV.B.2.e. (non-qualified deferred compensation), and IV.B.2.f. (severance plans) above. Further detail is provided in ***Exhibits I*** and ***II***.

4. Departed Employees

In addition, three employees that would have been Covered Employees had they remained employed are no longer employed by the Company. With respect to those employees, the Special Master has determined that cash salaries through the date of the termination of employment, and payment of up to $25,000 in perquisites and "other" compensation are consistent with the Public Interest Standard. No other payments to these employees of any kind would be consistent with the Public Interest Standard. Any exceptions to this limitation will require that the Company provide to the Office of the Special Master an independent justification for the payment that is satisfactory to the Special Master.

V. CORPORATE GOVERNANCE

As noted in Part III above, the Rule requires the Special Master to consider the extent to which compensation structures are "performance-based over a relevant performance period." 31 C.F.R. § 30.16(b)(1)(iv). In light of the importance of this principle, Citigroup must take certain additional corporate governance steps, including those required by the Rule, to ensure that the compensation structures for the Covered Employees, and the amounts payable or potentially payable under those structures, are consistent with the Public Interest Standard.

A. <u>Requirements Relating to Compensation Structures</u>

In order to ensure that objective compensation performance criteria are "measurable, enforceable, and actually enforced if not met," *id.* § 30.16(b)(1)(iv), long-term incentive awards may not be granted unless the Personnel and Compensation Committee of Citigroup's Board of Directors determines to grant such an award in light of the employee's performance as measured against objective performance criteria that the Committee has developed and reviewed in consultation with the Office of the Special

Master. This evaluation must be disclosed to shareholders in, and certified by the Committee as part of, Citigroup's securities filings. In addition, the Committee must retain discretion with respect to each employee, to reduce (but not to increase) the amount of any incentive award on the basis of its overall evaluation of the employee's or Citigroup's performance (notwithstanding full or partial satisfaction of the performance criteria).

In addition, as noted in Part III, above and described in ***Exhibits I*** and ***II***, the structures determined by the Special Master to be consistent with the Public Interest Standard include grants of stock in Citigroup. It is critical that these compensation structures achieve the Rule's objective of "appropriate[ly] allocat[ing] the components of compensation [including] long-term incentives, as well as the extent to which compensation is provided in...equity," *id.* § 30.16(b)(iii).

The Company must have in effect a policy that would prohibit an employee from engaging in hedging, derivative or other transactions that have an economically similar effect that would undermine the incentives created by the compensation structures set forth in ***Exhibits I*** and ***II***. Such transactions would be contrary to the principles set forth in the Rule.

B. <u>Additional Requirements</u>

In addition to the requirements set forth above, pursuant to the requirements of the Rule, Citigroup is required to institute the following corporate governance reforms:

(1) *Compensation Committee; Risk Review.* Citigroup must maintain a compensation committee comprised exclusively of independent directors. Every six months, the committee must discuss, evaluate, and review with Citigroup's senior risk officers any risks that could threaten the value of Citigroup. In particular, the committee must meet every six months to discuss, evaluate, and review the terms of each employee compensation plan to identify and limit the features in (1) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that threaten the value of Citigroup; (2) SEO or other employee compensation plans that could encourage behavior focused on short-term results and not on long-term value creation; and (3) employees' compensation plans that could encourage the manipulation of Citigroup's reported earnings to enhance the compensation of any of the employees. *Id.* § 30.4; *id.* § 30.5.

(2) *Disclosure with Respect to Compensation Consultants.* The compensation committee must disclose to Treasury an annual narrative description of whether Citigroup, its Board of Directors, or the committee has engaged a compensation consultant during the past three years. If so, the compensation committee must detail the types of services provided by the compensation consultant or any affiliate, including any "benchmarking" or comparisons employed to identify certain percentile levels of compensation. *Id.* § 30.11(c).

(3) *Disclosure of Perquisites.* As noted in Part IV, Citigroup must provide to Treasury an annual disclosure of any perquisite whose total value for Citigroup's fiscal year exceeds $25,000 for each of the Covered Employees. Citigroup must provide a narrative description of the amount and nature of these perquisites, the recipient of these perquisites, and a justification for offering these perquisites (including a justification for offering the perquisite, and not only for offering the perquisite with a value that exceeds $25,000). *Id.* § 30.11(b).

(4) *Clawback.* Citigroup must ensure that any incentive award paid to a Covered Employee is subject to a clawback if the award was based on materially inaccurate financial statements (which includes, but is not limited to, statements of earnings, revenues, or gains) or any other materially inaccurate performance metric criteria. Citigroup must exercise its clawback rights except to the extent that it is unreasonable to do so. *Id.* § 30.8.

(5) *Say-on-Pay.* Citigroup must permit a separate shareholder vote to approve the compensation of executives, as required to be disclosed pursuant to the federal securities laws (including the compensation discussion and analysis, the compensation tables, and any related material). *Id.* § 30.13.

(6) *Policy Addressing Excessive or Luxury Expenditures.* Citigroup was required to adopt an excessive or luxury expenditures policy, provide that policy to Treasury, and post it on Citigroup's website. If Citigroup's board of directors makes any material amendments to this policy, within ninety days of the adoption of the amended policy, the board of directors must provide the amended policy to Treasury and post the amended policy on the company website. *Id.* § 30.12.

(7) *Prohibition on Tax Gross-Ups.* Except as explicitly permitted under the Rule, Citigroup is prohibited from providing (formally or informally) tax gross-ups to any of the Covered Employees. *Id.* § 30.11(d).

(8) *CEO and CFO Certification.* Citigroup's chief executive officer and chief financial officer must provide to the Securities and Exchange Commission written certification of the Company's compliance with the various requirements of section 111 of EESA. The precise nature of the required certification is identified in the Rule. *Id.* § 30.15 Appx. A.

VI. Conclusion

The Special Master has reviewed the Proposed Structures for the Covered Employees for 2009 in light of the principles set forth at 31 C.F.R. § 30.16(b). On the basis of that review, the Special Master has determined that the Proposed Structures submitted by Citigroup require modification in order to meet the Public Interest Standard.

The Special Master has separately reviewed the compensation structures set forth in ***Exhibits I*** and ***II*** in light of the principles set forth at 31 C.F.R. § 30.16(b). Pursuant to the authority vested in the Special Master by the Rule, and in accordance with Section

30.16(a)(3) thereof, the Special Master hereby determines that the compensation structures set forth in ***Exhibits I*** and ***II***, including the amounts payable or potentially payable under such compensation structures, will not result in payments that are inconsistent with the purposes of section 111 of EESA or the TARP, and will not otherwise be contrary to the public interest.

Pursuant to the Interim Final Rule, Citigroup may, within 30 days of the date hereof, request in writing that the Special Master reconsider the determinations set forth in this Determination Memorandum. The request for reconsideration must specify a factual error or relevant new information not previously considered, and must demonstrate that such error or lack of information resulted in a material error in the initial determinations. If Citigroup does not request reconsideration within 30 days, the determinations set forth herein will be treated as final determinations. *Id.* § 30.16(c)(1).

The foregoing determinations are limited to the compensation structures described in ***Exhibits I*** and ***II***, and shall not be relied upon with respect to any other employee. The determinations are limited to the authority vested in the Special Master by Section 30.16(a)(3) of the Rule, and shall not constitute, or be construed to constitute, the judgment of the Office of the Special Master or Treasury with respect to the compliance of any compensation structure with any other provision of the Rule. Moreover, this Determination Memorandum has relied upon, and is qualified in its entirety by, the accuracy of the materials submitted by the Company to the Office of the Special Master, and the absence of any material misstatement or omission in such materials.

Finally, the foregoing determinations are limited to the compensation structures described herein, and no further compensation of any kind payable to any Covered Employee without the prior approval of the Special Master would be consistent with the Public Interest Standard.

EXHIBIT I

COVERED EMPLOYEES

2009 Compensation

Company Name: Citigroup Inc.

Employee ID	**Cash Salary** (Rate going forward.)	**Stock Salary** (Performance based: The stock vests at grant and is redeemable in three equal, annual installments beginning on the 2nd anniversary of grant.)	**Long-Term Restricted Stock** (Performance based: Awarded based on achievement of objective performance goals. Vests after 3 years of service. Transferability dependent on TARP repayment.)	**Total Direct Compensation** (Cash salary paid to date plus two months at new run rate + stock salary + long-term restricted stock.)
100001	$1	$0	$0	$1
100004	$475,000	$5,433,333	$2,850,000	$8,550,000
100005	$500,000	$3,400,000	$1,950,000	$5,850,000
100006	$0	$0	$0	$0
100007	$475,000	$5,629,167	$3,000,000	$9,000,000
100008	$475,000	$3,733,333	$2,000,000	$6,000,000
100009	$475,000	$3,979,167	$2,133,333	$6,400,000
100010	$475,000	$5,699,390	$3,000,000	$9,000,000
100011	$475,000	$4,683,333	$2,475,000	$7,425,000
100013	$475,000	$5,399,390	$2,850,000	$8,550,000
100014	$475,000	$5,733,333	$3,000,000	$9,000,000
100015	$475,000	$4,400,000	$2,333,333	$7,000,000
100017	$475,000	$3,200,000	$1,733,333	$5,200,000
100019	$475,000	$3,000,000	$1,633,333	$4,900,000
100020	$475,000	$2,845,833	$1,556,250	$4,668,750
100021	$475,000	$1,775,000	$1,000,000	$3,000,000
100022	$475,000	$2,520,000	$1,393,333	$4,180,000
100023	$475,000	$3,733,333	$2,000,000	$6,000,000
100025	$475,000	$250,000	$237,500	$712,500
100075	$500,000	$5,062,500	$2,666,667	$8,000,000
100107	$500,000	$2,916,666	$1,666,667	$5,000,000

Comparison of 2009 Compensation to Prior Years: 2007 & 2008 Compensation

2008 Cash decreased by $244.9M or 96.4%
Total Direct Compensation decreased by $272M or 69.7%

2007 Cash decreased by $78.4M or 89.6%
Total Direct Compensation decreased by $217.3M or 64.7%

Note: 1: Amounts reflected in this Exhibit do not include amounts the Company has asserted to be payable pursuant to legally binding rights under valid employment contracts, see 31 C.F.R. § 30.10(e)(2).
Note: 2: The total number of Covered Employees may be less than 25 because of terminations, departures and retirements after January 1, 2009.

EXHIBIT II
TERMS AND CONDITIONS OF PAYMENTS AND STRUCTURES CONSISTENT WITH THE PUBLIC INTEREST STANDARD

The following general terms and conditions shall govern the compensation structures described in ***Exhibit I***. The Special Master's determination that those structures are consistent with the Public Interest Standard is qualified in its entirety by the Company's adherence to these terms and conditions.

- ***Cash base salary***. Cash base salaries reflect the go-forward rate for the employee effective as of November 1, 2009. Compensation paid in the form of cash base salary prior to that date in accordance with the terms of employment as of June 14, 2009 shall be permitted unless otherwise noted. 31 C.F.R. § 30.16(a)(3)(iii).

- ***Stock salary***. Rates of stock salary grants reflect full-year values. Because this is a new compensation element, the amounts are payable on a *nunc pro tunc* basis effective January 1, 2009. Stock salary must be determined as a dollar amount through the date salary is earned, be accrued at the same time or times as the salary would otherwise be paid in cash, and vest immediately upon grant, with the number of shares based on the fair market value on the date of award. Stock granted as stock salary may only be redeemed in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year early if TARP obligations are repaid.

- ***Long-term restricted stock***. Long-term restricted stock may be granted upon the achievement of specified, objective performance criteria that have been developed and reviewed in consultation with the Office of the Special Master and certified by the Personnel and Compensation Committee of Citigroup's Board of Directors. Any such stock may vest only if the employee remains employed by the Company on the third anniversary of grant (or, if earlier, upon death or disability). The stock shall be transferable only in 25% increments for each 25% of TARP obligations repaid by the Company.

- ***Other compensation and perquisites***. No more than $25,000 in total other compensation and perquisites may be provided to any Covered Employee, absent exceptional circumstances for good cause shown, as defined by pertinent SEC regulations.

- ***Supplemental executive retirement plans and non-qualified deferred compensation plans***. Following the date of the Determination Memorandum, no additional amounts may be accrued under supplemental executive retirement plans, and no Company contributions may be made to other "non-qualified deferred compensation" plans, as defined by pertinent SEC regulations.

- ***Qualified Plans***. For the avoidance of doubt, the Special Master has determined that participation by the Covered Employees in tax-qualified retirement, health and welfare, and similar plans is consistent with the Public Interest Standard.

6. General Motors Company

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 22, 2009

Mr. Gregory E. Lau
Executive Director – Global Compensation
General Motors Company
300 Renaissance Drive
MC 482-C32-B61
Detroit, MI, 48265-3000

Re: ***Proposed Compensation Payments and Structures for Senior Executive Officers and Most Highly Compensated Employees***

Dear Mr. Lau:

Pursuant to the Department of the Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance, the Office of the Special Master has completed its review of your 2009 compensation submission on behalf of the Senior Executive Officers and certain Most Highly Compensated Employees of General Motors Company ("GM"). Attached as ***Annex A*** is a Determination Memorandum (accompanied by ***Exhibits I*** and ***II***) providing the determinations of the Special Master with respect to 2009 compensation for those employees. 31 C.F.R. § 30.16(a)(3).

The Interim Final Rule requires the Special Master to determine whether the compensation structure for each senior executive officer and certain most highly compensated employees "will or may result in payments inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." *Id.* § 30.16(a)(3). The Special Master has determined that, to satisfy this standard, 2009 compensation for GM's senior executive officers and certain most highly compensated employees generally must comport with the following standards:

- There can be no guarantee of any "bonus" or "retention" awards among the compensation structures approved by the Special Master.

- Rather than cash, the majority of each Corporate Employee's base salary will be paid in the form of stock. This stock will immediately vest, in accordance with the Interim Final Rule, but will only be redeemable in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year earlier if GM repays its TARP obligations.

- Base salary paid in cash should not exceed $500,000 per year, except in appropriate cases for good cause shown. Overall, cash compensation must be significantly reduced from cash amounts paid in 2008. In GM's case, cash compensation for these employees will decrease 31.0% from 2008 levels.

- Total compensation for each individual must both reflect the individual's value to GM and be appropriate when compared with the total compensation provided to persons in similar positions or roles at similar entities, and should target the 50th percentile of total compensation for such similarly situated employees. Overall, total direct compensation must be reduced from 2008 amounts. In GM's case, total direct compensation for these employees will decrease 20.4% from 2008 levels.

- If, and only if, the employee achieves objective performance metrics developed and reviewed in consultation with the Office of the Special Master, the employee may be eligible for long-term incentive awards. All such awards must be payable in the form of restricted stock that will be forfeited unless the employee stays with GM for at least three years following grant, and may only be redeemed in 25% installments for each 25% installment of GM's TARP obligations that are repaid. Such long-term incentive awards may not exceed one-third of total annual compensation.

- Any and all incentive compensation paid to employees will be subject to recovery or "clawback" if the payments are based on materially inaccurate financial statements or any other materially inaccurate performance metrics, or if the employee is terminated due to misconduct that occurred during the period in which the incentive was earned.

- Any and all "other" compensation and perquisites will not exceed $25,000 for each employee (absent exceptional circumstances for good cause shown).

- No severance benefit to which an employee becomes entitled in the future may take into account a cash salary increase, or any payment of stock salary, that the Special Master has approved for 2009.

- No additional amounts in 2009 may be accrued under supplemental executive retirement plans or credited by the company to other "non-qualified deferred compensation" plans after the date of the Determination Memorandum.

The Special Master has also determined that, in order for the approved compensation structures to satisfy the standards of 31 C.F.R. § 30.16(a)(3), GM must adopt policies applicable to these employees as follows:

- The achievement of any performance objectives must be certified by the Executive Compensation Committee of GM's Board of Directors, which is composed solely of independent directors, to the Office of the Special Master or, subject to the approval of the Special Master, in such other manner as is determined by the compensation committee. These performance objectives must be reviewed and approved by the Office of the Special Master.

- The employees will be prohibited from engaging in any hedging, derivative or other transactions that have an equivalent economic effect that would undermine the long-term performance incentives created by the compensation structures.

- GM may not provide a tax "gross up" of any kind to these employees.

- At least once every year, the Executive Compensation Committee of GM's Board of Directors must provide to the Department of the Treasury a narrative description identifying each compensation plan for its senior executive officers, and explaining how the plan does not encourage the senior executive officers to take unnecessary and excessive risks that threaten GM's value.

These requirements are described in further detail in the attached Determination Memorandum.

The Special Master's review has been guided by a number of considerations, including each of the principles articulated in the Interim Final Rule. *Id.* § 30.16(b)(1). The following principles were of particular importance to the Special Master in his determinations with respect to GM's compensation structures:

- *Performance-based compensation.* The majority of approved compensation depends on GM's performance, and ties the financial incentives of GM employees to the overall performance of the Company. A majority of the salary paid to employees under these structures will be paid in the form of stock; and, because the stock salary will become transferable only in three equal, annual installments beginning on the second anniversary of the date the stock salary is earned (with each installment redeemable one year earlier if GM repays its TARP obligations), the ultimate value realized by the employee will depend on GM's performance over the long term. Guaranteed amounts payable in cash, in contrast, are generally rejected. 31 *Id.* § 30.16(b)(1)(iv).

- *Taxpayer return.* The compensation structures approved by the Special Master reflect the need for GM to remain a competitive enterprise and, ultimately, to be able to repay TARP obligations. The Special Master has determined that the approved compensation structures are competitive when compared to those provided to persons in similar positions or roles at similar entities. Overall, the compensation structures generally provide for total compensation packages well below the 50th percentile when compared to such other executive officers and employees. *Id.* § 30.16(b)(1)(ii).

- *Appropriate Allocation.* The total compensation payable to GM employees is weighted heavily toward long-term structures that are tied to GM's performance and are easily understood by shareholders. As a general principle, guaranteed income is rejected. Fixed compensation payable to GM employees should consist only of cash salaries at sufficient levels to attract and retain employees and provide them a reasonable level of liquidity.

Pursuant to the Interim Final Rule, GM may, within 30 days of the date hereof, request in writing that the Special Master reconsider the determinations set forth in the Determination Memorandum. If GM does not request reconsideration within 30 days, these initial determinations will be treated as final determinations. *Id.* § 30.16(c)(1).

Very truly yours,

Kenneth R. Feinberg
Office of the Special Master
for TARP Executive Compensation

Attachments

cc: Ms. Mary T. Barra

ANNEX A
DETERMINATION MEMORANDUM

I. Introduction

The Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009 ("EESA"), requires the Secretary of the Treasury to establish standards related to executive compensation and corporate governance for financial institutions receiving financial assistance under the Troubled Asset Relief Program ("TARP"). Through the Department of the Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance (the "Rule"), the Secretary delegated to the Office of the Special Master for TARP Executive Compensation (the "Office of the Special Master" or, the "Office") responsibility for reviewing compensation structures of certain employees at financial institutions that received exceptional financial assistance under the TARP ("Exceptional Assistance Recipients"). 31 C.F.R. § 30.16(a); *id.* § 30.16(a)(3). For these employees, the Special Master must determine whether the compensation structure will or may result in payments "inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." *Id.*

General Motors Company ("GM" or the "Company"), one of seven Exceptional Assistance Recipients, has submitted to the Special Master proposed compensation structures (the "Proposed Structures") for review pursuant to Section 30.16(a)(3) of the Rule. These proposals apply to three employees that the Company has identified as Senior Executive Officers (the "Senior Executive Officers," or "SEOs") for purposes of the Rule, and seventeen employees the Company has identified as among the most highly compensated employees of the Company for purposes of the Rule (the "Most Highly Compensated Employees," and, together with the SEOs, the "Covered Employees").

The Covered Employees comprise two business unit categories: GM corporate employees ("Corporate Employees") and employees of GM's asset management unit ("Promark Employees"). The relatively heavy concentration of Promark Employees among the Covered Employee group—fifteen of the twenty employees—resulted from the method used to calculate a Most Highly Compensated Employee's compensation under the Rule. As a result of the accounting technique used to value equity compensation under this method, GM corporate employees who otherwise may have been Most Highly Compensated Employees saw their compensation reduced greatly because of the stock performance of GM's predecessor in 2008.

The Special Master has completed the review of the Company's Proposed Structures for the Covered Employees pursuant to the principles set forth in the Rule. *Id.* § 30.16(b)(1). This Determination Memorandum sets forth the determinations of the Special Master, pursuant to Section 30.16(a)(3) of the Rule, with respect to the Covered Employees.

II. Background

On June 15, 2009, the Department of the Treasury ("Treasury") promulgated the Rule, creating the Office of the Special Master and delineating its responsibilities. Immediately following that date, the Special Master, and the Department of the Treasury employees working in the Office of the Special Master, conducted extensive discussions with GM officials. During these discussions, the Office of the Special Master informed GM about the nature of the Office's work and the authority of the Special Master under the Rule. These discussions continued for a period of months, during which the Special Master and GM explored potential compensation structures for the Covered Employees.

The Rule requires that each Exceptional Assistance Recipient submit proposed compensation structures for each Senior Executive Officer and Most Highly Compensated Employee no later than August 14, 2009. 31 C.F.R. § 30.16(a)(3). On July 20, 2009, the Special Master requested from each Exceptional Assistance Recipient, including GM, certain data and documentary information necessary to facilitate the Special Master's review of the Company's compensation structures. The request required GM to submit data describing its proposed compensation structures, and the payments that would result from the proposed structures, concerning each Covered Employee.

In addition, the Rule authorizes the Special Master to request information from an Exceptional Assistance Recipient "under such procedures as the Special Master may determine." *Id.* § 30.16(d). GM was required to submit competitive market data indicating how the amounts payable under GM's Proposed Structures relate to the amounts paid to persons in similar positions or roles at similar entities. GM was also required to submit a range of documentation, including information related to proposed performance metrics, internal policies designed to curb excessive risk, and certain previously existing compensation plans and agreements.

GM submitted this information to the Office of the Special Master on August 7, 2009. Following a preliminary review of the submission, and the submission of certain additional information, on August 31, 2009, the Special Master determined that GM's submission was substantially complete for purposes of the Rule. *Id.* § 30.16(a)(3). The Office of the Special Master then commenced a formal review of GM's Proposed Structures for the Covered Employees. The Rule provides that the Special Master is required to issue a compensation determination within 60 days of a substantially complete submission. *Id.* § 30.16(a)(3).

The Office of the Special Master's review of the Company's proposals was aided by analysis from a number of internal and external sources, including:

- Treasury personnel detailed to the Office of the Special Master, including executive compensation specialists with significant experience in reviewing, analyzing, designing and administering executive compensation plans, and attorneys with experience in matters related to executive compensation;

- Competitive market data provided by the Company in connection with its submission to the Office of the Special Master;

- External information on comparable compensation structures extracted from the *U.S. Mercer Benchmark Database-Executive*;

- External information on comparable compensation structures extracted from Equilar's *ExecutiveInsight* database (which includes information drawn from publicly filed proxy statements) and Equilar's *Top 25 Survey Summary Report* (which includes information from a survey on the pay of highly compensated employees);

- Consultation with Lucian A. Bebchuk, a world-renowned expert in executive compensation and the William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance and Director of the Program on Corporate Governance at Harvard Law School; and

- Consultation with Kevin J. Murphy, a world-renowned expert in executive compensation and the Kenneth L. Trefftzs Chair in Finance in the department of finance and business economics at the University of Southern California's Marshall School of Business.

The Special Master considered these views, in light of the statutory and regulatory standards described in Part II below, when evaluating the Company's Proposed Structures for the Covered Employees for 2009.

III. STATUTORY AND REGULATORY STANDARDS

The Rule requires that the Special Master determine for each of the Covered Employees whether GM's Proposed Structures, including amounts payable or potentially payable under the compensation structure, "will or may result in payments that are inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." 31 C.F.R. § 30.16(a)(3) (as applied to Covered Employees of Exceptional Assistance Recipients, the "Public Interest Standard"). Regulations promulgated pursuant to the Rule require that the Special Master consider six principles when making these compensation determinations:

(1) *Risk.* The compensation structure should avoid incentives which encourage executive officers and employees to take unnecessary or excessive risks that could threaten the value of the exceptional assistance recipient, including incentives that reward employees for short-term or temporary increases in value or performance; or similar measures that may undercut the long-term value of the exceptional assistance recipient. Compensation packages should be aligned with sound risk management. *Id.* § 30.16(b)(1)(i).

(2) *Taxpayer return.* The compensation structure and amount payable should reflect the need for the exceptional assistance recipient to remain a competitive enterprise, to retain and recruit talented employees who will contribute to the recipient's future success, so that the Company will ultimately be able to repay its TARP obligations. *Id.* § 30.16(b)(1)(ii).

(3) *Appropriate allocation.* The compensation structure should appropriately allocate the components of compensation such as salary and short-term and long-term performance incentives, as well as the extent to which compensation is provided in cash, equity, or other types of compensation such as executive pensions, or other benefits, or perquisites, based on the specific role of the employee and other relevant circumstances, including the nature and amount of current compensation, deferred compensation, or other compensation and benefits previously paid or awarded. *Id.* § 30.16(b)(1)(iii).

(4) *Performance-based compensation.* An appropriate portion of the compensation should be performance-based over a relevant performance period. Performance-based compensation should be determined through tailored metrics that encompass individual performance and/or the performance of the Exceptional Assistance Recipient or a relevant business unit taking into consideration specific business objectives. Performance metrics may relate to employee compliance with relevant corporate policies. In addition, the likelihood of meeting the performance metrics should not be so great that the arrangement fails to provide an adequate incentive for the employee to perform, and performance metrics should be measurable, enforceable, and actually enforced if not met. *Id.* § 30.16(b)(1)(iv).

(5) *Comparable structures and payments.* The compensation structure, and amount payable where applicable, should be consistent with, and not excessive, taking into account compensation structures and amounts for persons in similar positions or roles at similar entities that are similarly situated, including, as applicable, entities competing in the same markets and similarly situated entities that are financially distressed or that are contemplating or undergoing reorganization. *Id.* § 30.16(b)(1)(v).

(6) *Employee contribution to TARP recipient value.* The compensation structure and amount payable should reflect the current or prospective contributions of an employee to the value of the Exceptional Assistance Recipient, taking into account multiple factors such as revenue production, specific expertise, compliance with company policy and regulation (including risk management), and corporate leadership, as well as the role the employee may have had with respect to any change in the financial health or competitive position of the recipient. *Id.* § 30.16(b)(1)(vi).

The Rule provides that the Special Master shall have discretion to determine the appropriate weight or relevance of a particular principle depending on the facts and circumstances surrounding the compensation structure or payment for a particular employee. *Id.* § 30.16(b). To the extent two or more principles may appear inconsistent in a particular situation, the Rule requires that the Special Master exercise his discretion in determining the relative weight to be accorded to each principle. *Id.*

The Rule provides that the Special Master may, in the course of applying these principles, take into account other compensation structures and other compensation earned, accrued, or paid, including compensation and compensation structures that are not subject to the restrictions of section 111 of EESA. For example, the Special Master may consider payments obligated to be made by the Company pursuant to certain legally binding rights under valid written employment contracts entered into prior to enactment of the statute and the accompanying Rule. *Id.* § 30.16(a)(3).

IV. Compensation Structures and Payments

A. GM Proposals

GM provided the Office of the Special Master with detailed information concerning its 2009 Proposed Structures for the Covered Employees, including amounts potentially payable under the Proposed Structures for each Covered Employee (the "Proposed Structures").

GM's proposals for Corporate Employees and Promark Employees reflected the significant differences between the businesses and their customary compensation structures. The Corporate Employees generally manage the Company's automotive business and their compensation structure is weighted more heavily toward stock salary than the Promark Employees, who manage GM and third-party pension trust fund and other assets.

GM supported its Proposed Structures with detailed assessments of each Covered Employee's tenure and responsibilities at the Company (or its applicable subsidiary) and historical compensation structure. The submission also included market data that, according to the Company, indicated that the amounts potentially payable to each employee were comparable to the compensation payable to persons in similar positions or roles at a "peer group" of entities selected by the Company. Separate peer groups were provided for the Corporate Employees and the Promark Employees.

1. Cash Salary

GM proposed raising the cash salary of each Covered Employee to annual rates of up to $1,800,000 million for Corporate Employees and up to $658,000 for Promark Employees. Under GM's proposal, all Covered Employees' salaries would increase for the remainder of 2009 to the levels at which they were paid prior to across-the-board salary reductions earlier in 2009.

2. Stock Salary

GM proposed that certain Covered Employees receive substantial stock salary over the remainder of 2009, in amounts of up to \$2,235,000. On each regular payroll date, Covered Employees would earn fully vested stock units, which would then settle in their entirety on January 2, 2011.

3. Annual Long-Term Incentive Awards

GM proposed that the Covered Employees receive annual long-term incentive awards, in amounts ranging from \$145,733 to \$1,815,000. Under the proposal, employees would receive awards generally equal to one third of total 2009 compensation, payable in long-term restricted stock that would vest on the last to occur of a public offering, the second anniversary of the award date and GM's repayment of its TARP obligations.

4. "Other" Compensation and Perquisites

GM proposed payments of "other" compensation, as well as perquisites, to the Covered Employees. These proposed payments varied in value.

5. Non-Qualified Deferred Compensation

GM also proposed that certain Covered Employees receive compensation in the form of accruals under a "non-qualified deferred compensation" plan.

B. Determinations of the Special Master

The Special Master has reviewed the Proposed Structures in detail by application of the principles set forth in the Rule and described in Part II above. In light of this review and analysis, the Special Master has determined that both the structural design of GM's proposals and the amounts potentially payable to Covered Employees under the proposals are inconsistent with the Public Interest Standard and, therefore, require modification.

The Special Master has determined, in light of the considerations that follow, that the compensation structures described in ***Exhibits I*** and ***II*** to this Determination Memorandum will not, by virtue of either their structural design or the amounts potentially payable under them, result in payments inconsistent with the Public Interest Standard.

1. Cash Salary

The Special Master reviewed the cash salary proposals in light of the principle that compensation structures should generally be comparable to "compensation structures and amounts for persons in similar positions or roles at similar entities." 31 C.F.R. § 30.16(b)(1)(v). The Special Master has concluded generally that, for Covered Employees at Exceptional Assistance Recipients, cash salaries should generally target the 50th percentile because such levels of cash salaries balance the need to attract and retain talented with the need for compensation structures that reflect the circumstances of Exceptional Assistance Recipients

In conducting the review of proposed cash salary amounts, the Special Master made use of the resources described in Part II. Based on this review, the Special Master has concluded that GM's proposed cash salaries for certain Corporate Employees and certain Promark Employees would be inconsistent with the Public Interest Standard because these amounts cannot be supported by comparison to cash salaries provided to persons in similar positions or roles at similar entities.

In addition, because cash salaries do not create incentives for employees to pursue long-term value creation or financial stability, the amount of cash salary provided to a Covered Employee must be considered in comparison to the portion of compensation that is "performance-based over a relevant performance period." *Id.* § 30.16(b)(1)(iv). The Special Master has concluded that the cash portion of the Covered Employee's compensation is not performance-based and generally should not exceed $500,000. See *Id.* § 30.16(b)(1)(iii).

As described in further detail in ***Exhibits I*** and ***II***, the cash salaries that the Special Master has determined are consistent with the Public Interest Standard compare appropriately to those paid to persons in similar positions or roles at similar entities, and are generally less than $500,000.

2. Stock Salary

The Special Master performed a review of the amount of stock salary GM proposed to pay the Covered Employees. The Special Master determined that GM's stock salary proposal would place the Covered Employees at or below the 50th percentile of compensation for persons in similar positions or roles at similar entities. These amounts are described in further detail in ***Exhibits I*** and ***II***.

The Special Master also reviewed the structure of GM's stock salary proposal. The Rule requires that the Special Master consider whether an appropriate portion of an employee's compensation is allocated to long-term incentives *Id.* § 30.16(b)(1)(iii). Stock salary that can be liquidated too soon could incentivize employees to pursue short-term results instead of long-term value creation. *See Id.* § 30.16(b)(1)(i). Under the Company's proposal, all stock salary would be redeemable by the employee in slightly more than one year after being granted The Special Master has concluded that one year is an insufficient holding period to provide an appropriate long-term incentive.

As described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard require that stock salary become redeemable in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year earlier if GM repays its TARP obligations.

3. Annual Long-Term Incentive Awards

The Special Master reviewed GM's proposed annual long-term incentive awards in light of the principle that performance-based compensation should be based on "performance metrics [that are] measurable, enforceable, and actually enforced if not met." *Id.* § 30.16(b)(1)(iv). GM's proposed annual long-term incentive awards included overall business goals. Neither the amounts of the awards allocated to individual employees nor the percentage of the awards that would vest would be calculated by the level of individual achievement. As a result, the Special Master has concluded that GM's proposed annual long-term incentive awards are inconsistent with the Public Interest Standard because they do not include tailored performance metrics.

The Special Master also evaluated GM's proposal in light of recently adopted international standards providing that incentive compensation should generally be payable over a period of three years, as well as the Rule's principle providing that performance-based compensation should be payable "over a relevant performance period," *id.* Under GM's proposal, the restricted stock could become fully vested after only two years of service. Accordingly, the Special Master has concluded that GM's proposed annual long-term incentive awards are inconsistent with the Public Interest Standard because they may vest over a period too short to be relevant to the long-term performance of the Company.

As described in ***Exhibits I*** and ***II***, the structures the Special Master has determined to be consistent with the Public Interest Standard include an annual long-term incentive award payable only upon the achievement of specified, objective performance criteria that have been developed and reviewed in consultation with the Office of the Special Master, and that will not vest unless the employee remains employed until the third anniversary of grant. In addition, as required by the Rule, these awards may only be redeemed in 25% installments for each 25% of GM's TARP obligations that are repaid.

4. "Other" Compensation and Perquisites

GM proposed payments of "other" compensation, as well as perquisites, to the Covered Employees. The Special Master has concluded that, absent special justification, employees—not the Company—generally should be responsible for paying personal expenses, and that significant portions of compensation structures should not be allocated to such perquisites and "other" compensation. *See id.* §30.16(b)(1)(iii).

The Rule requires that each Exceptional Assistance Recipient annually disclose to Treasury any perquisites where the total value for any Senior Executive Officer or Most Highly Compensated Employee exceeds $25,000. An express justification for offering these benefits must also be disclosed. Accordingly, as described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard provide no more than $25,000 in "other" compensation and perquisites to each of these employees. Any exceptions to this limitation will require that the Company provide to the Office of the Special Master an independent justification for the payment that is satisfactory to the Special Master. To the extent that payments exceeding this limitation have already been made to a Covered Employee in 2009, those amounts should be promptly returned to the Company.

5. Non-Qualified Deferred Compensation

GM also proposed that certain Covered Employees receive compensation in the form of accruals under a "non-qualified deferred compensation" plan. In such plans, employers periodically credit employees with an entitlement to post-retirement payments. Over time, these credits accumulate and employees may become entitled to substantial cash guarantees payable on retirement—in addition to any payments provided under retirement plans maintained for employees generally.

The Special Master has concluded that the primary portion of a Covered Employee's compensation package should be allocated to compensation structures that are "performance-based over a relevant performance period." *Id.* § 30.16(b)(1)(iv). Payments under the Company's "non-qualified deferred compensation" plans do not depend upon "individual performance and/or the performance of the [Company] or a relevant business unit," *id.*; instead, such accruals are simply guaranteed cash payments from the Company in the future. In addition, these payments can make it more difficult for shareholders to readily ascertain the full amount of pay due a top executive upon leaving the firm.

Covered Employees should fund their retirements using wealth accumulated based on Company performance while they are employed, rather than being guaranteed substantial retirement benefits by the Company regardless of Company performance during and after their tenures. Accordingly, as described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard prohibit further 2009 accruals for Covered Employees under supplemental retirement plans or Company credits to other "non-qualified deferred compensation" plans following the date of this Determination Memorandum.

6. Severance Arrangements

The Special Master has concluded that an increase in the amounts payable under these arrangements would be inconsistent with the principle that compensation should be performance-based, *id.* § 30.16(b)(1)(iv), and that payments should be appropriately allocated among the elements of compensation, *id.* § 30.16(b)(1)(iii). Accordingly, for the compensation structures described in ***Exhibits I*** and ***II*** to be consistent with the Public Interest Standard, the Company must ensure that 2009 compensation structures for these employees do not result in an increase in the amounts payable pursuant to these arrangements.

7. Departed Employees

In addition, three employees that would have been Covered Employees had they remained employed are no longer employed by the Company. With respect to these employees, the Special Master has determined that cash salaries through the date of the termination of employment, and payment of up to $25,000 in perquisites and "other" compensation are consistent with the Public Interest Standard. No other payments to these employees of any kind would be consistent with the Public Interest Standard. Any exceptions to this limitation will require that the Company provide to the Office of the Special Master an independent justification for the payment that is satisfactory to the Special Master.

V. CORPORATE GOVERNANCE

As noted in Part III above, the Rule requires the Special Master to consider the extent to which compensation structures are "performance-based over a relevant performance period," 31 C.F.R. § 30.16(b)(1)(iv). In light of the importance of this principle, GM must take certain additional corporate governance steps, including those required by the Rule, to ensure that the compensation structures for the Covered Employees, and the amounts payable or potentially payable under those structures, are consistent with the Public Interest Standard.

A. Requirements Relating to Compensation Structures

In order to ensure that objective compensation performance criteria are "measurable, enforceable, and actually enforced if not met," *id.* § 30.16(b)(1)(iv), long-term incentive awards may not vest unless the Company's compensation committee determines that the applicable level of performance—as measured against objective performance criteria that the compensation committee has developed and reviewed in consultation with the Office of the Special Master—has been met. This determination must be certified by the compensation committee to the Office of the Special Master or, subject to the approval of the Special Master, in such other manner as is determined by the compensation committee.

In addition, as noted in Part IV, above and described in ***Exhibits I*** and ***II***, the structures determined by the Special Master to be consistent with the Public Interest Standard include grants of stock in the Company. It is critical that these compensation structures achieve the Rule's objective of "appropriate[ly] allocat[ing] the components of compensation [including] long-term incentives, as well as the extent to which compensation is provided in...equity," *id.* § 30.16(b)(iii).

The Company must have in effect a policy that would prohibit an employee from engaging in hedging, derivative or other transactions that have an economically similar effect that would undermine the incentives created by the compensation structures set forth in ***Exhibits I*** and ***II***. Such transactions would be contrary to the principles set forth in the Rule.

B. Additional Requirements

In addition to the requirements set forth above, pursuant to the requirements of the Rule, the Company is required to institute the following corporate governance reforms:

(1) *Executive Compensation Committee; Risk Review.* GM must maintain a compensation committee comprised exclusively of independent directors. Every six months, the committee must discuss, evaluate, and review with GM's senior risk officers any risks that could threaten the value of GM. In particular, the committee must meet every six months to discuss, evaluate, and review the terms of each employee compensation plan to identify and limit the features in (1) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that threaten the value of the GM; (2) SEO or other employees' compensation plans that could encourage behavior focused on short-term results and not on long-term value creation; and (3) employee compensation plans that could encourage the manipulation of GM's reported earnings to enhance the compensation of any of the employees. *id.* § 30.4; *id.* § 30.5.

(2) *Disclosure with Respect to Compensation Consultants.* The Executive Compensation Committee must disclose to Treasury an annual narrative description of whether GM, its Board of Directors, or the committee has engaged a compensation consultant during the past three years. If so, the Executive Compensation Committee must detail the types of services provided by the compensation consultant or any affiliate, including any "benchmarking" or comparisons employed to identify certain percentile levels of compensation. *Id.* § 30.11(c).

(3) *Disclosure of Perquisites.* As noted in Part IV, GM must provide to Treasury an annual disclosure of any perquisite whose total value for GM's fiscal year exceeds $25,000 for each of the Covered Employees. GM must provide a narrative description of the amount and nature of these perquisites, the recipient of these perquisites, and a justification for offering these perquisites (including a justification for offering the perquisite, and not only for offering the perquisite with a value that exceeds $25,000). *Id.* § 30.11(b).

(4) *Clawback.* GM must ensure that any incentive award paid to a Covered Employee is subject to a clawback if the award was based on materially inaccurate financial statements (which includes, but is not limited to, statements of earnings, revenues, or gains) or any other materially inaccurate performance metric criteria. GM must exercise its clawback rights except to the extent that it is unreasonable to do so. *Id.* § 30.8.

(5) *Policy Addressing Excessive or Luxury Expenditures.* GM was required to adopt an excessive or luxury expenditures policy, provide that policy to Treasury, and post it on GM's website. If GM's board of directors makes any material amendments to this policy, within ninety days of the adoption of the amended policy, the board of directors must provide the amended policy to Treasury and post the amended policy on its Internet website. *Id.* § 30.12..

(6) *Prohibition on Tax Gross-Ups.* Except as explicitly permitted under the Rule, GM is prohibited from providing (formally or informally) tax gross-ups to any of the Covered Employees. *Id.* § 30.11(d).

(7) *CEO and CFO Certification.* GM's chief executive officer and chief financial officer must provide written certification of GM's compliance with the various requirements of section 111 of EESA. The precise nature of the required certification is identified in the Rule. *Id.* § 30.15 Appx. A.

VI. CONCLUSION

The Special Master has reviewed the Proposed Structures for the Covered Employees for 2009 in light of the principles set forth at 31 C.F.R. § 30.16(b). On the basis of that review, the Special Master has determined that the Proposed Structures submitted by GM require modification in order to meet the Public Interest Standard.

The Special Master has separately reviewed the compensation structures set forth in ***Exhibits I*** and ***II*** in light of the principles set forth at 31 C.F.R. § 30.16(b). Pursuant to the authority vested in the Special Master by the Rule, and in accordance with Section 30.16(a)(3) thereof, the Special Master hereby determines that the compensation structures set forth in ***Exhibits I*** and ***II***, including the amounts payable or potentially payable under such compensation structures, will not result in payments that are inconsistent with the purposes of section 111 of EESA or the TARP, and will not otherwise be contrary to the public interest.

Pursuant to the Interim Final Rule, GM may, within 30 days of the date hereof, request in writing that the Special Master reconsider the determinations set forth in this Determination Memorandum. The request for reconsideration must specify a factual error or relevant new information not previously considered, and must demonstrate that such error or lack of information resulted in a material error in the initial determinations. If GM does not request reconsideration within 30 days, the determinations set forth herein will be treated as final determinations. 31 C.F.R. § 30.16(c)(1).

The foregoing determinations are limited to the compensation structures described in ***Exhibits I*** and ***II***, and shall not be relied upon with respect to any other employee. The determinations are limited to the authority vested in the Special Master by Section 30.16(a)(3) of the Rule, and shall not constitute, or be construed to constitute, the judgment of the Office of the Special Master or Treasury with respect to the compliance of any compensation structure with any other provision of the Rule. Moreover, this Determination Memorandum has relied upon, and is qualified in its entirety by, the accuracy of the materials submitted by GM to the Office of the Special Master, and the absence of any material misstatement or omission in such materials.

Finally, the foregoing determinations are limited to the compensation structures described herein, and no further compensation of any kind payable to any Covered Employee without the prior approval of the Special Master would be consistent with the Public Interest Standard.

EXHIBIT I

COVERED EMPLOYEES

2009 Compensation

Company Name: General Motors Company

Employee ID	**Cash Salary** (Rate going forward.)	**Stock Salary** (Performance based: The stock vests at grant and is redeemable in three equal, annual installments beginning on the 2nd anniversary of grant.)	**Long-Term Restricted Stock** (Performance based: Awarded based on achievement of objective performance goals. Vests after 3 years of service. Transferability dependent on TARP repayment.)	**Total Direct Compensation** (Cash salary paid to date plus two months at new run rate + stock salary + long-term restricted stock.)
	$950,000	$2,421,667	$1,815,000	$5,445,000
	$400,000	$88,317	$233,408	$700,225
	$450,000	$137,717	$224,908	$674,725
	$353,333	$11,567	$172,533	$517,600
	$750,000	$436,467	$493,858	$1,481,575
	$276,667	$96,041	$183,021	$549,062
	$500,000	$316,222	$426,994	$1,280,883
	$433,333	$312,894	$314,342	$943,025
	$500,000	$576,667	$630,000	$1,881,000
	$443,333	$194,594	$241,475	$724,425
	$326,667	$123,091	$190,296	$570,887
	$313,333	$131,357	$181,928	$545,785
	$233,333	$61,967	$145,733	$437,200
	$500,000	$353,300	$365,158	$1,095,475
	$426,667	$186,817	$277,658	$832,975
	$500,000	$279,778	$353,889	$1,061,667
	$306,667	$79,517	$173,008	$519,025
	$294,500	$38,967	$166,733	$500,200
	$276,667	$187,250	$204,875	$614,625
	$500,000	$409,222	$526,319	$1,578,958

Comparison of 2009 Compensation to Prior Years: 2007 & 2008 Compensation

2008 Cash decreased by $3.9M or 31.0%
Total Direct Compensation decreased by $5.6M or 24.7%

2007 Cash decreased by $7.4M or 46.0%
Total Direct Compensation decreased by $4.4M or 16.9%

Note: 1: Amounts reflected in this Exhibit do not include amounts the Company has asserted to be payable pursuant to legally binding rights under valid employment contracts, see 31 C.F.R. § 30.10(e)(2).
Note: 2: The total number of Covered Employees may be less than 25 because of terminations, departures and retirements after January 1, 2009.

EXHIBIT II
TERMS AND CONDITIONS OF PAYMENTS AND STRUCTURES

CONSISTENT WITH THE PUBLIC INTEREST STANDARD

The following general terms and conditions shall govern the compensation structures described in ***Exhibit I***. The Special Master's determination that these structures are consistent with the Public Interest Standard is qualified in its entirety by the Company's adherence to these terms and conditions.

- ***Cash base salary***. Cash base salaries reflect the go-forward rate for the employee effective as of November 1, 2009. Compensation paid in the form of cash base salary prior to that date in accordance with the terms of employment as of June 14, 2009 shall be permitted unless otherwise noted. 31 C.F.R. § 30.16(a)(3)(iii).

- ***Stock salary***. Rates of stock salary grants reflect full-year values. Because this is a new compensation element, the amounts are payable on a *nunc pro tunc* basis effective January 1, 2009. Stock salary must be determined as a dollar amount through the date salary is earned, be accrued at the same time or times as the salary would otherwise be paid in cash, and vest immediately upon grant, with the number of shares or units based on the fair market value of a share on the date of award. Stock granted as stock salary may only be redeemed in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year early if TARP obligations are repaid.

- ***Long-term restricted stock***. Long-term restricted stock may be granted upon the achievement of specified, objective performance criteria that have been developed and reviewed in consultation with the Office of the Special Master and certified by the Compensation and Benefits Committee of the Company's Board of Directors. Any such stock may vest only if the employee remains employed by the Company on the third anniversary of grant (or, if earlier, upon death or disability). The stock shall be transferable only in 25% increments for each 25% of TARP obligations repaid by the Company.

- ***Other compensation and perquisites***. No more than $25,000 in total other compensation and perquisites may be provided to any Covered Employee, absent exceptional circumstances for good cause shown, as defined by pertinent SEC regulations.

- ***Supplemental executive retirement plans and non-qualified deferred compensation plans***. Following the date of the Determination Memorandum, no additional amounts may be accrued under supplemental executive retirement plans, and no Company contributions may be made to other "non-qualified deferred compensation" plans, as defined by pertinent SEC regulations.

- ***Qualified Plans***. For the avoidance of doubt, the Special Master has determined that participation by the Covered Employees in tax-qualified retirement, health and welfare, and similar plans is consistent with the Public Interest Standard.

7. General Motors Acceptance Corporation
Financial Services

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 22, 2009

Mr. Al de Molina
Chief Executive Officer
General Motors Acceptance
Corporation Financial Services
420 Toringdon Way
Suite 400
Charlotte, NC, 28277

Re: ***Proposed Compensation Payments and Structures for Senior Executive Officers and Most Highly Compensated Employees***

Dear Mr. de Molina:

Pursuant to the Department of the Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance, the Office of the Special Master has completed its review of your 2009 compensation submission on behalf of the senior executive officers and certain most highly compensated employees of General Motors Acceptance Corporation Financial Services ("GMAC"). Attached as ***Annex A*** is a Determination Memorandum (accompanied by ***Exhibits I*** and ***II***) providing the determinations of the Special Master with respect to 2009 compensation for those employees. *Id.* § 30.16(a)(3).

The Interim Final Rule requires the Special Master to determine whether the compensation structure for each senior executive officer and certain most highly compensated employees "will or may result in payments inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." 31 C.F.R. § 30.16(a)(3). The Special Master has determined that, to satisfy this standard, 2009 compensation for GMAC's senior executive officers and certain most highly compensated employees generally must comport with the following standards:

- There can be no guarantee of any "bonus" or "retention" awards among the compensation structures approved by the Special Master.

- Rather than cash, the majority of each individual's base salary will be paid in the form of stock. This stock will immediately vest, in accordance with the Interim Final Rule, but will only be redeemable in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year earlier if GMAC repays its TARP obligations.

- Base salary paid in cash should not exceed $500,000 per year, except in appropriate cases for good cause shown. Overall, cash compensation must be significantly reduced from cash amounts paid in 2008. In GMAC's case, cash compensation for these employees will decrease 50% from 2008 levels

- Total compensation for each individual must both reflect the individual's value to GMAC and be appropriate when compared with total compensation provided to persons in similar positions or roles at similar entities, and should generally target the 50th percentile of total compensation for such similarly situated employees. Overall, total direct compensation must be significantly reduced from 2008 amounts. In GMAC's case, total direct compensation for these employees will decrease 86% from 2008 levels.

- If—and only if—the employee achieves objective performance metrics developed and reviewed in consultation with the Office of the Special Master, employees may be eligible for long-term incentive awards. These awards, however, must be payable in the form of restricted stock that will be forfeited unless the employee stays with GMAC for at least three years following grant, and may only be redeemed in 25% installments for each 25% installment of GMAC's TARP obligations that are repaid. Such long-term incentive awards may not exceed one third of total annual compensation.

- Any and all incentive compensation paid to employees will be subject to recovery or "clawback" if the payments are based on materially inaccurate financial statements or any other materially inaccurate performance metrics, or if the employee is terminated due to misconduct that occurred during the period in which the incentive was earned.

- Any and all "other" compensation and perquisites will not exceed $25,000 for each employee (absent exceptional circumstances for good cause shown to the satisfaction of the Special Master).

- No severance benefit to which an employee becomes entitled in the future may take into account a cash salary increase, or any payment of stock salary, that the Special Master has approved for 2009.

- No additional amounts in 2009 may be accrued under supplemental executive retirement plans or credited by the company to other "non-qualified deferred compensation" plans after the date of the Determination Memorandum.

The Special Master has also determined that, in order for the approved compensation structures to satisfy the standards of *Id.* § 30.16(a)(3), GMAC must adopt policies applicable to these employees as follows:

- The achievement of any performance objectives must be certified in the company's securities filings by the Compensation, Nomination and Governance Committee of GMAC's Board of Directors, which is composed solely of independent directors. These performance objectives must be reviewed and approved by the Office of the Special Master.

- The employees will be prohibited from engaging in any hedging, derivative or other transactions that have an equivalent economic effect involving company stock that would undermine the long-term performance incentives created by the compensation structures.

- GMAC may not provide a tax "gross up" of any kind to these employees.

- At least once every year, GMAC's compensation committee must provide to the Department of the Treasury a narrative description identifying each compensation plan for its senior executive officers, and explaining how the plan does not encourage the senior executive officers to take unnecessary and excessive risks that threaten GMAC's value. These requirements are described in further detail in the attached Determination Memorandum.

The Special Master's review has been guided by a number of considerations, including each of the principles articulated in the Interim Final Rule. *Id.* § 30.16(b)(1). The following principles were of particular importance to the Special Master in his determinations with respect to GMAC's compensation structures:

- *Performance-based compensation.* The overwhelming majority of approved compensation depends on GMAC's performance, and ties the financial incentives of GMAC employees to the overall performance of the Company. A majority of the salary paid to employees under these structures will be paid in the form of stock units; and, because the stock salary will become transferable only in three equal, annual installments beginning on the second anniversary of the date stock salary is earned (with each installment redeemable one year earlier if GMAC repays its TARP obligations), the ultimate value realized by the executive will depend on GMAC's performance over the long term. Guaranteed amounts payable in cash, in contrast, are generally rejected. *Id.* § 30.16(b)(1)(iv).

- *Taxpayer return.* The compensation structures approved by the Special Master reflect the need for GMAC to remain a competitive enterprise and, ultimately, to be able to repay TARP obligations. The Special Master has determined that the approved compensation structures are competitive when compared to those provided to persons in similar positions or roles at similar entities. Overall, the compensation structures generally provide for total compensation packages that target the 50th percentile when compared to such other executive officers and employees. *Id.* § 30.16(b)(1)(ii).

- *Appropriate Allocation.* The total compensation payable to GMAC employees is weighted heavily towards long-term structures that are tied to GMAC's performance and are easily understood by shareholders. As a general principle, guaranteed income is rejected. Fixed compensation payable to GMAC employees should consist only of cash salaries at sufficient levels to attract and retain employees and provide them a reasonable level of liquidity.

Pursuant to the Interim Final Rule, the Company may, within 30 days of the date hereof, request in writing that the Special Master reconsider the determinations set forth in the Determination Memorandum. If the Company does not request reconsideration within 30 days, these initial determinations will be treated as final determinations. *Id.* § 30.16(c)(1).

Very truly yours,

Kenneth R. Feinberg
Kenneth R. Feinberg
Office of the Special Master
for TARP Executive Compensation

Attachments

cc: Mr. Kim Fennebresque
William B Solomon, Jr., Esquire
Drema M. Kalajian, Esquire

ANNEX A
DETERMINATION MEMORANDUM

I. INTRODUCTION

The Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009 ("EESA"), requires the Secretary of the Treasury to establish standards related to executive compensation and corporate governance for financial institutions receiving financial assistance under the Troubled Asset Relief Program ("TARP"). Through the Department of the Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance (the "Rule"), the Secretary delegated to the Office of the Special Master for TARP Executive Compensation (the "Office of the Special Master" or, the "Office") responsibility for reviewing compensation structures of certain employees at financial institutions that received exceptional financial assistance under the TARP ("Exceptional Assistance Recipients"). 31 C.F.R. § 30.16(a); *id.* § 30.16(a)(3). For these employees, the Special Master must determine whether the compensation structure will or may result in payments "inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." *Id.*

General Motors Acceptance Corporation Financial Services ("GMAC" or the "Company"), one of seven Exceptional Assistance Recipients, has submitted to the Special Master proposed compensation structures for review pursuant to Section 30.16(a)(3) of the Rule. These compensation structures apply to five employees that the Company has identified as senior executive officers (the "Senior Executive Officers," or "SEOs") for purposes of the Rule, and 17 employees the Company has identified as among the most highly compensated employees of the Company for purposes of the Rule (the "Most Highly Compensated Employees," and, together with the SEOs, the "Covered Employees").

The Special Master has completed the review of the Company's proposed compensation structures for the Covered Employees pursuant to the principles set forth in the Rule. *Id.* § 30.16(b)(1). This Determination Memorandum sets forth the determinations of the Special Master, pursuant to Section 30.16(a)(3) of the Rule, with respect to the Covered Employees.

II. BACKGROUND

On June 15, 2009, the Department of the Treasury ("Treasury") promulgated the Rule, creating the Office of the Special Master and delineating its responsibilities. Immediately following that date, the Special Master, and Treasury employees working in the Office of the Special Master, conducted extensive discussions with GMAC officials. During these discussions, the Office of the Special Master informed GMAC about the nature of the Office's work and the authority of the Special Master under the Rule. These discussions continued for a period of months, during which the Special Master and GMAC explored potential compensation structures for the Covered Employees.

The Rule required that each Exceptional Assistance Recipient submit proposed compensation structures for each senior executive officer and Most Highly Compensated Employee no later than August 14, 2009. 31 C.F.R. § 30.16(a)(3). On July 20, 2009, the Special Master requested from each Exceptional Assistance Recipient, including GMAC, certain data and documentary information necessary to facilitate the Special Master's review of the Company's compensation structures. The request required GMAC to submit data describing its proposed compensation structures, and the payments that would result from the proposed structures, concerning each Covered Employee.

In addition, the Rule authorizes the Special Master to request information from an Exceptional Assistance Recipient "under such procedures as the Special Master may determine." *Id.* § 30.16(d). GMAC was required to submit competitive market data indicating how the amounts payable under GMAC's proposed compensation structures relate to the amounts paid to persons in similar positions or roles at similar entities. GMAC was also required to submit a range of documentation, including information related to proposed performance metrics, internal policies designed to curb excessive risk, and certain previously existing compensation plans and agreements.

GMAC submitted this information to the Office of the Special Master on August 14, 2009. Following a preliminary review of the submission, and the submission of certain additional information, on August 31, 2009, the Special Master determined that GMAC's submission was substantially complete for purposes of the Rule. *Id.* The Office of the Special Master then commenced a formal review of GMAC's proposed compensation structures for the Covered Employees. The Rule provides that the Special Master is required to issue a compensation determination within 60 days of a substantially complete submission. *Id.* § 30.16(a)(3).

The Office of the Special Master's review of the Company's proposals was aided by analysis from a number of internal and external sources, including:

- Treasury personnel detailed to the Office of the Special Master, including executive compensation specialists with significant experience in reviewing, analyzing, designing and administering executive compensation plans, and attorneys with experience in matters related to executive compensation;

- Competitive market data provided by the Company in connection with its submission to the Office of the Special Master;

- External information on comparable compensation structures extracted from the U.S. Mercer Benchmark Database-Executive;

- External information on comparable compensation structures extracted from Equilar's ExecutiveInsight database (which includes information drawn from publicly filed proxy statements) and Equilar's Top 25 Survey Summary Report (which includes information from a survey on the pay of highly compensated employees);

- Consultation with Lucian A. Bebchuk, a world-renowned expert in executive compensation and the William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance and Director of the Program on Corporate Governance at Harvard Law School; and

- Consultation with of Kevin J. Murphy, a world-renowned expert in executive compensation and the Kenneth L. Trefftzs Chair in Finance in the department of finance and business economics at the University of Southern California's Marshall School of Business.

The Special Master considered these views, in light of the statutory and regulatory standards described in Part II below, when evaluating the Company's proposed compensation structures for the Covered Employees for 2009.

III. STATUTORY AND REGULATORY STANDARDS

The Rule requires that the Special Master determine for each of the Covered Employees whether GMAC's proposed compensation structure, including amounts payable or potentially payable under the compensation structure, "will or may result in payments that are inconsistent with the purposes of section 111 of EESA or TARP, or [is] otherwise contrary to the public interest." 31 C.F.R. § 30.16(a)(3) (as applied to Covered Employees of Exceptional Assistance Recipients, the "Public Interest Standard"). Regulations promulgated pursuant to the Rule require that the Special Master consider six principles when making these compensation determinations:

(1) *Risk.* The compensation structure should avoid incentives which encourage executive officers and employees to take unnecessary or excessive risks that could threaten the value of the exceptional assistance recipient, including incentives that reward employees for short-term or temporary increases in value or performance; or similar measures that may undercut the long-term value of the exceptional assistance recipient. Compensation packages should be aligned with sound risk management. *Id.* § 30.16(b)(1)(i).

(2) *Taxpayer return.* The compensation structure and amount payable should reflect the need for the exceptional assistance recipient to remain a competitive enterprise, to retain and recruit talented employees who will contribute to the recipient's future success, so that the Company will ultimately be able to repay its TARP obligations. *Id.* § 30.16(b)(1)(ii).

(3) *Appropriate allocation.* The compensation structure should appropriately allocate the components of compensation such as salary and short-term and long-term performance incentives, as well as the extent to which compensation is provided in cash, equity, or other types of compensation such as executive pensions, or other benefits, or perquisites, based on the specific role of the employee and other relevant circumstances, including the nature and amount of current compensation,

deferred compensation, or other compensation and benefits previously paid or awarded. *Id.* § 30.16(b)(1)(iii).

(4) *Performance-based compensation.* An appropriate portion of the compensation should be performance-based over a relevant performance period. Performance-based compensation should be determined through tailored metrics that encompass individual performance and/or the performance of the Exceptional Assistance Recipient or a relevant business unit taking into consideration specific business objectives. Performance metrics may relate to employee compliance with relevant corporate policies. In addition, the likelihood of meeting the performance metrics should not be so great that the arrangement fails to provide an adequate incentive for the employee to perform, and performance metrics should be measurable, enforceable, and actually enforced if not met. *Id.* § 30.16(b)(1)(iv).

(5) *Comparable structures and payments.* The compensation structure, and amount payable where applicable, should be consistent with, and not excessive, taking into account compensation structures and amounts for persons in similar positions or roles at similar entities that are similarly situated, including, as applicable, entities competing in the same markets and similarly situated entities that are financially distressed or that are contemplating or undergoing reorganization. *Id.* § 30.16(b)(1)(v).

(6) *Employee contribution to TARP recipient value.* The compensation structure and amount payable should reflect the current or prospective contributions of an employee to the value of the Exceptional Assistance Recipient, taking into account multiple factors such as revenue production, specific expertise, compliance with company policy and regulation (including risk management), and corporate leadership, as well as the role the employee may have had with respect to any change in the financial health or competitive position of the recipient. *Id.* § 30.16(b)(1)(vi).

The Rule provides that the Special Master shall have discretion to determine the appropriate weight or relevance of a particular principle depending on the facts and circumstances surrounding the compensation structure or payment for a particular employee. *Id.* § 30.16(b). To the extent two or more principles may appear inconsistent in a particular situation, the Rule requires that the Special Master exercise his discretion in determining the relative weight to be accorded to each principle. *Id.*

The Rule provides that the Special Master may, in the course of applying these principles, take into account other compensation structures and other compensation earned, accrued, or paid, including compensation and compensation structures that are not subject to the restrictions of section 111 of EESA. For example, the Special Master may consider payments obligated to be made by the Company pursuant to certain legally binding rights under valid written employment contracts entered into prior to enactment of the statute and the accompanying Rule. *Id.* § 30.16(a)(3).

IV. COMPENSATION STRUCTURES AND PAYMENTS

A. GMAC Proposals

GMAC has provided the Office of the Special Master with detailed information concerning its proposed 2009 compensation structures for the Covered Employees, including amounts potentially payable under the compensation structure for each Covered Employee (the "Proposed Structures").

GMAC supported its proposal with detailed assessments of each Covered Employee's tenure and responsibilities at the Company (or its applicable subsidiary) and historical compensation structure. The submission also included market data that, according to the Company, indicated that the amounts potentially payable to each employee were comparable to the compensation payable to persons in similar positions or roles at a "peer group" of entities selected by the Company.

1. Cash Salary

GMAC proposed increasing the cash salary of each Covered Employee to annualized amounts ranging from \$380,000 to \$1,000,000. The Company's proposal asserted that cash salaries at such levels could be justified by reference to the compensation of persons in similar positions or roles at similar entities.

2. Stock Salary

GMAC proposed that Covered Employees receive substantial stock salary, in annualized amounts ranging from \$400,000 to \$5,330,000. On each regular payroll date, Covered Employees would earn fully vested stock units, which would then settle in two tranches of 50% each on March 15, 2011, and March 15, 2012, respectively.

3. Annual Long-Term Incentive Awards

GMAC proposed that the Covered Employees be eligible in 2009 for substantial grants of annual long-term incentive awards, with total potential values ranging from \$400,000 to \$3,170,000. Under the proposal, the amount of an employee's award would be calculated based on achievement of individual performance goals, as assessed by the GMAC's compensation committee in consultation with the Company's chief executive officer. Awards would be paid in the form of long-term restricted stock with 50% vesting after two years of service and 50% vesting after three years of service. Actual payment would be made in 25% installments for each 25% repayment of GMAC's TARP obligations.

4. "Other" Compensation and Perquisites

GMAC proposed payments of "other" compensation, as well as perquisites, to the Covered Employees. These proposed payments varied in value.

5. Non-Qualified Deferred Compensation

GMAC proposed that certain Covered Employees receive substantial compensation in the form of accruals under a "non-qualified deferred compensation" plan.

6. Severance Arrangements

GMAC's submission to the Office of the Special Master indicated that, in some cases, the proposed compensation structures would result in increases in amounts payable to these employees pursuant to existing severance arrangements. These arrangements generally provide for cash amounts payable upon termination of employment, including termination in light of the employee's performance.

B. Determinations of the Special Master

The Special Master has reviewed the Proposed Structures in detail by application of the principles set forth in the Rule and described in Part II above. In light of this review and analysis, the Special Master has determined that both the structural design of GMAC's proposals and the amounts potentially payable to Covered Employees under the proposals would be inconsistent with the Public Interest Standard and, therefore, require modification.

The Special Master has determined, in light of the considerations that follow, that the compensation structures described in ***Exhibits I*** and ***II*** to this Determination Memorandum will not, by virtue of either their structural design or the amounts potentially payable under them, result in payments inconsistent with the Public Interest Standard.

1. Cash Salary

The Special Master reviewed the cash salary proposals in light of the principle that compensation structures should generally be comparable to "compensation structures and amounts for persons in similar positions or roles at similar entities." 31 C.F.R. § 30.16(b)(1)(v). The Special Master has concluded that, for Covered Employees at Exceptional Assistance Recipients, cash salaries generally should target the 50th percentile as compared to persons in similar positions or roles at similar entities because such levels of cash salaries balance the need to attract and retain talented employees with the need for compensation structures that reflect the circumstances of Exceptional Assistance Recipients

In conducting this review, the Special Master made use of the resources described in Part II. Based on this review, the Special Master has concluded that GMAC's proposed cash salaries would be inconsistent with the Public Interest Standard because the amounts potentially payable to certain Covered Employees cannot be supported by comparison to cash salaries provided to persons in similar positions or roles at similar entities.

In addition, because they do not create incentives for employees to pursue long-term value creation or financial stability, the amount of cash salary provided to a Covered Employee must be considered in comparison to the portion of compensation that is "performance-based over a relevant performance period." *Id.* § 30.16(b)(1)(iv). The Special Master has concluded that the cash portion of the Covered Employee's compensation should in most cases not exceed $500,000. See *Id.* § 30.16(b)(1)(iii).

As described in further detail in ***Exhibits I*** and ***II***, the cash salaries that the Special Master has determined to be consistent with the Public Interest Standard compare appropriately to those paid to persons in similar positions or roles at similar entities, and are generally less than $500,000.

2. <u>Stock Salary</u>

The Special Master reviewed the amounts of stock salary proposed by GMAC and found that they were not comparable to payments provided to persons in similar positions or roles at similar entities. The Special Master has concluded that the amounts of stock salary GMAC proposed paying to certain Covered Employees is excessive and that such payments would be inconsistent with the Public Interest Standard. The compensation structures that the Special Master has determined are consistent with the Public Interest Standard provide lesser amounts of stock salary, as described in further detail in ***Exhibits I*** and ***II***.

The Special Master also reviewed the structure of GMAC's stock salary proposal. The Rule requires that the Special Master consider whether an appropriate portion of an employee's compensation is allocated to long-term incentives *Id.* § 30.16(b)(1)(iii). Stock salary that can be liquidated too soon could incentivize employees to pursue short-term results instead of long-term value creation by paying excessive benefits to employees for short-term increases in share price. See *Id.* § 30.16(b)(1)(i). Under the Company's proposal, 50% of stock salary would be redeemable slightly more than one year after being granted, and 100% of stock salary would be redeemable slightly more than two years. The Special Master has concluded that one year is an insufficient holding period to provide an appropriate long-term incentive.

As described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard require that, at a minimum, stock salary only become redeemable in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year earlier if GMAC repays its TARP obligations.

In addition, GMAC proposed that certain restricted stock unit awards granted to Covered Employees in 2009 would be canceled in consideration of compensation provided to such employees under the Proposed Structures. The Special Master has concluded that the cancellation of such employees' restricted stock unit awards in consideration of eligibility to receive stock salary is consistent with the Public Interest

Standard, and that the determination that payment of stock salary to such employees is consistent with the Public Interest Standard is conditioned upon such cancellation.

3. Annual Long-Term Incentive Awards

The Special Master reviewed GMAC's proposed annual long-term incentive awards in light of the principle that performance-based compensation should be based on "performance metrics [that are] measurable, enforceable, and actually enforced if not met." *Id.* § 30.16(b)(1)(iv). The Special Master also evaluated GMAC's proposed awards by application of recently adopted international standards that provide that incentive compensation should generally be payable over a period of three years as well as the Rule's principle that performance-based compensation should be payable "over a relevant performance period," *id.*

Although GMAC proposed individually tailored performance metrics to calculate the size of long-term restricted stock awards, once awarded the restricted stock would partially vest after only two years of service. In addition, the restricted stock would vest immediately upon a Covered Employee's involuntary employment termination without "cause" either between the second and third anniversary of the grant date, or in the year following a change in control of GMAC. Accordingly, the Special Master has concluded that GMAC's proposed annual long-term incentive awards would be inconsistent with the Public Interest Standard because they may vest over a period too short to be relevant to the long-term performance of the Company.

As described in ***Exhibits I*** and ***II***, the structures the Special Master has determined to be consistent with the Public Interest Standard include an annual long-term incentive award payable only upon the achievement of specified, objective performance criteria that have been developed and reviewed in consultation with the Office of the Special Master, and that will not vest unless the employee remains employed until the third anniversary of grant. In addition, as required by the Rule, these awards may only be redeemed in 25% installments for each 25% of GMAC's TARP obligations that are repaid.

4. "Other" Compensation and Perquisites

GMAC proposed payments of "other" compensation, as well as perquisites, to the Covered Employees. The Special Master has concluded that, absent special justification, employees—not the Company—generally should be responsible for paying personal expenses, and that significant portions of compensation structures should not be allocated to such perquisites and "other" compensation. *See id.* §30.16(b)(1)(iii).

The Rule requires that each Exceptional Assistance Recipient annually disclose to Treasury any perquisites where the total value for any Senior Executive Officer or Most Highly Compensated Employee exceeds $25,000. An express justification for offering these benefits must also be disclosed. Accordingly, as described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard provide no more than $25,000 in "other" compensation and perquisites to each of these employees. Any exceptions to this limitation will require that the Company provide to the Office of the Special Master an independent justification for the payment that is satisfactory to the Special Master. To the extent that payments exceeding this limitation have already been made to a Covered Employee in 2009, those amounts should be promptly returned to the Company.

5. Non-Qualified Deferred Compensation

GMAC also proposed that certain Covered Employees receive compensation in the form of accruals under a "non-qualified deferred compensation" plan. In such plans, employers periodically credit employees with an entitlement to post-retirement payments. Over time, these credits accumulate and employees may become entitled to substantial cash guarantees payable on retirement—in addition to any payments provided under retirement plans maintained for employees generally.

The Special Master has concluded that the primary portion of a Covered Employee's compensation package should be allocated to compensation structures that are "performance-based over a relevant performance period." *Id.* § 30.16(b)(1)(iv). Payments under the Company's "non-qualified deferred compensation" plans do not depend upon "individual performance and/or the performance of the [Company] or a relevant business unit," *id.*; instead, such accruals are simply guaranteed cash payments from the Company in the future. In addition, these payments can make it more difficult for shareholders to readily ascertain the full amount of pay due a top executive upon leaving the firm.

Covered Employees should fund their retirements using wealth accumulated based on Company performance while they are employed, rather than being guaranteed substantial retirement benefits by the Company regardless of Company performance during and after their tenures. Accordingly, as described in ***Exhibits I*** and ***II***, the compensation structures the Special Master has determined to be consistent with the Public Interest Standard prohibit further 2009 accruals for Covered Employees under supplemental retirement plans or Company credits to other "non-qualified deferred compensation" plans following the date of this Determination Memorandum..

6. Severance Arrangements

GMAC's submission to the Office of the Special Master indicated that, in some cases, the proposed compensation structures would result in increases in amounts payable to these employees pursuant to existing severance arrangements. These arrangements generally provide for cash amounts payable upon termination of employment, including termination in light of the employee's performance.

The Special Master has concluded that an increase in the amounts payable under these arrangements would be inconsistent with the principle that compensation should be performance-based, *id.* § 30.16(b)(1)(iv), and that payments should be appropriately allocated among the elements of compensation, *id.* § 30.16(b)(1)(iii). Accordingly, for the compensation structures described in ***Exhibits I*** and ***II*** to be consistent with the

Public Interest Standard, the Company must ensure that 2009 compensation structures for these employees do not result in an increase in the amounts payable pursuant to these arrangements.

7. Departed Employees

In addition, three employees that would have been Covered Employees had they remained employed are no longer employed by the Company. With respect to these employees, the Special Master has determined that cash salaries through the date of the termination of employment, and payment of up to $25,000 in perquisites and "other" compensation are consistent with the Public Interest Standard. No other payments to these employees of any kind would be consistent with the Public Interest Standard. Any exceptions to this limitation will require that the Company provide to the Office of the Special Master an independent justification for the payment that is satisfactory to the Special Master.

V. CORPORATE GOVERNANCE

As noted in Part III above, the Rule requires the Special Master to consider the extent to which compensation structures are "performance-based over a relevant performance period," 31 C.F.R. § 30.16(b)(1)(iv). In light of the importance of this principle, GMAC must take certain additional corporate governance steps, including those required by the Rule, to ensure that the compensation structures for the Covered Employees, and the amounts payable or potentially payable under those structures, are consistent with the Public Interest Standard.

A. Requirements Relating to Compensation Structures

In order to ensure that objective compensation performance criteria are "measurable, enforceable, and actually enforced if not met," *id.* § 30.16(b)(1)(iv), long-term incentive awards may not be granted unless the Company's compensation committee determines to grant such an award in light of the employee's performance as measured against objective performance criteria that the Committee has developed and reviewed in consultation with the Office of the Special Master. This evaluation must be disclosed in, and certified by the committee as part of, the Company's securities filings. In addition, the committee must retain discretion with respect to each executive to reduce (but not to increase) the amount of any incentive award on the basis of its overall evaluation of the executive's or the Company's performance (notwithstanding full or partial satisfaction of the performance criteria).

In addition, as noted in Part III, above and described in ***Exhibits I*** and ***II***, the structures determined by the Special Master to be consistent with the Public Interest Standard include grants of stock in GMAC. It is critical that these compensation structures achieve the Rule's objective of "appropriate[ly] allocat[ing] the components of compensation [including] long-term incentives, as well as the extent to which compensation is provided in...equity," *id.* § 30.16(b)(iii).

The Company must have in effect a policy that would prohibit an employee from engaging in hedging, derivative or other transactions that have an economically similar effect that would undermine the incentives created by the compensation structures set forth in ***Exhibits I*** and ***II***. Such transactions would be contrary to the principles set forth in the Rule.

B. <u>Additional Requirements</u>

In addition to the requirements set forth above, pursuant to the requirements of the Rule, GMAC is required to institute the following corporate governance reforms:

(1) *Compensation Committee; Risk Review*. GMAC must maintain a compensation committee comprised exclusively of independent directors. Every six months, the committee must discuss, evaluate, and review with GMAC's senior risk officers any risks that could threaten the value of GMAC. In particular, the committee must meet every six months to discuss, evaluate, and review the terms of each employee compensation plan to identify and limit the features in (1) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that threaten the value of GMAC; (2) the SEO or other employee compensation plans that could encourage behavior focused on short-term results and not on long-term value creation; and (3) the employees' compensation plans that could encourage the manipulation of GMAC's reported earnings to enhance the compensation of any of the employees. *id.* § 30.4; *id.* § 30.5.

(2) *Disclosure with Respect to Compensation Consultants*. The compensation committee must disclose to Treasury an annual narrative description of whether GMAC, its Board of Directors, or the committee has engaged a compensation consultant during the past three years. If so, the compensation committee must detail the types of services provided by the compensation consultant or any affiliate, including any "benchmarking" or comparisons employed to identify certain percentile levels of compensation. *Id.* § 30.11(c).

(3) *Disclosure of Perquisites*. As noted in Part III, GMAC must provide to Treasury an annual disclosure of any perquisite whose total value for GMAC's fiscal year exceeds $25,000 for each of the Covered Employees. GMAC must provide a narrative description of the amount and nature of these perquisites, the recipient of these perquisites, and a justification for offering these perquisites (including a justification for offering the perquisite, and not only for offering the perquisite with a value that exceeds $25,000). *Id.* § 30.11(b).

(4) *Clawback*. GMAC must ensure that any incentive award paid to a Covered Employee is subject to a clawback if the award was based on materially inaccurate financial statements (which includes, but is not limited to, statements of earnings, revenues, or gains) or any other materially inaccurate performance metric criteria. GMAC must exercise its clawback rights except to the extent that it is unreasonable to do so. *Id.* § 30.8.

(5) *Policy Addressing Excessive or Luxury Expenditures.* GMAC was required to adopt an excessive or luxury expenditures policy, provide that policy to Treasury, and post it on the Company's website. If GMAC's board of directors makes any material amendments to this policy, within ninety days of the adoption of the amended policy, the board of directors must provide the amended policy to Treasury and post the amended policy on GMAC's Internet website. *Id.* § 30.12.

(6) *Prohibition on Tax Gross-Ups.* Except as explicitly permitted under the Rule, GMAC is prohibited from providing (formally or informally) tax gross-ups to any of the Covered Employees. *Id.* § 30.11(d).

(7) *CEO and CFO Certification.* GMAC's chief executive officer and chief financial officer must provide to the Securities and Exchange Commission written certification of GMAC's compliance with the various requirements of section 111 of EESA. The precise nature of the required certification is identified in the Rule. *Id.* § 30.15 Appx. A.

VI. CONCLUSION

The Special Master has reviewed the Proposed Structures for the Covered Employees for 2009 in light of the principles set forth at 31 C.F.R. § 30.16(b). On the basis of that review, the Special Master has determined that the Proposed Structures submitted by GMAC require modification in order to meet the Public Interest Standard.

The Special Master has separately reviewed the compensation structures set forth in ***Exhibits I*** and ***II*** in light of the principles set forth at 31 C.F.R. § 30.16(b). Pursuant to the authority vested in the Special Master by the Rule, and in accordance with Section 30.16(a)(3) thereof, the Special Master hereby determines that the compensation structures set forth in ***Exhibits I*** and ***II***, including the amounts payable or potentially payable under such compensation structures, will not result in payments that are inconsistent with the purposes of section 111 of EESA or the TARP, and will not otherwise be contrary to the public interest.

Pursuant to the Interim Final Rule, GMAC may, within 30 days of the date hereof, request in writing that the Special Master reconsider the determinations set forth in this Determination Memorandum. The request for reconsideration must specify a factual error or relevant new information not previously considered, and must demonstrate that such error or lack of information resulted in a material error in the initial determinations. If GMAC does not request reconsideration within 30 days, the determinations set forth herein will be treated as final determinations. 31 C.F.R. § 30.16(c)(1).

The foregoing determinations are limited to the compensation structures described in ***Exhibits I*** and ***II***, and shall not be relied upon with respect to any other employee. The determinations are limited to the authority vested in the Special Master by Section 30.16(a)(3) of the Rule, and shall not constitute, or be construed to constitute, the judgment of the Office of the Special Master or Treasury with respect to the compliance of any compensation structure with any other provision of the Rule. Moreover, this Determination Memorandum has relied upon, and is qualified in its entirety by, the accuracy of the materials submitted by GMAC to the Office of the Special Master, and the absence of any material misstatement or omission in such materials.

Finally, the foregoing determinations are limited to the compensation structures described herein, and no further compensation of any kind payable to any Covered Employee without the prior approval of the Special Master would be consistent with the Public Interest Standard.

EXHIBIT I

COVERED EMPLOYEES

2009 Compensation

Company Name: GMAC Financial Services

Employee ID	**Cash Salary** (Rate going forward.)	**Stock Salary** (Performance based: The stock vests at grant and is redeemable in three equal annual installments beginning on the 2nd anniversary of grant.)	**Long-Term Restricted Stock** (Performance based: Awarded based on achievement of objective performance goals. Vests after 3 years of service. Transferability dependent on TARP repayment.)	**Total Direct Compensation** (Cash salary paid to date plus two months at new run rate + stock salary + long-term restricted stock.)
582903	$850,000	$4,491,667	$2,816,667	$8,450,000
129881	$400,000	$588,333	$415,000	$1,320,000
151695	$500,000	$1,858,333	$1,088,000	$3,363,000
172265	$500,000	$2,730,000	$1,615,000	$4,845,000
197253	$500,000	$1,941,667	$1,050,000	$3,325,000
250095	$500,000	$4,437,500	$2,500,000	$7,500,000
265383	$375,000	$445,833	$400,000	$1,200,000
353403	$365,000	$646,111	$500,000	$1,500,000
391076	$450,000	$1,133,333	$725,000	$2,225,000
398005	$450,000	$625,833	$500,000	$1,530,000
501828	$450,000	$1,850,000	$1,150,000	$3,450,000
509014	$400,000	$852,278	$618,000	$1,855,000
513416	$450,000	$880,000	$665,000	$1,995,000
546145	$500,000	$1,641,667	$1,216,667	$3,650,000
555076	$480,000	$1,029,167	$750,000	$2,255,000
682168	$600,000	$3,083,333	$1,716,667	$5,150,000
699403	$380,000	$483,783	$420,000	$1,270,000
725547	$450,000	$1,220,833	$825,000	$2,475,000
805106	$500,000	$2,208,333	$1,300,000	$3,925,000
921597	$400,000	$1,149,872	$665,000	$2,070,000
936790	$400,000	$1,141,667	$725,000	$2,225,000
964006	$450,000	$2,391,667	$1,400,000	$4,200,000

Comparison of 2009 Compensation to Prior Years: 2007 & 2008 Compensation

2008 Cash decreased by $10.4M or 50.2%
Total Direct Compensation decreased by $413.3M or 85.6%

2007 Cash decreased by $5.0M or 42.5%
Total Direct Compensation decreased by $185.9M or 78.2%

Note: 1: Amounts reflected in this Exhibit do not include amounts the Company has asserted to be payable pursuant to legally binding rights under valid employment contracts, see 31 C.F.R. § 30.10(e)(2).
Note: 2: The total number of Covered Employees may be less than 25 because of terminations, departures and retirements after January 1, 2009.

EXHIBIT II
TERMS AND CONDITIONS OF PAYMENTS AND STRUCTURES CONSISTENT WITH THE PUBLIC INTEREST STANDARD

The following general terms and conditions shall govern the compensation structures described in ***Exhibit I***. The Special Master's determination that those structures are consistent with the Public Interest Standard is qualified in its entirety by the Company's adherence to these terms and conditions.

- ***Cash base salary***. Cash base salaries reflect the go-forward rate for the employee effective as of November 1, 2009. Compensation paid in the form of cash base salary prior to that date in accordance with the terms of employment as of June 14, 2009 shall be permitted unless otherwise noted. 31 C.F.R. § 30.16(a)(3)(iii).

- ***Stock salary***. Rates of stock salary grants reflect full-year values. Because this is a new compensation element, the amounts are payable on a *nunc pro tunc* basis effective January 1, 2009. Stock salary must be determined as a dollar amount through the date salary is earned, be accrued at the same time or times as the salary would otherwise be paid in cash, and vest immediately upon grant, with the number of shares or units based on the fair market value or a share on the date of award. Stock or stock units granted as stock salary may only be redeemed in three equal, annual installments beginning on the second anniversary of grant, with each installment redeemable one year early if TARP obligations are repaid.

- ***Long-term restricted stock***. Long-term restricted stock may be granted upon the achievement of specified, objective performance criteria that have been developed and reviewed in consultation with the Office of the Special Master and certified by the Company's compensation committee. Any such stock may vest only if the employee remains employed by the Company on the third anniversary of grant (or, if earlier, upon death or disability). The stock shall be transferable only in 25% increments for each 25% of TARP obligations repaid by the Company.

- ***Other compensation and perquisites***. No more than $25,000 in total other compensation and perquisites may be provided to any Covered Employee, absent exceptional circumstances for good cause shown, as defined by pertinent SEC regulations.

- ***Supplemental executive retirement plans and non-qualified deferred compensation plans***. Following the date of the Determination Memorandum, no additional amounts may be accrued under supplemental executive retirement plans, and no Company contributions may be made to other "non-qualified deferred compensation" plans, as defined by pertinent SEC regulations.

- ***Qualified Plans***. For the avoidance of doubt, the Special Master has determined that participation by the Covered Employees in tax-qualified retirement, health and welfare, and similar plans is consistent with the Public Interest Standard.

Chairman TOWNS. Thank you. Thank you very much for your testimony and thank you for the job that you have done.

Let me begin by asking you do they really get it, the fact that the American people are angry about this excessive pay?

Mr. FEINBERG. Well, you will have to ask the seven companies. I found that the submissions did not adequately address the major concerns expressed by the American people.

Chairman TOWNS. How did you deal with the contract situation, where a person has a contract which has been signed and, of course, now, all of a sudden, you are asking that he gives back? What was the reaction to that or how did you handle it?

Mr. FEINBERG. The law that was enacted gives me three options when it comes to old contracts for compensation that were entered into long before this law was passed and my office was created. First, I examined the contract to determine whether or not, in my independent judgment, I found the contract to be valid or not. I want the committee to understand that the sanctity of contract under the Constitution is very, very important and I was loathe to find contracts invalid when they were entered into years ago between officials and the company. So there was not a case where I terminated or invalidated a contract.

But that is just the beginning of the inquiry, Mr. Chairman. The law then said if I found a contract valid, I could, under the law, attempt, with the company and the official, to renegotiate that contrary voluntarily. That worked very well. With one or two or three exceptions, in every single case the company worked with me and my staff in renegotiating those old contracts so that they would be turned into stock in the company moving forward and would be subject to the same rules and restrictions as 2009 salarized stock.

Then the law said if a company refused to negotiate a valid contract—and that was very, very rare—the law permitted me—I have to honor that contract, but the law permitted me to take that contract amount into consideration in setting 2009 salary, and that's what I did in those cases. You want that contract enforced? It is a valid contract? The Constitution protects it? OK. But I am going to look at the amount of that contract and I am going to factor into my prospective 2009, 2010 salaries the fact that we had to honor that contract because it wasn't renegotiated. And I think we have done that fairly successfully.

Chairman TOWNS. Thank you very much. This is on AIG. Can you do anything to stop AIG from paying nearly $180 million in bonuses next year to employees in the very AIG division most responsible for the failure of AIG, that is, the Financial Products Division?

Mr. FEINBERG. You pose a question which the special master will have to address very quickly in 2010, when those allegedly guaranteed contracts come up, and we are going to have to see, with AIG—and let me just say AIG has been quite cooperative in this process. We have met with them numerous times. We will have to sit down with AIG in 2010, in a couple months, January, and I am admonished by your question, Mr. Chairman, that this committee is looking at these contracts, and we will see what we can work out with AIG going forward in an effort to satisfy the statute, satisfy the regulations, satisfy the American people; and I view that as a top priority.

Chairman TOWNS. Because you have to recognize people feel that if you failed, you should not be rewarded for your failure. That is a big issue and that is why the American people are so angry because, in many instances, the Government is now bailing out people who failed, and they are getting a bonus.

I now yield to the ranking member 5 minutes.

Mr. ISSA. Thank you, Mr. Chairman.

I want to go through something before I actually wade into questions, just because I want to set the tone of this hearing so that it not be in any way confrontational.

Is it fair to say—and I am going to make the assumption it is, but I will ask you for confirmation—General Motors was bankrupt, Chrysler was bankrupt, and their financial divisions, GMAC and so on, not because of the financial crisis; they were already in trouble, had a real problem with their cost of doing business, etc., and then they were caught up in that last nail in the coffin. So four out of your seven companies, it is fair to say these are companies that are bankrupt and not even directly related to the collapse, but tangentially related to the collapse and, as such, are under your purview. Is that fair to say?

Mr. FEINBERG. I guess it is fair to say, Congressman. I have enough problems focusing on executive comp without figuring out exactly what caused the bankruptcies, but I guess that the assumption in your question is accurate, yes.

Mr. ISSA. Second, we own those companies because whatever amount we took, we took and do not expect to get it all back, because we put a lot into them that is not coming back, particularly Chrysler, I think, notably.

Mr. FEINBERG. That is correct.

Mr. ISSA. Or Chrysler division of Fiat, however we want to put it.

So I am going to leave those companies alone for a moment and I am going to concentrate on the big three.

AIG. In my opening statement, I said that AIG was unlikely to return all of the money. Do you share that with us, that you are trying to maximize the return, but without an expectation that we are going to, whether we pay them a little or a lot, we are not probably going to get $180 billion back?

Mr. FEINBERG. I think that is right, and I think that in the submissions that AIG provided us and in our conversations with AIG, that is a fair assumption.

Mr. ISSA. OK, so, again, we own 80 percent of AIG; we are not likely to get paid it all back. You are managing it on behalf of the stockholders, which are the American people.

OK, we will go to the top two. Citi, it now looks like, was really in a lot more trouble than people understood; B of A not so much. Fair to say. B of A is likely to return all the money over a period of time that is reasonably maybe 3 years or whatever; Citi, there is still a little bit of doubt.

So when you are managing all seven of these, do you manage them to maintain the best 25 people to maximize the return to the American people?

Mr. FEINBERG. I deal with each of the seven differently, as you point out. And you are absolutely right that my primary statutory obligation is to set compensation so that the taxpayer gets their money back. That is correct.

Mr. ISSA. And now I get into the little bit harder part of this. Looking at B of A and AIG, more than half of their top 25 people have left. Does it concern you that many of those people had contracts and they had to balance, OK, I can make nothing going forward or I can renegotiate my contract, or I can take what I am entitled to and leave? Do you believe that this limitation that was put on to your maneuverability led to some of those people leaving and has it hurt—it is hard to measure—hurt having that question of do we have the best 25 people to maximize the return to the American people?

Mr. FEINBERG. I can't answer that question because I am not sure the vagaries and the various reasons that people leave a company. They may have left because they didn't want to be under the thumb of the special master. They may have left because——

Mr. ISSA. But you are so nice.

Mr. FEINBERG. I am sorry? Well, that is what you say.

They may have left because they had another job opportunity. They may have left because they didn't even want the public glare. I don't know the reasons they left, but I agree with you, Congressman Issa, that it is of concern, yes.

Mr. ISSA. Well, following up on that concern, because the details of the breadth and width of what you can negotiate, Ford is doing better and Ford is innovating and Ford is able to be sort of the standalone one American company that isn't under scrutiny. Are you concerned that they will hire the best and the brightest from Chrysler and GM? Similarly, with only Citi, AIG, and B and A [Bank of America]—we will leave AIG out, but Citi and B of A under your direct control, is it very possible that some of these individuals will leave the best for better pay and, as a result, yes, we will get people that will work for the wages we set, but will we in fact be hurting B of A's long-term future on behalf of the stockholders, of which we are only a temporary stockholder?

Mr. FEINBERG. Yes. And the statute agrees with you in spelling out that one important factor I must consider is the retention and attraction of good people to these companies in order for them to thrive and repay the American taxpayer.

Mr. ISSA. Mr. Chairman, if I could ask just one quick followup.

If that is the case, should we look at a statute that envisions, particularly as to Citi and B of A, a vote of the stockholders or some kind of affirmation by the long-term stockholders of these companies that in fact they agree with the pay packages we are setting as in the best interest? Obviously, the board commenting, you commenting, but leave something to those stockholders that the chairman and I both said we had to further empower into the pay decision?

Mr. FEINBERG. You and other Members of Congress are now looking at this whole question of corporate governance, how to empower shareholders, independent compensation committees, independent consultants on comp. That whole area of corporate governance is something that is worthy of consideration by Congress, yes.

Mr. ISSA. Thank you.

Thank you, Mr. Chairman.

Chairman TOWNS. Thank you very much.

I am wondering if Wall Street will curb its excessive bonus culture without Government intervention based on what he was saying. Do you think that will happen?

Mr. FEINBERG. Again, it is a murky crystal ball, Mr. Chairman.

Chairman Towns. Congressman Clay from Missouri.

Mr. CLAY. Thank you, Mr. Chairman.

Thank you, Mr. Feinberg, for being here. I applaud your diligence in the difficult task that was set before you. Reeling in excessive executive compensation is an important mission and is of great benefit to our economy and to the American taxpayer. I continue to be alarmed by the reported trends in executive compensation that expose the disproportionate nature of corporate pay packages. According to the research, pay to CEOs is at an all-time high at over 400 times the average worker's pay. How has executive pay grown to these extreme amounts and what factors contributed to these trends?

Mr. FEINBERG. I am not a historian in terms of the causes of the growth. I confronted, under the statute and the regulations, clear directives to rein in compensation, while at the same time making sure these companies repay the taxpayers. Others have written on the various reasons that the gap has grown between executive compensation and line workers, and I have tried to take that into account in limiting executive comp under my mandate.

Mr. CLAY. You know, I have long been concerned about guaranteed bonuses. As we have seen with AIG, guaranteed bonuses and incentives do not seem to encourage productivity. Aren't guaranteed bonuses of any kind inconsistent with effective risk management?

Mr. FEINBERG. Well, I think they are. I don't know about of any kind; there may be some that haven't crossed my desk. But you will find in my report, I think it is fair to say, other than base cash salary, a complete rejection of the notion of guaranteed compensation. Instead, we tie the overwhelming amount of compensation for these executive officials to performance, not guarantees, and have worked as best we can to eliminate guaranteed payments as part of any compensation package.

Mr. CLAY. In order to hold TARP recipients fully responsible, is there any possibility of nullifying prior payment obligations to executives?

Mr. FEINBERG. Yes. We have been very successful in doing that. As I mentioned to the chairman and the ranking minority member, in almost every case where we confronted a prior guaranteed contract, we were able to negotiate voluntarily with the companies and get them to yield on that guaranteed contract and, instead, roll that amount into stock going forward over 4 years tied to performance.

Mr. CLAY. Have any employees or recipients taken legal action because of your or because those corporations' actions?

Mr. FEINBERG. No.

Mr. CLAY. No?

Mr. FEINBERG. No.

Mr. CLAY. OK.

Mr. FEINBERG. We are very persuasive.

Mr. CLAY. Have the huge bonuses led to a culture of entitlement? In other words, do executives now expect packages like this regardless of performance?

Mr. FEINBERG. I think huge guaranteed bonuses undercut performance. If you are guaranteed a huge cash salary, or you are guaranteed a bonus regardless of performance, or you are guaranteed commission payments regardless of sales, I think that what we learned is that undercuts the statutory directive that we tie compensation more to the overall financial health of these seven companies; and that is what we tried to do in the report.

Mr. CLAY. Thank you for your response, Mr. Feinberg.

Mr. FEINBERG. Thank you.

Mr. CLAY. Mr. Chairman, I yield back.

Chairman TOWNS. Thank you very much.

I now yield to the gentleman from Indiana, Mr. Burton.

Mr. BURTON. Thank you, Mr. Chairman.

Here is a quote by an executive from one of the companies, he says, "There is no question people have left because of uncertainty of our ability to pay. It is a highly competitive market out there."

One of the things that concerns me is that you have top talent, and you said that you had some people that were making, what, $13 million and you cut them down to $350,000 or something like that. Why would anybody in their right mind, if they are an executive for a company like that, who has the talent to manage and run a company, why would they take a pay cut from $13 million down to $350,000? And does that damage the company?

Mr. FEINBERG. Absolutely it would damage the company, and that isn't what we did. What we did is we took—Congressman Burton, we took $13 million in guaranteed cash, reduced it to $350,000 in guaranteed cash and told that executive we will give you $13 million, or $9 million or $8 million—I don't know the exact amount—in stock. Now, you have a vested interest in that stock. If that stock, over the next 4 years, goes up, you may get more than this.

Mr. BURTON. Let me interrupt you, Mr. Feinberg.

Mr. FEINBERG. So we tried to tie it.

Mr. BURTON. Well, if a person has a contract—and I think you used the term alleged contracts—if they have a contract that guarantees a certain amount of money and you say you want them to renegotiate that and pay them $350,000, what would be the rationale for them to take the $350,000 and not go ahead with the contract and take their money?

Mr. FEINBERG. The rationale would be, A, that they want to stay at the company and redeem that stock in value that may be even more than $13 million.

Mr. BURTON. Well, I can understand that you believe these people have the best interest of the company at heart, and probably they do, but when you are talking about that kind of a cut and whether or not somebody could get that money immediately within the contract, it seems to me that most people would take the money and run. And as I said before, this quote says very clearly that they said it is a highly competitive market out there and they are jumping ship.

Now, if they jump ship and you don't have top talent running these companies, the American taxpayer, who is the majority stockholder, has inferior people running the company. Doesn't that concern you?

Mr. FEINBERG. It sure does.

Mr. BURTON. So what do you do about that?

Mr. FEINBERG. I think that if you look at the levels of total compensation that we established in our determination, we think—I made this recommendation, my conclusion—they won't jump ship. They won't. I think that——

Mr. BURTON. Well, they already have.

Mr. FEINBERG. Some have before my recommendations.

Mr. BURTON. First of all, I understand you are doing what you have been instructed to do, but it doesn't make any sense to me, if somebody has a contractual guarantee of a certain amount of money, that they are going to take $350,000 and then say, OK, I will take it in stock, when you have an economy like we have right now and they could take the money and go. And if they go to another company, they could make the same amount of money or maybe even more than they were making where they are. So the top talent, it seems to me, would be encouraged to leave.

Now, the other thing I wanted to ask you is this. Who do you answer to when you make these decisions?

Mr. FEINBERG. Under the law, I make these—I have final authority, non-appealable. These decisions are mine and mine alone. I serve at the discretion of the Secretary of the Treasury——

Mr. BURTON. But he doesn't—once you make a decision, you don't say to him this is what my recommendation is; the decision is final.

Mr. FEINBERG. Under the law as written, the regulations afford me final binding authority to issue those determinations.

Mr. BURTON. That is a Treasury regulation, it is not a law, is it not?

Mr. FEINBERG. That is the Treasury regulation that evolve out of the statute, yes.

Mr. BURTON. But the point is, as far as accountability is concerned—and I am not inferring that you are not doing a good job, I am just saying that you really don't answer to anybody.

Mr. FEINBERG. Well, I answer to this committee and other committees with oversight functions.

Mr. BURTON. Well, come on, let's be straight about this. You are the czar; you make the decision, that is it, right?

Mr. FEINBERG. Under the law, I make the decision.

Mr. BURTON. OK. So if these people leave these companies because they are not being compensated as was in the contract—and I am not saying they didn't make too much money and they were accountable and didn't do their job properly, I am just saying when you need top talent to run a company like General Motors or Chrysler or AIG, you want people there that can really do the job. Now, they may not have done their job right in the past, but they may have the knowledge and the talent to do the job. And you are saying to them, here, we are going to renegotiate your contract, and you take $350,000 and we will extend it and give you stock for the $13 million that you were going to get; and they say, hey, the heck with that, I want my money and I am going to leave. So you have people that don't have the knowledge and the competence to run that company, so the stockholders, the American people, are in danger of seeing their money, the TARP money, going down the tubes because the company doesn't respond.

Mr. FEINBERG. My response to you, Congressman, is this. I have tried my best in this report to implement that statutory directive that they stay on the job and that the taxpayer get his money back. I will defend these recommendations.

Now, you may say, if I were doing your job, I would have a different level of compensation or do it differently. Fine. I did the best I could to try and maximize the very objective you are stating, which is keep these people on the job, and I think we have done that.

Mr. BURTON. Mr. Chairman, may I have one final question, please?

Chairman TOWNS. I would be delighted to yield to the gentleman an additional minute.

Mr. BURTON. The Federal Reserve issued guidelines under which the Fed would review, if necessary, amend, or reject the compensation policies of all banks regulated by the Fed. Are you familiar with that?

Mr. FEINBERG. That just came out last week, yes.

Mr. BURTON. That really concerns me because what we are talking about is you or somebody going beyond where you are right now and regulating people that did not get TARP money simply because they are regulated by the Fed. What do you think about that?

Mr. FEINBERG. Congressman, my limit, what I am doing to these seven, and only these seven companies—what the Federal Reserve is proposing or whatever is not on my watch and you will have to ask the Federal Reserve about the scope of those regulations.

Mr. BURTON. Thank you, Mr. Chairman.

Mr. FEINBERG. Thank you.

Chairman TOWNS. Thank you very much.

I now yield 5 minutes to the gentlewoman from Ohio, Ms. Marcy Kaptur.

Ms. KAPTUR. Thank you, Mr. Chairman, very much.

Mr. Feinberg, thank you for coming today. From whom did you receive the first call suggesting you be appointed to your present position?

Mr. FEINBERG. I received the first call from the Deputy Secretary of the Treasury, Neal Wolin.

Ms. KAPTUR. All right. And who else did you hear from prior to your appointment?

Mr. FEINBERG. The only other person is the Secretary of the Treasury.

Ms. KAPTUR. And approximately when did those calls happen, earlier this year?

Mr. FEINBERG. I am sorry?

Ms. KAPTUR. When did those calls happen, earlier this year?

Mr. FEINBERG. Yes, I think about 5 or 6 months ago.

Ms. KAPTUR. All right. Is your Federal position classified as Schedule C or are you classified as Civil Service or some other category?

Mr. FEINBERG. Special Government Employee.

Ms. KAPTUR. Special Government Employee?

Mr. FEINBERG. Yes.

Ms. KAPTUR. Does that mean you have a special contract with the Treasury?

Mr. FEINBERG. I believe that is the case.

Ms. KAPTUR. All right. And that is a matter of public record?

Mr. FEINBERG. Yes, it is.

Ms. KAPTUR. Thank you. For whom did you work prior to your current position?

Mr. FEINBERG. I was in a private law firm in private practice.

Ms. KAPTUR. OK. And could you state the name of that firm for the record?

Mr. FEINBERG. Yes. The name of the firm is Feinberg Rosen, LLP.

Ms. KAPTUR. All right. And where are they located?

Mr. FEINBERG. Washington, DC and New York City.

Ms. KAPTUR. New York City. Where is their principal headquarters?

Mr. FEINBERG. Washington, DC.

Ms. KAPTUR. Do you have any relationship with that firm now?

Mr. FEINBERG. Yes.

Ms. KAPTUR. All right. Could you state the relationship with that firm?

Mr. FEINBERG. I am the founding partner of the firm.

Ms. KAPTUR. You are a founding partner.

Mr. FEINBERG. Yes.

Ms. KAPTUR. Is it true that three of the institutions whose compensation you are supervising are or have been clients of that firm, including Citigroup, CitiBank, AIG, and Bank of America with the acquisition of Merrill Lynch?

Mr. FEINBERG. No, that is not true.

Ms. KAPTUR. That is not true.

Mr. FEINBERG. No.

Ms. KAPTUR. It has been reported in the press that is actually the case, so the client list——

Mr. FEINBERG. It may be reported in the press. It is not true.

Ms. KAPTUR. It is not true. Are any of the institutions under your purview, have they been clients of that company?

Mr. FEINBERG. No.

Ms. KAPTUR. They have not. All right. Let me ask you, you stated that it is a good idea to tie the stock opportunities for employees of these companies to a 4-year term, all right? And you said it pays out a third in what year?

Mr. FEINBERG. A third after 2 years, a third after 3 years, and a third after 4 years.

Ms. KAPTUR. All right. You know, that doesn't sound very long-term to me. How did you arrive at 4 years?

Mr. FEINBERG. Well, it is a very difficult question. We concluded that asking individuals to delay the payment of their salary beyond a 4th year would simply work too much of a hardship, that is a problem of keeping them on the job and trying to get the taxpayers' money back. We concluded that a 4-year payout of salary was a fair limitation.

Now, what we also did, Congresswoman, which is implicit in your question, we also required that any additional stock that might be issued to these officials would not vest for at least 3 years and would not be redeemable at all until TARP loan money was repaid to the taxpayer. So that was the balance we struck.

Ms. KAPTUR. I guess I just find it surprising. If you look at a 2-year time horizon, a 3-year time horizon, a 4-year time horizon, the way I look at the world, that isn't a very long time at all.

Mr. FEINBERG. Well, it may not be a long time—I guess it is relative—but our concern was that if we are reducing compensation for these officials across the board by about 50 percent, and we are obligated to keep these companies in business to repay loan taxpayer money, that asking these officials to wait more than 4 years to redeem their salarized stock was simply too onerous. Now, maybe it should have been 5 years or 6 years. We thought 4 years was a pretty good compromise.

Ms. KAPTUR. On the outer edge, but on the inner edge it is 2 years. You were quoted in the New York Times, October 23rd, stating anybody making $100 million a year is engaged in excessive risk. You approved compensation packages worth $9 million or more for six executives, including one at AIG, two at Bank of America, and three at Citigroup. That $9 million is 23 times as much as the pay for the President of the United States, 46 times the pay for the Fed Chair and Treasury Secretary, and more than 50 times as much as a military general. How did you determine that amount was not contrary to the public interest?

Mr. FEINBERG. Well, we did it in a number of ways. First, we gathered all the data we could gather and examined the data as to what constitute competitive marketplace compensation. Then what we did is we made sure that $9 million or $8 million was not guaranteed compensation. The cash component of that $9 million is likely to be $500,000 or less. The rest of it, as Congressman Burton pointed out, the rest of it is tied to stock which cannot be redeemed at once, has to be held 2, 3, 4 years; and a big chunk of that compensation cannot be redeemed by the official until and unless TARP money is repaid to the taxpayer.

So it may be $9 million in theory, but in practice, we believe, it will be a lot less than that.

Chairman TOWNS. The gentlewoman's time has expired.

Ms. KAPTUR. Thank you, Mr. Chairman. I would like to place in the record information we have about the clients of the gentleman's law firm and would appreciate response. Thank you so very much.

Chairman TOWNS. Without objection.

The gentleman from Indiana, Mr. Souder.

Mr. SOUDER. Thank you, Mr. Chairman.

I am sure it doesn't shock Mr. Feinberg that some of us on the Republican side, as outraged as we are about the salaries, as outraged as we are about the corruption and the crisis that was triggered by greed, that we have deep uncomfortability about the Government, in effect, taking over a majority of these companies or having somebody setting their salaries.

I will say the word czar does fit you, and you seem to fit comfortably in the word czar, as we have debated, because if you don't have anybody directly that you are reporting to and you are explaining how you make these decisions, but it is still a little scary, as an elected official or as people watching in the country, to see one person with this much power over major institutions in our society; and the challenges to how you are making decisions, who are you are talking to, why aren't you reporting to any elected official directly in the Treasury Department or the President is not a good precedent for a democracy.

Now, let me ask you a fundamental question. AIG we talk about like it is one company. In reality, it is 80 financial and 120 insurance, or the other way around. Did you separate out in this top 25 those who—and not all divisions were bad. Did you separate out which divisions actually caused the problem?

Same at Bank of America. Bank of America and Citibank had traditional banking things that were regulated, and their compensation might have been fair inside that industry, but they had these non-bank rogue divisions that went crazy. Are you doing all 25 evaluations as if it is one institution, rather than, in fact, separate institutions, some of which clearly caused the problem and some of which didn't because of incompetent management?

Mr. FEINBERG. Under the law, I am looking at the top 25 compensated individuals at AIG as the parent. In other words, I am not looking at 7 people at this unit and 5 people at that unit in determining the top 25. That was really submitted to us by the company itself under the law, and we worked from that.

Mr. SOUDER. In other words, my question is, then, Congress didn't separate, we blended them all together.

Now, let me go back, because what the American people are frustrated with was that we had—and I voted for TARP every time it has come up, OK, because I believe our country was going to collapse because some of these people didn't look at basic—you know, the economy is growing at 16 percent over 4 years; housing is going up at 200 percent. What kind of incompetent person can't figure out that people may, for example, be self-reporting income? How in the world nobody looked at the risk of securitization? Why didn't they ask, in the bonding companies that we have had in here, the rating companies, why didn't anybody at these different companies say, hey, isn't it strange that these companies are getting AAA for selling us bad credit? Why were they only checking 10 to 20 percent and then paying bonuses if you cleared these?

The question I have is are we aimed at the wrong thing? Why are we looking at compensation here, rather than do you think we could have looked at—because one of the questions, oh, we have to pay these people this or they will go to another company. What about stigma here, that you were incompetent? Wouldn't we have been better off analyzing what actually went wrong in these companies, finding out which managers were clearing it, holding them accountable by whether they performed their basic duty or whether they looked the other way to get profit in their company in an effect through investigations whether it was a violation of the law or incompetence, putting a stigma on them and all of a sudden pay would have been different?

The problem in an oligopolistic situation right now is we don't have pure capitalism working. The bonding companies didn't work like capitalism is supposed to work. The stockholders and the boards weren't paying enough attention. In an investigation here, isn't the real problem not the compensation, but the people who did crummy jobs aren't being singled out? Wink wink. The next tier of management wink winked, and you are treating Bank of America and Citibank and AIG, those who participated in this huge coverup and incompetence, the same as those who were running the traditional banking part, and they are all part of the parent?

Mr. FEINBERG. Congressman, I can only say, in response to your——

Mr. SOUDER. I asked your opinion, now, not just what you are required to by law.

Mr. FEINBERG. Well, but, I mean, I think that is a fair answer. I am confronted with a statute and some regulations, and I am asked to very expressly and explicitly deal with what Congress has asked me to deal with. You are raising some very good questions, but——

Mr. SOUDER. I am asking you. You are inside now. You are looking at these. You have to be measuring these different execs, and one of them maximized his return and in fact could go over to Chase or somebody. If you are trying to keep him there, don't you look at whether they were competent in their area?

In other words, if you adjusted some of their pay by whether or not they were over an area that unbelievably rewarded people who were behind in their mortgages as more value and securitization than people who were paying, now, that is some kind of stupidity. No risk management. Yet, you are analyzing and people—isn't that one of the valuables even under statute that would measure whether or not they are employable?

Mr. FEINBERG. I think, to the extent that you are asking do we also look at the importance of the role of the individual, how long they had been at the company, what capacity they served, yes, we do look at that.

Mr. SOUDER. Did they handle these toxic things and overlook?

Mr. FEINBERG. I also think, if I may, Congressman, implicitly, you are raising a very important question raised earlier, which is the extent to which, quite apart from my compensation decisions, what about corporate governance reform designed to rein in the discretion of some of these officials, and that is a subject which is, of course, worthy and is now being considered by Congress.

Chairman TOWNS. The gentleman from Texas, Mr. Cuellar.

Mr. CUELLAR. Thank you, Mr. Chairman.

Thank you, Mr. Feinberg, for being here with us. I understand you have a very difficult job and I appreciate it.

I guess if I can look at the scenario, this is what the scenario is. You have companies that have received TARP dollars, companies that have not received TARP dollars, and, of course, you have the regulators also, the Federal regulators; and I guess the basic premise is if you received Federal dollars, therefore, we can dwell into your compensation, regardless of your performance or not. And if you have not received Federal TARP dollars, we are not going to get into the free market forces. Is that pretty much?

Mr. FEINBERG. Correct.

Mr. CUELLAR. OK. Now, we talked about compensation, and I think in the past, when AIG took off all those conferences that they went off and there was an outrage from the public saying why are they going to those conferences and meeting in those luxurious resorts, people were saying you have to watch how you spend those dollars. Do you remember that?

Mr. FEINBERG. Yes, I remember that.

Mr. CUELLAR. All right. So I guess one of the things we have to look at as legislators is sometimes the public looks at perception, saying if you all are the regulators, then you have to watch what you do also. And I am just reading something that just came out in the Washington Post, I believe it was on October 19th. The Fed chairman, Ben Bernanke, and I think several of his employees went to an October 19th San Francisco Fed conference on Asian and global financial situations. They went and they traveled to the Bacara Resort & Spa near Santa Barbara, CA, I guess. Some of those suites go up to $2,000 a night, and you can go on and on and on and on and on.

I think out of the 100 participants there, I believe one-third of the participants there were Federal employees. Now, whether they got good discounts on the hotel rooms, it was not during the season, I guess—and I know that is not under your watch and I don't mean to put you on this, but I guess that is one of the things we have to be very, very careful, because if you have TARP, non-TARP entities, and then you have the Federal regulators saying you have to watch what you do and spend the money, we just have to be very careful how we regulate.

Any comments, without you going——

Mr. FEINBERG. I completely agree with your comment about being careful. I assure you that the Office of the Special Master is very, very cognizant of your concern about image and how it looks with the regulators. I can't speak for the Federal Reserve, but I can tell you that our office is very cognizant of that concern about perks and excessive compensation, travel allowances, etc.

Mr. CUELLAR. Thank you very much.

Mr. FEINBERG. Thank you.

Chairman TOWNS. I now yield 5 minutes to the gentleman from North Carolina, Mr. McHenry.

Mr. MCHENRY. Thank you, Mr. Chairman.

Thank you, Mr. Feinberg, for your testimony. I appreciate how candid you are. I was saying to a colleague that your extreme confidence is necessary with the extreme job that you have. But I also appreciate your just being frank with us. That is what we need.

Now, I just want to touch on a couple things quickly and I have some other questions. You report to the Secretary of the Treasury, he is your boss, is that correct?

Mr. FEINBERG. Correct.

Mr. MCHENRY. How often do you meet with Secretary Geithner?

Mr. FEINBERG. I have met with the Secretary probably three or four times in the last 5 months.

Mr. MCHENRY. In the last how many months?

Mr. FEINBERG. Five months.

Mr. MCHENRY. Five months. OK. So every other month, roughly. OK. And in terms of this discussion about cash, in your testimony you discuss cash, and when people hear that and when I read the Wall Street Journal story, I think that the language differential here is important, the distinction. You are talking about cash as your monthly salary or weekly salary, however they pay, and then if you get a cash bonus at the end of the year, that is your cash package, correct?

Mr. FEINBERG. Correct.

Mr. MCHENRY. OK. Now, the Wall Street Journal story that you reference in your opening statement says that you raised the base pay for 89 individuals; you cut it for a couple others; you left it the same for others. That is their base salary that they receive monthly, is that correct?

Mr. FEINBERG. That is what the Wall Street Journal says. My definition of base salary is quite different. My definition of base salary is not only what you get twice a month, but also draws that may be provided you over the course of the year, guaranteed commissions, guaranteed bonuses. The example, Congressman, that the news article referred to said that in one case with Citibank I had raised the base salary by 111 percent, to $475,000. I pointed out earlier to the committee that the total cash that official received last year was $13 million, and I reduced it by 98 percent.

Mr. MCHENRY. And that $13 million figure is not any stock awards.

Mr. FEINBERG. That was cash.

Mr. MCHENRY. That was cash.

Mr. FEINBERG. Cash.

Mr. MCHENRY. OK. All right. I just want to understand this distinction because I read in the Wall Street Journal and then I hear your testimony, which is different, and I just want to understand. You are talking about that twice a month. Their comparison here is the twice a month pay or monthly pay to what you are now setting as their monthly pay.

Mr. FEINBERG. I guess that is right. It is unclear to me in that story what they mean.

Mr. MCHENRY. OK. So what you are looking at is you would up that base guarantee in that factor, but the rest you are having with stock. Now——

Mr. FEINBERG. I am also eliminating all cash guarantees, like bonuses guaranteed regardless of performance, like commissions guaranteed regardless of sales, like any other type of cash guarantee. Those are completely eliminated under my program.

Mr. MCHENRY. OK, I want to discuss a larger issue here. Do you use compensation consultants within your office?

Mr. FEINBERG. In the Office of the Special Master? Yes.

Mr. MCHENRY. OK. Are these compensation consultants that have other clients?

Mr. FEINBERG. No. No, they may have clients that I am not aware of. They are both academics.

Mr. MCHENRY. Both academics. OK. All right. Now, in terms of compensation consultants, there has been a lot of discussion about this, but I think there is another piece here, which is the tax ramifications for salary and bonuses. Have you encountered this as a challenge in dealing with these institutions?

Mr. FEINBERG. We certainly have.

Mr. MCHENRY. Can you discuss—because we are in Congress here; we set the tax rules. What can we do to make the tax code more effective so that executives' actions are tied to shareholders' interests?

Mr. FEINBERG. Well, that is a complicated question about the tax code. I would have to get back to you on that. I can tell you that you are absolutely right, Congressman, that we run into these problems every day in establishing deferred compensation. You know, it may vest today under the law, but it is not redeemable for 2 years, 3 years, 4 years, what are the tax consequences of this. We have run into that problem and I would be glad to get back to you and lay out some of the tax issues that have arisen in the course of my 5 months on the job.

Mr. MCHENRY. I would certainly appreciate that.

Mr. FEINBERG. I will.

Mr. MCHENRY. Finally, the number of 25. I find it arbitrary. Do you find it arbitrary?

Mr. FEINBERG. Of course it is arbitrary.

Mr. MCHENRY. Have you encountered this as a problem, where you have two executives, one makes marginally more than the other; one is the No. 26th executive, the other is the No. 25th; and then perhaps you have a class of people that are very similar to the 20th or 25th executive that fall under your purview? Have you seen anything currently that you have 26th executive making more than the people that you have just given new rules to?

Mr. FEINBERG. No, we haven't seen that yet. Of course, we haven't got to the new top 25 in 2010, which may vary. We haven't seen the problem yet of the difference between No. 25 and No. 26. What we are seeing is the arbitrariness of 26 to 100 when the 100th person is cutoff at 100 and there may be hundreds or thousands of employees at 101 and 102 and 1,000 and 5,000 and 10,000 that are subject to the same compensation structure. So we are running into that problem a little bit, but hopefully we will be able to come up with a program that will take that into account.

Chairman TOWNS. The gentleman's time has expired.

Mr. MCHENRY. Thank you for your testimony.

Mr. Chairman, if I may submit for the record a question I have about contracting out services that are not under your purview as well.

Chairman TOWNS. Without objection, so ordered.

I now recognize the gentleman from Vermont, Mr. Welch.

Mr. WELCH. Thank you, Mr. Chairman. Thank you very much.

Mr. Feinberg, I thank you and I thank your staff for their tremendous work that you have been doing. I think we all really appreciate it. I have questions in two areas, but first a brief statement.

Trying to figure out what is the "right level of compensation" ultimately is an arbitrary decision, but there has been a premise in corporate America that the more you are paid, the more you are worth. Disgraced and incompetent executives who walked away with hundreds of millions of dollars, Stanley O'Neal, Richard Fuld, the list goes on, have proven that to be wrong. And I think the two concerns that we have here in Congress are, one, what compensation practices are going to drive a constructive business model so that bankers make money by lending rather than ripping folks off in kite schemes like subprime mortgages; and then, No. 2, with respect to the taxpayer bailout, which was presented to us as something that had to be done even if we didn't want to do it, how can we get some of that money back for the American taxpayer?

And this isn't in your purview, but it is a question I want to ask because you probably have more practical experience on this than anyone in America, certainly more than any of us on the committee. Among the TARP recipients was Goldman Sachs. They have since paid that money back with interest. And Goldman Sachs is good at what it does and it is now on track to have another year of record profits and likely to award bonuses in the range of $21 billion to $23 billion to its employees. Part of their bottom line profit came from part of the taxpayer payment to AIG, which totaled over $100 billion. AIG took the taxpayer money and wrote a $12.9 billion check to Goldman to cover collateralized debt obligations and some of these exotic instruments that were in jeopardy because of the collapse of AIG.

Do you have an opinion as to whether or not Goldman Sachs should repay taxpayers that $12.9 billion before it awards $23 billion in bonuses to its employees?

Mr. FEINBERG. Congressman, I don't have an opinion. I have read that story, just as others have. I have enough difficulty focusing on the seven companies that are on my watch. And whether or not Goldman should either voluntarily or by force of Congress, congressional directive, repay——

Mr. WELCH. Let me ask you this. I understand you have a limited purview, and I can't tell you that nobody is listening and it is just between us, but I know that one of your concerns is taxpayer fairness; and, again, that is in the eye of the beholder, but it is a fairness standard.

One of the things that we have learned in this entire catastrophe of the financial meltdown is that most of the things that were done that are truly outrageous and harmful to taxpayers and our economy were all legal. Legal but not fair and not right. And if we are going to restore some sense of fairness that the American taxpayer needs, do you think that we have to address such transfers where the goal of the taxpayer bailout was to revive the financial system, but not to reward any individual firm?

Mr. FEINBERG. Yes. I am hopeful that the model that we have developed for the seven companies that is in this report—and executive compensation is not the answer to all of these problems, but to the extent that executive compensation has a role to play going forward in improving the economy and promoting fairness, I would like to think that the recommendations we have made in this report might be adopted voluntarily by other companies on Wall Street and might be seen as one step among many that can be taken to deal with the overall problem.

Mr. WELCH. OK, thank you.

I yield back.

Thank you, Mr. Feinberg.

Chairman TOWNS. Thank you very much.

I now yield to the gentleman from California, Congressman Bilbray.

Mr. BILBRAY. Thank you, Mr. Chairman.

Mr. Feinberg, I guess with my wife on the other side of the continent, I spent some quality time with Publius Hamilton and the Federal papers last night, and I am just thinking of what our Founding Fathers must be thinking watching the entire process that we are talking about today, the concept of the Federal Government is actually looking at these kinds of private sector jurisdictions that have changed.

And I think, rightfully so, we should be looking at it. I think one of the greatest things when you read the Federal papers is the concept of rights and responsibilities go together, and when the taxpayer was required to take on responsibilities, those rights obviously start following, and I appreciate your working on this part of it, breaking very new ground. Let's just hope it is not ground that we have to cover ever again in the future, and let's work on that.

I think that your comment about the regulation that we are considering, one of the concerns I see is basically continuing the process of the Federal Government deciding salary rather than empowering stockholders, who are actually the ones who bear the financial responsibility and should have it. Wouldn't you agree that is the vehicle that we probably should be looking at, is those who pay play and determine who get——

Mr. FEINBERG. I think that is right. As I said earlier, the asterisk to that general view, which I share, is that at least as to these seven companies, Congress spoke and said that since the taxpayer is the primary creditor of these seven companies who received the most TARP assistance, as to these seven, and only these seven, there should be more monitoring and determination of pay.

Mr. BILBRAY. Because rights and responsibilities—the fiscal responsibility leads the right to be able to intervene. What worries some of us is that we are starting to see this as being an excuse to intervene in other companies where the responsibility has not been taken over but the right is being proposed to be preempted.

Mr. FEINBERG. I can't speak for the Federal Reserve or others. I know that I have publicly and again today expressed the view that my jurisdiction should not be extended beyond these seven companies, and only as long as they still owe the taxpayers money.

Mr. BILBRAY. And I appreciate that. How many members of your team were drawn from your private law firm?

Mr. FEINBERG. I think myself and two others.

Mr. BILBRAY. Would you mind naming them?

Mr. FEINBERG. Ms. Camille Biros, who is sitting right here, and Ms. Jacqueline Zins, who is also sitting next to Ms. Biros.

Mr. BILBRAY. OK.

Mr. FEINBERG. The rest are all Treasury officials.

Mr. BILBRAY. OK. All the rest of them are Treasury.

Mr. FEINBERG. Yes, I believe so.

Mr. BILBRAY. Do you have the names of the Treasury officials?

Mr. FEINBERG. They are all here; I can get you those names, yes.

Mr. BILBRAY. OK. Appreciate that.

Now, there are a lot of reports going around, but the latest is, according to those reports, your team includes academic consultants.

Mr. FEINBERG. Two, Professor Lucian Bebchuk from Harvard and Professor Kevin Murphy from the University of Southern California.

Mr. BILBRAY. I appreciate that. And that is the kind of clarity I think that President Obama really wanted to set as a new example, rightfully so, pointing out the previous administrations have not been as transparent as we hope; and that creates concerns that really so many times just don't need to be there.

At this time, will you provide to the members of this committee the names and the subjects and the venues of all the individuals that you rely on to work out this issue?

Mr. FEINBERG. I would be glad to do that. I can tell you right now, summarily, there are the two academics at Harvard and Southern Cal, and there are the people here at Treasury with two others from my law firm, and that is about it, about 15 people. But I will get you the information and, in transparency, lay it out to you and let you have all that information.

Mr. BILBRAY. Thank you very much. That is how we avoid all of the he says/she says or we hear reports and we don't have it. Thank you very much.

Mr. ISSA. Would the gentleman yield?

Mr. BILBRAY. I yield to the gentleman from California.

Mr. ISSA. Being an old employer, I couldn't resist asking one question. You have had more than half of the key 25 of AIG and B of A depart. How many outside individuals under similar pay to the people that you are losing did you hire? In other words, not from within, not people that are already No. 26 or 28, but how many new outside people have entered the ranks of the top 25 of those two companies under the conditions you are willing not pay?

Mr. FEINBERG. I don't know the answer to that, Congressman. It is a fair question and I will try to get you that answer.

Mr. ISSA. If you would get back to us on that.

Additionally, Madam Chair, I would like to enter Bloomberg.com's article into the record at this time because it has been brought, and then just ask one closing question, which is if the credit default swaps had not been paid at full value, but at 60 cents on the dollar, which was the negotiated amount, wouldn't that amount that wouldn't have gone to Goldman Sachs and other companies, wouldn't that have been greater than all of the executive compensation that you are going to handle over your tenure?

Mr. FEINBERG. I am not sure, but I——

Mr. ISSA. By a magnitude of many?

Mr. FEINBERG. I am not sure, but I will assume, based on the ranking minority member's question that the answer is a definitive yes.

Mr. ISSA. Thank you.

Thank you, Madam Chair. I yield back.

Mr. BILBRAY. I yield back.

Mrs. MALONEY [presiding]. Thank you very much.

Mr. Foster is recognized for 5 minutes.

Mr. FOSTER. Thank you, Master Feinberg, for appearing today. I really appreciate it.

The first question I have is sort of technical. When you attempt to align compensation incentives with long-term company performance using stock that has to be held over time or vests over time, do you encounter problems in preventing employees from simply hedging against a possible decline in the stock value?

Mr. FEINBERG. Prohibited by our rules and regulations. Very good question.

Mr. FOSTER. And who enforces this, especially for former employees that are holding the stock that is going to vest over time?

Mr. FEINBERG. I would guess with any of our final compensation determinations, if there is a violation, I would assume that would be referred to the Department of Justice.

Mr. FOSTER. OK, but do they have to report? If you leave the firm and then, you know, for the next several years you have to go and file some piece of paper that says I have not taken a hedging position in some offshore derivative market that you don't know about?

Mr. FEINBERG. I think we would monitor that and be required to do that, yes.

Mr. FOSTER. OK, so there are financial statements that have to be filed——

Mr. FEINBERG. I think so.

Mr. FOSTER [continuing]. Years after you are terminated. OK. And your staff is at least not shaking their head. OK.

All right, so now——

Mr. FEINBERG. I may get corrected in the next hour, and, if so, I will let you know.

Mr. FOSTER. OK, thank you. Now, down the hall in the Financial Services Committee, that I also serve on, we have broader concerns about the compensation structures for systemically important firms, and not just TARP recipients. So based on your experience in dealing with the corporate culture and so on, I was wondering if I could have your reaction, in writing if you are not comfortable doing it now, to two possible structural changes in compensation that might help going forward in systemically important firms.

The first one is the requirement of periodic stress tests for systemically important firms with negative implications for executive compensation in the case that the stress test didn't come out well. So that if you are seen to be operating a company that will not withstand a 20 percent decline in asset values, or whatever the stress test would be based on, that actually that would have a negative implication for the bonuses this year. So that is suggestion one.

Suggestion two is that, as you probably are aware, the administration or the Treasury and the Financial Services Committee staff jointly proposed industry-wide assessment into an FDIC-like insurance fund, and it would be post-funded so that this would be after—if a too-big-to-fail firm failed, the whole industry or at least firms above, I believe, $10 billion in assets effectively have to pay into this fund to cover the losses. And I was wondering if you have a reaction, or could provide one, against making that assessment not only against the firms themselves, but against the highly compensated individuals, perhaps even using a clawback provision.

Mr. FEINBERG. Again, those are questions I will get back to you. Those corporate governance questions are very important. They are all part of the total determination of what constitutes credible compensation. To the extent that over the next few months we are dealing in designing compensation structures for employees 26 to 100, which is on my watch, it is suggestions such as yours, Congressman, that we should take a look at. I don't know if it should be part of my report or be part of the broader corporate governance reform effort that is underway. But clearly those are suggestions that ought to be considered, yes.

Mr. FOSTER. So what I am looking for is a response of you personally, not as special master, because you have been on the front lines of this, you have dealt with the corporate culture, you have seen what makes people jump and what makes them shrug, and that is what we have to understand.

Mr. FEINBERG. I will honor your request and get back to you, then, as a layman, as a private citizen.

Mr. FOSTER. Thanks very much.

Mr. FEINBERG. Thank you.

Mr. FOSTER. With that, I yield back.

Mrs. MALONEY. Thank you.

Mr. Jordan from Ohio.

Mr. JORDAN. I thank the Chair.

And I apologize, I was over on the floor handling a few suspensions for this committee, so if I ask some things that have already been asked, bear with me, if you would.

Mr. Feinberg, we appreciate your being here, and your staff as well.

In some of your responses to Congressman Bilbray you talked about the independence of your place. Was there any coordination last week when your findings came out along with what the Fed is planning to do? And as I read what the Fed is planning to do, I think about Security National Bank in Urbana, OH. It looks like the president there could be, in fact, potentially having the Government look at his or her compensation. So was there any coordination or is it just the luck of the way the world works that they happened to come out the same day?

Mr. FEINBERG. We have been—it was the luck that it came out the same day, frankly. We have coordinated with the Federal Reserve in terms of keeping each other apprised of what I am doing. We had no input that I am aware of, none, in terms of what the Federal Reserve released last week in terms of the content of its proscriptions.

Mr. JORDAN. So not relevant to content, but relative to timing there was——

Mr. FEINBERG. No, no. As a matter of fact, we did not. I had no contact with the Federal Reserve concerning the timing of their release, no.

Mr. JORDAN. Complete coincidence that those two came out the same day.

Mr. FEINBERG. All I can tell you, Congressman, is that there was no coordination and no communication in that regard.

Mr. JORDAN. All right. Again, sort of picking up where Congressman Bilbray was, in the big picture sense, are you troubled—you know, you think about car czar, pay czar, TARP program, energy czar, stimulus package, bailouts for the auto industry. As you look back—and you can probably guess where I come from—do you think we might have been a little better off if we had never started down this road in the first place?

Mr. FEINBERG. I am not going to second guess Congress; I have learned over the years that is a mistake.

Mr. JORDAN. The American people sure do and I sure do.

Mr. FEINBERG. I can only say, Congressman, as I have said it publicly, that my role is relatively very, very limited. It is these seven companies that are owned by the American people that I am focused on, and that is all I am focused on.

Mr. JORDAN. Let me ask you this, Mr. Feinberg, then. The slippery slope argument. Are you nervous—in light of comments by people like Senator Schumer, who has talked about expanding this to any publicly traded company—I guess I just look at this and I am thinking who would have thought, in the United States of America, we would have the Federal Government, the special master of executive compensation telling a private American citizen what they can make?

Sometimes, if you step back and ask the fundamental question, I think you stop and think wow, this is amazing where we are at today in the United States of America, and that is a concern. And it is also a concern that, when you think about it, you know, we are a country of over 300 million people and we have this huge market. We are the largest economy in the world and now one person, one single person is deciding what people make. To me, that is a dangerous, dangerous place we are going.

And then when you couple it with, again, what Senator Schumer has said, where this potentially can take us as a Nation, it is no wonder Americans are frightened, and, frankly, some Members of Congress are pretty scared too where we are headed.

Mr. FEINBERG. I have two answers to your concern. One, my job and my office and what I am doing was established by Congress in a Federal statute, accompanied by official Treasury regulations. I am serving under the law and I am obligated to serve under the law.

Mr. JORDAN. Mr. Feinberg, I understand that, and I get it, and I get the fact that these companies, these firms held out their money and took the taxpayer dollars. I get that. My question is does it trouble you, as the person who has that responsibility, where it could potentially lead and the implications of taking this step, when you already have Members of Congress, frankly, important Members, influential Members like Senator Schumer, talking about where it goes next?

Mr. FEINBERG. I am troubled, and I say so in my public statement. I am troubled at the notion that my role currently with these seven companies, I am troubled at the notion that it could be expanded. That is a mistake.

Mr. JORDAN. Well, it is important that you emphasize what you said earlier: it stops here. That is what scares people, and God bless you for saying it, but it is important that you stick to it.

Now, let me ask you one quick question; I have a couple seconds left. It seems to me that the administration has gone to great lengths to keep you. You met with the Treasury Secretary a couple times, you don't meet with the Obama administration. So tell me about that, tell me the relationship you have with Treasury Secretary Geithner.

Mr. FEINBERG. I have an excellent relationship not only with the Secretary of the Treasury, I would like to think, but with other officials at Treasury and at the Federal Reserve in terms of consulting with them concerning these decisions that I am making, suggestions that I am making. They have been extremely cooperative in offering their advice to me at my request.

Ultimately, the decision is mine, but I have sought out a wide range of views—the academics that I mentioned earlier that are our consultants, individuals at Treasury, individuals at the Federal Reserve—in an effort to come up with a report that I think is balanced, that is fair, and, most importantly, complies with the statute and the regulations.

Mr. JORDAN. Thank you, Madam Chair.

Mrs. MALONEY. Thank you. The gentleman's time has expired.

Dr. Chu.

Ms. CHU. Thank you, Madam Chair.

And thank you, Mr. Feinberg, for testifying before us today. I know you have the limited purview of these seven companies, but Goldman Sachs, JP Morgan Chase, and Morgan Stanley, of course, had substantial loans. They have paid it off since and they are no longer under executive pay restrictions. However, with their profits recovering from the Government bailouts, all three firms are expected to make huge payments to their executives this year and, in fact, according to Attorney General Cuomo, Goldman earned $2.3 billion in 2008, yet paid out more than twice that amount, $4.8 billion, in bonuses.

What authority would it take to stop such negligent and reckless behavior? What can we do to stop this? This is very upsetting to the American people, as you know.

Mr. FEINBERG. Well, that is a huge legitimate question, what authority. Historically, the authority has been the self-regulating marketplace. Now, to the extent that is supplemented by the Federal Reserve, by the regulators like the SEC, the FDIC, that is a subject that Congress may want to revisit.

I want to emphasize my reluctance to attempt in any way to broaden my jurisdiction beyond these seven companies where I am trying to collect money representing the taxpayers as a creditor. I am not saying it is not a legitimate concern, I am just saying that it is a subject that goes well beyond my jurisdiction, it seems to me.

Ms. CHU. Well, there is one company, GMAC, which is under your jurisdiction, and it has already received $12.5 billion of TARP money. However, they are asking for a third bailout. How do you plan to ensure that the additional $5.6 billion that they are requesting doesn't go toward these unscrupulous compensation practices?

Mr. FEINBERG. We are very vigilant in making sure that the compensation practices that we have articulated in this report are fair, are reasonable, and will be paid by GMAC to its employees as part of this program. I am not sure where that extra requested funding will go, but we want to make sure, under the law, that there are sufficient funds at GMAC to pay these officials, and we will make sure of that.

Ms. CHU. And for them to control their compensation practices?

Mr. FEINBERG. They control their compensation practices subject to our rules and regulations, which we have mandatory jurisdiction, Congresswoman, to make sure that we are monitoring those compensation practices.

Ms. CHU. Well, let's talk about AIG. I know that you made some major exceptions to pay cuts for three senior AIG executives who had signed contracts for multi-million dollars bonuses prior to your appointment. You stated that you are reluctant to invalidate contracts prior to the enactment of this current law, but do you have the authority to override these contractual rights? What can be done about this situation? You have AIG employees who—well, let's see, four employees made over $4 million, one employee made $10.5 million.

Mr. FEINBERG. We have authority under the law to attempt to work with the company in renegotiating those contracts. We have been successful in almost every case, although that is the exception that you have referenced, three individuals at AIG. What we did with those three individuals at AIG, they had a contract, they insisted on honoring that contract, they had every right to insist on honoring that contract, and, therefore, under the law, I took those contracts into account in reducing their 2009 compensation. Beyond that, I had no authority to act, and I think that is what I did under those circumstances.

Ms. CHU. OK, well, there are alarming findings that executive compensation is actually increasing, even though there is this outrage by Americans. Now that you have had the experience with these seven companies, what would be your recommendation on a going forward basis?

Mr. FEINBERG. I think, going forward, we will continue, first, to implement the recommendations in our report that call for a reduction in cash compensation of around 90 percent; a reduction in overall compensation of around 50 percent, cash plus stock. In addition, I am hoping—and we have also reined in perks; we have also tied compensation to long-term performance; and I am hoping that our recommendations will be followed not only by these seven companies, which are required to follow them, but I am hoping that some of our recommendations will voluntarily be adopted by other companies seeking to improve their compensation practices. We shall see.

Ms. CHU. Thank you.

I yield back.

Mrs. MALONEY. The gentlelady's time has expired.

Mr. Cummings is recognized for 5 minutes, to be followed by Mr. Connolly.

Mr. CUMMINGS. Mr. Feinberg, I want to thank you for your testimony. I have listened to you very, very carefully and I do believe that you have done what you have been instructed to do, and I think you have done an outstanding job.

Mr. FEINBERG. Thank you.

Mr. CUMMINGS. Let me just try to get down to where the rubber meets the road. You know, I think part of the reason why this is going on, why you are doing what you are doing and why the Congress asked you to do what you are doing is so that—and you have implied this in your testimony. Part of the reason is to try to get other companies to do this, beyond the seven.

I know you have gotten maximum cooperation, I think you said, with AIG and I have had an opportunity to meet with the former head of AIG, Mr. Liddy, and to listen quite a bit to what he had to say, and I read the papers just like you do. I have absolutely no confidence, none, that the things that you are able to do—and it has nothing to do with you. There is a culture along Wall Street that will cause them to reduce salaries consistent with what you just said a minute ago. And you are a very bright and straightforward person. What would cause them to even do it? Because my dealings with them is like we are on two different planets. I think when they talk about multi-million dollar bonuses, it is like shoe shine money to them. I am serious.

And when I talked to Mr. Liddy about my constituents, who were being thrown out of their houses because of foreclosure, losing their savings, everything, and they still wanted to give money to the financial products division, and to seem to not even have a clue or not give a hoot about these folks, and at the same time handing out millions. I mean, I just can't see how, with all your fine work, that is going to be turned around. I just don't. I have been around a long time.

No. 2, I was wondering what advice—do you have conversations with the President? Because, let me tell you, I believe that the American people—in order for all of the things that the President is trying to do to right this economic ship, if the American people aren't there and if they feel like they are getting screwed every which way, and certainly it goes beyond these seven companies, so the question becomes, what do we see, what do you see?

I mean, I know what you are hoping, but Mr. Barofsky said something the other day that really impressed me, when he was giving us a little talk about his report. He said that Secretary Geithner and others, whenever he comes before us, they listen. So here you are before us. You are the man with the seven companies. I am trying to figure out what will it take, if anything—this may be a culture that is impossible to turn around—to make these folks move in another direction.

Mr. FEINBERG. Congressman, you are asking a political science question about the gap, the gap between Wall Street and Main Street thinking on this subject. A, I can play whatever role I can play, hopefully, in impressing upon Wall Street generally the value of what is in this report. Whether or not Wall Street will pick up on any of this I do not know.

Mr. CUMMINGS. And give me your best argument. That is what I want to hear. You are talking to Wall Street and you say, Wall Street, we have a great rapport here. This is why you should do this. Your best argument.

Mr. FEINBERG. My best argument would be to Wall Street that this is why you should do this, because if you don't do this, there may be a time when Congress or others will rein in pay and will limit your discretion and will limit your unilateral ability to determine what to pay people. I mean, to the extent that these modest proposals—modest in the sense that they only apply to seven companies—to the extent that they are ignored in the private marketplace, ignored, well, I mean, the question is will Congress, in its wisdom, sit by and allow compensation to go forward under the old regime and the old way of doing things. I don't know.

I have enough problems, as you have witnessed this morning, dealing with these seven companies, and suggesting that my role should definitely not go beyond these seven companies, to express a view on what global decisions should be made by Congress to try and rein in Wall Street. That is a subject beyond my jurisdiction and one that I wisely don't want to get near because I don't want to undercut my credibility and my effectiveness in terms of dealing with these seven companies.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

Chairman TOWNS [presiding]. We might need another Master to do that.

Congressman Connolly.

Mr. CONNOLLY. Thank you, Mr. Chairman.

Mr. Feinberg, thank you for your willingness to serve. You know, in listening to some of the rhetoric about this subject on the other side of the aisle, one would think, if one knew nothing, that Congress and the Federal Government just have this irrational compulsion to interfere in the private sector and arbitrarily set compensation limits. Well, what is your understanding of why your job was created, Mr. Feinberg?

Mr. FEINBERG. My job was—it is clear. My job was created by Congress and the Treasury to establish compensation determinations designed with one primary objective in mind, to get the taxpayers' money back. And that is the primary objective. Now, how we do that——

Mr. CONNOLLY. Mr. Feinberg, I understand that, and thank you. But why? Did something go wrong? Why did we decide on these seven companies?

Mr. FEINBERG. These are the seven companies that were allowed, I guess, to survive on the back of the taxpayers' willingness to contribute these funds.

Mr. CONNOLLY. Ah. So the private sector, the free market, in fact, had failed, is that correct?

Mr. FEINBERG. Correct.

Mr. CONNOLLY. Let's take one of the seven companies you oversee, AIG. The largest corporate quarterly loss in American history was in the last quarter of last calendar year, and it was none other than AIG, is that correct?

Mr. FEINBERG. Correct.

Mr. CONNOLLY. And AIG has been the biggest recipient of bailout funds, is that correct?

Mr. FEINBERG. I think that is—yes, that is correct.

Mr. CONNOLLY. So it had the largest loss and the largest single taxpayer bailout in American history, is that correct?

Mr. FEINBERG. Correct.

Mr. CONNOLLY. Does the public have any interest at all in wanting to see some kind of rational compensation limits in a company it has bailed out, the biggest in its history?

Mr. FEINBERG. Insofar as the public's view is reflected by the statute that I am working under, yes.

Mr. CONNOLLY. Does that seem a rational concern on our part to you?

Mr. FEINBERG. No.

Mr. CONNOLLY. You think it is not rational?

Mr. FEINBERG. I think it is, it is a rational response to the crisis, yes.

Mr. CONNOLLY. In protecting the public's interest.

Mr. FEINBERG. Yes.

Mr. CONNOLLY. Thank you.

Let me ask you this question. One of the four broad mandates that Congress gave you in creating the statute that created the special master was to review prior payments. When your office reviewed prior payments to senior executives in AIG, what did you find? Because presumably you found something wrong in the fact that you have chosen to roll back some of that compensation.

Mr. FEINBERG. With most of the companies we found that, prior to the enactment of the law, there had been prior payments actually made. There was nothing nefarious or illegal about it; those were contracts that were entered into prior to the enactment of the statute creating my office.

What we did find, going forward under my tenure, we did find that there were pending payments that were obligated to be made under prior contracts, and we were able, through negotiation with the companies, in almost every respect except two or three cited earlier, to get those contracts voluntarily invalidated; and, instead, we rolled the amounts that were involved in those contracts into prospective performance-based stock.

Mr. CONNOLLY. Ah, performance-based.

Mr. FEINBERG. Yes.

Mr. CONNOLLY. When you looked at compensation, prior compensations, and in your report you are submitting today, looking forward, I assume that there is some rational basis for your coming up with the recommendations you came up with. For example, we have heard some rhetoric here today that would seem to suggest that the sky is the limit; we have no business even talking about limiting executive compensation, even in companies we have bailed out. And you agree that within some reason any limit is arbitrary.

Mr. FEINBERG. I think that is right.

Mr. CONNOLLY. But, would you not agree, however, if I said the CEO's compensation in Company X ought to be 200 percent of Company X's entire profit for the year, that would be an irrational compensation, would it not?

Mr. FEINBERG. I think it probably would.

Mr. CONNOLLY. So it is not entirely arbitrary.

Mr. FEINBERG. Oh, no. Our decisions weren't arbitrary. Our decisions absolutely, I think, were based on reasonable evaluation of the data and the anecdotal information we received from the seven companies. I would defend my report as being not at all arbitrary, but very, very principled, very rational, and very reasonable. Now, people may disagree, but I think it is clearly a reasonable and defensible report that was submitted to the Secretary.

Mr. CONNOLLY. And you used the words performance-based. Could you just elaborate on that? Because that is where we get into the rational or arbitrary here. It is tied to some kind of rational expectation of financial performance on the part of the company, is that correct?

Mr. FEINBERG. That is absolutely correct. We rejected out of hand the notion that regardless of company performance there should be guaranteed salaries, guaranteed bonuses, guaranteed commissions, guaranteed perks, guaranteed, guaranteed, guaranteed. And what we said in our report, and what I recommended, is that the era of the compensation guarantee is over and, instead, other than small cash-based salaries, the remainder of the compensation package should be tied to performance; and not only tied to company performance, but tied to company performance over a period of time so that you cannot simply short the stock, sell it after a year, roll it over, you have to hold it for up to 4 years.

And then we are hoping the long-term benefit of holding that stock will tie the officials' compensation to the overall value of the company as reflected in the stock. In addition, one other point, we also offered up the notion of long-term incentive-based stock, in addition to salary. But that stock cannot be redeemed, it cannot be sold until and unless the taxpayers get their money back.

That is the formula we tried to use to correct what we thought in our report were the problems with executive compensation practices in these seven companies.

Mr. CONNOLLY. I thank you.

My time is up, Mr. Chairman. Thank you.

Chairman TOWNS. Right. Thank you very much.

I yield 1 minute to the gentleman——

Mr. JORDAN. Oh, I appreciate the chairman yielding.

I just want to make a point on my friend and colleague from Virginia. They talked about the private sector failing. I think this is important to understand. The private sector didn't fail; we had some institutions that had some major problems. But to argue that the private sector failed is just, in my judgment, fundamentally wrong. Institutions fail in the private sector every single day in this country and across the planet. That is part of capitalism. The problem is once we start down the road, that is when we get into all these questions and all these problems.

Chairman TOWNS. Thank you very much.

Let me just say this before I yield to the gentlewoman from New York. There is a lot of concern about these folks who failed going to another company. I am not sure that anybody would be too excited about hiring people that fail. I don't think you have to worry about that too much. One company in the ground and then you expect to get big money to go to another one and do the same thing? So I don't know that is a real concern.

Mr. FEINBERG. Well, we hear the argument all the time, and the argument goes—you expressed one view and the ranking minority member has expressed a view. There are a lot of vacancies. The question is those vacancies are now gone and whoever was going to leave would have left. I don't know. We are trying to implement the statute keeping in mind both of those positions. It is a balancing act.

Chairman TOWNS. You know, I think about Members of Congress. We think we are so great, but when we leave somebody takes our seat. They do real well.

I yield now 5 minutes to the gentlewoman from New York.

Mrs. MALONEY. Thank you, Mr. Chairman.

First, I would like to welcome Mr. Feinberg and mention his truly outstanding work as a special master for 9/11 during a very difficult period in our country. With a very difficult topic you did a very fine job.

I would like to ask how we are faring internationally in terms of our compensation compared to foreign countries. We are in a global market now; we are competing with firms across the world. How does U.S. executive pay compare to, say, pay in Japan and in European countries?

Mr. FEINBERG. I can get you that data, Congresswoman. I can tell you that what I do know is that there has been a great deal of recent G–20 and other cooperation between Treasury and the Secretary and other countries in trying to come up with a common set of international standards governing compensation. How much American compensation varies from Japan or Germany or Italy, I don't know, but I can certainly get you that data.

Mrs. MALONEY. I would like to know. I also have read that the United Kingdom adopted say on pay rules or a shareholder vote on executive pay. Are you aware of that and has that made any difference in pay scale? Have you followed what has happened in the United Kingdom?

Mr. FEINBERG. Again, I think that is of recent vintage. I will, again, try and secure some information concerning the impact of that in the United Kingdom.

Mrs. MALONEY. The United Kingdom's five largest banks have reportedly agreed to abide by the G–20 executive compensation rules. Have U.S. banks, likewise, agreed to accept these conditions, which include an independent compensation committee and clawbacks for poor performance?

Mr. FEINBERG. Not on my watch. I don't know. I am limited to these seven companies. And, again, at the risk of disappointing you, I will get you answers to these questions, Congresswoman.

Mrs. MALONEY. Are you aware of any other legislative fixes or actions that we should be taking in terms of tying executive pay more to performance?

Mr. FEINBERG. Well, that raises the whole question that I have discussed earlier about corporate governance and what Congress is considering, as I understand it, in both the House and the Senate concerning both corporate governance reforms in Federal legislation and corporate regulatory reform. And both of those subjects certainly are part of the overall concern about total compensation, even though those two subjects aren't directly part of my jurisdiction.

Mrs. MALONEY. OK, the law gives firms the right to appeal within 30 days of the compensation determination. Do you anticipate appeals, and, if so, how will they be conducted?

Mr. FEINBERG. I haven't received any appeals as yet. I am hopeful there won't be any appeals. If there are, under the law, we will certainly give due consideration to those appeals, but as of today, Congresswoman, we don't have any appeals.

Mrs. MALONEY. The New York Times reported that Citigroup, as well as other banks, continue to offer grant guaranteed bonuses to employees. Does that violate the Treasury regulations?

Mr. FEINBERG. It all depends whether those employees that are getting those grants, allegedly in the New York Times, fall within my jurisdiction of 1 to 25 or 26 to 100. Citigroup and other companies under my jurisdiction at least legally have the authority to act independently if they are not part of my mandatory jurisdiction. Now, I could, under the law, issue some advisory opinion if I knew more about such bonuses, and we will look into that.

Mrs. MALONEY. Do you have the authority to override contractual rights?

Mr. FEINBERG. No. If the contractual rights are found by my office to be valid, legal, and binding, then we give due deference to the Constitution and the fact that the sanctity of contracts should be upheld. But, as I said earlier, we do have under the law two ways to deal with these old contracts that might be found to be valid: one, we can seek to renegotiate those contracts with the company—we have been very successful in doing that—and getting the company to voluntarily yield on those contracts and roll it over into performance-based stock. Second, if a company refuses to voluntarily modify the contract, we can take those contracts into account in establishing prospective compensation. So we do have some weapons at our disposal.

Mrs. MALONEY. Thank you. My time has expired. We have been called to a vote. Thank you again for your service to our Nation.

Mr. FEINBERG. Thank you again. And, Congresswoman, thank you for all your help on 9/11. You were a stalwart in convincing your constituents to come into the fund, and I will always be in your debt for that. Thank you.

Mrs. MALONEY. Thank you.

Chairman TOWNS. Thank you very much.

Let me thank you for your testimony. You were an outstanding witness, no question about it. We want to let you know we appreciate that, appreciate the work that you have done, and we really, really want to continue to stay in touch with you as we move forward, because, as I indicated earlier in my opening statement, the American people are angry; and, of course, you are helping to sort of calm them down. Thank you so much.

Mr. FEINBERG. Mr. Chairman, you and the ranking minority member need only call and I will be up here as soon as possible. Thank you all very much.

Chairman TOWNS. Thank you very much. Thank you.

Now, our second panel consists of two witnesses, Professor Black and Professor Roberts. As with the first panel, it is the committee's policy that all witnesses are sworn in, so please stand and raise your right hands as I administer the oath.

[Witnesses sworn.]

Chairman TOWNS. Let the record reflect that the witnesses answered in the affirmative.

William K. Black is associate professor of economics and law at the University of Missouri, Kansas City, and author of the book, "The Best Way to Rob a Bank Is to Own One." Of course, we welcome you to the committee.

Russell Roberts is professor of economics at George Mason University and a research scholar at Stanford University, Hoover Institution. Welcome.

Your entire statement will be placed in the record and I would like to ask you if you would assume the time. The clock starts on green, then goes to yellow and then it turns red, so we would like for you to do it within 5 minutes. We might have to stop you because of the fact we have votes on the floor but we want to get as far as we can before.

Thank you very much. Why don't we start with you, Mr. Roberts?

STATEMENTS OF RUSSELL ROBERTS, PROFESSOR OF ECONOMICS, GEORGE MASON UNIVERSITY; AND WILLIAM K. BLACK, ASSOCIATE PROFESSOR OF ECONOMICS AND LAW, UNIVERSITY OF MISSOURI-KANSAS CITY

STATEMENT OF RUSSELL ROBERTS

Mr. ROBERTS. Thank you, Chairman Towns, Ranking Member Issa and distinguished members of the committee.

Americans are angry about executive compensation. Rightfully so. The executives at General Motors and Chrysler do not deserve to make a lot of money. They made bad products that people did not want to buy.

The executives on Wall Street do not deserve to make a lot of money. They were reckless, they borrowed huge sums to make bets that did not pay off and they wasted trillions of dollars of precious capital, funneling it into housing instead of health innovation, high mileage cars or a thousand investments more productive than more and bigger houses.

Everyday folks who are out of work through no fault of their own, want to know why people who made bad decisions not only have a job but a big salary to go with it. No wonder they are angry at Wall Street, but if we keep getting angry at Wall Street, we will miss the real source of the problem. It is right here in Washington.

We are what we do, not what we wish to be, not what we say we are, but what we do. What we do here in Washington is rescue large companies, large financial institutions and rich people from the consequences of their mistakes. When mistakes don't cost you anything, you do more of them.

When your teenager drives drunk and wrecks the car, you keep giving him a do-over, repairing the car and handing him back the keys, and he is going to keep driving drunk. Washington keeps giving bad banks and Wall Street firms a do-over. Here are the keys, keep driving. The story always ends with a crash.

Capitalism is a profit and loss system. The profits encourage risk-taking. The losses encourage prudence. Is it a surprise that when the government takes the losses instead of investors, that investing gets less prudent. If you always bail out lenders, is it surprising that firms can borrow enormous amounts of money living on the edge of insolvency?

I am mad at Wall Street, but I am a lot madder at the people who gave them the keys to drive our economy off a cliff. I am mad at the people who have taken hundreds of billions of dollars of taxpayer money and given it to some of the richest people in human history. I am mad at President Bush, President Obama, Secretary Paulson, Secretary Geithner and Chairman Bernanke, and I am mad at Congress. You helped risk-takers continue to expect that the rules that apply to the rest of us, don't apply to the people with the right connections. You have saved the system, but it is not a system worth saving. It is not capitalism, it is crony capitalism.

Using a special master for compensation to get our money back is too little, too late. Many people argue that because the government handed out the money, the government has a right to dictate how it is spent, but in a constitutional democracy like ours, it is not the government that has rights. We, the people, have rights. The Constitution exists to restrain government, not to empower it.

Whether government has the right to limit pay is not the question. The question is whether it is a good idea for the government to have the power to set compensation. Despite our anger, the answer is no.

Haye, the Nobel Laureate economist, said: "The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design." The special master imagines he can design compensation packages that "align incentives," while "retaining key talent," but it is impossible for any one person, no matter how wise, to anticipate the consequences of such decisions. Nor does he have any incentive to acquire that knowledge. He has no skin in the game.

A single individual has been given enormous arbitrary power with insufficient accountability or transparency. This is not good for the rule of law, democracy or capitalism. By focusing on those who owe the government TARP money, the special master distracts us from other firms that benefited from government rescue such as Goldman Sachs and JP Morgan Chase.

The comfort we receive from seeing compensation reduced distracts us from the policies that created the problem in the first place, the rescue of Wall Street from its own recklessness. It is a charade of political window dressing to make crony capitalism look respectable.

I want my country back. Let us get the government out of the auto business, out of the banking business, and out of the compensation design business. We need explicit timetables to disengage from government ownership, including a plan for how the Federal Reserve will draw down its balance sheet. Most of all, we need to stop trying to imagine we can design housing markets, mortgage markets and financial markets and compensation.

I want my country back. I want a country where responsibility still means something, where rich and poor, Main Street and Wall Street live by the same rules. We don't need a special master to level the playing field; we just need to take the crony out of crony capitalism so we can get back to the real thing.

Thank you very much.

[The prepared statement of Mr. Roberts follows:]

MERCATUS CENTER
GEORGE MASON UNIVERSITY

The Vices and Virtues of Limiting Executive Compensation

TESTIMONY

by

Russell Roberts
Professor of Economics
George Mason University

House Committee on Oversight and Government Reform
Hearing entitled "Executive Compensation: How Much is Too Much?"
October 28, 2009 11:00 AM
2154 Rayburn House Office Building

Russell Roberts is a professor of economics at George Mason University, the J. Fish and Lillian F. Smith Distinguished Scholar at the University's Mercatus Center, and a research scholar at Stanford University's Hoover Institution.

He is the author of three books on how markets work. A member of the Mercatus Center's Financial Markets Working Group, he is finishing a monograph on the financial crisis. He is also the host of the weekly award-winning podcast, EconTalk. He holds a Ph. D in economics from the University of Chicago.

Chairman Towns, Ranking Member Issa, and Distinguished Members of the Committee:

Americans are angry about executive compensation.

Rightfully so.

The executives at General Motors and Chrysler don't deserve to make a lot of money. They made bad products that people didn't want to buy.

The executives on Wall Street don't deserve to make a lot of money. They were reckless with other people's money. They made bad bets that didn't pay off. And they wasted trillions of dollars of precious capital, funneling it into housing instead of health innovation or high mileage cars or a thousand investments more valuable than bigger houses.

Everyday folks who are out of work through no fault of their own want to know why people who made bad decisions not only have a job but a big salary to go with it.

No wonder they're angry at Wall Street,

But if we keep getting angry at Wall Street, we'll miss the real source of the problem. It's right here. In Washington.

We are what we do. Not what we wish to be. Not what we say we are. But what we do. And what we do here in Washington is rescue big companies and rich people from the consequences of their mistakes. When mistakes don't cost you anything, you do more of them.

When your teenager drives drunk and wrecks the car, and you keep give him a do-over—repairing the car and handing him back the keys—he's going to keep driving drunk. Washington keeps giving the bad banks and Wall Street firms a do-over. Here are the keys. Keep driving. The story always ends with a crash.

Capitalism is a profit and loss system. The profits encourage risk-taking. The losses encourage prudence. Is it a surprise that when the government takes the losses, instead of the investors, that investing gets less prudent? If you always bail out lenders, is it surprising that firms can borrow enormous amounts of money living on the edge of insolvency?

I'm mad at Wall Street. But I'm a lot madder at the people who gave them the keys to drive our economy off the cliff. I'm mad at the people who have taken hundreds of billions of taxpayer money and given it to some of the richest people in human history. I'm mad at Bush and Obama and Paulson and Geithner and Bernanake. And I'm mad at Congress. You made sure that risk-takers continue to expect that the rules that apply to the rest of us don't apply to people with the right connections.

You have saved the system, but it's not a system worth saving. It's not capitalism but crony capitalism.

Using a Special Master for Compensation to get our money back is too little, too late.

Many people argue that because the government handed out the money, the government has a right to dictate how it is spent. It's a reasonable thought in personal relations. If I offer you money, I have a right to attach strings to my generosity. But in a constitutional democracy like ours, it is not the government that has rights. We, the people, have rights. The Constitution exists to restrain government, not to empower it.

Whether government has the right or not isn't the question. The question is whether we want government to have the power to set compensation. Despite our anger, the answer is no.

F. A. Hayek, the Nobel Laureate economist, said: "The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design."

The Special Master imagines he can design compensation packages that "align incentives" while "retaining key talent."

But it is impossible for any one person—no matter how wise—to anticipate the consequences of such decisions. Certainly the Special Master does not possess that knowledge.

Nor does he have any incentive to acquire that knowledge. He has no skin in the game.

Worse, a single individual has been given enormous arbitrary power. He threatens to expand that power. This is not good for the rule of law, democracy or capitalism.

By focusing on those who owe the government TARP money, the Special Master distracts from the other firms that benefited from government rescue—Goldman Sachs and JP Morgan Chase and others.

The comfort we receive from seeing compensation reduced distracts us from the policies that created the problem in the first place—the rescue of Wall Street from its own recklessness.

It is a charade of political window dressing to make crony capitalism look respectable.

I want my country back.

Let's get the government out of the auto business, out of the banking business and out of the compensation design business. We need explicit timetables to disengage from government ownership including a plan for how the Federal Reserve will draw down its balance sheet. Most of all, we need to stop trying to imagine we can design housing markets and mortgage markets and financial markets and compensation.

I want my country back.

I want a country where responsibility still means something. Where rich and poor, Main Street and Wall Street live by the same rules. We don't need a Special Master to level the playing field. We just need to take the crony out of crony capitalism so we can get back to the real thing.

Chairman TOWNS. Thank you very much.
Professor Black.

STATEMENT OF WILLIAM K. BLACK

Mr. BLACK. I join Russ in thanking you all for having us and making this opportunity. I would certainly agree with him strongly that what we have is crony capitalism, but it isn't crony capitalism that occurs simply because of bail-out. That is critical to understand. The same process occurred when creditors were wiped out, when subordinated debt holders were wiped out, when shareholders were wiped out, it happened when there were absolutely no bail-outs, Enron and WorldCom. All of these circumstances, it was the same mechanism, executive compensation that drove those frauds. It is what is produced, the crony capitalism.

You can stop the bail-outs, and I think you should, but you are still going to have this problem unless you deal with pay. You have to deal with not simply executive compensation, you have to deal with compensation more broadly. Look what happened.

In the savings and loans crisis, there was an exhaustive investigation of what happened. The National Commission found that in the typical, large failure, fraud was invariably present and that the means of the fraud was accounting fraud and that the way you convert the firm assets to the benefit of the CEO is through modern compensation mechanisms. You saw that in abundance with Enron and WorldCom, the use of the rank and yank system to incent people to commit frauds.

In other words, we have known for at least 35 years how to do incentives. It came, not from government, but from a very conservative libertarian, Michael Jensen who said, "We're doing it all wrong, we need to change compensation. We need to go to much more aggressive performance-based pay," and he set out how you should do it.

What did Mr. Feinberg just report? That 35 years later, even after these disastrous failures, they could not get it right, that they designed systems and tried to run it past him which obviously further misaligned the interests of shareholders from those of the managers.

We need to stop that system. That is the system that has caused this crisis. Why did loan brokers bring in bad loans, consistently? Because they were put on incentive systems based solely on volume and not on quality. Why did appraisers get inflated? It is because compensation created a Gresham's dynamic in which bad ethics drove good ethics out of the marketplace. There are really good quantitative numbers on this.

Chairman TOWNS. Professor Black, we are going to have to interrupt you. We have to run to vote and we will be back 10 minutes after the last vote.

[Recess.]

Chairman TOWNS. Let me apologize, Professor Black. We thought we would be able to get your testimony finished, but we ran out of time. You have to vote around here and if you don't vote, you constituents will talk about it. We talk about anger, that is the same kind of anger we get with this compensation, if you don't vote, so we had to run over to make the vote.

If you will continue, please?

Mr. BLACK. To resume, the critical thing to understand about accounting control fraud in connection with executive compensation is that it is a sure thing. It is a very simple formula for how you optimize. You grow really rapidly, you make very, very bad loans, you have extreme leverage and you put in minimal loss reserves.

If you do those four things, you will produce, not just profits, but record profits. Then you can use seemingly normal, corporate mechanisms of compensation to convert firm assets to your benefit as the CEO. It is the perfect crime, if you do it without giving orders to engage in the accounting fraud. You can give that order through modern executive compensation.

I cannot send a memo at Fannie Mae that says to 10,000 employees, we want to commit accounting fraud, but I can do the same thing with my compensation system. All I have to do is extend it, not just to the top 100, these modern compensation systems go much farther down in the organization, and you will get, as a relatively junior officer, an incredible increase in your income, and as a more senior officer, even more. All you have to do is fudge the numbers. Then all I have to do as the CEO is not care and pay you a maximum bonus based on those fudged numbers.

The degree of this fudging is extraordinary. IndyMac losses on Alt A, liars loans, are running roughly 80 percent it appears. OTS, the Office of Thrift Supervision, reports overall, Alt A loans are causing losses of 55 percent. Those are staggering numbers. The FBI has publicly testified that it would be irresponsible to discuss the current crisis without discussing the role of fraud in it.

So, no, compensation isn't what directly causes the largest losses. Compensation, incents you to make deliberately bad loans to grow very rapidly to produce financial bubbles. That produces catastrophic losses and that is the system we have right now.

I don't know where I am in terms of time. I think I have probably done 5 minutes and I will stop. I know the day is not young.

[The prepared statement of Mr. Black follows:]

The Disastrous Unexpected Consequences of Private Compensation Reforms

TESTIMONY

of

William K. Black
Associate Professor of Economics and Law
University of Missouri-Kansas City

House Committee on Oversight and Government Reform
Hearing: "Executive Compensation: How Much is Too Much?"
October 28, 2009 11:00 a.m.
2514 Rayburn House Office Building

William Black is a professor with dual appointments in economics and law at the University of Missouri-Kansas City. He is also a white-collar criminologist and a former senior financial regulator.[1] He was the staff leader of the reregulation of the savings & loan industry in 2004-07. He developed the concept of "control fraud" – in which those that control seemingly legitimate entities use them as "weapons" of fraud. He has served as the deputy staff director of the national commission that investigated the causes of the S&L debacle, as a consultant for the World Bank on anti-corruption efforts, and as an expert witness for the government in its enforcement action against Fannie Mae's former senior leaders.

Dr. Akerlof described Dr. Black's book about control fraud (*The Best Way to Rob a Bank is to Own One*) as "a classic." Paul Volcker and Representatives Leach and Levitas also praised it. Bill Black has also taught at the LBJ School of Public Affairs at the University of Texas at Austin and at Santa Clara University. He is co-authoring a new book on the ongoing crisis with Professors Galbraith and Auerbach of the LBJ School of Public Affairs.

[1] His regulatory career is profiled in Chapter 2 of Professor Riccucci's book *Unsung Heroes* (Georgetown U. Press: 1995), Chapter 4 ("The Consummate Professional: Creating Leadership") of Professor Bowman, et al's book *The Professional Edge* (M.E. Sharpe 2004), and Joseph M. Tonon's article: "The Costs of Speaking Truth to Power: How Professionalism Facilitates Credible Communication" *Journal of Public Administration Research and Theory* 2008 18(2):275-295.

Chairman Towns, Ranking Member Issa, and Distinguished Members of the Committee:

Here are my main points:

- This crisis, like prior crises, is primarily a story of accounting "control fraud"
- Accounting control fraud produces guaranteed, record (fictional) profits
- When it is epidemic it hyper-inflates financial bubbles and leads to crisis
- The FBI began warning publicly about mortgage fraud "epidemic" in September 2004 and later added that 80% of the losses were caused when lender personnel were involved – yet nothing was done against the control frauds
- Executive compensation is central to why we have recurrent, intensifying crises: it creates perverse incentives for accounting control fraud and it creates a perfect crime – if you create perfect crimes you will cause disaster. Average CFO's tenure is three years.
- Executive compensation combined with accounting control fraud doesn't simply defeat "private market discipline" – it renders it perverse; it aids the fraud
- This creates a Gresham's dynamic in which bad ethics drives out good ethics
- Only government, through regulation and prosecution, can prevent such perfect crimes. The issue isn't regulation v. markets. The rule of law is essential to make markets function properly. Right now, the markets are too often "spontaneously generating" fraud networks. This is the consequence of deregulation and desupervision. Sometimes that consequence is unintended.
- Deregulation, non-regulation, and desupervision of financial sectors are all equivalent to decriminalizing accounting control fraud – without effective regulators the Department of Justice cannot succeed
- The compensation problem is far broader than the compensation of senior executives and the compensation of executives at entities that received TARP aid
- "Too big to fail" enshrines systemically dangerous institutions (SDIs) and exacerbates these perverse incentives, but ending bailouts would *not* restore effective private market discipline
- The refusal of elite business officials to take responsibility for their often criminal actions, the constant effort to blame it all on "the government," is not simply fallacious – it turns CEOs into infants
- We, the citizens, need to go on strike. The CEOs that caused this crisis are not "Atlas" – holding up the world for us. We, the U.S. citizens, held up the world for them when their frauds caused the world to come crashing down. If they were to go on strike the world would be a far better place. They are the parasites. As Professor Roberts has said, they have used the disaster they created and their political power to turn the U.S. into "crony capitalism." So, we, the productive and honest class must go on strike. Not one more penny should go to bail out failed firms or their creditors unless there is a clear legal obligation to do so (the FDIC, of course, will pay its obligations). Let us investigate and prosecute the control frauds and recover compensation gained through accounting fraud. No more bonuses for any lender that takes advantage of the accounting gimmicks the bankers demanded to hide their losses – thereby inflating their "profits" and compensation. No more bonuses for firms that continue the "don't ask; don't tell"

> underwriting system that did so much to cause this crisis and continues to make it harder to prosecute the frauds.

Americans are not nearly as angry as they should be about executive compensation. If they knew more, they would be angrier. The current crisis is only the latest in a series of intensifying crises brought on by epidemics of "control fraud." "Control fraud" is a white-collar criminology theory that explains frauds in which those that control a seemingly legitimate entity use it as a "weapon." In the financial sphere, accounting is the "weapon of choice." Accounting control frauds' ability to create record (fictional) profits means that compensation is a major driver of fraud epidemics and executive compensation is the primary means by which control frauds convert a firm's assets to their own personal benefit – while minimizing the risk of prosecution.

The National Commission on Financial Institution Reform Recovery and Enforcement (NCFIRRE) (1993), documented the distinctive pattern of business practices that lenders typically employ to optimize accounting control fraud.

> The typical large [S&L] failure was a stockholder-owned, state-chartered institution in Texas or California where regulation and supervision were most lax.... [It] had grown at an extremely rapid rate, achieving high concentrations of assets in risky ventures.... [E]very accounting trick available was used to make the institution look profitable, safe, and solvent. Evidence of fraud was invariably present as was the ability of the operators to "milk" the organization through high dividends and salaries, bonuses, perks and other means (NCFIRRE 1993: 3-4).

Enron, WorldCom and their ilk provided the second recent U.S. epidemic of accounting control fraud. The FBI began warning against the latest epidemic – mortgage fraud – in its congressional testimony in September 2004. The FBI has also emphasized that 80% of the losses from mortgage fraud occur when lender personnel are involved in the fraud.

Unfortunately, unlike the relatively prompt and properly focused FBI investigations during the S&L debacle, criminal investigations of the major nonprime lenders did not begin during the current crisis until the secondary market in nonprime mortgage paper collapsed in March 2007. The FBI has found:

> Many of these bankrupt subprime lenders manipulated their reported loan portfolio risks and used various accounting schemes to inflate their financial reports (FBI Report FY07).
>
> [It] would be irresponsible to neglect mortgage fraud's impact on the U.S. housing and financial markets (FBI testimony 2009).

Each of these control fraud epidemics emanated from the private sector, particularly from elite lenders and investors. They were made possible because ineffective regulation, perverse "private market discipline," and modern compensation optimized a "criminogenic environment" in which strong, perverse incentives encouraged accounting fraud. It is essential that executive compensation and "private market discipline" be fixed before they cause another crisis. Effective regulation is the only means to do this.

The recipe for optimizing accounting control fraud

The formula for a lender optimizing accounting control fraud has four parts:

1. Grow extremely rapidly (Ponzi-like)
2. Lend to the uncreditworthy
3. Extreme leverage
4. Grossly inadequate loss reserves

The central fact that must be understood is that this formula produces nearly immediate, extraordinary, and guaranteed short-term "profits." The formula is simple accounting mathematics. Accounting fraud is a sure thing – not a "risk" as we think of that term in finance (Akerlof & Romer 1993; Black 2005). Accounting frauds rarely engage in fraud for the purpose of slightly increasing reported profits. They typically engage in fraud to report exceptional profits.

The reason that extreme growth optimizes accounting fraud is obvious, but the concept that *deliberately* making uncreditworthy loans optimizes short-term accounting profits is counter-intuitive. The first two ingredients in the accounting fraud formula are related. Lenders in a mature market such as home mortgages cannot simply decide to grow rapidly by making *good* loans. Lenders can grow rapidly by making good loans through two means. They can acquire competitors (a strategy that inherently cannot be followed by a very large number of lenders) or they can drop their yields and seek to compete on the basis of price (i.e., their mortgage interest rate in this context). Their competitors are almost certain to match any reduction in mortgage interest rates, so the latter strategy generally fails to provide substantial growth while the lower price leads to reduced "profit" margins.

Lending to the uncreditworthy, however, allows exceptional growth and allows one to charge a higher interest rate. The combination maximizes accounting income. As James Pierce, Executive Director of the National Commission on Financial Institution Reform, Recovery and Enforcement (NCFIRRE) explained:

> Accounting abuses also provided the ultimate perverse incentive: it paid to seek out bad loans because only those who had no intention of repaying would be willing to offer the high loan fees and interest required for the best looting. It was rational for operators to drive their institutions ever deeper into insolvency as they looted them. (1994: 10-11; see also Akerlof & Romer 1993; Black 1993; Black, Calavita & Pontell 1995; Black 2005)

In order to make bad loans a practice, a control fraud must gut its underwriting and internal and external controls. Under conventional (failed) economic theory this should be impossible for the existing bad loans would be obvious to any creditor or purchaser of the bad loans. In the ongoing crisis, the answer to this problem was the financial equivalent of "don't ask; don't tell."

> Any request for loan level tapes is TOTALLY UNREASONABLE!!! Most investors don't have it and can't provide it. [W]e MUST produce a credit estimate. It is your responsibility to provide those credit estimates and your responsibility to devise some method for doing so. [S&P '01]

The context is that a professional credit rater at Standard & Poors has asked for access the nonprime mortgage loan files backing an exotic derivative so that he can review a sample of them to evaluate credit risk. One cannot evaluate fraud risk, the most serious credit risk, without reviewing a sample of the loan files, so the request should be routinely granted. His supervisor's answer, shown above (the punctuation is from the original), is facially insane. Note that the supervisor makes multiple revealing statements. In addition to the obvious – I don't care how you do it, find a way to rate it favorably so we can get our (premium) fee – he notes that the "investors" typically do not have the loan files. The investors were the entities, generally investment banks, purchasing the underlying nonprime loans and pooling them to back structured financial derivatives, primarily collateralized debt obligations (CDOs). If the investment banks don't have the loan files then it is extremely likely that they did not review a sample of the loan files before they purchased the mortgages. The entities that purchase interests in the CDOs from these investment banks obviously cannot conduct due diligence either before they purchase. This entire industry, supposedly composed of experts in evaluating risk, religiously avoided reviewing the primary risk – even during a massive bubble and even after the FBI's warning of an epidemic of mortgage fraud.

Fitch, the smallest of the big three rating agencies, finally reviewed a small sample of the underlying nonprime loans in November 1007. The date that they released their study is important, for it came after the collapse of the entire secondary nonprime market. In other words, they wouldn't lose any business because new CDOs were not being created and rated. Fitch's twin findings were:

> The result of the [Fitch loan file] analysis was disconcerting…as there was the appearance of fraud or misrepresentation in almost every file.
>
> [T]he files indicated that fraud was not only present, but, in most cases, could have been identified with adequate underwriting …prior to the loan funding. [Fitch 11.07]

Note that Fitch did not find these frauds through a field investigation. It simply did a file review and reported on frauds so crude that they were obvious from the files.

When competitors mimic this optimization strategy the net effect of this competition further optimizes accounting fraud. This perverse competitive effect is also counter-intuitive. As more firms emulated the initial accounting control frauds strategy of making subprime and "liar's loans" to buyers that could not repay the loans the competition among the lenders reduced non-prime mortgage interest rates. That effect, of course, reduced their accounting profits. ("Alt A" loans were, falsely, represented by their issuers as equivalent in risk to (extremely low risk) "prime" loans. They were made without verifying the borrower's most important representations. In the trade, they were known as "liar's loans" because failing to verify such information maximizes "adverse selection" and leads to pervasive deceit.) The dominant effects of rapidly expanding nonprime lending, however, were to massively expand growth and to extend and hyper-inflate the housing bubble. The net effect of increased competition among non-prime lenders was to substantially increase short-term "profits."

The greater a firm's leverage (debt to equity ratio), the greater its return on equity, the more likely its stock to increase in value, and the larger the executive compensation. If the lender were to place the loss reserves appropriate to lending (and required by generally accepted accounting principles (GAAP)) primarily to the borrowers least likely to repay the loans its "profits" would disappear and it would report that it was insolvent and unprofitable. The executives would not be paid any bonuses and their stock options and shares would be worthless. It would also make it impossible to sell their non-prime mortgages to others. Accounting control frauds therefore do not comply with GAAP and record proper loss reserves. This optimizes their short-term "profits" but constitutes securities fraud if they are publicly traded.

Optimizing the Ability to Make Bad Loans

The glaring difficulty with a lender adopting a strategy of deliberately making an enormous number of bad loans is that an honest lender's entire institutional structure and culture is designed to prevent bad loans. Large lenders, and bubbles are inherently the product of the actions of large lenders, have multiple layers of internal and external controls that are typically extremely effective in preventing bad home mortgage loans. Losses on prime home mortgage loans are generally well under one percent.

The internal controls at large lenders are supposed to include the loan officer, the loan officer's supervisor, loan underwriters, internal appraisers, the credit committee, the senior risk manager, the internal auditor, the audit committee, the chief operations officer (COO), CFO and CEO, the asset/liability committee, and the board of directors. The external controls include the outside auditor, rating agencies, and appraisers. A large lender will have roughly a dozen overlapping controls that are supposed to stop any practice that leads to significant numbers of preventable bad loans.

Each of these control layers must fail – contemporaneously – to permit an overall strategy of making tens of thousands of bad loans. The odds against each of these controls failing contemporaneously and independently due to random events are miniscule. The odds that the controls will all fail independently and the failures will continue for five years without being restored are essentially zero.

Lenders that engage in accounting control fraud need to end normal, prudent underwriting and to pervert multiple layers of "controls" into non-controls that will (1) endorse a lending strategy of making bad loans, (2) fail to book loss reserves that will cover the resultant losses, (3) produce and "bless" fraudulent accounting statements that purport to show that making bad loans is exceptionally profitable, and (4) pay extraordinary bonuses premised on the fraudulent profits. It is impossible to produce and maintain such a pervasively fraudulent firm (and suborn the external controls) without the active support of the senior officers controlling the firm (Black, Calavita & Ponetell 1995; Calavita, Pontell & Tillman 1997; Black 2002).

Creating a Corrupt "Tone at the Top" Suborns Internal Controls

A large firm obviously cannot send a memorandum or email message to a thousand employees instructing them to commit accounting fraud. The firm can, however, send the same message without any risk of criminal prosecution through its compensation system.

Modern executive compensation systems suborn internal controls. (Control frauds do not "defeat" controls — they turn them into oxymoronic allies.) The Business Roundtable is made up of the nation's 100 largest firms. In response to the series of accounting control fraud failures (e.g., Enron and WorldCom) in 2001 and 2002, the Roundtable chose Franklin Raines, then Fannie Mae's CEO, as its spokesman to explain why that epidemic of fraud had occurred. In a *Business Week* interview he was asked:

> [*Businessweek:*] **We've had a terrible scandal on Wall Street. What is your view?**
>
> [Raines:] Investment banking is a business that's so denominated in dollars that the temptations are great, so you have to have very strong rules. My experience is where there is a one-to-one relation between if I do X, money will hit my pocket, you tend to see people doing X a lot. You've got to be very careful about that. Don't just say: "If you hit this revenue number, your bonus is going to be this." It sets up an incentive that's overwhelming. You wave enough money in front of people, and good people will do bad things.

Unfortunately, Raines' insights stemmed from his implementation of just such a system.[2] Raines knew that the unit that should have been most resistant to this "overwhelming" financial incentive, Fannie Mae's Internal Audit department, had

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[2] Raines' observation about the perverse impact of such compensation systems has been confirmed by statistical tests. As Bebchuk & Fried, the leading experts on compensation systems, observed in their study of Fannie Mae's compensation system:

> As we noted at the outset, we do not know whether Raines and Howard were in any way influenced by the incentives to inflate earnings created by their compensation packages. There is a growing body of evidence, however, that in the aggregate, the structure of executive pay affects the incentive to inflate earnings.[10] For example, pay arrangements that enable executives to time the unwinding of equity incentives have been correlated with attempts to increase short-term stock prices by inflating earnings. Thus, the problem of rewards for short-term results is of general concern.
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> n. 10 *See, e.g.*, Scott L. Summers & John T. Sweeney, **Fraudulently Misstated Financial Statements and Insider Trading: An Empirical Analysis**, 73 *Acct. Rev.* 131 (1998). For further discussion of this problem, see [Lucian Bebchuk & Jesse Fried, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation* (2004):] at 183-85.

Executive Compensation at Fannie Mae: A Case Study of Perverse Incentives, Nonperformance Pay, and Camouflage. Lucian A. Bebchuk and Jesse M. Fried. *Journal of Corporation Law*, 2005, Vol. 30, pp. 807-822 (at p. 811).

Even scholars opposed to many aspects of financial regulation have noted the endemic nature of these perverse incentives and their close ties to accounting and securities fraud. Markham, Jerry W. **Regulating Excessive Executive Compensation – Why Bother?** (available on SSRN: See, e.g., pp. 20- 21). The depth of consensus on this issue is shown by the strong concurrence of the intellectual father of executive bonus systems, Michael Jensen, who has concluded that (as implemented) they have caused pervasive perverse incentives and led to endemic accounting and securities fraud. Jensen concludes:

- When managers make any decisions other than those that maximize value in order to affect reporting to the capital markets they are lying
- And for too long we in finance have implicitly condoned or even collaborated in this lying. Specifically I am referring to "managing earnings", "income smoothing", etc.
- When we use terms other than lying to describe earnings management behavior we inadvertently encourage the sacrifice of integrity in corporations and in board rooms and elsewhere

Recent Evidence from Survey of 401 CFO's Reveals Fundamental Lack of Integrity

- Graham, Harvey & Rajgopal survey ("Economic Implications of Corp. Fin. Reporting" http://ssrn.com/abstract=491627) of 401 CFOs find:
- 78% of surveyed executives willing to knowingly sacrifice value to smooth earnings
- Recent scandals have made CFOs less willing to use accounting manipulations to manage earnings, but
- Perfectly willing to change the real operating decisions of the firm to destroy long run value to support short run earnings targets

Jensen, Michael. **Putting Integrity Into Finance Theory and Practice: A Positive Approach (June 9, 2007)** (available on SSRN).

succumbed to it. Mr. Rajappa, its head, instructed his internal auditors in a formal address in 2000 (and provided the text to Raines, who praised it):

> By now every one of you must have 6.46 [the earnings per share bonus target] branded in your brains. You must be able to say it in your sleep, you must be able to recite it forwards and backwards, you must have a raging fire in your belly that burns away all doubts, you must live, breath and dream 6.46, you must be obsessed on 6.46.... After all, thanks to Frank [Raines], we all have a lot of money riding on it.... We must do this with a fiery determination, not on some days, not on most days but day in and day out, give it your best, not 50%, not 75%, not 100%, but 150%. Remember, Frank has given us an opportunity to earn not *just* our salaries, benefits, raises, ESPP, but substantially over and above if we make 6.46. So it is our *moral obligation* to give well above our 100% and if we do this, we would have made tangible contributions to Frank's goals [emphasis in original].

Internal audit is the "anti-canary" in the corporate "mines"; by the time it is suborned every other unit is corrupted.

The CEO does not have to order, or be aware of, the specific frauds – some employees will do whatever is needed to "earn" their top bonus. The CEO simply communicates – by paying large bonuses based on fictional profits – that he does not care *how* they meet the target. This can create a perfect crime for it gives the CEO ideal deniability. The most common example of this in the housing crisis was the nearly universal practice among nonprime lenders of paying loan officers bonuses on the basis of loan volume irrespective of loan quality. As their peers see that the worst loan officers who make the worst loans maximize their bonuses (and that the "controls" approve even horrific loans), many of them will mimic the worst loan officers' practices. The most moral loan officers leave. This is one example of a Gresham's dynamic in which bad ethics drive good ethics out of the marketplace.

By paying large bonuses if extreme "profits" are obtained even to junior officers the CEO also minimizes the risk of whistleblowers. Whistleblowers are the most common means by which authorities learn of these elite frauds. They pose a special risk to the senior officers running an accounting fraud because they can place the officers on notice of the firm's fraudulent accounting practices by communicating the frauds to the officers. Ignoring the fraudulent practices, or covering them up, can establish the senior officers' knowledge of the frauds and their intent to permit or assist the fraud. Even if the whistleblower communicates the fraud only to junior officers they may inform the senior managers or the internal or external auditors in the belief that it reduces their risk of prosecution. Some potential whistleblowers may be discouraged from blowing the whistle because they will lose their bonus. More, however, are likely to be discouraged from blowing the whistle if scores of their friends and peers will lose their bonuses and cease to be their friends.

When the CEO leads the fraud and uses executive compensation to suborn internal "controls" he and his subordinate officers can also use the power to hire, fire, reward, and discipline to break any resistance to making bad loans. The best employees will reject bad loans – and be criticized and overruled by their superiors. If they persist in rejecting bad loans they can be disciplined or fired – and their vacant cubical will serve as a warning to their peers. It is less grisly than the King placing his enemy's head on a pike, but probably more effective in deterring undesired (desirable) behavior.

Using Compensation to Suborn External Controls

Accounting control frauds optimize their frauds not by "defeating" external controls, but rather by suborning them and turning them into their most valuable allies. U.S. accounting control frauds typically retain top tier audit firms precisely because these firms' reputation is so valuable in assisting their frauds. The value of a top tier audit firm "blessing" fraudulent financial statements is obvious. The blessing helps the control fraud deceive creditors, investors, and regulators. It also makes it difficult to prosecute the CEO who "relied" on the outside auditors.

The value of having one of the top three rating agencies give a collateralized debt obligation (CDO) "tranche" backed by "liar's loans" a "AAA" rating is even more obvious. (CDOs are a variety of "structured finance" in which the cash flows from the underlying mortgages go in order of priority to the owners of different layers of financial derivatives. The top CDO layer (tranche) has the first claim to cash flows and is the least toxic of an extraordinarily toxic instrument. A tranche rated "AAA" (while the nonprime secondary market was still operating), was considerably more valuable and more liquid. The "AAA" rating also appears to validate the "high" quality of the nonprime assets and demonstrate that the nonprime mortgage lenders must be prudent.

Appraisers cannot provide substantial reputation advantages to a control fraud because no appraisal firm has a national reputation remotely analogous to a top tier audit or ratings firm. Nevertheless, outside appraisers can appear to provide an independent, expert, and professional opinion of the market value of the pledged real estate. That opinion, if materially inflated, offers two advantages to accounting control frauds. It allows the lender to make a substantially larger loan (which increases fees and "income") and it allows the lender to claim that the loan is prudent even if the borrower defaults. Appraisers can make horrific loans appear to be good loans.

Control frauds suborn each of these controls primarily by using compensation to create a Gresham's dynamic. In the case of audit firms they also exploit "agency" problems. It is important to understand that while a Gresham's dynamic can lead to endemic corruption of these "controls" they can cause a crisis by suborning only a small portion of the professionals. The senior officers at the control fraud choose the professionals the lender will employ and they can choose the weakest link to provide the opinions they need to aid their accounting fraud.

The existence of a strong Gresham's dynamic has been confirmed in each of these three external "controls."

> [A]busive operators of S&L[s] sought out compliant and cooperative accountants. The result was a sort of "Gresham's Law" in which the bad professionals forced out the good (NCFIRRE 1993: 76).

The typical large S&L fraud invariably used a top tier audit firm and was successful in getting "clean" opinions for several years. Enron, WorldCom and their ilk were consistently able to obtain clean opinions from top tier audit firms, as were the large nonprime specialty lenders.

A major rating agency has confirmed that customers created a Gresham's dynamic during the current crisis. Moody's (2007) reports how much business it lost when it sought to give more realistic (i.e., lower) ratings to the most toxic tranches of toxic CDOs:

> [I]t was a slippery slope. What happened in '04 and '05 with respect to subordinated tranches is ... our competition, Fitch and S&P, went nuts. Everything was investment grade. We lost 50% of our coverage [business share]....

One should not have too much sympathy for Moody's loss of market share on "subordinated tranches." The real money for the agencies on CDOs was the top tranche. The agencies (ludicrously) helped their clients structure their CDO tranches such that the overwhelming bulk of CDOs composed of nonprime loans was purportedly top tier. Moody's joined its peers in giving virtually all of the (toxic) top tier "AAA" or "AA" ratings even though that was facially absurd. Its competitors, by giving even the toxic subordinated tranches "investment grade" ratings, made it possible for pension funds and governments to acquire for investment billions of dollars of ultra-toxic assets that would suffer nearly total losses of market value.

The Gresham's dynamic in appraisals has been established repeatedly in surveys of appraisers.

> A new survey of the national appraisal industry found that 90 percent of appraisers reported that mortgage brokers, real estate agents, lenders and even consumers have put pressure on them to raise property valuations to enable deals to go through. That percentage is up sharply from a parallel survey conducted in 2003, when 55 percent of appraisers reported attempts to influence their findings and 45 percent reported "never." Now the latter category is down to just 10 percent.
>
> The survey found that 75 percent of appraisers reported "negative ramifications" if they refused to cooperate and come in with a higher valuation. Sixty-eight percent said they lost the client -- typically a mortgage broker or lender --

> following their refusal to fudge the numbers, and 45 percent reported not receiving payment for their appraisal.
>
> Though mortgage brokers were ranked the most common source of pressure -- 71 percent of appraisers said brokers had sought to interfere with their work -- agents came in a close second at 56 percent. Both numbers were up significantly from where they were in the 2003 survey. Also identified as sources of pressure were consumers -- typically home sellers (35 percent) -- as well as mortgage lenders (33 percent) and appraisal management companies (25 percent) (*Washington Post*, February 3, 2007).

Appraisal profession leaders have been remarkably open about the destructive effects of t his Gresham's dynamic.

> Given the decline in mortgage activity, appraisers are scrambling for work in a way that's testing the industry's moral fiber, especially in hard-hit markets such as South Florida. It's getting to the point where, says Faravelli [Manager of the California Association of Real Estate Appraisers], with unusual candor for a trade-group official, "You show me an honest appraiser and I'll show you a [financially] poor one" (*Market Watch,* April 24, 2007).

The intimidation can be extreme. Mr. Inserra, an Illinois appraiser testified before Congress about a physical threat:

> Inserra knows how intense the pressure to inflate values can get. Three years ago, he found himself battling one of his largest clients. The bank's senior vice president in charge of mortgage lending tried to get Inserra to "hit a number," industry parlance for inflating the appraisal. He wouldn't do it.
>
> "The discussion got so heated," recalled Inserra, "that he threatened to do harm to my family if I didn't co-operate. I really thought he might do it. I got a restraining order from a judge."
>
> In the end, the banker didn't hurt his family, but he did punish Inserra by depriving him of the $200,000 in annual business he had been getting from the bank (*Ibid*).

Inflating an appraisal is an act of fraud and the only reason that a lender would seek an inflated appraisal – or tolerate inflated appraisals – is if it is an accounting control fraud. Lenders and their trade associations emphasize this point.

> “We have absolutely no incentive to have appraisers inflate home values," Washington Mutual said in a release. "We use third-party appraisal companies to make sure that appraisals are objective and accurate" (*The Seattle Times*, November 1, 2007).

The Mortgage Bankers Association (MBA) first noted why it would be irrational for a lender to inflate appraised values, particularly during a mortgage fraud epidemic.

> If the appraisal contains inflated, inaccurate or material omissions related to the value of the property, the lender will likely suffer a greater loss if the loan goes into foreclosure. Furthermore, a borrower who obtains financing based on an inflated value may be less likely to continue making payments when he or she discovers the value of their home is lower than the outstanding loan balance.
>
> MBA recognizes that mortgage fraud is a burgeoning crime that is impacting more and more companies and communities.
>
> MBA opposes all fraud that affects the mortgage industry, and it is important to understand that mortgage lending institutions do not benefit from inflated appraisals (MBA October 2007).

MBA's logic is impeccable, but it does not explain why lenders were a significant direct source of pressure to inflate appraisals and why they permitted their agents (e.g., loan brokers) to be an even larger source of appraisal intimidation given their incentive and ability to ensure that appraisals they relied on were not inflated. Why did so many lenders directly, or indirectly through their agents, push for inflated appraisals when inflated appraisals are disastrous for the lender? Why did the nonprime specialty lenders routinely pay their loan officers and brokers primarily through compensation systems that created an intense incentive for them to pressure the appraisers to inflate the appraisals? The answer is accounting control fraud. Inflating the appraisal allowed the lender to make more, and larger, loans to uncreditworthy borrowers that would pay a premium interest rate. That maximized short-term accounting "profits" and the senior officers' compensation. Accounting control frauds do not act to further the best interests of the lender. They maximize the CEO's interests at the expense of the lender. The CEO loots the firm through accounting fraud.

The New York Attorney General's investigation of Washington Mutual (WAMU) (one of the largest nonprime mortgage lenders) and its appraisal practices supports this dynamic.

> New York Attorney General Andrew Cuomo said [that] a major real estate appraisal company colluded with the nation's largest savings and loan companies to inflate the values of homes nationwide, contributing to the subprime mortgage crisis.
>
> "This is a case we believe is indicative of an industrywide problem," Cuomo said in a news conference.
>
> Cuomo announced the civil lawsuit against eAppraiseIT that accuses the First American Corp. subsidiary of caving in to pressure from Washington Mutual Inc. to use a list of "proven appraisers" who he claims inflated home appraisals.

> He also released e-mails that he said show executives were aware they were violating federal regulations. The lawsuit filed in state Supreme Court in Manhattan seeks to stop the practice, recover profits and assess penalties.
>
> "These blatant actions of First American and eAppraiseIT have contributed to the growing foreclosure crisis and turmoil in the housing market," Cuomo said in a statement. "By allowing Washington Mutual to hand-pick appraisers who inflated values, First American helped set the current mortgage crisis in motion."
>
> "First American and eAppraiseIT violated that independence when Washington Mutual strong-armed them into a system designed to rip off homeowners and investors alike," he said (*The Seattle Times,* November 1, 2007).

Note particularly Attorney General Cuomo's claim that WAMU "rip[ped] off … investors." That is an express claim that it operated as an accounting control fraud and inflated appraisals in order to maximize accounting "profits." Pressure to inflate appraisals was endemic among nonprime lending specialists.

> Appraisers complained on blogs and industry message boards of being pressured by mortgage brokers, lenders and even builders to "hit a number," in industry parlance, meaning the other party wanted them to appraise the home at a certain amount regardless of what it was actually worth. Appraisers risked being blacklisted if they stuck to their guns. "We know that it went on and we know just about everybody was involved to some extent," said Marc Savitt, the National Association of Mortgage Banker's immediate past president and chief point person during the first half of 2009 (*Washington Independent,* August 5, 2009).

Modern Executive Compensation Minimizes the CEO's Risk of Prosecution

In addition to creating the perverse incentives discussed above, modern executive compensation allows CEOs running accounting control frauds to become enormously rich while minimizing the risk of detection and prosecution. Modern executive compensation is premised on the claim that senior officers must be paid extremely high bonuses to incentivize them to cause the firm to engage in riskier activities that could produce exceptional returns. Proponents claim that such compensation "aligns" the CEO's interests with those of the shareholders (Easterbrook & Fischel 1991). Control fraud theory demonstrates that it can do the opposite – further misalign the interests of fraudulent CEOs to both encourage them to loot the firm and provide an optimal means of looting the firm. I have discussed both aspects in some detail elsewhere (Black 2003, 2005) and will limit this discussion to a brief summary. Accounting control frauds normally control their boards of directors and cause their compensation to be based largely on short-term accounting gains and to be exceptionally large if the firm is highly "profitable." Accounting fraud guarantees extreme short-term profits while the bubble is inflating. Fraudulent CEOs use normal corporate mechanisms to convert firm assets to his personal benefit on the basis of the firm's record "profits." This minimizes the risk that their frauds will be detected or prosecuted. They can get rich enough through a year or two of accounting fraud to retire wealthy. The firm's failure does not mean that the fraud mechanism has failed. Fraudulent CEOs maximize their "take" by maximizing accounting "profits" – through means that often cause the firm to fail. They maximize their income by causing the lender to grow rapidly as the bubble hyper-inflates, a strategy that often causes the firm to fail.

Why accounting control fraud turns private market discipline perverse

Accounting control fraud produces very large "profits" and "equity." Lenders worry primarily about insolvency, so firms reporting large profits and substantial equity are the customers to which they most wish to lend. Instead of providing discipline, creditors provide the bulk of the funds that control frauds loot.

Whenever these control fraud epidemics occur, however, theoclassical economists try to excuse the behavior of the elite frauds by blaming it all on the government. During the S&L debacle, they claimed that the problem was deposit insurance. The economists claimed that deposit insurance removed the incentive of creditors to engage in "private market discipline" (depositors are S&Ls' dominant creditor and most deposits are fully insured).

The logic was that because it is expensive to monitor for fraud, fully insured creditors (i.e., depositors) would not bear those expenses because they were fully protected from loss. This logic was falsified by the S&L debacle. First, shareholders are also supposed to provide effective discipline (indeed, they must do so under the "efficient markets hypothesis" – the core principle of modern finance). Shareholders are not insured and were routinely wiped out by S&L receiverships. Second, many S&L control frauds had subordinated debt. S&L receiverships also routinely wiped out the subordinated debt holders. Theoclassical economists argued that subordinated debt holders were the ideal form of private market discipline because (1) they are at exceptionally great risk of loss in the event of insolvency and (2) they are supposed to be particularly "sophisticated." In no case did subordinated debt holders provide effective discipline against an S&L control fraud. S&Ls also had uninsured risk exposure in receiverships through syndicated loans and joint ventures – none provided effective discipline. We resolve a number of the worst S&L control frauds through liquidating receiverships. Even general creditors knew they were at risk of loss.

Note also that a major fraudulent investment banker – Michael Milken's Drexel Burnham Lambert – failed during the S&L debacle. (Several of the worst S&L control frauds such as Charles Keating's Lincoln Savings were Drexel's "captives.") Drexel's creditors suffered serious losses.

The second recent epidemic of accounting control fraud, centered largely among high tech firms, again falsified the claim that private market discipline would stop accounting control frauds if there were no deposit insurance. None of the major control frauds in that epidemic was federally insured and their creditors suffered very large losses.

The current epidemic has also falsified the claim. The leading entities that specialized in making nonprime mortgage loans were overwhelmingly uninsured – as were the leading entities that purchased financial derivatives backed largely by fraudulent mortgage loans. Most of these entities went bankrupt and their creditors suffered major losses. The U.S. had not bailed out investment banks in any recent crisis. The recent precedents were that they, like hundreds of mortgage banking firms specializing in nonprime loans, were allowed to fail and their creditors suffered serious losses precisely because private market discipline was so ineffective in constraining losses. To sum it up, creditors had strong incentives to engage in private market discipline in 2002-06 when the housing bubble was expanding and particularly after the FBI's September 2004 warning that there was an "epidemic" of mortgage fraud developing, but they did engage in effective private market discipline. They did the opposite – they provided massive loans to fund extreme growth by the uninsured nonprime lending specialist firms. "Private market discipline" was an oxymoron. Instead, of discipline, the creditors acted like an accelerant spreading the arsonists' flames.

As Professor Roberts phrased it last month: "Who lent them the money? Each other." "That's sick, that's bad for capitalism, its bad for democracy."

One of the fundamental errors of logic is to impute causality to factors that occurred after the event one is trying to explain. Here, the bailout came after the perverse private market discipline and it came in circumstances where if creditors were to have predicted from past events they could have had no reasonable basis for believing that the U.S. government would bail out creditors not covered by federal deposit insurance. A second fundamental logical error is to offer an explanation that cannot explain the overall factual pattern. If the hope that the government would bail out uninsured creditors of lenders the government considered "too big to fail" is supposed to explain why Citi made insane loans to Lehman, what explains why lenders also made insane loans to relatively small mortgage banking firms that (a) were not in fact bailed out and (b) no one could have rationally believed would be bailed out? Something universal had to be involved to explain the pattern of a wholesale breakdown of private market discipline in lending to nonprime mortgage specialists. The FBI's accurate warnings that mortgage fraud was epidemic and coming primarily from the lenders are consistent with accounting control fraud, which explains the overall pattern of perverse private market discipline.

The private sector will not solve this problem

The private sector has actually gotten worse in many compensation dimensions.

> James F. Reda & Associates, an independent compensation consultant in New York ... looked at proxy filings issued by almost 200 companies in the first half of 2009. The firm analyzed changes these companies made to their pay plans that take effect this year.
>
> The biggest shock? Instead of seeing a greater reliance on long-term incentive programs, the Reda report found that changes in these companies' plans made

> short-term incentive pay a bigger part of the compensation pie (Gretchen Morgenson NYT 8.16.09).

The fundamental problem is perverse incentives. The control frauds and the "merely abusive" will have the worst compensation systems. The best run companies will tend to have the best compensation systems. The Gresham's dynamic and short-run nature of senior officers will remain. The only issues are how soon and how severe the next epidemic of accounting control fraud and financial crisis will be. Only the government, through regulation and prosecution, can break this dynamic. Once the dynamic is broken useful peer pressure might also reemerge. That won't deter the control frauds, but it may be helpful against the abusive CEO.

The criticism that some are making of regulation of executive compensation is actually a testament to the need for regulation. The criticism is the claim that if we require compensation to be tied to real, long-term performance the best managers will flee America for the City of London (or China). In other words, the argument endorses a Gresham's dynamic that drives a "competition in laxity" in which the nation with the weakest standards ends up with all the best business leaders.

This is a bizarre argument. It is based on the false assumption that the best leaders insist on being paid the most compensation based on short-term accounting gains that CEOs can produce at will. The dynamic enshrines and rewards abuse and fraud. The idea that the senior officers of the systemically dangerous institutions that created this global crisis represent the world's greatest pool of talent is preposterous. In reality, the UK is cracking down on pay. If we really want to keep all these failed officers in the U.S. we can create a rule that we only bail out financial institutions whose operations are really based in the U.S. The U.S. taxpayers would be happy to see China, rather than the U.S., stuck with bailing out the failed bankers in the next crisis.

What we can do

We need to recognize that compensation, not simply executive compensation, is what has perverted private market discipline. Second, we need to recognize the critical role that executive compensation plays in producing epidemics of accounting control fraud. Third, we need a massive crackdown on accounting fraud – which will allow us to claw back the massive fruits of accounting fraud that executives have already received. We need to provide the FBI promptly with a minimum of 1000 new white-collar crime specialists and prioritize their investigations on the leading nonprime specialty lenders and investors. The Fourth, we need to realize that huge pay for senior executives must be given only on the basis of real, sustained performance.

That means the taxpayers should go on strike. No more money for bailouts – not a penny – until we recover the past compensation obtained through fraud and end executive compensation programs that produce a criminogenic environment for accounting control fraud. We need to end the accounting gimmicks that the industry demanded (and Congress provided) that allow lenders to avoid recognizing losses. This inflates net worth and earnings enormously and maximizes "moral hazard." It leads to completely unjustified compensation. No company that takes advantage of these accounting gimmicks should be allowed to use performance pay.

We also need to end "don't ask; don't tell." Neither banks nor the regulators appear to be locating the underlying loan files on the toxic mortgages. This makes it impossible to spot frauds before it is too late, it inflates reported profits, and it slows the making of criminal referrals against the frauds.

We don't have to set salaries. We need to set standards that better tie pay to long-term performance and have clear "clawback" authority where the numbers are frauds.

As Mr. Meyerson said on April 27, 2009:

> The role of government is to mitigate those [crises]. And I think it historically can. And I think when it's doesn't it's because the regulators have grown lax. It's because you get things like the SEC, the Securities and Exchange Commission under George W. Bush, which really as in the Bernie Madoff case just to take an extreme example almost felt its mandate was to look the other way. I think if that's what we have as regulators then "yes", regulations under those conditions don't work. So, you need a civil service and you need officials that are committed to this. But you can keep explosions from happening if government is vigilant.

What we need is a commitment to "vigilant" regulators who do not have a "mandate … to look the other way." That does mean professionals from the civil service rather than the shameful political appointees that were appointed precisely because they did not believe in regulation.

Chairman TOWNS. Thank you very much. Let me thank both of you for your testimony. Again, I apologize for the break and the interruption that we had.

Let me begin with you, Professor Black. Please explain the relationship between what you term accounting control fraud and excessive executive compensation.

Mr. BLACK. This exists both in the criminology literature and the economics literature, and indeed, we work together on it. The most famous piece is by the Nobel Prize winner, George Akerlof, and Paul Romer, then at Berkeley, now at Stanford. They had an article in 1993 entitled, "Looting, Bankruptcy for Profit." This is how it works.

I gave you the optimization condition. You grow really rapidly, make deliberately very bad loans, you have extreme leverage, you don't put on loss reserves. If you do those things, it must be the case that you will record record earnings. That was true in the savings and loans crisis where Lincoln Savings and Vernons, the two worst control frauds in America, recorded at different time periods obviously that they were the most profitable savings and loans in America.

By the way, as a footnote, this also screws up any econometric analysis. It produces perverse results.

So, now we have record income. Directly, of course, under modern executive compensation which is extremely large and heavily oriented toward short term accounting gains, this produces maximum bonuses. Frank Raines, in the context of Fannie Mae, when he was still running it, was asked by Business Week, why do we have all these frauds, referring to the Enron and WorldCom frauds, and he said, it is because of modern executive compensation, that when you put enough money in front of people, good people will do bad things. The exact quotation is in my testimony, but that last line is, I think, word for word.

Chairman TOWNS. Thank you, very much, Professor Black.

Professor Roberts, I understand your aversion to the bail-out, but given the existing relationship between the government and the seven largest bail-out firms, how would you address executive compensation issues until such time as the government has been repaid and able to get out of the companies?

Mr. ROBERTS. Special Master Feinberg, I thought, did a masterful job defending what he is doing in those seven firms. As he said, he is helped by consultants, Lucian Bebchuk and Kevin Murphy, two economists I have a lot of respect for, but unfortunately, there is no way that they can successfully figure out the consequences of their decisions. The mix of short term and long term pay, the special master talked about it as if it is a science. It is not a science; it is really a wild guess. I think the real danger of his enterprise, besides the violation of the rule of law, the arbitrariness, the non-transparency, the lack of accountability, the biggest problem is that it distracts the American people. It makes them feel good; oh, we are taking care of these seven firms, but it distracts people from the real cause of the crisis and the real reason they were so over compensated which is those government bail-outs.

I think we ought to be focusing on the incentives that those bail-outs created for egregious executive pay and outrageous pay. I think if we do that, we have a chance of preventing it from happening again in the future. If we stick with this system of trying to knock it down, ex post in an ad hoc way, I am worried we are going to miss the real lesson.

Chairman TOWNS. You don't think that through this process that the folks on Wall Street would get the message?

Mr. ROBERTS. No, I don't think they will actually. I don't think they will get the message at all. I think we have seven firms being told that they have to behave; the rest of the firms are getting away with it. Goldman Sachs and JP Morgan Chase and some of the other members mentioned are making record profits. The reason they are making those record profits is, with my money as a taxpayer, because of the incentives we created for them and their expectation that they would get bailed out.

That expectation came true and they acted profligately and irresponsibly. I think the whole system needs to be fixed. The only way to fix it is not from the top down with these ad hoc, arbitrary decisions, but rather, by taking away the very system that allowed them to thrive which is the government rescue. That is what has created the expectation and that created the current problem, and it will create the next problem if we don't fix it.

Chairman TOWNS. What else do you think we need to do?

Mr. ROBERTS. Well, politically, since there is a lot of anger on Main Street, I would go after some folks over whom you have direct legislative control. I think it is a good time to get rid of some corporate welfare; it is a good time to get rid of payments to millionaire agribusiness folks; it is a good time to get rid of the sugar quota which makes ever American pay more for food, takes jobs out of America into Canada where they don't have such sugar quotas. Politically, I think it is a great time to do some things that are often hard to do. I would love to see Congress do that.

In terms of the financial crisis, I think we are going to have to have recognition of the Government's role and I hope the housing market will change. I hope we have learned something about the challenges and dangers of trying to create home ownership for every American. That is not the American dream; it is the dream of the National Association of Homebuilders and the National Association of Realtors. That has been a mistake. Fannie and Freddie are going to cost us at least $100 billion. You budgeted $400 billion and I am worried it is going to be more than that. The Federal Reserve holds $1 trillion or so of their loans, many of which will turn out to be bad loans, so I am worried about where that is going.

I would like to see, if possible, Congress put some pressure on the Fed to get out of that business, get out of the mortgage business which it is in now, have the Federal Government get out of the mortgage business, but most importantly, we have to get out of the banking business. I don't want a banking system that is run implicitly or explicitly by Washington. It is not going to work. It is just going to create the next set of problems like the ones we are in the middle of now.

Chairman TOWNS. We have to get our money back.

Mr. ROBERTS. I am worried about that too. I understand that urge and politically, it is very important to get your money back, but I hate to say this, it might be a mistake to get the money back.

It could be that by propping up these organizations in desperation to keep them going, we are going to cause other distortions, other problems, other waste that we don't see because we want our money back.

The special master is worried about losing key personnel. Maybe he ought to lose them. Maybe they ought to go do something else. Maybe these organizations ought to go out of business and let some other organization thrive. We are still funneling capital and scarce resources into them.

We talked earlier about GMAC. GMAC wants another bail-out. Maybe we ought to say, hey, enough. It is a mistake. We are not going to get our money back. I am not going to keep throwing good money after bad because that is the risk we are playing right now, that we are going to continue to throw money at these folks. It is what we are doing with Freddie and Fannie, it is what we are doing with AIG. Maybe we ought to cut our losses and get out.

I understand the political pressure on you to get our money back, but may be that is a bad risk. To be honest, the special master has no incentive to care about whether that is a good decision or not. He is tasked with trying to get the money back. Again, I understand the advantages of that politically, but economically and for citizens as a whole, it may be a mistake.

Chairman TOWNS. My time has expired and I yield to the gentleman from California, Mr. Issa.

Mr. ISSA. Thank you, Mr. Chairman.

I will start with Professor Roberts. Ironically, the 1992 act felt that executives were not linked to enough risk. In other words, their pay was not at risk in those days and it was going up, so peoples' compensation was less linked to performance. The law, particularly double taxing, was designed to minimize the growth in the base pay and maximize the growth in risk win.

Can you comment on what we should do differently if we want to see a change in that?

Mr. ROBERTS. Earlier I quoted Frederick Hayek, the Nobel Laureate, an economics economist, who talked about the purpose of economics to be to tell people that what they imagine they can design, they cannot really design. There is an inevitable tendency on the part of Congress, and everyone wants to do this, to try to create the perfect system as if it is like the engine of a car. We are going to tweak the carburetor, add some more oxygen and gasoline and a mix of this, and it is a bit of a fantasy to think that the wisest people in the world could tinker and fine tune the mix of current and future compensation to get the right level of risk taking, especially if in the background you have the feeling, and the expectation, and it turns out to be true, that if you mess up, someone is going to rescue you and bail you out. Particularly the bail out of lenders to those folks is what is really dangerous. That is what we have done over and over again.

Mr. ISSA. Thank you for answering my question and describing the Fed. That is what they do. They sit there saying, we can tinker with the economy and there will be no recession, there will be no inflation, everything will be perfect until it isn't.

Professor Black, you talked about Franklin Raines. We have a special regard for Franklin Raines here at the dais. What part of the catastrophe that the world felt do you put on Freddie and Fannie taking on, knowingly, willingly and in fact, demanding to take on, trillions of dollars of loans which had no underlying net value? In other words, they had no equity, no skin in the game by the individuals and thus, no skin in the game for the banks once they got them onto Freddie and Fannie, or Countrywide.

We are talking executive compensation, you are complaining about it, but in a sense, wasn't a great deal of this growth in financial communities profit at the expense of the taxpayers from day one because we were taking the risky investments deliberately under the Federal balance book?

Mr. BLACK. No. It is actually a more complicated story.

Mr. ISSA. I appreciate the more complicated, but no deserves an explanation. No, the GSEs did not take sub prime onto their books?

Mr. BLACK. Fannie and Freddie took less of it onto their books than did purely private entities.

Mr. ISSA. Let us go through that. Freddie and Fannie took trillions onto the books, right?

Mr. BLACK. No.

Mr. ISSA. $1.9 trillion?

Mr. BLACK. Of sub prime?

Mr. ISSA. Of sub prime?

Mr. BLACK. No.

Mr. ISSA. What figure do you have?

Mr. BLACK. For sub prime, they have very little actually. Relatively speaking, they have relatively little sub prime. They have much more of Alt A.

Mr. ISSA. You are talking about liars loans?

Mr. BLACK. You may be under the impression I am here to defend Fannie and Freddie. I assure you I am in a very different position.

Mr. ISSA. Let us go through it. If you take AIG's FP division providing AAA rating for products that were sub prime, you take Freddie and Fannie taking on sub prime and Alt A, you are right about one thing, Alt A is the other name for that basket of loans which did not have ordinary income ratios and equity.

The fact is the banks that took that and flipped did very well and their executives deserved all that great pay because they managed to make money with no risk if they got it off their books. Isn't that right?

Mr. BLACK. In general, no. In general, these things were sold with recourse put backs.

Mr. ISSA. So you bought a credit default and then you wrap or ensured the failure?

Mr. BLACK. Perhaps you did. We don't know about the credit default swap market, you have to understand. That market is still almost completely opaque.

Mr. ISSA. Professor Roberts, perhaps you have more transparency in this particular area if you don't mind answering the same question?

Mr. ROBERTS. The question is, what about Fannie and Freddie's involvement?

Mr. ISSA. And Franklin Raines who was compensated incredibly well.

Mr. ROBERTS. Ninety million dollars over a 6-year period. He had to give some of that back with an accounting fraud problem in 2004, but he did very well and those are the facts.

As you point out, sub prime is an elusive definition. The way it should be defined is troubled loans which could be for many reasons. The most interesting statistic that I know of Fannie and Freddie is that in 2007 at the beginning of the collapse when almost everyone started to realize this was going to have trouble, 23 percent of Fannie and Freddie's home purchase loans that they purchased, loans they purchased that were used to buy a house, had less than 5 percent down. One in every four loans they were buying had very little skin in the game. I think right those loans are on the books of the Fed. I don't think they are going to turn out very well when they reset.

Mr. ISSA. Thank you, Mr. Chairman, very much.

I would only note that Chairman Kucinich was actually holding a hearing during that time in which those loans were still being put on, showing the destruction that was happening in Cleveland at the time and the foreclosure rate that was climbing.

Chairman TOWNS. Thank you very much.

I yield 5 minutes to the gentleman from Missouri, Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman.

I want to thank the witnesses for participating today.

Professor Black, you have stated that government regulation and prosecution are the only solutions that can prevent an issue like this from occurring again. We now see corporations going so far as to sell derivatives on life insurance policies greatly increasing their risk. One can easily see the slippery slope at work here. Corporations will risk more, assuming that taxpayer dollars will be used to save them once again.

You have referred to the need for effective regulators. In your view, what jurisdictional power would these regulators have?

Mr. BLACK. We should be regulating the financial lenders of America. Not regulating the loan brokers and mortgage bankers was a disastrous policy. My counterpart talked about how you can screw up regulation. That is quite true. That is why we don't do it that way.

Let me tell you what we did and why it was so effective in dealing with non-sub prime crisis of 1991–1992. We didn't try to adopt perfect rules. We looked in the industry for their best practices. We didn't go al the way to the best practice. We said what do the prudent lenders do? We had rules that said, you have to act in accordance with prudent members of the industry. That worked phenomenally well. It stopped what would have been a sub prime crisis in those years.

We deregulated and de-supervised after that point and thought it was illegitimate, impossible to regulate. It isn't, but you don't do it by creating every dot and jot. That is not the way good regulators do it.

Mr. CLAY. Professor Roberts, anything to add to that?

Mr. ROBERTS. Yes. There is always the hope that this time will be different. When we find ourselves back in the same place, you do start to think that maybe there is some fundamental mistake we are making. I think there is a strong desire to see an improved regulatory system. We are going to get a different regulatory system, but the question is, is it going to be improved.

The challenge is that Fannie and Freddie, to take an example, had their own regulator, OFAO which wasn't distracted by anything. Why did OFAO stand by and watch Fannie and Freddie make worse loans than they did before, increasingly risky loans, loans without documentation, zero down payment loans, loans with 103 percent of the value of the house? Why did they sit and do that and also stand by and catch accounting fraud way too late after it had already been spiraling out of control?

The answer is, politics. The people involved in the regulation got leaned on, partly by Congress, partly by Fannie and Freddie, as is well known. They were got in a vice, Congress wants Fannie and Freddie to be more active in getting loans to people who can't otherwise get a loan. That is a wonderful idea. Can't disagree with it. Everybody likes it. Fannie and Freddie want to make a lot of money, so they are all of a sudden pushing to take riskier loans. Everybody is happy until the taxpayer foots the bill.

The fundamental question is, why is the next regulatory system going to be insulated from that kind of political pressure. The answer is, it won't be. I would suggest we look for a different mechanism. I would say again, as long as lenders and financial institutions think they will be bailed out of their mistake, this problem will happen over and over and over again.

Mr. CLAY. You left out Treasury and Federal Reserve.

Mr. ROBERTS. In which part?

Mr. CLAY. As far as OFAO?

Mr. ROBERTS. They are also involved. They were also involved in regulation, but I would even go further. We could go to Basel II and Basel II's role in trying to regulate investment banks. Think about how great this was. Basel II said, we have to have stiffer capital requirements to make sure that these investment banks are sufficiently capitalized so that they will not go broke. We are going to make sure they are AAA and we are going to give them more leverage if they are backed by housing because we know housing can't go down.

That was a bit of an error that helped, not just create, but was a huge factor in this because it gave banks an incentive to create something that looked like AAA, which it was not, the toxic assets which we are talking about.

Mr. CLAY. Going back to compensation, these regulations that you speak of, should they apply to compensation for all corporate employees or just executives? I would like to hear from both, Professor Black and Professor Roberts.

Mr. BLACK. You don't want to make the cutoff the executives because they can define that in any way and get around anything. I put a quotation in here, since we are talking about Fannie Mae. I was an expert witness for the government against Frank Raines, you do understand, on these issues in which the complete internal audit system at Fannie Mae was destroyed by the compensation system.

If you leave it to private structures, we know empirically what they will do and that they have done for 35 years. They will systematically misalign the incentives to produce precisely this disaster which, again, did not arise because of government bail-outs. There were no government bail-outs of Enron or WorldCom. There were no government bail-outs of Drexel Burnham Lambert which was the big investment banking firm before this.

Under the theory we have heard, private market discipline should have been very effective because there were no bail-outs. It was completely ineffective. It was completely ineffective this time again. If you rely on private market discipline, you will be back here and the only question is whether it is 3 or 5 years from now, with a bigger disaster on your hands.

Chairman TOWNS. Thank you very much. The gentleman's time has expired.

I now yield for 5 minutes to the gentlewoman from Ohio, Marcy Kaptur.

Ms. KAPTUR. Thank you, Mr. Chairman.

Mr. Roberts, I am hearing you say that regulation was the problem. Am I simplifying too much your statement?

Mr. ROBERTS. Not so much regulation, but the anticipation of a bail-out.

Ms. KAPTUR. Anticipation. Thank you.

If we go back to the 1980's when the S&Ls were bailed out, that was a big green light.

Mr. ROBERTS. Yes.

Ms. KAPTUR. And they went and did more and much worse and now bailed out again.

Mr. ROBERTS. Yes.

Ms. KAPTUR. You heard the testimony this morning and, Mr. Black, you did as well. I want each of you to react to the special master's statements about 2 and 4 year bonuses and stock opportunities and whether you think that time period will really work to exert any restraint inside the system.

My big question to you really is, looking at the mess we have now, what do we do as a country to put the wheels back on this financial system? There are all kinds of proposals up here for consumer credit agencies, new powers for Treasury, systemic risk councils and all of the rest. Cut through all of that. What do we need to do to restore a banking system to prudence in this country and to get our hands on the bank holding companies and all these other contortionists that turn themselves into something every time they get into trouble? What do we do? What would you advise the President? What would you advise us?

Mr. ROBERTS. I would put away the checkbook. That would be the first thing I would advise because I believe, contrary to Professor Black, although we agree on a lot. I agree that the availability of that government checkbook is a huge driver of the irresponsibility that we have seen.

I totally agree with you about the 2 to 4 year thing; that is window dressing. That gives the illusion that it is long term. First of all, 4 years is not long term. Second, 3 years into it, 4 years is not long term. They are going to have an incentive and unfortunately, it has happened in the past, to have the stock price go up and down a lot because when it goes down a lot, then you get your options at a low price. When it goes up a lot, you exercise them. So it takes a year and you only get a third of them, or 2 years you only get a third of them but still a bad incentive under the current system.

One of the common things you hear is we need to recreate securitization, get into the old model. People are scared of securitization. They should be.

Ms. KAPTUR. I am scared of it. Look what it did to us.

Mr. ROBERTS. Right. People say we have to recreate Fannie and Freddie. You know what the benefit of Fannie and Freddie was for the person who took out a mortgage? It was a quarter of a percent. That is dwarfed by the hundreds of billions of dollars that we as taxpayers are going to be on the hook for. I want more transparency. Let us not try to recreate what we have but make it safer which is a mirage and an illusion. Let us be cautious. We should be cautious, we had a very bad experience.

My first lesson is, don't try to recreate what we had before but safer. That is an illusion. Second, don't think you can arbitrarily steer this and that like the 2 to 4 year thing and think, oh, we have solved the problem because we have the right incentives. Take away the checkbook so that people have to bear their losses.

My view is if we are back here in 5 years with the kind of crisis that Professor Black is worried about, I will say good riddance. You drove your company into the ground, too bad. We are not going to bail you out. You lost your money, you took your chances. It is over and people learn a lesson from it and it will improve.

The current system has no incentive for learning or improvement. It is a disaster.

Ms. KAPTUR. Mr. Black.

Mr. BLACK. I certainly agree that the bail-out is a disaster. I think probably 98 percent of Americans believe that the bail-out is a disaster. You are always going to hear from anyone who teaches economics and teaches criminology you have to change the incentive structure. The incentive structure is broken. It will produce recurrent, intensifying crises. It produces perfect crimes under this system. If you allow that to continue, the idea that we are going to have a cleansing every 5 years of a global crisis, is not appealing to me. We can do better and we have done better.

If you appoint people to run agencies who do not believe in regulating, of course you will have a disaster. There is an article by the FHA/HUD person, very conservative, Hudson Institute, about Fannie and Freddie who was in charge of monitoring the regulation of Fannie and Freddie. What does he say? It had nothing to do with incentives for housing. It is entirely driven by compensation and profit. He is a very conservative gentleman in a position to know.

The person running OFAO, I met with the Director as part of all this. This is a conservative, partisan, Republican who hates regulation. OFAO had perfectly adequate regulatory powers to stop Frank Raines and his successor, Mudd, who was every bit as bad from doing what they did which is going to cost America $200-plus billion. They did nothing because they didn't believe it was legitimate to regulate. I met with these people—we can't regulate a place. How could we affect compensation? That is their decision. Maybe if the losses have actually occurred, then maybe we could act.

In the savings and loan crisis, because we recognized accounting fraud, we targeted Lincoln Savings while it was reporting it was the most profitable savings and loan in America. Can you imagine how different that is than the modern world? You talk about putting up with pressure. Charles Keating wrote, “Get Black. Kill him dead.” He hired private detectives twice to investigate me. He sued me for $400 million in my individual capacity in a Bivens action.

He got a majority of this House to co-sponsor a resolution calling on us not to go forward with re-regulation and got the Speaker of the House, James Wright, Jr., to go after us. One of the proposed charges of the Independent Ethics Counsel was the effort of James Wright to fire William K. Black and we got five Senators who I blew the whistle on, the Keating Five.

We took it and we re-regulated the industry and we stopped control frauds that were growing at an average of 50 percent a year and would have produced a crisis of this magnitude if it had been allowed to go on.

Yes, you are right. The leadership is vital and we have to have a system in which we have real Civil Service and where we have a real Justice Department. Your effort to get at least 1,000 additional FBI agents assigned to deal with these frauds is absolutely critical. The Justice Department, in terms of prosecutors, needs help as well.

We have to change the incentive structures. One way is through deterrence, the whole theory of conservatives about how you deal with crime, but another is to get rid of the perverse incentives that now produce the perfect crimes.

Chairman TOWNS. The lady’s time has expired.

The gentleman from Maryland?

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

Following up on what you just said, Professor Black, the President of the United States calls you in tomorrow and asks the question I think Ms. Kaptur asked of Professor Roberts, what do I do to fix this mess and no matter what I have to do, I am going to do it, even if it is just one term because I don’t want to see my country go through this again. What would you do, Professor Black?

Mr. BLACK. Change your senior leaders of your effort because they don’t believe in regulation. I mean Summers, and I mean Geithner.

Mr. CUMMINGS. All right.

Mr. BLACK. Two, we have a series of actings running most of our Federal agencies and to the extent we don’t, for example, Sheila Bair at FDIC, trying to do things, we have Treasury fighting a war against Sheila Bair. Stop that. Put the Brooksley Borns, the Sheila Bairs, the Mike Patriarcas—a name you probably haven’t heard of—in charge of these agencies.

Increase the FBI immediately. Increase the Justice Department. Direct that the priority in these cases be against the large specialty entities. The FBI currently has one-fifth as many agents working this crisis as it had working the savings and loan crisis. In this crisis, the only question is how many orders of magnitude worse is it than the savings and loan crisis. It is a farce. They are being overrun.

It is 2½ years since the secondary market collapsed and there has not been a single indictment, much less conviction of anyone for the related loans. There are specialized actions on Bear Stearns on insider trading mostly and false disclosures.

We need to do those things. We need to fix executive compensation and not just executive compensation. It is what is destroying our system of appraisals. Is there anybody in America that doubts that they can get a highly inflated appraisal?

Mr. CUMMINGS. Let me ask you this. I want to sit right where you are. When I look at the Wall Street crowd, I believe there are certain things that may be illegal, but I believe there are other things that are not illegal but to me are unethical and wrong. I am not sure where the line is drawn there.

To give you an example, the New York Times reported last Friday that many former Freddie Mac employees had signed non-disclosure or secrecy agreements as part of their severance package. However, now both Freddie Mac and its Government Conservator, the Federal Housing Finance Agency, are invoking those secrecy agreements in class action securities litigation lawsuits against the mortgage giant. Do you think such secrecy agreements are reasonable corporate tactics? While criminal investigations can penetrate these agreements, civil securities litigation can be thwarted by the silence of key departed decisionmakers. This seems to run counter to your testimony on the defeating fraud control. I am just curious.

Mr. BLACK. I agree. I think that it is terrible public policy—those things should be void as against public policy. I will give you an example. After I gave one of my talks on control fraud, a gentleman came up to me and said, I was the guy that hired the elite MBAs for Exxon and it is true that we lost a number of folks originally to Enron in those years, but you know what, I kept getting phone calls a year later, 2 years later saying, is that job still open, this is not a place I want to be.

This kind of executive compensation, when it rewards fraud, think of what it creates as a culture. Whenever we talk business ethics, it is incessantly tone at the top. When the tone at the top is fraud, they create a culture of fraud. The folks at Enron were not the smartest guys in the room, they were the least moral guys left at the place after the best people had left.

By the way, the average CFO in America lasts 3 years. You can talk all you want about long term perspective but until we change that, it ain't going to happen. That is one of the reasons why you are going to have very high turnover at any of these places.

Mr. CUMMINGS. Let me ask you this. When we see Goldman Sachs giving all this money in bonuses and whatever, let us say the money didn't go there, would it then go to shareholders? Should shareholders be playing a bigger role? Do you follow? If you have billions of dollars going out the door in bonuses, it seems to me that money should be going somewhere and the logical place for it to go would be shareholders.

Mr. BLACK. Well, it is worse than that. We, first, have gimmicked the accounting rules at the behest of the industry. This is something where Congress has culpability, frankly, in my view. You put pressure on FASB so that banks no longer have to recognize their losses.

Second, the quotation in my testimony from Standard & Poor's about how they never, ever looked at the quality of the loans, put those two things together and we are paying bonuses based on purported profits that are accounting gimmick numbers. Why would we allow bonuses until they clean up the accounting and find the actual loan quality by reviewing a sample of the underlying loan files which nobody is doing and which that farcical stress test never even looked at.

Mr. CUMMINGS. Thank you, Mr. Chairman.

Chairman TOWNS. Thank you very much. Let me ask a couple questions.

Professor Black, you stated in your written testimony, Americans are not nearly as angry as they should be about executive compensation. If they knew more, they would be angrier. Could you look into the camera and in one or two sentences, summarize what more they need to know or what more they need to do?

Mr. BLACK. They need to know that it isn't merely a populism issue, that it is the key driver along with non-regulation that produced recurrent, intensifying crises and will do so again in the near term unless we fix it. They are producing perfect crimes and people will act on incentives, they will commit these perfect crimes.

The way you commit this perfect crime is to make huge amounts of bad loans with extreme leverage. What does that produce? It produces a bubble and it produces a crisis. It does so whether you bail them out or not. You shouldn't bail them out, we agree on that. We agree that it makes the incentives work, we agree on that. It is not a necessary condition.

Chairman TOWNS. Let us reverse positions for a moment. You are now a Member of Congress. When they come to us and say this particular company is too big to fail, what do we do then, when they come and tell you that? It is too big to fail?

Mr. BLACK. That is nonsense. The idea that you could keep them alive if it were true is worse than nonsense because they have just defined these. In their lexicon, they want a good word, so they call them systemically important, gold star. It sounds good. They are systemically dangerous institutions. By definition, if a single one of them fails, under Treasury's logic, it causes a global economic crisis.

Why would we allow such entities to exist and then unhinge further any discipline and maximize moral hazard? It is like we were trying to produce a bigger and badder disaster. We have closed very large institutions in the past, we do it through receiverships. We do a pass through receivership and the place closes on a Friday and it opens on a Monday and the ATMs work most of the weekend. This is something that can be done. What is lacking is the will.

Chairman TOWNS. Professor Roberts, do you want to add something to that?

Mr. ROBERTS. Yes. I want to tell a story. I was interviewing Alan Meltzer for my weekly pod cast, econ talk, and he mentioned the power of FDICIA, the FDIC Improvement Act, and he told me how it could have been used to help this transition. It would let some people go out of business, some would have and some wouldn't have. I said why didn't anyone suggest that to the Treasury? He said, I told Secretary Paulson that we should use FIDICIA and he said, well, I asked the bankers and they were against it. I guess they would be.

It really is a question of will and the challenge is, as you say, too big to fail. Guess who thinks they are too big to fail, the people whose money they want to get back, and it is up to politicians and policymakers, it is up to Bernanke, Paulson and Geithner to say no.

Bear Stearns is a perfect example. In March 2008, Bear Stearns was insolvent, there was a worry it was going to have systemic risk. It is an interesting question of whether it would or would not. I don't know but when we decided to bail them out, Lehman Brothers which had a very similar balance sheet, decided to double down. They borrowed more money because I think they thought they were going to be bailed out.

One of their largest lenders was a money market fund which is supposed to be extremely conservative. Reserve Primary, actually the very first money market fund, was lending money to Lehman Brothers to finance their mortgage-backed securities. Why would they do that? I suggest it is because they probably thought they would get baild out.

They weren't, as it turned out, the only one, and we have drawn the lesson that was our mistake that we didn't bail them out. I think our big mistake was bailing out Bear Stearns. By the way, even when we did not bail out Lehman Brothers, the stock market didn't tank for a week. Everyone said that was the crisis, that was when it started. It actually may have been when Secretary Paulson came up here and said, if you don't give me a blank check $700 billion, the world is going to hell in a hand basket, we are going to have an apocalypse. The whole economy of the world is going to be dissolved. That kind of scare talk I think had a big effect. John Taylor from Stanford has written about this and how it affected how people behave. I think we have made some terrible mistakes in not having the will to say no.

Mr. BLACK. Can I add it is not even a matter of deciding to use FIDICIA, the Prompt Corrective Action Law was passed after the savings and loan crisis in the belief that excessive regulatory forbearance had helped cause the crisis. The act, in general, is mandatory, particularly for deeply insolvent places but it has a terrible weakness we told people about back when they were considering it. It can be gamed by accounting and it is gamed by accounting. That is why these places aren't closed. You actually tried to mandate it.

Chairman TOWNS. I now yield 5 minutes to the gentleman from California.

Mr. ISSA. Thank you, Mr. Chairman.

This is a sort of an anecdotal question. Do either one of you believe for a moment that the executives who took their deferred compensation that had become due—in other words, their accrued contracts before Mr. Feinberg took over and rolled them into future stock appreciation plans, meaning they rolled that many dollars into a plan that would mature in 3 to 5 years that would essentially execute at the price of the stock—believe, for example, at BofA that was not simply people saying am I better off taking my money here or better off taking it here, realizing that the top 25 at Bank of America, I assume, are the most knowledgeable, best negotiators and smartest bankers on the planet, notwithstanding the crisis?

Remember, all bankers on the planet don't look as smart as they used to, but do either of you doubt for a moment that when we went to negotiate that part, we basically were negotiating an if it is better for you, you will roll it over and if it isn't, you will do something else situation, the idea that we would negotiate out existing contracts? It is sort of a comment on the quality of those people that we gave a deal.

Mr. ROBERTS. I was deeply inspired by the special master's comments about his respect for the Constitution. They were then followed by remarks where he said, if they didn't voluntarily agree, we would make them. I think it is a very bad situation when the power of a single individual with no appeal and very little transparency was relying on the Wall Street Journal, unfortunately, to find out what was really going on. We will find out in more detail how accurate that is, I assume. He disputes it naturally, but I think it is a very bad situation.

I am very sympathetic to Chairman Towns' point of what alternative do these folks have? The standard view is, they are the best people in the business, they have lots of alternatives. The alternatives are a lot smaller, there are fewer than there used to be, so I think a lot of these folks were maybe doing the best they could. They certainly did the best they could for themselves. There is political pressure on the special master from them, lobbying him to do what is good for them.

Mr. ISSA. I agree.

I wanted to continue the line you were already on, Professor Black. That was that our bail-out was inherently the wrong statement. In other words, we put in new money as basically subordinated money. We are a preferred stock and preferred stock comes after all debt.

Do either of you doubt for a moment as a practical matter that the world would have been different had we told the creditors and stockholders of these entities that we would come in only if we came in as senior debt? In other words, we will come in, we will provide x-amount but you will subordinate your existing debt in order for us to keep your companies alive. Wouldn't that have changed the dynamics dramatically of where we would be, which would be in the first position, what their interest would be to get us out so that their other lenders and stockholders would have a value again?

I realize there are some regulatory questions at FDIC about how you legitimize that as equity, not debt, but we had the power to call it whatever we wanted. We called it equity so that we could say that their capital position was improved. Bill Isaac and other people who gave us lots of alternatives felt that we ignored every one except the one we took and the one we took was the one that froze the markets when Secretary Paulson said you have to do it now, it is a crisis, we can't go the weekend.

Would either of you comment on that alternative from a purely incentive basis to cause their interests to be aligned with ours?

Mr. BLACK. I said not very nice things about Geithner and Summers. Let me add Paulson to the list as well.

Mr. ISSA. They are all going to have to write their own books.

Mr. BLACK. I would not want him negotiating on my behalf if I was the United States of America. I don't believe that is how he acted when he was at Goldman. I think he was a very unfaithful agent to the interests of the American people.

Mr. ISSA. Professor Black, I am going to followup on that. Earlier, I talked about the fact that Secretary Geithner's operation, maybe not him but his operation at the New York Fed took an opportunity to negotiate credit defaults at some amount—probably 60 cents on the dollar, maybe less, they were certainly worth less at that point—and put on 100 cents on the dollar. Do you believe the New York Fed acted in the best interest of the American people when they paid out 100 cents on the dollar with our tax dollars?

Mr. BLACK. No. I think they acted completely contrary to the interest of the American people. More than that, why were we baling out AIG anyway?

Mr. ISSA. Or at least the British division.

Mr. BLACK. AIG was never federally insured. I am a signatory with a number of folks, including some very conservative folks, about what we propose should have been done at AIG which is a separate bankruptcy for the trading arm. These two things you put together for a reason.

In both cases, even if we were going to do a bail-out, which we shouldn't have, we did it in a way that was incredibly harmful to the American people and so obviously harmful that an experienced Goldman Sachs executive would never do that accidentally.

Mr. ISSA. Or several of them.

Professor Roberts.

Mr. ROBERTS. I think the key point is the idea that you would only pay 50, 60 or 80 cents on the dollar, any of those would have been better than the complete bail-out of creditors because creditors are the people who restrain risk taking. The creditor only cares about one thing, down side. They want to make sure that the organization stays solvent. Stockholders get the up side benefit.

By taking the skin out of the game for creditors, which is what we have consistently done with these bail-outs and the bail-outs starting in 1984, Continental of Illinois basically says to creditors, lend money, you will get it back in the first case scenario. That is a disaster.

The story you are talking about, which was reported by Bloomberg, that when Tim Geithner was head of the New York Fed, he interrupted a negotiation where they were only going to pay 60 cents on the dollar and said, we will pay the whole thing, it is terrifying.

If a Martian came down and said, what is the U.S. financial system designed to do, I am afraid they would say, it is designed to funnel money to Goldman Sachs. That may not be true, but the fact that it looks to be true is not a healthy thing for a democracy.

Mr. ISSA. No, not at all.

Mr. BLACK. And in the most opaque way possible.

Mr. ISSA. On that note, Mr. Chairman, we continue on a bipartisan basis, to want to audit the Fed, so perhaps that could be one of the things we glean from it.

Mr. Chairman, in closing, I just want to say that I think today's hearing has created an opportunity for us to revisit how we would effectively look at Freddie and Fannie, and our friend, Franklin Raines, and their participation in the disaster that befell America. I would ask that we do some background discovery in preparation for a hearing where we could work together to find a common way to figure out what their role was and how to prevent it since the GSEs are here, at least for the time being.

I yield back.

Chairman TOWNS. I understand your concerns and these are things we can look at as we move forward but also remember that we are running out of time in terms of this session.

Is there anyone of this side seeking to be recognized before I recognize Mr. Burton? Yes, Congresswoman Kaptur.

Ms. KAPTUR. Thank you, Mr. Chairman.

When I think back to last fall, Mr. Paulson used the tactic of fear that intimidated the Congress, in my opinion, and many people in the country. The argument that was used was, if we don't do this, TARP and the bail-out, the country would be worse off for it.

I keep looking back at what has happened and I am thinking what could be worse in a district like mine with over 13 percent unemployment, foreclosures up by 94 percent, no credit being lent because the supervisory fees and the FDIC fees being paid by the banks that didn't do anything wrong have gone up 20 times. Credit unions are being asked to pay these exorbitant additional fees. They ground credit to a halt. I am thinking what could be worse than what has been done.

You are saying that if we had resolved this in a different way, perhaps the American people would have taken some nicks, but I am saying to myself, didn't they do it in the worst way. My question to you is how do you react to their argument today if we hadn't done that, it would be worse?

Mr. ROBERTS. That is always the argument. They can always come back with that. The first question is, were they right and the second question is, did they actually make it better, can we point to things they did to make it better?

The thing I think that is often forgotten is the connection between Wall Street and Main Street. The claim is if we hadn't saved these organizations, these financial giants, the turmoil would have spilled over into Main Street and the average American would have paid a fierce price.

As you point out, they paid a fierce price anyway. We have unemployment on the rise headed toward double digits. Contrary to all the economists who think they can see the future, I want to let you know they can't. They don't know whether it is going to get better or not, we don't know if we are on the mend.

I would suggest the single biggest mistake we have made, whether it was for the right or the wrong reasons, whether you are cynical or whether you are an idealist, the biggest mistake we have made is that we have created an incredible environment of uncertainty about the future for both policy, compensation, who is running the auto industry, what is health care going to be, what about the environment. We have all this great stuff we are trying to do, but no matter whether it is good or not, whether you agree with this piece or that piece, the fundamental situation is that for the average American businessperson who has to take risks with their own money on the line outside of Wall Street, there is still this thing that if you go out of business, you lose all your money.

The biggest problem right now is that for small business and any business that is not on Wall Street, they are scared and rightly so.

Ms. KAPTUR. Do you know what they are doing, Mr. Roberts? They are now talking about going after the small business sector and securitizing any loans made to them. They are trying to vacuum what is left in the country of equity again.

Mr. ROBERTS. It is a mistake. My point is that because of the uncertainty about what is coming down the road, in a desperate attempt to give people ad hoc power to fix, as a result we have created an atmosphere where people don't know what the rules of the game are, they can't plan for the future. Everybody is waiting to see maybe I will get mine, maybe I will get a bail-out, maybe I will get a tax increase. Everybody is sitting on the sidelines waiting.

Until that gets fixed, I would suggest that Main Street will not recover. All the stimulus money in the world, all the new improved this and that, until we get people confident about the future, we are not going to make progress.

Ms. KAPTUR. Mr. Black and Mr. Roberts, one effort that you might put in the area of game theory, if they had put you two in charge, even though you have different points of view on some things, you have come together on others and it would be very interesting for me and perhaps other Members, going back to September, involving others in our country. You mentioned Mr. Patriarca. I happen to think a lot of Mr. William Isaac who resolved a lot of institutions back in the 1980's. Put some of those minds in the room and say, if you could unwind what was done and you could start from scratch, what would you have done, just in the form of game theory, to resolve these big ones.

I will tell you what is being said to us. Well, Congresswoman, you don't really understand because you never really understood credit default swaps and collateralized debt obligations. Because those were involved, we couldn't resolve the institutions and take them into receivership as we normally would with the FDIC. You get all this flak.

Mr. BLACK. The truth is they didn't know. The truth is this was an entire marketplace built on don't ask, don't tell where no one, and I mean no one, looked at the underlying loan files until Fitch does in November 2007 because the secondary markets tanked and they are not going to lose any business. Then they say the results were disconcerting, that there was the appearance of fraud in nearly every file. You could see it on the face of the files. So they don't want to look because what they are going to see in that box is a bad thing, not a good thing. Let us put the burden on them. Make them make the case publicly with full disclosure exactly why they made these decisions, what decisions they made and when they made them, and who made them.

Chairman TOWNS. The gentlelady's time has expired.

I now yield to the gentleman from Indiana, the former Chair of this committee, Mr. Burton.

Mr. BURTON. That is my picture up there. Do you think I look like that?

Chairman TOWNS. Your high school picture.

Mr. BURTON. Thank you, Mr. Chairman. I apologize for not getting back quicker. We had two Foreign Affairs meetings and I couldn't get back.

Do you think the pay czar is constitutionally permissible? What do you believe the implications are for giving somebody this kind of authority, a czar like this, either of you?

Mr. BLACK. I think it probably will pass a constitutional test, particularly with this Supreme Court. I don't know there will even be a challenge to it on a timely basis. I think everybody agrees it is not the right way and it is not even a theory of 2nd best—maybe it is somewhere like 12th best—on the way to approach these things.

The best way was not to do nothing in the sense of allowing the incentives to remain perverse. If you are going to close the places, of course that takes care of the perverse incentive.

Mr. BURTON. What do you think about the approach that he has taken by reducing compensation for these people say guys making $12, $13 million, including bonuses, and he says, we are going to cut your salary to $450,000 and will give the rest to you in stock as time goes by? What do you think that does to the competent people who run these companies? What do you think is going to happen or what is happen? I think Bank of America has lost half of their people, their top management people.

Mr. BLACK. As I said, senior officers in America have incredibly short tenures without this program. CFOs average 3 years, so you are going to get huge turnovers at these places and turnover is particularly high on Wall Street because all of these guys have zero loyalty to the organization. They are always in play.

Mr. BURTON. So you don't think this would increase the likelihood that they would leave faster?

Mr. BLACK. I think it will increase the likelihood of some people. In economics, we think about things on the margin. On the margin, it has to do that but that is inevitable whenever you go to performance pay.

Mr. BURTON. I would disagree with you. I think if I were a person who had that kind of salary commitment and they said they were going to cut it to $450,000 a year, I would say, I think I will go out on the street, take my $13 million and see if I can't get a job with the same kind of compensation. What do you think about that, Professor?

Mr. ROBERTS. Some of them, maybe they can't which means you are stuck with whoever you have but as you say, I think a lot of them left because they saw the handwriting on the wall and knew they could do better somewhere else and they are gone. Again, I want to emphasize it is clear we want to try to get back that money. Obviously the taxpayer would rather have more money than less money. The idea that we are going to pour money into AIG or into Bank of America or into City Group with the idea that we have to get our money, maybe they ought to disappear.

Mr. BURTON. What does that do to the management people who may have the talent and know-how to help get a company out of this kind of mess and they leave and you go to second or third tier executives?

Mr. ROBERTS. And you are counting on them looking forward to getting that stock bonus down the road in 2, 3 or 4 years. What is their optimism about that if they know the best people are gone? It is really not a good system.

Mr. BURTON. I just think the taxpayers who are the stockholders ought to be very concerned about having top notch people in these executive positions to try to get some of their money back.

I have a couple more quick questions. The Fed has indicated that they may start talking about expanding the salary conditions on all banks. What do you think about that, what do you think the possibility is?

Mr. ROBERTS. Everybody likes more power, except for the special master. He said he didn't want any more, he is happy with seven.

Mr. BURTON. I know he said that.

Mr. ROBERTS. That is what he said but the Fed, I am sure, would grow and survive. I think as I said before, that is the wrong way to fix the problem. The wrong way to fix the problem is to say, you are out of control, you take too much risk, so I am going to take away some of your goodies so that you behave better in the future. It is not good for our financial systems, it is not good for our capital system or investment. It is not good for productivity and innovation.

As Professor Black said, a lot of people went out and took loans that they didn't investigate. Why would they do that? The answer was because they had the incentive to do that, but we have to keep our eye on the prize that they were financing those lousy investments with borrowed money, money from the other players in the game. Why would people lend folks money for lousy, risky loans? The answer is, because they thought they were going to get the money back.

If we solve that problem, we don't have to have this top down, micromanaging of salaries. Forget whether it is possible, the political implications of it are extremely destructive.

Mr. BURTON. I have two more quick questions and then I will let the chairman adjourn the meeting if he so chooses.

Do you think Freddie Mac and Fannie Mae should have the same kind of salary restructuring done on them?

Mr. ROBERTS. I think it is shocking that they don't. They put us \$100 billion in the red so far and I think it is on the way to maybe \$200–\$400 million. We don't really know and I think if you do audit the Fed, I would really like you to look at those mortgages they are holding because they are not market to market.

Mr. BURTON. The thing that bothers me is that we have done this to these executives and they were responsible, at least in part, for this, but Freddie Mac and Fannie Mae haven't done anything about that.

The last thing I would like to ask, can you compare the crisis we face now with the financial institutions to what happened in the S&L crisis back in the last 1980's?

Mr. BLACK. The crisis is vastly larger. It was a much easier crisis to stop; this was far more obvious. There was almost complete destruction of regulation this decade. It started in the decade before.

Mr. ROBERTS. I see it as a spillover of the same mistaken attempts for a free lunch. Everybody wants a free lunch. I want a very high return investment but no risk, of course. I want it safe and an extremely high rate of interest. That desire of the American people, of every human being, for that kind of free lunch should not be indulged.

Mr. BURTON. They handled the S&L crisis much differently than they did this one.

Mr. ROBERTS. That is correct.

Mr. BURTON. And it worked out.

Mr. ROBERTS. Unfortunately, the roots of it are the same, an attempt to tell people there is no risk. You put in your deposits, don't worry about it. It is all taken care of. The government guarantees it. That government guarantee explicit there, implicit with Fannie and Freddie, implicit with the investment banks, is the fundamental source of the problem. It is a desire to deliver politically a free lunch. You will make your money but no risk of loss.

We ought to be treated like grown-ups. I would like to be treated like a grown up. I take my risk, I profit if I make a good choice, I am prudent. I make a bad choice, I lose my money. That is what capitalism is about and we have lost and have to get it back.

Chairman TOWNS. Thank you very much. The gentleman's time has expired.

I yield to the gentleman from Maryland, Mr. Cummings.

Mr. CUMMINGS. Thank you very much.

Earlier, I asked Mr. Feinberg where are we going from here. It was his hope that if he controlled the compensation for the seven companies, that they might follow by example. I told him that I just don't see that happening. I wish it would.

I am just wondering as I listened to you talk about what you might do, it is hard for me to see some of those things happening. What do you foresee? Let us be realistic. Let us assume the things you talked about don't happen. Mr. Black, Geithner is not going anywhere. I am just telling you that—probably not. I am not trying to take away from what you have said, so what do you foresee?

Mr. BLACK. First, our motto was it is not necessary to hope in order to persevere. I would say the circumstances were vastly worse in the savings and loans crisis in terms of the correlation of political forces.

President Reagan's Justice Department threatened to indict the chairman of our agency criminally for re-regulating the industry under the Anti-Deficiency Act under the argument that we were closing too many insolvent institutions. That was the world that we lived in, so I don't give up.

I know these things seem improbable, I know the forces opposing us seem unbeatable, but America has not been characterized by crony capitalism and it is up to us to keep it from going that route. If we give up and aim real low in terms of reforms, that is exactly what we will get because the master is frankly wrong on that point you asked about.

Some well run corporations may listen to him. That is not where the problem is. The problem is in the majority of corporations, that is what the statistics show, that they deliberately and egregiously misalign the interests through their compensation system. They will not listen to the Master, they will continue to produce further crises whether or not we bail out the institutions.

Mr. CUMMINGS. Professor Roberts.

Mr. ROBERTS. On an optimistic note, whether most corporations or some corporations adopt the idea of incentivizing long term incentives through stockholdings, many corporations already do that. Of course some are flawed, some make mistakes, but most of them don't come to Washington with their hand out. That is a problem right now of the auto industry because of their special political pull and the financial sector through an even more special political pull, their long term relationship with Washington. That is what has to be stopped.

On the optimistic side, true, Mr. Geithner is not going anywhere but you here in Congress want to stay in office, you are going to listen to the American people. If the American people say, we had to have these rescues, we have to recreate what we had before and make sure we stay as before, you are right, nothing is going to change.

If they say, which I think they are increasingly saying, we want to stop giving money to really rich people and the right way to fix that is not to take it away at the last minute from seven of them but to destroy the incentives that allow them to take it in the first place, then I think we have a chance to really fix the problem.

It is not going to be easy. As Professor Black said, it is a long road. We all, I hope, have something to contribute, some of us a very small bit, some of you a lot larger, but it is not a force of nature. It is a matter of will and that will be bolstered by the American peoples' outrage not just at the fact that people make a lot of money, but the way they made it, through taking risks with money that was borrowed on the presumption that it would be paid back by the taxpayer.

That is corrupt. That is the crony capitalism we have to stop and it is in your hands. The next time the Congress as a whole confirms a candidate for the Chair of the Fed or Secretary of the Treasury, I would like you to have him make a commitment—they may not keep it—that they will not return money dollar for dollar to lenders who make bad risks and finance bad bets.

Ask them to commit to 50 cents on the dollar. Ask them to commit to encouraging losses. They may not keep that promise but that is where it starts, people putting at least their reputation on the line. I think there is hope there.

Mr. CUMMINGS. We see people being thrown out of their homes because of foreclosure. The Washington Post just had an article saying how in some instances it has doubled over last year and then you see people losing their jobs and what have you. Are you surprised there is not more of a balance here? In other words, we hear about spending $180 billion for AIG but we have people in our district that it would probably take, at best, $10,000 and they could stay in their homes. It is hard for the American people to understand it, it makes no sense. I think that adds insult to injury, the loss of jobs, savings, etc.

Mr. BLACK. That is why crony capitalism destroys democracies over time as well, corrupts them. People understand after a while that it isn't what they do, it is who they know.

One of the things that is unusual about America in polls is how few Americans have that view compared to other places. It is a real productive process not to have that view, to believe that merit really is something important. It is perfectly rational, as people see more and more cases of the rich getting bailed out, to say no, it is mostly a matter of who you know. It is a sick system and people start withdrawing from that system. Nations and even societies break down when it happens.

Mr. CUMMINGS. Thank you, Mr. Chairman.

Chairman TOWNS. Thank you very much.

Let me thank the gentleman from Maryland, his time has expired.

Let me begin by thanking all the witnesses, Mr. Feinberg, you, Professor Black, and Professor Roberts.

Let me thank the Members on both sides of aisle who attended the hearing. The American people are angry. They are angry that while millions of hardworking Americans are losing their homes, their life savings, that bank executives are rewarding themselves for failure.

The idea that hundreds of thousands of dollars in salary, plus millions of dollars in stock options, is not enough for the executives, bailed out by the American people, is exactly the type of thinking that got us into this financial crisis in the first place.

We need to link bank executive compensation to performance. I have never seen or heard of people that fail getting a bonus. Of course the answer is that if we do not give them a bonus after they have failed, they might leave. I think that you should say goodbye. That is exactly what the special master and Obama administration have done. Without this crucial link, we will continue to have perverse incentives for bank executives to take unjustified risks with taxpayers' money. This is unwise and unacceptable and must be stopped.

Again, let me thank you, the witnesses, for being here and thank the Members for attending.

The committee is now adjourned.

[Whereupon, at 3:17 p.m., the committee was adjourned.]

[The prepared statements of Hon. Dennis J. Kucinich, Hon. Gerald E. Connolly, Hon. Dan Burton, and additional information submitted for the hearing record follow:]

Oversight and Government Reform Hearing
Executive Pay: How Much Is Too Much?
Statement of Congressman Dennis J. Kucinich
October 28, 2009

I want to thank you Mr. Chairman for holding this hearing and for your persistence in investigating the fallout from the financial crisis.

Earlier this month the Special Inspector General for TARP, Neil Barofsky, gave us a sobering report on the lack of communication and cooperation between the Fed and Treasury to control executive compensation at AIG-- a company still owned by the American taxpayer. Today we'll hear from Mr. Feinberg, who has been charged with the task of controlling compensation at the seven firms who have received exceptional financial assistance from TARP.

Americans are right to be angry with executives who are rewarded handsomely--with taxpayer money, no less--for utterly failing to run their companies. These two men are doing necessary work to protect the investment of the American taxpayer.

Executive compensation at companies that have received government support, however, is only a small fraction of the problem.

The reality is that executive compensation relative to the rest of the workforce has been skyrocketing for the past 30 years. This is the fundamental problem that we must address.

In 1980, the average CEO made 42 times that of the average worker. By 2008, that number had exploded to 319 times the average worker. That year, the top five hedge fund managers all made over $1 billion. The top five CEOs of publicly traded companies all made over $50 million. For perspective, $5 billion would buy health insurance for about 1.6 million people.

Contrast that with the fact that the poverty level in this country is 13%. An astonishing 19%--almost one-fifth of the children in this country-- lives in poverty.

This is a moral outrage. We're here today, talking about millions of dollars in compensation for individuals, while one-fifth of the children in this country are deprived of the basic necessities of life and the joys of being young.

Opening Statement of Congressman Gerald E. Connolly

October 28th, 2009

Oversight and Government Reform Committee

Executive Pay: How Much is Too Much?

Thank you, Chairman Towns for holding this important hearing on executive compensation. Some seem not to remember, that this Congress is stuck with a TARP program executed under the prior administration. Despite the best efforts of some in Congress, TARP funding was allowed to flow to banks with no strings attached, enabling the outrageous AIG bonus payments that elicited public fury earlier this year. I applaud you for holding a hearing that is an important part of the Committee's broader efforts to oversee the TARP, and to ensure that we recover as much taxpayer money as possible.

Some may argue that the government should not regulate executive compensation, because the market should allow workers to earn the full marginal product of their labor. This argument ignores that we are partial owners of these firms, and therefore should have a role in determining compensation of their executives. Second, this argument ignores the reality that, for the last decade in particular, executive compensation of financial executives does not seem to have been related to their contribution to their firms' long term productivity. Finally, this anti-interventionist argument ignores the historical relationship between moderate pay for executives and strong economic performance for the nation as a whole. The historical record does not suggest that the public benefits from high executive compensation.

Let us remember that Ken Feinberg is presenting compensation proposals for the seven firms that have received the most taxpayer assistance. For example, we own 80% of AIG. We have every right and indeed a compelling responsibility to regulate executive pay at that firm and others in which we have a substantial ownership stake.

Over the last seventy years, the ratio of salaries of CEOs to average workers has grown from 82:1 to 367:1, according to a Harvard University study from 2005. The ratio of the highest compensated CEO to the pay of the average worker has grown even more, according to Business Week, from 131:1 to 25,052:1. These skyrocketing wages for CEOs have not translated into either economic productivity or higher total economic output.

According to the Bureau of Labor Statistics, worker productivity grew more quickly between 1947 and 1973, when executive compensation was proportionally lower, than the average productivity gains from 1980 to the present, when executive pay accelerated relative to average workers' pay. Gross Domestic Product (GDP), representing total U.S. economic output, grew faster during periods in which executive wages were relatively low; GDP grew 4.4% annually in the 1960s before falling steadily as executive wages skyrocketed from the 1970s to the present. What was true nationally was frequently true for individual firms. CEOs for Merrill Lynch, Citigroup, and Washington Mutual earned between $44 and $161 million in 2007, as they were running their firms into bankruptcy. The notion that the market is working for executive compensation is demonstrably false.

Thank you again, Chairman Towns for holding this meeting. I applaud the administration for its efforts to control executive compensation at bailed out firms and to recover taxpayer money that would otherwise be lost as a result of the manner in which the prior administration executed the TARP.

Congressman Dan Burton
Committee on Oversight and Government Reform
Hearing of the Subcommittee on the Western Hemisphere
Title: Executive Pay: How Much is Too Much?"
October 28, 2009

Opening Statement

Thank you Mr. Chairman and Ranking Member Issa for convening a Full Committee hearing about executive compensation. This is an issue that interests me very much.

With recent media reports about Wall Street bonuses, and the release of the Report of the Special Master for TARP Executive Compensation: 2009 Executive Compensation Determinations for the TARP Exceptional Assistance Recipients this hearing could not have been scheduled at a more appropriate time. I look forward to listening to the testimony of both witness panels, and I want to personally welcome Mr. Feinberg and Professors Dr. Black and Dr. Roberts.

The Chairman believes that the structure of executive compensation was a significant factor in the financial services industry meltdown. The Obama Administration gave Mr. Feinberg to job of more closely tying compensation to long-term performance; something the White House believes will help prevent employees from taking unnecessary risks for short-term gains.

I believe, and there is evidence to support it, that regulating executive compensation has had unintended consequences in the past and did not necessarily prevent imprudent behavior. Whether Mr. Feinberg's approach to executive compensation reform is more successful than previous attempts to rein in excessive risk-taking, only time will tell.

Let me be clear. I am not here to defend Wall Street or absolve them of any wrongdoing in terms of executive compensation or accounting methods. However, I do not believe the ills of the financial crisis are easily summed up as the result of executive compensation packages gone wrong. We would be derelict in our duty as policymakers if we did not examine the role that Federal "affordable" housing policy played in encouraging unsustainable lending and inflating the housing bubble, which when it collapsed, left banks loaded with toxic mortgage-backed securities.

Lest I be accused of being the great defender of Wall Street, I believe it would be abhorrent and a slap in the face to every taxpayer who helped bailout out AIG, Citigroup, Bank of America, Chrysler, GM, GMAC, and Chrysler Financial if it was business as usual at these companies when as it applies to executive compensation.

However, I have my doubts about whether the Administration's approach of tying executive compensation to long-term performance will prevent firms from taking on reckless risk in the future.

I realize that Mr. Feinberg's jurisdiction is strictly limited to the seven firms that received exceptional TARP assistance, but I question the current state of affairs where the government is more involved than ever in the highest levels of decision-making at several of the largest financial institutions. I wonder what this means the U.S. system of government and capitalism.

For instance, on October 22, 2009, the Federal Reserve issued a proposal in which the Fed would review, and if necessary, amend or reject the compensation policies of banks regulated by the Fed.

According to the Federal Reserve press release: "Flaws in incentive compensation practices were one of the many factors contributing to the financial crisis. Inappropriate bonus or other compensation practices can incent senior executives or lower level employees, such as traders or mortgage officers, to take imprudent risks that significantly and adversely affect the firm. With that in mind, the Federal Reserve's guidance and supervisory reviews cover all employees who have the ability to materially affect the risk profile of an organization, either individually, or as part of a group."

I am concerned about just how far the long-arm of the Federal government will will reach into the day-to-day operations of private firms. Thank you Mr. Chairman for allowing me to express my concerns about this important policy issue.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

December 7, 2009

The Honorable Bill Foster
1339 Longworth House Office Building
Washington, DC 20515

RE: House Committee on Oversight and Government Reform: Testimony of Kenneth R. Feinberg on October 28, 2009

Dear Representative Foster:

Thank you for the opportunity to appear before the House Committee on Oversight and Government Reform.

During my testimony you requested further information regarding the following three questions. I respond to each of your questions:

First, you asked whether and how compliance with the decisions of the Office of the Special Master will be monitored.

The Treasury's Financial Stability Oversight Board is responsible for ensuring that each recipient of assistance under the TARP, including each Exceptional Assistance Recipient, is in compliance with Treasury's TARP regulations, including the requirement that each Exceptional Assistance Recipient comply with the determinations of the Office of the Special Master.[1]

Second, you asked whether, to comply with the Determination Memoranda issued by the Office of the Special Master on October 22, 2009, the Exceptional Assistance Recipients would have to implement a policy prohibiting hedging or derivative transactions, and how compliance with those policies would be monitored.

My understanding is that each Exceptional Assistance Recipient is in the process of reviewing and adopting a policy that will ensure that the employees subject to my determinations will not engage in any transaction that would have the effect of undermining the incentives created by the compensation structures outlined in my Report. The Office of the Special Master is working with each company to ensure that the policies achieve the critical objective of making sure that the compensation structures we have approved give the employees of these companies performance-based incentives to maximize the value of the company and repay the taxpayer.

[1] Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, §104, 122 Stat. 3765, 3770 (Oct. 3, 2008).

Lastly, you asked whether the Special Master has views, as a private citizen, whether (1) executive compensation should be adjusted to reflect the firm's performance in periodic stress tests conducted for systemically significant firms, and (2) executive compensation should be subject to a "clawback," with the proceeds of clawed back compensation paid into a fund designed to cover losses in the financial services industry.

Exactly how to link compensation to performance—and how to measure performance—are questions which our team in the Office of the Special Master focused upon. We consulted the world-renowned compensation experts mentioned in my Report, compensation consultants working with the companies in the course of making their submissions, and, of course, the companies themselves while considering these issues.

Overall, we found several different approaches to linking pay to performance appealing, and have adopted them. For example, we required that no incentive award could be granted unless the compensation committee of the company, composed only of independent directors, found that objective performance metrics had been met. And we required that those incentives could be paid only in stock vesting over a three-year period and payable only when the company had successfully repaid the taxpayer.

These are not, of course, the only ways to make sure that compensation reflects the firm's financial stability, and we remain open to new, creative approaches such as those described in your question. Both of your suggestions deserve further study by our team and by the Exceptional Assistance Recipients. Given that my mandate is limited only to the seven Exceptional Assistance Recipients, however, I would not speculate as to whether these ideas would be equally appropriate for companies beyond my limited jurisdiction.

If you have any additional questions, please do not hesitate to contact me.

Very truly yours,

Kenneth R. Feinberg
Special Master for TARP Executive Compensation

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

December 7, 2009

The Honorable Darrell E. Issa
2347 Rayburn House Office Building
Washington, DC 20515

RE: House Committee on Oversight and Government Reform: Testimony of Kenneth R. Feinberg on October 28, 2009

Dear Representative Issa:

Thank you for the opportunity to appear before the House Committee on Oversight and Government Reform.

During my testimony you requested further information regarding how many outside, lateral hires have been added to the "Top 25" group of employees at American International Group and Bank of America.

Under pertinent Treasury regulations, with the exception of a newly hired Chief Executive Officer or Chief Financial Officer, the group of employees subject to the Special Master's "Top 25" review of compensation payments is determined on the basis of annual compensation for the previous fiscal year.[1] Therefore, newly hired employees, with the exception of the new Chief Executive Officer of American International Group, were not included in the Report detailing my initial determinations with respect to these companies. However, to the extent that an official position or total annual compensation in 2009 places any newly hired employee among the "Top 25" employees of American International Group or Bank of America, the pay of that employee will be subject to the Special Master's determinations with respect to prospective compensation determinations to be made for 2010.

If you have any additional questions, please do not hesitate to contact me.

Very truly yours,

Kenneth R. Feinberg
Special Master for TARP Executive Compensation

[1] Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (Oct. 3, 2008).

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

December 7, 2009

The Honorable Brian P. Bilbray
2348 Rayburn House Office Building
Washington, D.C. 20515

RE: House Committee on Oversight and Government Reform: Testimony of Kenneth R. Feinberg on October 28, 2009

Dear Representative Bilbray:

Thank you for the opportunity to appear before the House Committee on Oversight and Government Reform.

During my testimony you requested the names of all of the individuals, including employees of Feinberg Rozen, LLP and employees of Treasury, assisting with the work of the Office of the Special Master for TARP Executive Compensation.

As I noted during my testimony, in addition to myself, two employees of Feinberg Rozen, LLP, Camille Biros and Jacqueline Zins, are working on behalf of the Office of the Special Master. Two academic consultants have also assisted in our work: Lucian A. Bebchuk, the William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance and Director of the Program on Corporate Governance at Harvard Law School, and Kevin J. Murphy, the Kenneth L. Trefftzs Chair in Finance in the Department of Finance and Business Economics at the University of Southern California's Marshall School of Business.

In addition, nine Treasury employees have been detailed to the Office of the Special Master to assist in our work. These employees include compensation specialists with significant experience in reviewing, analyzing, designing and administering executive compensation plans, and attorneys with experience in matters related to executive compensation. The employees include Mary Pat Fox, Patricia Geoghegan, Christina Hoag, Robert Jackson, Jr., Bruce Mackay, Eric MacPherson, Katherine Mueller, William Mulvey, and Jacob Samuels-Kalow.

If you have any additional questions, please do not hesitate to contact me.

Very truly yours,

Kenneth R. Feinberg
Special Master for TARP Executive Compensation

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

December 7, 2009

The Honorable Marcy C. Kaptur
2186 Rayburn House Office Building
Washington, DC 20515

RE: House Committee on Oversight and Government Reform: Testimony of Kenneth R. Feinberg on October 28, 2009

Dear Representative Kaptur:

Thank you for the opportunity to appear before the House Committee on Oversight and Government Reform.

During my testimony you inquired whether any of the seven financial institutions that have received "exceptional assistance" under the Troubled Asset Relief Program ("TARP") are, or have ever been, clients of Feinberg Rozen, LLP. None of those seven financial institutions are, or have ever been, clients of Feinberg Rozen, LLP. What you may be referring to is the fact that I have acted as a professional mediator in various disputes involving these and other companies (and my Firm webpage so reflects this). But none of these companies you refer to have ever been clients of mine. When they participated in such mediations, they were represented by their own retained counsel and at no time did I represent them or counsel them concerning the mediations themselves.

I am also currently acting as Settlement Administrator in the SEC/AIG Fair Fund settlement, involving the determination, allocation and distribution of settlement proceeds. But in this matter, I have been appointed by the United States District Court for the Southern District of New York upon recommendation by the SEC.[1] AIG, having settled the dispute with the SEC in negotiations in which I was never involved, was not involved in my appointment.

In sum, there is no conflict of interest whatsoever in my current role as Special Master for Executive Compensation. Indeed, all of the above has been previously disclosed to the Office of the Assistant General Counsel for the Department of the Treasury, which carefully examined my entire background and relationship to the seven TARP recipients. I have received an official determination from that Office that absolutely no conflict of interest has existed or continues to exist. I have no doubt whatsoever that the integrity of the Office of the Special Master has been upheld in any and all respects.

[1] *See* U.S. Sec. & Exch. Comm'n v. Am. Int'l Group, Inc., 06 Civ. 1000 (LAP).

Finally, I am currently employed by the Department of the Treasury as a "Special Government Employee,"[2] and report to the Assistant Secretary for Financial Stability, Department of the Treasury.

If you have any additional questions, or seek additional clarification, please do not hesitate to contact me.

Very truly yours,

Kenneth R. Feinberg
Special Master for TARP Executive Compensation

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[2] *See* Interim Final Rule on TARP Standards for Compensation and Corporate Governance, Treas. Reg. § 30 (2009); *see also* Treasury Directive 61-05 (defining Special Government Employee as "an officer or employee of the Department who is retained, designated, appointed, or employed to perform temporary duties, with or without compensation, for a period not to exceed 130 days during any period of 365 consecutive days, either on a full-time or intermittent basis"), *available at* http://www.treas.gov/regs/td61-05.htm.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

December 7, 2009

The Honorable Patrick T. McHenry
224 Cannon House Office Building
Washington, D.C. 20515

RE: House Committee on Oversight and Government Reform: Testimony of Kenneth R. Feinberg on October 28, 2009

Dear Representative McHenry:

Thank you for the opportunity to appear before the House Committee on Oversight and Government Reform.

During my testimony you requested further information regarding the following three questions. I respond to each of your questions:

First, you asked what can be done to make the tax code more effective, so that the actions of executives are directly tied to shareholders interests.

Throughout our work with the companies, we were careful to take into consideration the tax effects our compensation decisions could have on executives. We worked closely with counsel for the companies, as well as Treasury officials, to be certain that the determinations detailed in our Report were consistent with the objectives of applicable tax law.

How the tax code could be amended to more closely align executives' incentives with those of shareholders has been the subject of considerable debate among tax experts for decades. Even the effects of previous amendments to the tax laws related to executive compensation, including certain amendments enacted in 1992, are the subject of dispute.[1] In light of the limited nature of my mandate, I would defer to experts in the tax community, and of course to the Congress, with respect to specific changes to the tax code and their effects on executive compensation.

Second, you asked how the proposed regulations on executive compensation apply to contracted services.

Treasury's executive compensation regulations address these issues through provisions designed to prevent abuse. For example, the regulations provide that, where

[1] *See, e.g.*, Gregg D. Polsky, *Controlling Executive Compensation through the Tax Code*, 64 WASH. & LEE L. REV. 877, 880 (2007) (weighing empirical evidence with respect to the effects of certain amendments to the tax code).

individuals who work for a TARP recipient are formally employed by intermediaries (such as personal services corporations that hire contractors), the intermediary is disregarded, and the individuals will be considered "employees" of the TARP recipient and therefore are subject to the compensation restrictions. Under a similar rule, an individual who works for a TARP recipient but is formally employed by an outside partnership will be subject to the compensation restrictions where the facts show that the partnership was created in order to evade the requirements of the statute.

These provisions ensure that companies receiving taxpayer assistance are required to comply with both the letter and spirit of the compensation standards enacted by Congress and implemented by Treasury's compensation regulations.

Lastly, you inquired whether there is any incentive for financial institutions to move in the direction of contracting out work in order to avoid the executive compensation regulations.

No. As noted above, Treasury's executive compensation regulations include rules that ensure that arrangements like these cannot be used to evade the statutory requirements. In the course of my work on our initial Report, which describes our compensation determinations for each of the "Top 25" executives at the seven firms receiving exceptional taxpayer assistance, we did not observe any evidence that financial institutions have moved in the direction of contracting out work to avoid our regulations or the Special Mater review process.

If you have any additional questions, please do not hesitate to contact me.

Very truly yours,

Kenneth R. Feinberg
Special Master for TARP Executive Compensation

ONE HUNDRED ELEVENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

2157 RAYBURN HOUSE OFFICE BUILDING

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November 12, 2009

Mr. Kenneth R. Feinberg
Special Master for TARP Executive Compensation
Office of the Special Master for TARP Executive Compensation
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Mr. Feinberg:

Thank you for appearing before the Committee on Oversight and Government Reform on Wednesday, October 28, 2009, for the hearing entitled, "Executive Compensation: How Much is Too Much?." We appreciate the time and effort you gave as a witness before the Committee.

Pursuant to the Rules of the Committee on Oversight and Government Reform, the hearing record remains open to permit members of the Committee to submit additional questions to the witnesses. Attached are questions directed to you from Reps. Marcy Kaptur (D-OH) and Patrick McHenry (R-NC). In preparing your answers to these questions, please address your response to the Member who has submitted the questions and include the text of the Member's question along with your response.

Please provide your response to these questions by November 30, 2009. Your response should be addressed to the Committee office at 2157 Rayburn House Office Building, Washington, DC 20515. Please also send an electronic version of your response by e-mail to Carla Hultberg, Chief Clerk, at carla.hultberg@mail.house.gov in a single Word or WordPerfect formatted document.

Thank you for your prompt attention to this request. If you need additional information or have other questions, please contact Carla Hultberg at (202) 225-5051.

Sincerely,

E Towns

Edolphus Towns
Chairman

Attachments

PATRICK T. McHENRY
MEMBER OF CONGRESS
10TH DISTRICT, NORTH CAROLINA

224 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
(202) 225-2576
FAX: (202) 225-0316
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November 3, 2009

The Honorable Edolphus Towns
Chairman
Committee on Oversight and Government Reform
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Towns:

In connection with the Oversight and Government Reform Committee's hearing on October 28, 2009, "Executive Compensation: How Much is Too Much," I ask that you submit to the witness, Kenneth Feinberg, the following questions for the hearing record:

1) Financial institutions are able to hire contractors for services, and in essence can pay that contractor millions of dollars – even more than the CEO of that financial institution, in some cases. How do your proposed regulations on executive compensation apply to contracted services?

2) These contracts can be made with individuals, not just companies. Is there any incentive for financial institutions to move in the direction of contracting out work in order to avoid your regulations and give higher compensation to workers?

Mr. Chairman, thank you for your assistance with this matter. If you or your staff has any questions regarding the aforementioned questions, please contact Alexis Rudakewych on my staff at 5-2575.

Sincerely,

Patrick McHenry
Member of Congress

cc: The Honorable Darrell Issa

Questions for the Record
Hearing: "*Executive Pay: How much is Too Much?*"
Representative Marcy Kaptur

1. Mr. Feinberg, in the hearing, the following questioning took place:

*Ms. Kaptur. Is it true that three of the institutions whose compensation you are supervising are or have been clients of that firm, including Citigroup, CitiBank, AIG, and Bank of America with the acquisition of Merrill Lynch?

*Mr. Feinberg. No, that is not true.

*Ms. Kaptur. That is not true.

*Mr. Feinberg. No.

*Ms. Kaptur. It has been reported in the press that that is actually the case, so the client list -

*Mr. Feinberg. It may be reported in the press. It is not true.

*Ms. Kaptur. It is not true. Are any of the institutions under your purview, have they been clients of that company?

*Mr. Feinberg. No.

Please review the included documents, which are printouts of Feinberg and Rozen, LLC's website, including the names of their clients. These were printed out on October 28, 2009, as noted at the bottom of each page. This was the date of the hearing.

On page 5 of the documents, you will see that AIG is listed as one of Feinberg and Rosen LLC's clients. On page 6 you will see that Citibank NA (Subsidiary of Citicorp), and Merrill Lynch (now owned by Bank of America) are listed. On page 7, you will see the SEC v. AIG settlement listed.

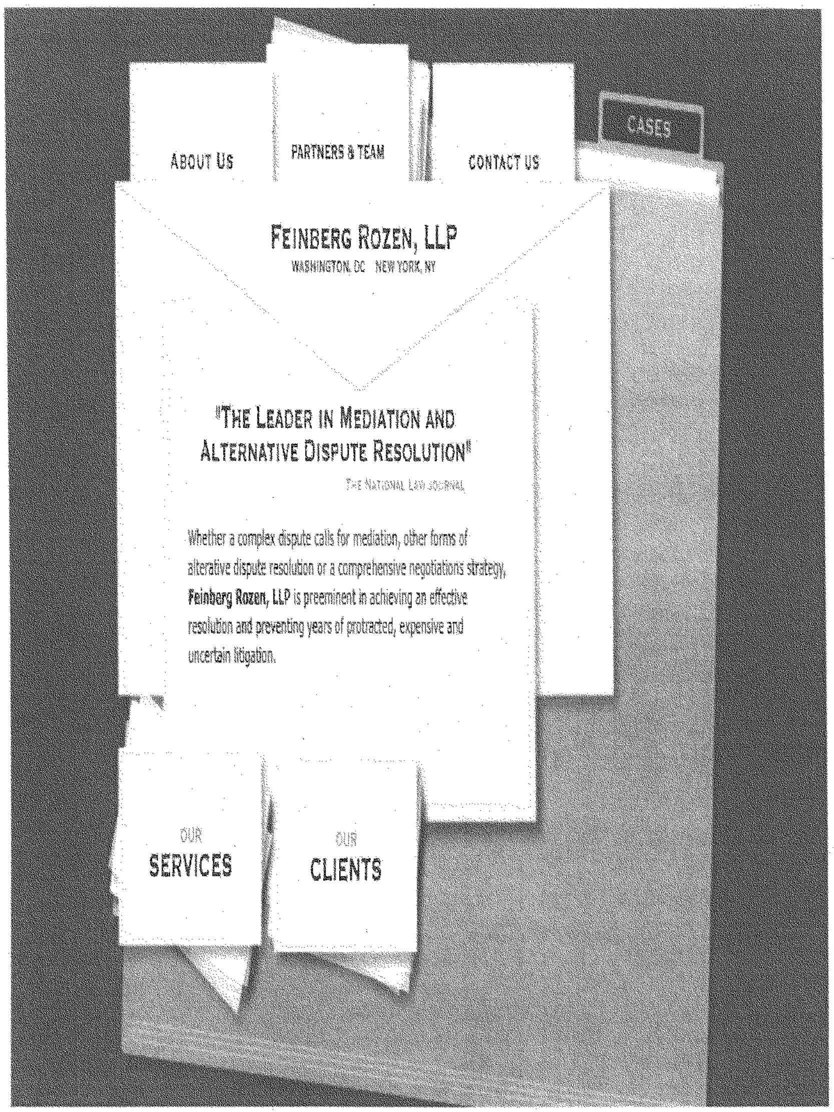
Can you at this time please clarify for the record why the webpage of your firm, Feinberg and Rosen LLC has listed AIG, Citibank NA (Subsidiary of Citicorp), and Merrill Lynch, now a part of Bank of America when you stated for the record, under oath, that these institutions were not nor had been clients of your firm?

Please also clarify for the record if you are overseeing the executive compensation at AIG, Bank of America, and Citicorp or Citigroup.

Mr. Feinberg, is there a conflict of interest for you in this position given the clientele of your firm? Please clarify in full detail why or why not. If there is a conflict of interest, please address in full detail what you have done to curtail this conflict of interest given your position in the U.S. Department of the Treasury, serving as "Special Master" in regard to executive compensation for the 7 recipients of the most funds from the TARP program. Is the integrity of the position being upheld?

2. Mr. Feinberg, did you disclose the clientele of your firm to the Treasury during whatever vetting process you underwent? Can you please describe in full detail that vetting process?
3. Mr. Feinberg, please provide the contract that you have with the U.S. Department of Treasury for your Special Master position. To whom do you report?

Attachments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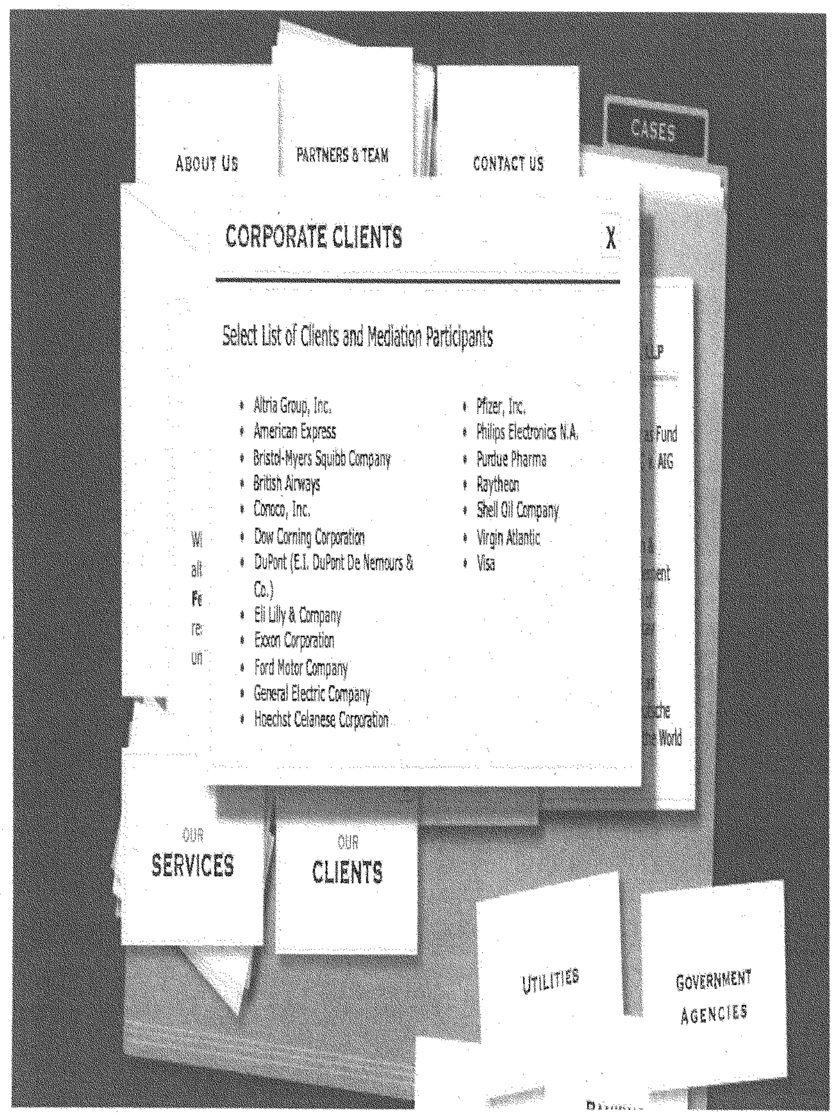
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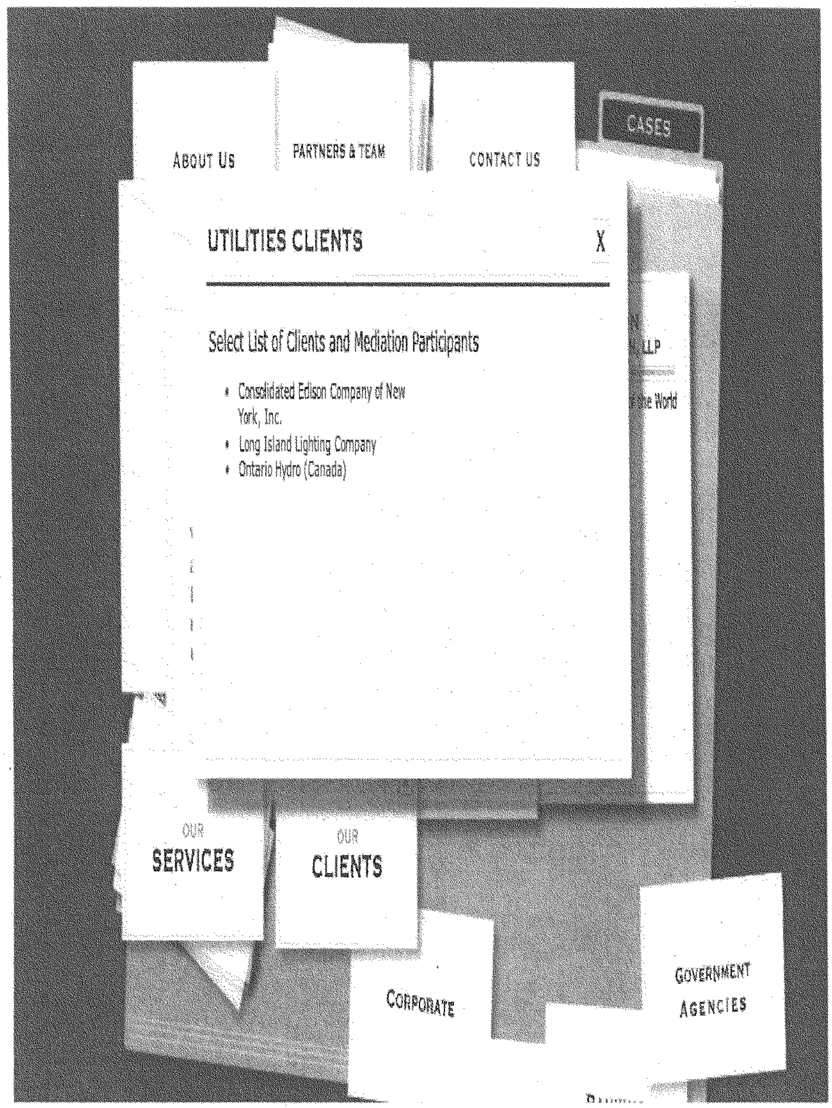
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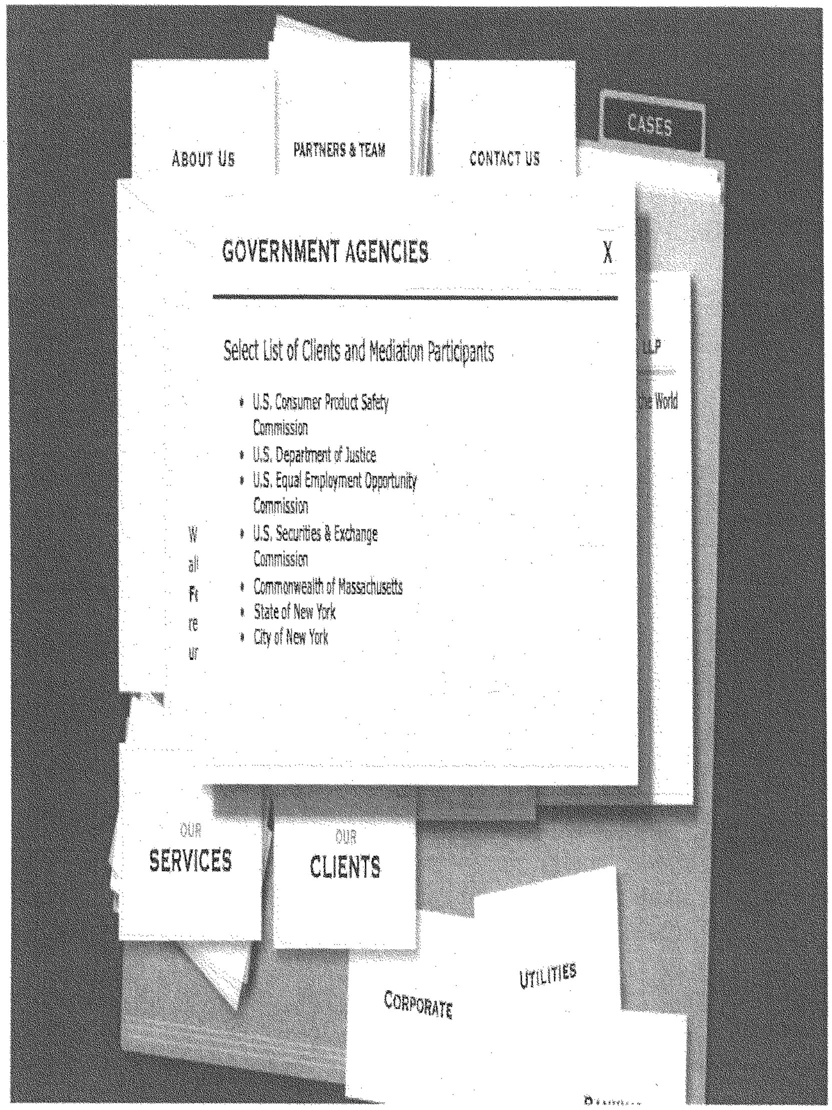
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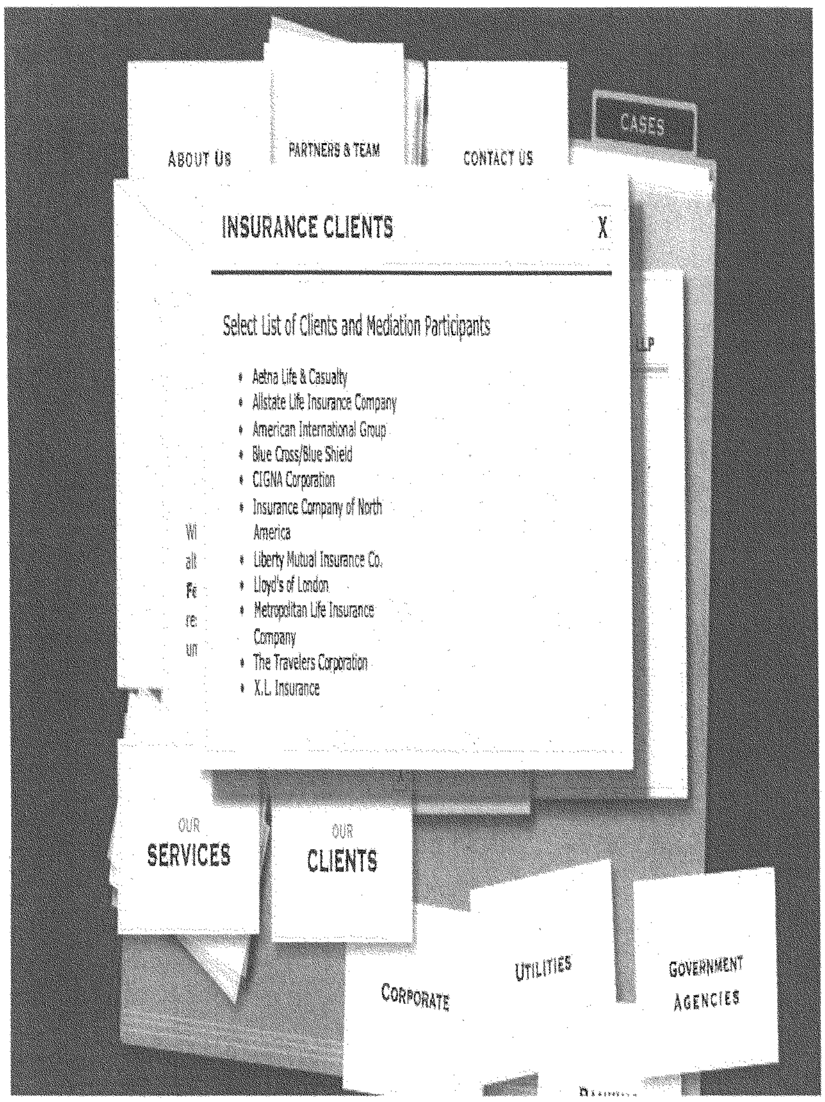
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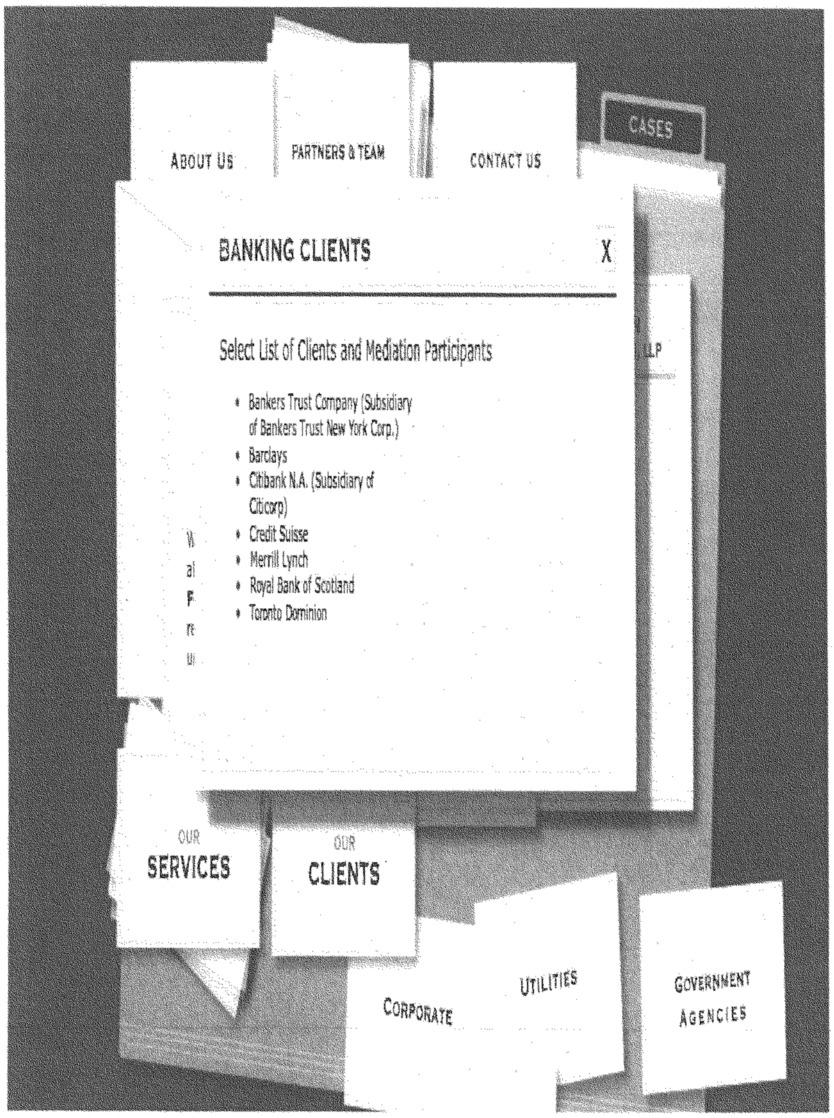
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The firm's founder, Kenneth R. Feinberg and his partner, Michael K. Rozen, have extensive experience in the fields of negotiation, mediation, arbitration, and court-sponsored Special Master settlement procedures. They are frequently retained by clients to help devise and implement national settlement strategies for the comprehensive resolution of complex protracted litigation.

SEC v. AIG Settlement

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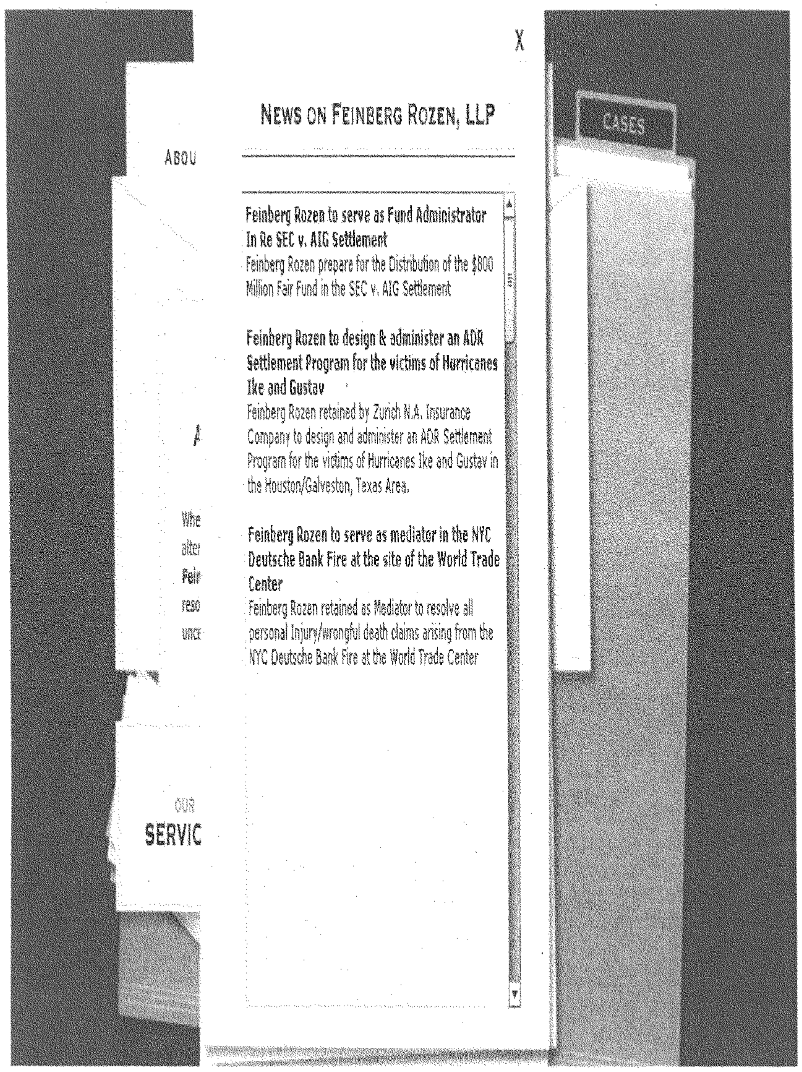
X

SEC v. AIG Settlement

Mr. Feinberg was appointed by the Federal Court of the Southern District of New York to serve as Fund Administrator for the approximately $800 million settlement in the matter entitled In Re United States Securities and Exchange Commission v. American International Group, Inc. (06 Civ. 1000). The Firm's responsibilities include the design of the Plan of Allocation, the determination of the allocation formula and the supervision of the distribution of payments to eligible claimants. For more information go to www.aigsettlementadministration.com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Feinberg Rozen prepare for the Distribution of the $800 Million Fair Fund in the SEC v. AIG Settlement
Feinberg Rozen to design & administer an ADR Settlement Program for the victims of Hurricanes Ike and Gustav
Feinberg Rozen retained by Zurich N.A. Insurance Company to design and administer an ADR Settlement Program for the victims of Hurricanes Ike and Gustav in the Houston/Galveston, Texas Area.
Feinberg Rozen to serve as mediator in the NYC Deutsche Bank Fire at the site of the World Trade Center
Feinberg Rozen retained as Mediator to resolve all personal Injury/wrongful death claims arising from the NYC Deutsche Bank Fire at the World Trade Center
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