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U.S. HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
SUBCOMMITTEE ON ECONOMIC GROWTH, JOB CREATION,
AND REGULATORY AFFAIRS

STATEMENT OF THE HONORABLE CHRISTY ROMERO
SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM
(SIGTARP)

BEFORE THE
U.S. 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 Committee, I am honored to appear before you today to discuss SIGTARP's second evaluation of Treasury-approved pay for top employees at companies that stood out from the more than 700 TARP recipients because the amount and nature of their bailouts were considered "exceptional."

The Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") serves as the watchdog over the Troubled Asset Relief Program ("TARP"), the Federal bailout resulting from the financial crisis. SIGTARP protects the interests of those who funded TARP programs – American taxpayers. Our mission is to promote economic stability through transparency, robust enforcement, and coordinated oversight.

I want to thank the Committee for your unwavering support in helping SIGTARP fulfill this mission. Let me first provide the Committee with a brief overview of the important work that SIGTARP is doing. SIGTARP is a white-collar law enforcement agency. In the last year alone, SIGTARP, as a result of its investigations, nearly doubled the number of individuals criminally charged to 121 (including 83 senior officers), and nearly tripled the number of defendants convicted to 84, with others awaiting trial. The consequences for these crimes are severe, with 36 individuals already sentenced to prison while others convicted await sentencing. The prison sentences imposed have been lengthy (for example, 30 years, 14 years, 12 years, 11.5 years, 8 years, and 6 years) reflecting the severity and complexity of the crimes SIGTARP investigates. We are sending the message to perpetrators, scam-artists, and fraudsters of the financial crisis that committing crimes against the American taxpayer will not be tolerated. Along with jail time, SIGTARP's investigations have prevented \$555 million of TARP funds from being lost to massive fraud at the now-failed Colonial Bank. SIGTARP investigations have

also resulted in court orders for the return of \$4.15 billion to the Government and victims (including TARP companies), evidencing that SIGTARP as an agency more than pays for itself.

In our oversight role, SIGTARP has made 114 recommendations to Treasury to prevent fraud, waste and abuse related to TARP. Treasury has not implemented 50 of our recommendations to date. All SIGTARP recommendations can and should be implemented by Treasury without further delay. Finally, SIGTARP has brought significant transparency to TARP's 13 different programs through our 17 Quarterly Reports and 23 audits and other reports. SIGTARP's most recent evaluation, "Treasury Continues Approving Excessive Pay for Top Executives at Bailed-Out Companies," is the subject of my testimony before the Committee today. Treasury is in the process of approving 2013 pay packages for top employees at General Motors and GMAC (now rebranded as Ally Financial). SIGTARP has made recommendations to improve Treasury's process.

Background

In early 2009, after Congress provided in the TARP law that Treasury should require appropriate standards for executive compensation at TARP companies, several major TARP recipients paid employees billions of dollars in bonuses. On February 4, 2009, the President called the bonuses "shameful" stating, "...what gets people upset – and rightfully so – are executives being rewarded for failure. Especially when those rewards are subsidized by U.S. taxpayers.... As part of the reforms we are announcing today, top executives at firms receiving extraordinary help from U.S. taxpayers will have their compensation capped at \$500,000 – a fraction of the salaries that have been reported recently. And if these executives receive any

additional compensation, it will come in the form of stock that can't be paid up until taxpayers are paid back for their assistance.”¹

In June 2009, Treasury issued a rule to implement the standards required by the TARP law, as well as subsequent Recovery Act legislation that gave Treasury discretion to adopt additional standards on executive compensation. In the rule, Treasury created the Office of Special Master for TARP Executive Compensation (“OSM”). Kenneth R. Feinberg served as the Special Master and was succeeded in September 2010 by Patricia Geoghegan, who is the current Acting Special Master. Mr. Feinberg testified before the Congressional Oversight Panel, “Congress delegated to the Secretary of Treasury, who delegated to me the legal responsibility for linking executive compensation to regulation.”

OSM has jurisdiction over compensation at the seven companies that stood out from the more than 700 TARP recipients because of the amount and nature of their “exceptional” bailouts. These seven companies were: AIG, Ally, GM, Bank of America, Citigroup, Chrysler and Chrysler Financial. Mr. Feinberg testified before the Congressional Oversight Panel, “once Congress provided substantial taxpayer assistance to these companies, I was, in effect, a surrogate creditor to the taxpayer.” Mr. Feinberg testified before the House Oversight and Government Reform Committee, “These seven companies are owned by the taxpayer. And the taxpayer as creditors are asking these companies to rein in compensation.”

OSM’s primary responsibility is to approve compensation payments and structure each year for each of the Top 25 employees at the TARP exceptional assistance companies. OSM can disapprove pay that is inappropriate, unsound, or excessive, although those terms are not defined

¹ Remarks by President Barack Obama, February 4, 2009 (see online at: www.whitehouse.gov/the_press_office/RemarksbyPresidentBarackObamaOnExecutiveCompensationSecretaryGeithner/)

in Treasury's rule.² Under Treasury's Rule, the Special Master must determine whether compensation is inconsistent with the law or are otherwise contrary to the public interest. In meeting this "public interest standard", the Special Master uses discretion to apply six broad principles listed in Treasury's rule and to determine the appropriate weight or relevance of those principles depending on the facts and circumstances or when principles conflict.³

Special Master Feinberg told SIGTARP that these principles are inherently inconsistent because of conflicting goals and company-specific circumstances. Three OSM principles illustrate this inconsistency: One principle states that compensation should be consistent with that of persons in similar positions or roles at similar entities, while other principles call for a significant portion of compensation to be paid over the long term and for compensation to avoid incentives to take excessive risks. Therefore, compensation paid over the long term may avoid excessive risk, but may not reflect compensation of an employee's peers, particularly in industries where compensation practices have historically encouraged excessive risk taking.

The Process Developed by Special Master Feinberg to Approve Pay Packages

When asked about how principles give rise to vagueness and ambiguity with regard to compliance, Special Master Feinberg testified before the Congressional Oversight Panel, "It seems to me that what we found is that the rule delegated to the special master the ability to provide more detailed principles that would be used to effectuate the rule." And that is what he did. Feinberg developed what he called "prescriptions" to shift compensation for Top 25

² See Press release on Interim Final Rule for TARP, June 10, 2009 (online at: <http://www.treasury.gov/press-center/press-releases/Pages/tg165.aspx>). OSM also approves compensation structures (rather than setting individual pay packages) for certain executive officers and the next 75 most highly compensated employees.

³ The six principles are: (1) avoiding incentives to take risks; (2) keeping the company competitive and retaining and recruiting employees who would contribute to the company's success and its ability to repay TARP; (3) allocating compensation between salary and incentives; (4) basing a portion of pay on performance metrics; (5) setting compensation consistent with persons in similar positions at similarly situated companies; and (6) setting compensation that reflects an employee's contribution to the company's value.

employees away from large guaranteed cash salaries and toward stock. He testified before the House Committee on Financial services that he developed these prescriptions under the public interest standard.

Mr. Feinberg testified before the Congressional Oversight Panel about his prescriptions:

I would say that the fundamental conclusion we drew is that you want to set up a competitive packages that provides competitive cash to the employee, but in a limited amount, a competitive amount. We said under \$500,000 annually. And that the appropriate balance should be struck by giving the remaining compensation in a given year in stock in that company, but over a relatively lengthy period of time so that you are undercutting any incentive for quick turnaround, quick flip, making the stock in effect cash. And instead, you've got to hold as nontransferable a good share of that stock over as long as four years.

Feinberg's prescriptions were:

50th percentile: In trying to keep the companies competitive, Feinberg told SIGTARP that the 50th percentile was an "obvious" starting point and an "appropriate" level of compensation to balance the need to retain and attract people. To the House Committee on Financial Services, Feinberg testified, "total pay should generally not exceed the 50th percentile of total compensation for similarly situated employees."

To determine the 50th percentile, the companies submit market data that indicates the market pay for each Top 25 employee. OSM uses Equilar's *ExecutiveInsight Total Compensation Report*, an executive compensation benchmarking tool, among other resources, to assess the reasonableness of that market data. Feinberg testified before the House Committee on Financial Services, "there is a view constantly expressed by the companies under my jurisdiction that they are entitled to more, and more, and more. And that's the competitive market data that they provide to us. "

Cash salaries limited to \$500,000: Feinberg testified before the House Committee on Financial Services that “...base cash salaries should rarely exceed \$500,000, and only then for good cause shown, and should be, in many cases, well under \$500,000...” OSM staff told SIGTARP that the \$500,000 cash salary limit was based partially on President Obama’s statement that salaries should be limited to \$500,000. However, according to Feinberg, his decision to limit cash salaries to \$500,000 and to increase the proportion of compensation in the form of stock struck a balance between reducing excessive risk and providing enough compensation to keep employees’ “skin in the game.” He testified before Congress, that “other than small cash-based salaries, the remainder of the compensation package should be tied to performance” over a period of time. Requiring incentive compensation to be paid in the form of long-term restricted stock – and to be contingent on performance and on TARP repayment: OSM determines how much of the remaining compensation would be paid in stock that is earned immediately versus long-term restricted stock.⁴ In its first ruling issued October 22, 2009, OSM stated, “As the Secretary noted in his June 10 statement, incentive pay can be undermined by compensation practices that set the performance bar too low or simply reward rising tides. The Special Master’s rulings require that incentives be paid only if executives reach objective goals agreed upon in consultation with the Special Master—and only if TARP is repaid.” As previously reported in SIGTARP’s January 2012 report, OSM officials told SIGTARP that companies were very hesitant to pay long-term restricted stock because there was no certainty that some of the companies would ever be free of TARP. Feinberg testified that long-term restricted stock was “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.”

⁴ The Recovery Act limited long-term restricted stock to one-third of the employee’s pay.

As SIGTARP reported in January 2012, OSM used this process for 2009, 2010, and 2011 pay.⁵ In his final recommendation before he left in 2010, Special Master Feinberg made recommendations to his successor. Feinberg recommended that his successor “limit guaranteed cash,” “demand a performance component for most compensation,” and “hold the line on cash salaries.”

SIGTARP’s January 2012 Report

On January 23, 2012, SIGTARP published a report finding that, from 2009 to 2011, the Special Master could not rein in excessive compensation at the seven companies that received exceptional TARP assistance because he was under the constraint that his most important goal was to get the companies to repay TARP. Special Master Feinberg said that the companies pressured him to let the companies pay executives enough to keep them from quitting, and that Treasury officials pressured him to let the companies pay executives enough to keep the companies competitive and on track to repay TARP funds.

Given OSM’s overriding goal, the seven companies had significant leverage over OSM by proposing and negotiating for excessive pay packages based on historical pay, warning Special Master Feinberg that if he didn’t provide competitive pay packages, top officials would leave and go elsewhere.

In proposing high pay packages based on historical pay prior to their bailout, the TARP companies failed to take into account the exceptional situation they had gotten themselves into that necessitated taxpayer bailout. Rather than view their compensation through the lens of

⁵ On October 22, 2009, OSM issued its first compensation determinations for 137 employees of 7 companies that had received TARP exceptional assistance. In December 2009, Bank of America and Citigroup repaid their exceptional assistance and were no longer subject to the Special Master’s rulings. On March 23, 2010, OSM issued 2010 pay determinations for 121 employees of the 5 remaining companies. In May 2010, Chrysler Financial exited TARP. On April 1, 2011, OSM issued compensation determinations for 98 employees of the remaining 4 companies. In July 2011, Chrysler exited TARP.

partial Government ownership, the companies argued that their proposed pay packages were necessary to retain or attract employees crucial to the company paying back TARP. For example, Ally CEO Michael Carpenter told SIGTARP, “We had an individual who was making \$1.5 million total compensation with \$1 million in cash. Cutting this person’s salary to \$500,000 cash resulted in the person being cash poor. This individual is in their early 40s, with two kids in private school, who is now considered cash poor. ... We were concerned that these people would not meet their monthly expenses due to the reduction in cash.”

SIGTARP reported that under conflicting principles and pressures, despite reducing some pay from pre-bailout times, the Special Master approved multimillion-dollar compensation packages for many of the top 25 employees but tried to shift them away from large cash salaries and toward stock. OSM approved pay packages worth \$5 million or more for 49 individuals.

SIGTARP reported that although OSM developed prescriptions, OSM did not have any established criteria for applying those prescriptions. Because there were so many differences in the companies’ situations, companies pushed back on the prescriptions and OSM made many exceptions to the prescriptions on a case-by-case basis. SIGTARP recommended that OSM (1) substantiate good cause for cash salaries greater than \$500,000; (2) better document its use of market data to determine the 50th percentile; and (3) develop more robust policies, procedures, or guidelines.

In addition, SIGTARP concluded in its 2012 report that while historically the Government has not been involved in pay decisions at private companies, one lesson of this financial crisis is that regulators should take an active role in monitoring and regulating factors that could contribute to another financial crisis, such as executive compensation. As a nation we are not out of the woods because many former TARP recipients remain as systemically important

financial institutions. These companies have the responsibility to reduce risk taking that could trigger systemic consequences, including excessive cash compensation and other compensation not tied to long-term performance. For institutions that exited TARP, the responsibility for reforming compensation practices falls on the companies and their regulators. The regulators' strength and leadership in the area of executive compensation are crucial. Taxpayers are looking to the regulators to protect them so that history does not repeat itself.

SIGTARP initiated a second evaluation of OSM's pay-setting process for 2012 for top 25 employees of the remaining TARP exceptional assistance companies, AIG, GM, and Ally in light of the findings in SIGTARP's earlier report. Despite SIGTARP's January 2012 report identifying serious concerns with OSM's pay-setting process, Treasury continued to use the same process for setting 2012 pay without significant change. According to the Acting Special Master Geoghegan, the process OSM process used to set 2012 pay has not changed. She told SIGTARP that this was OSM's fourth year and the companies were not proposing anything out of the ordinary.

SIGTARP's Conclusions in its 2013 Evaluation

While taxpayers struggle to overcome the recent financial crisis and look to the U.S. Government to put a lid on compensation for executives of firms whose missteps nearly crippled the U.S. financial system, Treasury continues to allow excessive executive pay. AIG, Ally, and GM executives continue to rake in Treasury-approved multimillion-dollar pay packages that often exceed guidelines from OSM.⁶ Treasury's formal response to SIGTARP's 2012 report came from Acting Special Master Geoghegan, who stated: "...OSM has succeeded in achieving

⁶ OSM's primary responsibility is to set pay packages for the Top 25 employees at companies whose amount and nature of their TARP bailout were labeled "exceptional." At the end of 2012, only three companies receiving exceptional assistance under TARP remained: AIG, GM, and Ally.

its mission” by reducing pay for the top 25 executives at these companies from the pay they received prior to TARP.

Treasury’s success should not be judged based on reductions in pay from a time when these companies stood on their own without taxpayer assistance. If that is the definition of success, the work of OSM was effectively over when Special Master Feinberg set the first pay packages in 2009, and there is no longer a need for a Special Master. Rather, Treasury’s success should be based on whether Treasury awards appropriate pay for executives while taxpayers continue to fund these companies’ bailouts.

SIGTARP found that once again, in 2012, Treasury failed to rein in excessive pay. In 2012, OSM approved pay packages of \$3 million or more for 54% of the 69 Top 25 employees at AIG, GM, and Ally – 23% of these top executives (16 of 69) received Treasury-approved pay packages of \$5 million or more, and 30% (21 of 69) received pay ranging from \$3 million to \$4.9 million. Treasury seemingly set a floor, awarding 2012 total pay of at least \$1 million for all but one person. Treasury approved 24 of AIG’s top 25 employees to receive pay packages worth at least \$2 million.

Taxpayers deserve transparency on Treasury’s decisions to award multimillion-dollar pay packages to executives at companies that had been stuck in TARP for four years. First, even though OSM set guidelines aimed at curbing excessive pay, SIGTARP previously warned that Treasury lacked robust criteria, policies, and procedures to ensure those guidelines are met. Treasury made no meaningful reform to its processes. Second, absent robust criteria, policies, and procedures to ensure its guidelines were met, OSM’s decisions were largely driven by the pay proposals of the same companies that historically, and again in 2012, proposed excessive

pay. Third, with the companies exercising significant leverage, the Acting Special Master rolled back OSM's application of guidelines aimed at curbing excessive pay.

Despite SIGTARP's previous warning that Treasury lacked robust criteria, policies, and procedures to ensure that Treasury's guidelines to curb excessive pay are met, Treasury made no meaningful reform to its processes.

Former Special Master Feinberg developed guidelines aimed at curbing excessive pay and reducing excessive risk taking. Treasury Secretary Geithner testified that executive compensation played a material role in causing the financial crisis because it encouraged excessive risk taking. Feinberg previously told SIGTARP that he limited cash salaries to \$500,000 and shifted compensation more toward stock to reduce excessive risk and keep employees' "skin in the game." Feinberg also previously told SIGTARP that he targeted total compensation at the 50th percentile for similarly situated employees at similarly situated entities to keep the companies competitive. Feinberg testified before Congress that he used long-term restricted stock tied to performance metrics to correct problems with executive compensation practices at these companies.

Although SIGTARP previously reported serious problems with OSM's pay-setting process and recommended fixes for those problems, Treasury failed to take any meaningful action in response. SIGTARP reported that OSM approved multimillion-dollar compensation packages, trying to shift these packages away from large cash salaries and toward stock, but that OSM did not have any criteria for applying its guidelines. SIGTARP reported that OSM awarded cash salaries greater than \$500,000 without OSM substantiating good cause. The only action Treasury took in response to SIGTARP's findings and recommendations was to document

its use of market data on the 50th percentile and, in an eight-page spreadsheet, document limited explanations for cash salaries exceeding \$500,000.

Despite SIGTARP's previous warnings, Treasury did not establish meaningful criteria for having good cause to award cash salaries greater than \$500,000. In 2012, OSM did not independently analyze the basis for awarding cash salaries greater than \$500,000. Without this analysis, OSM put itself in the position of relying heavily on justifications by the companies – companies that historically have pushed back on the Special Master's limitations on compensation, in particular, on cash salaries. By not making substantive changes, Treasury is clinging to the status quo of awarding multimillion-dollar pay packages.

OSM's decisions were largely driven by the companies' pay proposals, the same companies that historically, and again in 2012, proposed excessive pay, failing to appreciate the extraordinary situation they were in, with taxpayers funding and partially owning them.

Many believe that AIG, Ally, and GM would not exist except for the Government assistance each so desperately requested. SIGTARP previously reported that, given OSM's overriding goal to get the companies to repay TARP, the companies had significant leverage over OSM by proposing and negotiating for excessive pay, warning that if OSM did not provide competitive pay packages, top executives would leave and go elsewhere. This was also the case for 2012 pay. For 2012, AIG negotiated for Treasury-approved pay of approximately \$108 million for 25 employees, GM negotiated for Treasury-approved pay of \$64 million for 23 employees, and Ally negotiated for Treasury-approved pay of approximately \$78 million for 21 employees.

By proposing and negotiating for excessive 2012 pay, these executives continue to lack an appreciation for their extraordinary situations and fail to view themselves through the lenses of companies substantially owned by the Government. Other company actions or statements in 2012 shed light on the companies' lack of appreciation for their extraordinary situation. AIG CEO Robert Benmosche, who has raked in the most compensation of any employee under OSM – \$42 million in four years, with a cash salary exceeding by 200% the median salary of his peers – was quoted in New York Magazine as stating that neither Treasury nor the Federal Reserve Board has thanked him for repaying AIG's rescue package. GM CEO Dan Akerson asked Treasury Secretary Geithner to relieve GM from OSM's pay restrictions, a move Akerson said would ultimately benefit taxpayers, and issued a proxy statement complaining about the pay restrictions. Ally executives sought pay raises for the president of its subsidiary, Residential Capital, LLC ("ResCap"), despite the fact that ResCap filed bankruptcy in 2012 and sought extra pay for ResCap employees from the bankruptcy court.

Absent robust policies, procedures, or criteria to implement OSM's guidelines, in 2012, the Acting Special Master approved compensation largely driven by the three companies' proposals. For example, OSM awarded \$6.2 million in pay raises to 18 employees. Treasury approved a \$1 million pay raise for the CEO of AIG's Chartis subsidiary, a \$200,000 pay raise for a ResCap employee – weeks before ResCap filed for bankruptcy – and a \$100,000 pay raise for an executive at GM's European unit, despite that unit experiencing significant losses. OSM's written explanations for the pay raises lacked substance, largely parroting what each company asserted to OSM without any independent analysis by OSM. By requesting these pay raises, the companies failed to appreciate that they continued to be funded by taxpayers.

With the companies having significant leverage, the Acting Special Master appears to have rolled back OSM's application of guidelines.

50th Percentile Guideline: In 2012, OSM did not follow its own guidelines aimed at curbing excessive pay by having total compensation generally not exceed the 50th percentile for similarly situated employees. Treasury awarded total pay packages exceeding the 50th percentile by approximately \$37 million for approximately 63% of the top 25 employees of AIG, GM, and Ally. The Acting Special Master appears to have rolled back the 50th percentile guideline, telling SIGTARP, for example, that she set total compensation for all of Ally's Top 25 employees between the 50th and 75th percentiles.

Cash Salaries Limited to \$500,000: OSM's lack of meaningful criteria and independent analysis contributed to OSM's rolling back its guideline to limit cash salaries to \$500,000. In 2012, OSM approved cash salaries greater than \$500,000 for one-third of the employees within OSM's pay-setting jurisdiction (23 of 69 Top 25 employees at AIG, GM, and Ally).

Acting Special Master Geoghegan is not following former Special Master Feinberg's final recommendation that she "limit guaranteed cash," "demand a performance component for most compensation," and "hold the line on cash salaries." Feinberg testified before Congress that "...base cash salaries should rarely exceed \$500,000, and only then for good cause shown, and should be, in many cases, well under \$500,000..." However, Acting Special Master Geoghegan told SIGTARP there is no cash salary cap, and \$500,000 is a "discretionary guideline that is useful," but there is no law or regulation that says she needs "a memo to permit a company to go above \$500,000."

Never have there been so many exceptions to the \$500,000 cash salary guideline for the number of people under the Acting Special Master's jurisdiction as there were in 2012. The Acting Special Master increased the number of employees with Treasury-approved cash salaries greater than \$500,000 from 22 employees in 2011 to 23 employees in 2012. The number has quadrupled from six employees in 2009, despite the fact that the number of companies OSM reviews decreased as companies repaid and exited TARP.

In addition to questioning the approval of cash salaries in excess of \$500,000 for one-third of the employees, SIGTARP questions whether OSM is following the spirit of its \$500,000 cash salary guideline. Although OSM guidelines target salaries greater than \$500,000, notably in 2012, OSM allowed 25 employees to have cash salaries exactly at the \$500,000 limit (falling outside OSM's guideline by \$1). Accordingly, OSM allowed cash salaries of \$500,000 or more for 70% (48 of 69) of Top 25 employees at AIG, GM, and Ally. OSM allowed cash salaries of \$450,000 or more for 94% (65 of 69) of Top 25 employees at AIG, GM, and Ally. In stark contrast, the 2011 median household income of U.S. taxpayers who fund these companies was approximately \$50,000.

Similar to OSM's explanations for approving pay raises, OSM's "justifications" for good cause for cash salaries to exceed \$500,000 largely parrot what each company asserted orally or in writing to OSM. Acting Special Master Geoghegan told SIGTARP that OSM does not perform an independent analysis, in part due to the 60-day constraint to issue a decision on the companies' proposals (which come in February). OSM uses data supplied by the companies, talks to company officials and other Treasury officials, and looks at publicly available data. Because many of the same employees remained in the top 25 from 2011 to 2012, OSM could have analyzed those employees' responsibilities and value to the company throughout the year,

and then could have used the end of the year information to supplement its existing information. OSM should not limit itself to perform its primary mission from February to early April, when it issued its determination memorandums. By using only the 60 days, OSM missed an opportunity to conduct an independent analysis that could have limited pay raises and high cash salaries.

More importantly, the Acting Special Master appears to have no desire to independently analyze whether good cause exists to award an employee a cash salary greater than \$500,000. The Acting Special Master told SIGTARP that it would be “utterly normal” for these individuals in the top 25 to expect over \$500,000 in cash salary. That might be true if the companies had not been bailed out and were not still significantly owned by taxpayers. Acting Special Master Geoghegan said OSM “does not spend that much time on a small decision like whether to continue to give this person \$600,000.” She described taking an extra two hours to look at this person’s pay justification to see whether there was “added responsibility” as a “waste of time.” She said she did not think that when the \$500,000 guideline was formulated, it would take an “independent little project” to determine when someone should go above \$500,000. If the pay czar is not even willing to independently analyze high cash salaries for 23 employees, who else will protect taxpayers?

The Acting Special Master told SIGTARP that OSM would not normally reopen executive compensation from year to year because it would be disruptive, and it is “relatively easy for OSM to keep things the way they were.” The Acting Special Master largely based her decisions on prior years’ pay, telling SIGTARP that OSM would not change pay based on a change in circumstances. However, even where there was a negative change such as ResCap filing bankruptcy or GM Europe suffering significant losses, OSM did not reduce the compensation for the employees in charge of those entities.

Long-Term Restricted Stock: By removing long-term restricted stock from some executives' pay and using it only in half of the pay packages, the Acting Special Master is effectively removing a key OSM guideline aimed at reducing excessive risk by tying individual compensation to long-term company success. She also removed long-term restricted stock for senior executives, including the CEOs of AIG, GM, and Ally, calling it "a burden" to compensate them with long-term restricted stock "that has no value." However, Treasury's rule states that the portion of performance-based compensation compared to total compensation should be greater for positions that exercise high levels of responsibility. After making her decisions on pay in April 2012, she subsequently removed long-term restricted stock for all of Ally's top 25 employees on the basis that the company's subsidiary, ResCap, had filed bankruptcy, and that the company had announced it was exploring strategic alternatives such as a possible sale of international operations. However, only three employees in Ally's top 25 worked at ResCap and OSM knew in April that ResCap was planning a restructuring. In addition, both GM and AIG were selling international operations.

The guidelines originally created by former Special Master Feinberg were aimed at fixing the material role executive compensation played in causing the financial crisis by encouraging excessive risk taking. By not holding the line on large cash salaries (awarding \$500,000 or more to 70% of the executives under OSM's pay-setting jurisdiction, and allowing 94% of employees to be paid cash salaries of \$450,000 or more), and removing long-term, incentive-based stock as requested by the companies, OSM is effectively relinquishing some of OSM's authority to the companies, which have their own best interests in mind. The Acting Special Master told SIGTARP that OSM is not the compensation committee. SIGTARP agrees – the compensation committee looks out for the interest of the company. The Office of the Special Master's job is to

look out for the interests of taxpayers, which it cannot do if it continues to rely to a great extent on the companies' proposals and justifications without conducting its own independent analysis. The Acting Special Master needs to be mindful of Feinberg's words that the "taxpayer as creditors are asking these companies to rein in compensation."

There are two lessons to be learned from OSM's 2012 pay-setting process and decisions: First, guidelines aimed at curbing excessive pay are not effective, absent robust policies, procedures, or criteria to ensure that the guidelines are met. This is the second report by SIGTARP to warn that the Office of the Special Master, after four years, still does not have robust policies, procedures, or criteria to ensure that pay for executives at TARP exceptional assistance companies stays within OSM's guidelines. Perhaps the Acting Special Master thinks that OSM has already succeeded in achieving its mission by limiting compensation for these executives from pre-TARP levels or believes that OSM's existing processes are sufficient. The question is whether it is sufficient for taxpayers. Treasury continues to award excessive pay packages, including large guaranteed cash salaries. Meaningful reform is still possible because GM and Ally remain under OSM's jurisdiction. Without meaningful reform, including independent analysis by OSM, Treasury risks that TARP companies could potentially misuse taxpayer dollars for excessive executive compensation.

Second, while historically the Government has not been involved in pay decisions at private companies, one lesson of this financial crisis is that regulators should take an active role in monitoring and regulating factors that could contribute to another financial crisis, including executive compensation that encourages excessive risk taking. According to OSM, OSM's

authority to set pay for AIG executives has ended. SIGTARP previously reported that AIG CEO Benmosche told SIGTARP that the Special Master's practices would have no lasting impact. He also said, however, that pay and performance must be linked, and if the majority of income is fixed, or guaranteed, then pay is not linked to performance. Given AIG's considerable pushback on OSM's limitations on pay as reported in SIGTARP's prior report, it is highly likely that AIG could return to past compensation practices. The responsibility shifts to the Federal Reserve Board to ensure that AIG does not encourage excessive risk taking through compensation.

SIGTARP's Recommendations Going Forward

SIGTARP recommends the following:

1. Each year, Treasury should reevaluate total compensation for those employees at TARP exceptional assistance companies remaining in the Top 25 from the prior year, including determining whether to reduce total compensation.
2. To ensure that Treasury effectively applies guidelines aimed at curbing excessive pay and reducing risk taking, Treasury should develop policies, procedures, and criteria for approving pay in excess of Treasury guidelines.
3. Treasury should independently analyze whether good cause exists to award a Top 25 employee a pay raise or a cash salary over \$500,000. To ensure that the Office of the Special Master has sufficient time to conduct this analysis, Treasury should allow OSM to work on setting Top 25 pay prior to OSM's receiving the company pay proposals, which starts the 60-day timeline.

4. To be consistent with Treasury's Interim Final Rule that the portion of performance-based compensation compared to total compensation should be greater for positions that exercise higher levels of responsibility, Treasury should return to using long-term restricted stock for employees, particularly senior employees such as CEOs.

Chairman Jordan, Ranking Member Cartwright, and members of the Committee, thank you again for this opportunity to appear before you, and I would be pleased to respond to any questions that you may have.

If you are aware of fraud, waste, abuse, mismanagement or misrepresentations affiliated with the troubled asset relief program, please contact the SIGTARP Hotline.

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