

TESTIMONY OF
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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 statutory¹ and regulatory² 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 only these seven companies. Although I do have interpretive authority under the Standards, and advisory authority under the law to make recommendations and nonbinding determinations as to officials of other companies who received TARP financial

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.*

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.