Embargoed until delivery

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.

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").

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.

- 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.

- **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.