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Acting Special Master for TARP Executive Compensation Patricia Geoghegan
U.S. Department of the Treasury
Written Testimony Before the
House Committee on Oversight and Government Reform
Subcommittee on Economic Growth, Job Creation and Regulatory Affairs

February 26, 2013

Chairman Jordan, Ranking Member Cartwright, and Members of the Subcommittee, I thank you for the opportunity to testify today on the subject of executive compensation. I serve as the Acting Special Master for the Troubled Asset Relief Program Executive Compensation.

In the fall of 2008, our economy stood at the brink. The financial institutions and markets that Americans rely on to protect our savings, finance our homes and college educations, and fund our businesses were threatened as at no time since the Great Depression. Across the country, people were rapidly losing confidence in our financial system and in the government's ability to safeguard their economic future.

Congress acted by passing the Emergency Economic Stabilization Act (EESA) in October 2008, which created the Troubled Asset Relief Program (TARP). TARP was part of the broad-based federal response to the financial crisis that helped prevent a second Great Depression. And the law, as amended in 2009, included important restrictions on executive compensation at businesses that received TARP assistance. Those restrictions were designed to help ensure that compensation of top executives was aligned not only with the interests of shareholders, but also with the interests of taxpayers in preventing excessive risk-taking and recovering the TARP assistance.

The Treasury Department acted quickly to implement these restrictions through the Interim Final Rule, TARP Standards for Compensation and Corporate Governance, which provided for, among other things, the creation of the Office of the Special Master.

The Special Master's office was established in June 2009 under the leadership of Kenneth Feinberg. The Special Master's office was given an important responsibility under EESA and accompanying Treasury regulations: it was to review—and either approve or modify—the pay packages for the top 25 employees of seven companies that had received “exceptional assistance” under TARP.¹ Today, the Special Master only has jurisdiction to approve or modify pay packages for the two remaining companies that received exceptional assistance.

I joined Treasury in August 2009 to work on TARP executive compensation with Mr. Feinberg and the Special Master's office staff. During that time, we worked closely to shape the process

¹ The original seven companies were AIG, Ally Financial, Bank of America, Citigroup, Chrysler, Chrysler Financial, and GM. In 2009, the Office of the Special Master (OSM) reviewed a total of 136 top 25 pay packages proposed for these seven companies; in 2010 OSM reviewed 119 top 25 pay packages proposed for the then remaining five exceptional assistance companies; in 2011 OSM reviewed 98 top 25 pay packages proposed for the remaining four companies; and in 2012 OSM reviewed 70 pay packages for AIG, GM, and Ally Financial. The number of pay packages reviewed by OSM in any year may in fact be less than 25 per company because of departures and retirements of top 25 employees between January 1 and the date of the annual determination letters.

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and framework by which we reviewed the pay for the top executives at seven TARP recipients. Under Mr. Feinberg's direction, we issued our first top 25 compensation determinations in October 2009, and subsequent determinations in 2010.² In September 2010, Mr. Feinberg stepped down as the Special Master, and I was appointed to succeed him. Accordingly, I have headed the office for the 2011 and 2012 compensation determinations.

In October 2009, Mr. Feinberg testified before the full House Oversight and Government Reform Committee as to how we were carrying out the responsibilities of the Special Master. And what he said then describes how we have carried out those responsibilities to this day. He described our objective as 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."

There were initially seven companies subject to the Special Master's jurisdiction. Today, only two companies are still subject to the jurisdiction of the Special Master. Treasury has exited its investments in five of the original seven companies, and is on track to exit a sixth by early 2014.

Moreover, taking as a group the original seven companies whose payments to top executives were subject to the Special Master's office review and considering the recoveries by Treasury and the Federal Reserve on a combined basis, **the taxpayers have now recovered more than the total assistance provided.**

The Process of the Office of the Special Master Balances the Objectives of the Law

As Mr. Feinberg noted almost four years ago, the Special Master's office has worked to achieve a balance between limiting compensation, while at the same time keeping compensation at levels that enable the exceptional assistance companies to remain competitive and repay taxpayers.

The process that I helped Mr. Feinberg create, and that we continue to follow today, accomplishes this objective by requesting comprehensive submissions from the exceptional assistance companies, which we then thoroughly and carefully examine. In reviewing these submissions, we analyze market data to determine what constitutes competitive marketplace compensation. The regulations make clear that we must consider market forces in determining compensation levels that will permit the exceptional assistance recipients to compete—including maintaining the ability to attract and retain employees—so they can exit TARP and repay taxpayers. The Special Master's office staff has also always included one or more executive compensation professionals. We have received help from academics who did not have companies as clients, to ensure there was no conflict of interest.

The original submissions from the seven companies were in large part contrary to the statute and the regulations, and contrary to the public interest. The companies wanted too much cash and guaranteed salary. They wanted stock that would be immediately transferable. And the submissions made no mention or insufficient mention of the perks that were part of the overall salary—such as personal use of corporate aircraft, golf club dues, et cetera.

² OSM's annual review process results in the issuance of its annual top 25 determination letters, which can be found online at www.financialstability.gov (click on "Executive Compensation").

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Therefore, we required the companies to drastically revise their proposals, and we established a number of guidelines that were the foundation of the initial determinations in 2009 and 2010. As Mr. Feinberg's successor, I have continued to follow these guidelines in our determinations for the remaining companies.

These guidelines included the following:

First, we said that pay generally should not exceed the levels paid for similar positions at similar companies.

Second, we required that most pay packages should be primarily stock-based. In this way, compensation is tied to the long-term performance of the company and executives are not just focused on short-term results or encouraged to take excessive risks.

Third, we drastically cut cash compensation.

Fourth, we required that incentives be contingent on the achievement of pre-established performance goals.

Fifth, we significantly limited executive perks.

As both Mr. Feinberg and I have consistently stated, these are guidelines rather than rigid formulas. Each compensation determination requires the exercise of discretion and judgment. And they each require achieving an appropriate balance between limiting pay and also keeping the companies competitive so they can repay taxpayers.

The Office of the Special Master is Achieving its Mission

An objective and thorough look at the record shows that the Special Master's office struck an appropriate balance in achieving its mission. Pay has been cut and taxpayers are being repaid. Starting in 2009:

- We cut average cash pay for the top 25 executives at the seven companies that originally received exceptional assistance by more than 90 percent.
- We cut average total pay for those top 25 executives by more than 50 percent.
- We fundamentally restructured the top 25 pay packages so that most pay packages are primarily stock-based (generally including the use of stock salary that immediately vests but is payable over time), with a relatively small percentage of cash pay (in most cases not exceeding \$500,000), so that executives are not just focused on short-term results and are not encouraged to take excessive risks.
- We provided that, when a pay package includes incentive compensation, it is in the form of long-term restricted stock awarded upon the achievement of pre-established performance metrics and paid out generally over a three-year period.
- We significantly limited executive perquisites.

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- Taken together, the original seven companies under the jurisdiction of the Special Master's office have fully returned the \$352 billion in total assistance provided—plus an additional positive return to date of more than \$6 billion.

The Special Master's office has followed the same guidelines established under Mr. Feinberg's leadership in 2009 for the 2010, 2011, and 2012 top 25 determinations. We continue to receive detailed submissions from the companies, which we evaluate very carefully. We continue to review and evaluate market data to make sure that compensation does not exceed the levels paid for similar positions at similar companies. We continue to limit cash salary and require that most compensation be in the form of stock, we continue to require that incentive compensation be awarded only on the achievement of pre-established performance goals, and we continue to limit perks. This demonstrates a clear and thorough process to determine compensation.

Specifically, in 2012, our determinations regarding the three companies that still had exceptional assistance outstanding reflect the following:

- **We continue to limit compensation.**
 - AIG's average pay packages for its top 25 employees were at the 48th percentile compared to similar positions at similar companies.
 - GM's average pay packages for its top 25 employees were at the 50th percentile compared to similar positions at similar companies.
 - Ally Financial's average pay packages for its top 25 employees were mid-way between the 50th and the 75th percentiles compared to similar positions at similar companies.³
 - Most pay (83 percent overall in 2012) is in the form of stock, which means that the ultimate value of the majority of the pay of top executives will depend on the future performance of the company, generally over a three-year period.⁴
- **We continue only to permit pay increases that are reasonable under the circumstances.** Mr. Feinberg acknowledged in 2009 that, while emphasizing decreases in cash and total pay, he had permitted individual pay increases where appropriate based on the unique facts and circumstances of each case. That continues to be our approach. Neither AIG nor Ally Financial proposed any net increase in compensation for its top 25 executives for 2012. Although GM did propose a net increase in compensation for 2012, its pay packages nevertheless were on average at the 50th percentile for comparable positions at comparable entities. Moreover, we required that more than 97 percent of the approved pay increases be in the form of stock compensation rather than cash. In addition, the three current CEOs have not had any pay increase during their respective tenures.

³ The above results are consistent with the benchmarks OSM has historically used for the three companies. (In simplified terms, if a pay package is at the 50th percentile—also sometimes referred to as the median—half the comparable pay packages are above that number and half are below; if a pay package is at the 60th percentile, 40 percent of the comparable pay packages are above that number and 60 percent are below, etc.)

⁴ This result is consistent with the 82 percent overall number for 2011 and 2010.

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- **We continue to require that compensation be predominately in stock and therefore performance-based.** Ninety-four percent of the pay packages we approved in 2012 contained a majority of stock compensation (rather than cash), up from 74 percent in 2010.⁵
- **We continue to limit the amount of cash compensation.** In certain instances under Mr. Feinberg, as well as today (for example, a total of 23 individuals in 2012 versus 22 in 2010), the Special Master’s office has approved a cash salary above \$500,000. In virtually every one of these cases, however, the large majority of the executive’s pay package has been in the form of stock-based compensation. Moreover, for 2012, cash salaries for the top 25 executives at the three companies as a group were on average one percent less than the median of cash salaries for similar positions at similar entities.⁶

It’s also important to note that in the 2012 proxy season, AIG received a 99 percent approval rate in its shareholder “say-on-pay” vote on 2011 compensation, and GM received a 97 percent approval rate. These approval rates are far higher than average results for shareholder say-on-pay votes.⁷

Moving Forward

Today, only two companies remain under the jurisdiction of the Special Master’s office, and by next year we expect there will be only one remaining company. In December 2012, GM purchased 200 million shares of its common stock held by Treasury and Treasury announced plans to exit its remaining investment in GM by early 2014. In addition, Treasury has outlined its exit strategy for its investment in Ally Financial. Treasury expects to monetize its remaining investment as the company completes two strategic initiatives begun last year, which are the Chapter 11 proceeding involving Ally Financial’s mortgage subsidiary ResCap, and the sale of Ally Financial’s international operations.

We will continue to follow the framework and guidelines we used in the 2009-2012 determinations for GM and Ally Financial until they have exited TARP.

⁵ OSM also succeeded in increasing the percentage of pay packages that include long-term restricted stock to 73 percent of the total number of pay packages approved in 2012 and 2011, versus 67 percent of the total number of pay packages approved in 2010 and 2009.

⁶ Total cash in the pay packages approved by OSM was even smaller in comparison. For example, in 2012 the average total cash pay approved for AIG, GM, and Ally Financial was 63 percent lower than the median for total cash pay (i.e., cash salary and cash incentives) for similar positions at similar companies. This is because similar companies also pay cash bonuses, which are not permitted for executives whose pay packages are subject to review by OSM.

⁷ Ally Financial does not have publicly held equity and therefore is not required to hold a shareholder say-on-pay vote. Note also that the say-on-pay vote results were not skewed by reason of Treasury’s then ownership interests in AIG and GM; Treasury casts its say-on-pay votes in proportion to the “for” or “against” votes cast by the other shareholders.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

January 25, 2013

The Honorable Christy L. Romero
Special Inspector General
for the Troubled Asset Relief Program
1801 L Street, NW, 4th Floor
Washington, D.C. 20036

Re: Treasury Response to SIGTARP Draft Audit Report

Dear Ms. Romero:

I write in response to your draft audit report of January 10, 2013 (Draft), pertaining to your review of the 2012 determinations of the Office of the Special Master for TARP Executive Compensation (OSM). Specifically, your team reviewed OSM's 2012 compensation determinations for the Top 25 most highly compensated executives (Top 25) at the three remaining companies that received "exceptional assistance" under the Troubled Asset Relief Program (TARP).¹ This letter provides Treasury's response to the Draft.²

I. A Summary of the Facts Regarding OSM's Achievements.

The facts show that OSM continues to fulfill its regulatory requirements. OSM has limited excessive compensation while at the same time keeping compensation at levels that enable the "exceptional assistance" recipients to remain competitive and repay TARP assistance. Specifically, in 2012, OSM's determinations regarding the three companies that still had "exceptional assistance" outstanding were as follows:

- AIG's average total compensation for the Top 25 was at the 48th percentile of similar positions at similar companies.
- GM's average total compensation for the Top 25 was at the 50th percentile of similar positions at similar companies.
- Ally's average total compensation for the Top 25 was mid-way between the 50th and the 75th percentiles of similar positions at similar companies, which is consistent with its average since 2009 and is due to its unique circumstances.

These determinations continue what OSM has accomplished since its inception in 2009.

¹ The original seven exceptional assistance recipients were Ally Financial (formerly GMAC), AIG, Bank of America, Chrysler, Chrysler Financial, Citigroup, and GM. Ally Financial, AIG, and GM were still subject to OSM's determinations in 2012.

² We note that SIGTARP did not provide a copy of the report's Executive Summary.

- OSM cut average cash pay for the Top 25 executives at the seven companies that originally received exceptional assistance by more than 90 percent.
- OSM cut average total pay for the Top 25 executives by more than 50 percent. The three current CEOs also have not had any pay increase during their respective tenures.
- Each year, OSM's determinations have limited the proportion of current cash pay for Top 25 executives (generally not more than 20 percent cash). OSM has required that the majority of Top 25 executive compensation (generally more than 80 percent) be in the form of stock-based pay – the ultimate value of which will depend on the company's performance over the subsequent three-year period. OSM also has strictly limited perquisites for these executives.
- Company proposals have included decreases for individual executives from one year to the next, and companies do not always award the full target amount of incentive compensation approved by OSM. For example, Ally Financial awarded only approximately 75 percent of the total target incentive compensation approved for the Top 25 executives in 2011.
- As of today, five of the seven exceptional assistance recipients – AIG, Bank of America, Citigroup, Chrysler, and Chrysler Financial – have exited TARP entirely.
- AIG, one of the three companies covered in the Draft, is the most recent exceptional assistance recipient to repay its investments. Not only did it exit TARP, but it also repaid the Federal Reserve Bank of New York. Treasury and the Federal Reserve realized an additional positive return of \$22.7 billion.
- Taken together, the original seven companies under OSM's jurisdiction have returned the \$352 billion in total assistance provided, plus an additional positive return to date of more than \$6 billion.³ We anticipate significant additional repayments, which would increase that overall positive return.⁴

In addition, OSM maintains a high level of transparency in its determinations. All its letters include OSM's procedures and guidelines, as well as a breakdown of the exact dollar amount of cash salary, stock salary, and long-term restricted stock for each Top 25 executive. A new feature in the 2012 Top 25 determination letters, in response to SIGTARP's recommendation, is an overview of the market data that OSM reviews in making its determinations. All this information, along with the compensation regulation itself, is publicly available on OSM's

³ The \$352 billion total includes commitments to AIG of \$69.8 billion by Treasury and \$112 billion by the Federal Reserve Bank of New York for a total of approximately \$182 billion. It does not include the other assistance provided by the Federal Reserve or the Federal Deposit Insurance Corporation, including their commitments under the Asset Guarantee Program.

⁴ Although the total investment in Ally Financial, Chrysler, Chrysler Financial and GM was always expected to produce a loss, the current outstanding investment is already more than offset by the profits from the investments in Citigroup, Bank of America, and AIG, and Treasury's remaining shares in Ally Financial and GM have significant value.

website at www.financialstability.gov (click on “Executive Compensation”).

OSM’s work also has helped lay the foundation for broader reforms to executive compensation by Congress, federal regulators (including the Federal Reserve and the Securities and Exchange Commission), and global financial leaders. Effective implementation of the reforms required by the Dodd-Frank Wall Street Reform and Consumer Protection Act will be crucial to help prevent irresponsible financial sector risk-taking in the future.

II. The Draft Report Contains Many Inaccuracies.

Treasury is committed to transparency in all its programs, including TARP. Our cooperation with your team in this audit was no different. We participated in ten interviews, produced all requested documents, and provided detailed written responses to questions. Nonetheless, the Draft is inaccurate in numerous ways. Indeed, we provided 500 comments and edits to address those inaccuracies, and we also met with your team to explain our concerns.

The next day, your team informed us that you had considered all 500 comments and edits and had declined to make any material changes.⁵ We therefore disagree with numerous issues in the Draft. Our overarching concern is that SIGTARP appears to disregard OSM’s responsibilities under the law. As such, we believe it is helpful to review those responsibilities before further addressing the Draft’s inaccuracies.

The Emergency Economic Stabilization Act of 2008 (EESA), as amended, includes certain limits on executive compensation. Those limits apply to senior executives at companies that received TARP assistance, for as long as that assistance is outstanding. An Interim Final Rule (IFR) implementing those restrictions created OSM, and gives it the responsibility to review – and either approve or modify – proposed pay packages for the Top 25 at the TARP recipients that received “exceptional assistance.” While there were originally seven such companies, only three were still subject to OSM’s review during your audit.

Under the IFR, OSM’s review of compensation for the Top 25 is supposed to determine that pay package proposals are not “inconsistent with the purposes of” EESA (“including the maximization of overall returns to the taxpayers of the United States and providing stability and preventing disruptions to financial markets”⁶) or “otherwise contrary to the public interest.”⁷ The IFR instructs OSM to apply six principles to fulfill those purposes.⁸ The IFR provides OSM discretion to weigh the principles based on the circumstances unique to each company and executive.

⁵ In this audit, SIGTARP deviated from the process it has followed for the past four years. SIGTARP (and other oversight bodies) traditionally provides Treasury two opportunities to provide technical comments, first in a fact sheet and then in a draft report. Then Treasury receives an official draft for formal comment, as here. SIGTARP’s senior leadership confirmed we would see at least one draft for technical comment in this audit; that it would never be the case that Treasury would see only a draft for formal comment. Instead, SIGTARP provided only this Draft.

⁶ 31 C.F.R. § 30.16(b)(1).

⁷ 31 C.F.R. § 30.16(b)(1).

⁸ The full text is available at www.financialstability.gov, click on “Executive Compensation.”

OSM has sought the appropriate balance between these sometimes competing considerations in making all our determinations. Those principles include determining that compensation “avoid incentives to take ... excessive risks;”⁹ that it reflect “the need for the TARP recipient to remain a competitive enterprise, to retain and recruit talented employees who will contribute to the TARP recipient’s future success, and ultimately to be able to repay TARP obligations;”¹⁰ that components of compensation be “appropriately” allocated;¹¹ that an “appropriate portion” be performance-based pay;¹² that compensation “be consistent with, and not excessive taking into account, compensation structures and amounts for persons in similar positions or roles at similar entities;”¹³ and that compensation “should reflect the current or prospective contributions of an employee to the value of the TARP recipient.”¹⁴

III. The Draft Criticizes OSM for Balancing the Objectives in the IFR.

The Draft criticizes OSM for approving “excessive” pay packages. The IFR requires that OSM strike a balance between limiting compensation and approving pay packages consistent with comparable positions at comparable companies. Therefore, in evaluating the companies’ pay package proposals, OSM reviews market data surveying compensation for comparable positions in comparable entities. As noted above, based on the relevant market data for 2012, AIG’s average total compensation for the Top 25 was at the 48th percentile of similar positions at similar companies and GM’s was at the 50th. Ally, which has historically been higher due to its unique circumstances, was nevertheless mid-way between the 50th and the 75th percentiles.

The Draft highlights the number of pay packages above the 50th percentile benchmark as inconsistent with OSM’s guidelines. The 50th percentile is merely a benchmark. It is not a specific limitation on each individual; it is a consideration in relation to the overall objectives noted above. The compensation of some individuals may be above that benchmark, whereas others may fall below.

In 2012, while some packages at each company were above the benchmark, 13 AIG packages (or more than half), were at or below the benchmark; 11 GM packages (or almost half) were at or below the benchmark; and nine Ally packages (or almost half) were at or below the benchmark. But the goal is for each company’s set of compensation packages, as an average, to approach the 50th percentile of similar positions at similar companies (or, in the case of Ally, its historical range). On average, OSM’s 2012 determinations were consistent with its guidelines and the IFR.

IV. The Draft Mischaracterizes Information OSM Provided SIGTARP.

The Draft criticizes OSM for having “no criteria” for allowing pay packages without any long-term restricted stock. This is misleading. As we explained several times, OSM has approved

⁹ 31 C.F.R. § 30.16(b)(1)(i).

¹⁰ 31 C.F.R. § 30.16(b)(1)(ii).

¹¹ 31 C.F.R. § 30.16(b)(1)(iii).

¹² 31 C.F.R. § 30.16(b)(1)(iv).

¹³ 31 C.F.R. § 30.16(b)(1)(v).

¹⁴ 31 C.F.R. § 30.16(b)(1)(vi).

such requests in limited circumstances – typically (1) where the executive is very senior and may retire in the next few years; or (2) where, due to particular circumstances, the executive’s position may disappear in the near future (e.g., the planned disposition of a subsidiary or other corporate changes).

In those limited circumstances, approving pay packages without long-term restricted stock is reasonable and consistent with the IFR. This is because the IFR requires the executive to forfeit the long-term restricted stock if the executive does not continue to provide services for an additional two years after the date of the award – regardless of the reason. So, for executives who may retire, or whose future is uncertain due to corporate changes, any long-term restricted stock awarded to them would have no value and thus would not serve the IFR principle of designing compensation so as to retain talented employees.

V. SIGTARP’s Recommendations.

The Draft makes four recommendations. The first recommendation is that OSM should reevaluate both total compensation each year and whether to reduce total compensation. OSM generally agrees with this idea. While we believe our existing procedures achieve this – OSM reevaluates total compensation each year and our due diligence process is designed to alert us to any developments that suggest compensation should be reduced – we will review whether there are additional ways to improve our process.

The second recommendation is that OSM should develop more policies, procedures, and criteria, without which “Treasury risks that TARP companies could potentially misuse taxpayer dollars for excessive executive compensation.” Although we are not aware of any facts that support such an assertion, we will review whether there are any policies or procedures in addition to those we already have in place that could help to prevent any such activity.

The third recommendation is that OSM should “independently analyze” a company’s justification in requesting a pay package with cash salary in excess of \$500,000. SIGTARP’s concern appears to be that companies may provide inaccurate information in their submissions. While we believe our existing procedures are rigorous, we will consider whether any changes are appropriate. Among other things, OSM currently analyzes each company’s public securities law filings; consults with Treasury officials responsible for managing Treasury’s investments in the companies; reviews public reports about the companies and their top personnel; and analyzes the companies’ established performance goals for their executives. In addition, each company’s CEO and CFO certify their pay proposals under penalties of perjury.

The fourth recommendation is that OSM should “return” to the use of long-term restricted stock in the compensation packages. As explained above and in our discussions with you, long-term restricted stock continues to be a central element in most compensation packages. There are circumstances that we believe warrant exception, and we will continue to make sure any such exception is justified.

VI. Conclusion.

Thank you for the opportunity to respond to the Draft. Although we disagree with your findings and conclusions, OSM has benefitted from the audit review. I look forward to working with you in the future as Treasury completes the wind down of its TARP investments.

Sincerely,

A handwritten signature in cursive script that reads "Patricia Geoghegan".

Patricia Geoghegan
Acting Special Master
for TARP Executive Compensation