Mr. Chairman and Members of the Committee:

I thank you for the opportunity to testify today. The subject of executive compensation continues to concern 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 2009 I was asked to serve as the Special Master for TARP Executive Compensation by Secretary Geithner. In that capacity, under the relevant statutory and regulatory authority, I have a number of responsibilities related to the oversight and review of financial industry compensation.

My primary responsibilities include making determinations regarding the compensation of certain employees of TARP recipients that have received exceptional financial assistance. There were originally seven recipients of exceptional financial assistance. Currently, five companies have outstanding “exceptional assistance” from the American taxpayer: AIG, Chrysler, Chrysler Financial, GM and GMAC. (Two companies that were previously under my jurisdiction—Bank of America and Citigroup—have repaid their “exceptional” taxpayer assistance, although Citigroup will continue to be subject to the rules applicable to all TARP recipients until it completes its repayment of all TARP obligations.) Under pertinent Treasury regulations, I am required to determine individual compensation for the “top 25” executives at these five companies, and to make determinations on compensation structures—but not individual payments—for executive officers and 75 additional employees who are not in the “top 25” group. This mandatory jurisdiction applies only to the “exceptional assistance” recipients and does not extend to employees of any other financial institutions or

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2 See TARP Standards for Compensation and Corporate Governance, 31 C.F.R. § 30.1 et seq.
corporations. Although I do have discretion to make recommendations and render nonbinding determinations concerning other TARP recipients, this jurisdiction is purely advisory and not mandatory, and I have no legal authority to make binding determinations pertaining to executive compensation for any companies other than the exceptional assistance recipients.

The Committee has asked me to focus on three separate inquiries.

First, you noted the necessity that I balance the competing obligations of reining in excessive compensation to protect the public good and allowing compensation sufficient to maximize the public’s investment in the financial industry. The tension between reining in excessive compensation and allowing necessary compensation is, of course, a very real difficulty that I have faced and continue to face in making individual compensation determinations. Under Treasury regulations, my primary directive in overseeing compensation structures and payments within my jurisdiction is to determine whether the structures or payments in question were, are or may be “inconsistent with the purposes of section 111 of EESA or TARP, or are otherwise contrary to the public interest.” In my determinations I have referred to this directive as the Public Interest Standard; to meet it, a compensation package must balance appropriately the competing obligations you described.

Because achieving this balance is a fundamental component of the Public Interest Standard, it has played a determinative role in each of the rulings issued by the Office of the Special Master. In particular, the October 22, 2009, Determination Memoranda, which addressed compensation structures and payments for the “top 25” executives of the exceptional assistance recipients, and the December 11, 2009, Determination Memoranda, which addressed compensation structures for executive officers not in the “top 25” and up to 75 additional most highly compensated employees, were designed to balance the need to protect the public good while allowing necessary compensation in appropriate cases. Likewise, whether compensation structures and payments meet the Public Interest Standard will be the basis of my forthcoming 2010 determinations for the five remaining exceptional assistance recipients.

Second, you asked for a description of the variables and considerations at issue when determining whether compensation levels or structures are appropriate. Treasury
regulations require that, when I determine whether a payment or compensation structure meets the Public Interest Standard, I consider the following six principles:\footnote{3 See 31 C.F.R. § 30.16(b)(i-vi).}

(1) **Risk.** The compensation structure should avoid incentives that encourage employees to take unnecessary or excessive risks that could threaten the value of the company, 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 company. Compensation packages should be aligned with sound risk management.

(2) **Taxpayer return.** The compensation structure and amount payable should reflect the need for the company 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.

(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.

(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 company 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.

(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.

(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 company, 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.

Under the regulations, I 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 executive, which I must often exercise when two or more principles are in conflict in a particular situation.

To actually apply these principles and make my compensation determinations, I have relied on numerous sources. Empirical compensation data has been provided to me by the exceptional assistance recipients, and additional data has been secured by my office through independent means. My office includes a special detail of Treasury personnel, 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. I have also benefitted from the input and sound advice of outside academic experts—including world-renowned executive compensation experts Lucian A. Bebchuk of Harvard Law School and Kevin J. Murphy of the University of Southern California’s Marshall School of Business—who were retained by my office to help guide me in making my individual and structural compensation decisions. My objective in employing each of these resources is a thorough application of the mandated principles to assure that my compensation determinations are consistent with the Public Interest Standard.

By application of the principles to the facts and circumstances underlying my determinations to date, I have developed a number of generally applicable, practical prescriptions under the Public Interest Standard, including the following:

(1) Guaranteed income (including guaranteed bonuses) is rejected, except for cash salaries at sufficient levels to attract and retain employees and provide them a reasonable level of liquidity. These generally should not exceed $500,000 per year, except in exceptional cases for good cause shown.

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4 In particular, my office obtained access to independent compensation data from the U.S. Mercer Benchmark Database-Executive as well as Equilar’s ExecutiveInsight database (which includes information drawn from public securities filings) and Top 25 Survey Summary Report (which includes information from a survey on pay of highly compensated employees).
The value of any remaining compensation must be tied to performance. Accordingly, the majority of each employee’s compensation should be paid in stock rather than cash. Under Treasury regulations, this stock will immediately vest, but will only be transferable in three equal, annual installments beginning on the second anniversary of grant—with each installment redeemable a year earlier if the company repays its obligations to the American taxpayer.

Incentive compensation should be paid if—and only if—an executive achieves objective performance criteria approved by a compensation committee comprised solely of independent directors. Incentive compensation should be delivered in a mix of cash and stock, payable over time and subject to “clawback” if the performance resulting in the compensation is later discovered to be inaccurate.

Each individual’s total compensation must reflect the employee’s value to the company and be appropriate when compared with the total compensation of similarly situated employees at similar companies. Total pay should generally not exceed the 50th percentile of total compensation for similarly situated employees.

Employees should be prohibited from engaging in any hedging, derivative or other transactions that undermine the long-term performance incentives created by a company’s compensation structures.

Significant amounts should not be allocated to compensation components that are not performance-based and are difficult for shareholders to value, such as outsized perquisites and executive retirement plans.

Finally, Mr. Chairman, you asked that I identify the variables or considerations that are unique to my office. Aside from the principles previously articulated in my testimony above, and among the many distinctive aspects of our work, I wish to emphasize three unique characteristics of my limited mandate.

First, our office is charged with assuring both that the companies subject to our determinations thrive in the marketplace so that they can repay the American taxpayer and that those same companies avoid excessive risk taking that could threaten their long-term viability. To balance those objectives, we have emphasized that the bulk of compensation must be performance-based, and depend on the long-term performance of the company rather than short-term gains. We have also insisted that total compensation must be appropriately allocated and weighted heavily towards long-term structures that are tied to performance and easily understood by shareholders and the public.

Second, a distinctive and critical part of my work is the recognition that the authority of the Special Master is limited. In particular, under the pertinent statute and
regulations, I do not have the authority to unilaterally alter "grandfathered" contracts that companies entered into with employees prior to the enactment of the Recovery Act. I am, however, permitted to pursue voluntary restructuring of these contracts, and my office has had some success in doing so. For example, the October 22, 2009, Determination Memoranda covering Bank of America and Citigroup provided Special Master approval of restructured contracts in which employees agreed to forgo "grandfathered" guaranteed cash payments for a combination of reasonable cash salaries and long-term stock holdings in their companies. We have, however, been unable to restructure such agreements in other instances. In those cases, Treasury regulations permit me to take these payments into account when determining appropriate prospective compensation structures. For example, in my October 22, 2009, Determination Memorandum covering AIG, I took "grandfathered" retention contracts into account when setting prospective compensation. In particular, as a result of officials’ refusals to restructure their cash retention payments, I refused to approve cash salary amounts proposed by the company, which, in light of the retention payments, would have resulted in an excessive level of cash compensation. Attempting to renegotiate these agreements—and, where necessary, taking payments under "grandfathered" contracts into account when setting prospective compensation—has been a unique challenge.

Third, a very unique aspect of my work is the fact that Treasury regulations give me the unprecedented responsibility of balancing the principles set forth in the regulations to actually make individual compensation determinations for 25 individual officials employed by the exceptional assistance firms, and setting the compensation structures that will apply to the 26 to 100 individual officials and executive officers. I believe that much of the attention focused on my work is directly attributable to this fact—not only has my office promulgated generally applicable compensation principles and prescriptions, but we have shown that these principles can work in practice by calculating individual compensation packages for officials in these companies. I believe this is the most "unique" aspect of my work and will hopefully have the most permanent impact.

Mr. Chairman, I thank you and the other members of the Committee. This statement constitutes my formal testimony.