



The Special Master's Determinations for Executive Compensation of Companies Receiving Exceptional Assistance Under TARP

Special Inspector General for the Troubled Asset Relief Program



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January 23, 2012

MEMORANDUM FOR: Mr. Timothy Massad – Assistant Secretary for
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Ms. Patricia Geoghegan – Acting Special Master,
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Department of the Treasury

FROM: Ms. Christy L. Romero – Deputy Special Inspector General
for the Troubled Asset Relief Program *by J. Romero*

SUBJECT: The Special Master's Determinations for Executive Compensation of
Companies Receiving Exceptional Assistance Under the Troubled
Asset Relief Program (SIGTARP 12-001)

We are providing this report for your information and use. It discusses the Special Master's Determinations for Executive Compensation of Companies Receiving Exceptional Assistance Under the Troubled Asset Relief Program.

The Office of the Special Inspector General for the Troubled Asset Relief Program conducted this evaluation (engagement code 017) under the authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978, as amended.

We considered comments from the Department of the Treasury when preparing the report. Treasury's comments are addressed in the report, where applicable, and a copy of Treasury's response is included in Appendix G.

We appreciate the courtesies extended to our staff. For additional information on this report, please contact Mr. Kurt Hyde, Deputy Special Inspector General for Audit and Evaluation (Kurt.Hyde@treasury.gov / 202-622-4633), or Ms. Kimberley A. Caprio, Assistant Deputy Special Inspector General for Audit and Evaluation (Kim.Caprio@treasury.gov / 202-927-8978).



Summary

When Congress created the Troubled Asset Relief Program ("TARP") in 2008, it included some limits on compensation for employees at companies that received TARP assistance. After several major TARP recipients paid employees billions of dollars in bonuses for 2008, the President, the U.S. Department of the Treasury ("Treasury"), and Congress expressed frustration. The President announced the capping at \$500,000 of annual salaries at companies that had received "exceptional assistance" under TARP, with any further compensation to be paid in stock that could not be cashed in until the company paid back TARP. After the President's announcement, Congress passed legislation under which Treasury created the Office of the Special Master for TARP Executive Compensation ("OSM"). Kenneth R. Feinberg served as the Special Master and was succeeded by Patricia Geoghegan.

The seven companies that received assistance that was "exceptional" – because of the amount and the nature of their bailouts – stood out from the more than 700 financial institutions in the Capital Purchase Program. Those seven companies were American International Group, Inc. ("AIG"), Bank of America Corporation ("Bank of America"), Citigroup Inc. ("Citigroup"), Chrysler Financial Services Americas LLC ("Chrysler Financial"), Chrysler Holding LLC ("Chrysler"), General Motors Corporation ("GM"), and Ally Financial Inc. ("Ally"), formerly GMAC, Inc. The Special Master's authority was narrowly limited to setting pay for the Top 25 most highly paid employees at these companies, and approving compensation structures, rather than individual pay, for the next 75 most highly compensated employees. The Special Master worked under six principles developed by Treasury: (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 pay on performance metrics; (5) setting compensation consistent with similar peers at similarly situated companies; and (6) setting compensation that reflects an employee's contribution to the company's value.

The Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") initiated

this evaluation of the process designed by OSM to set pay packages and OSM's decisions on compensation for the Top 25 employees at the companies that received exceptional assistance under TARP. Under this evaluation, SIGTARP assessed the criteria used by OSM to evaluate and make determinations on each company's executive compensation and whether OSM consistently applied criteria to all seven companies.

What SIGTARP Found

SIGTARP found that the Special Master could not effectively rein in excessive compensation at the seven companies because he was under the constraint that his most important goal was to get the companies to repay TARP. Although generally he limited cash compensation and made some reductions in pay, the Special Master still approved total compensation packages in the millions. 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 did not 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 partial Government ownership, the companies argued that their proposed pay packages were necessary to retain or attract employees who were crucial to the company. For example, Ally officials pushed for high pay, despite knowing that Feinberg was concerned that a majority of the company's Top 25 employees were part of the problem that resulted in the need for a bailout. In 2009, AIG proposed cash raises for several of its Top 25 employees and the ability to sell stock salary immediately.

Under conflicting principles and pressures, despite reducing some pay, 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 over the 2009 to 2011 period for 49 individuals. OSM set pay using what Feinberg called “prescriptions” that he developed, including that total compensation would be set at the 50th percentile for similarly situated employees, and that cash salaries should not exceed \$500,000, except for good cause. Although OSM developed general prescriptions, OSM did not have any established criteria at the beginning of the process for applying those prescriptions.

Some companies pushed back on OSM by claiming that their compensation should be higher than the 50th percentile. The companies’ beliefs may relate to what has been called the “Lake Wobegon Effect,” named after radio host Garrison Keillor’s fictional hometown where “all the children are above average.” Companies also proposed that their employees be paid cash salaries higher than \$500,000, claiming that the employees were crucial. For 10 employees in 2009, and 22 employees in 2010 and 2011, GM, Chrysler Financial, Ally, and AIG convinced OSM to approve cash salaries greater than \$500,000. With the exception of Bank of America’s retiring CEO, the Special Master approved cash salaries in excess of \$500,000 for the CEO of each company who asked for a higher salary, and approved millions of dollars in CEO stock compensation.

AIG’s proposed compensation for its Top 25 employees did not reflect the unprecedented nature of AIG’s taxpayer-funded bailout and the fact that taxpayers owned a majority of AIG. The proposed AIG compensation was excessive. In 2009, AIG wanted cash salary raises ranging from 20% to 129% for one group of employees and from 84% to 550% for another group. AIG proposed high cash salaries, even though some of these employees would also be paid significant retention payments. Feinberg told SIGTARP that AIG was anti-stock salary and wanted to pay employees in cash. Feinberg told SIGTARP that in his 2009 discussions with AIG, AIG believed that its common stock was essentially worthless. Feinberg told the Congressional Oversight Panel (“COP”) that AIG common stock “wasn’t worth enough to appropriately compensate top officials.” Feinberg told SIGTARP that he was pressured by other senior Treasury officials and was told to be careful, that AIG owed a fortune, and that Treasury

did not want it to go belly up. Treasury told him that paying salaries and grandfathered awards in stock rather than cash would jeopardize AIG. Feinberg said that Treasury officials felt those amounts were relatively small compared to the Government’s exposure in AIG. However, Feinberg said that no one trumped his decisions.

In 2009, OSM approved total compensation of cash and stock of more than \$1 million each for five AIG employees including a \$10.5 million pay package for AIG’s new CEO that included a \$3 million cash salary. OSM approved compensation ranging from \$4.3 million to \$7.1 million each for four AIG employees who that year were also scheduled to receive cash retention awards of up to \$2.4 million. OSM was tough on employees of AIG Financial Products (“AIGFP”), the unit whose losses contributed to the need for Government intervention. For five AIGFP employees who were scheduled to receive retention awards of up to approximately \$4.7 million, OSM froze their salaries at 2007 levels and gave them no stock. In 2010, OSM also cut AIG’s proposed salaries, but compared to 2009, approved much larger compensation packages for AIG’s Top 25 employees, despite the fact that 18 of these employees were scheduled to receive significant retention awards and other payments. In 2010, OSM approved 21 of AIG’s 22 employees to receive between \$1 million and \$7.6 million, with 17 of those pay packages exceeding \$3 million. OSM approved cash salaries of more than \$500,000 for five employees, and cash salaries ranging from \$442,874 to \$500,000 for 12 employees. OSM approved all but three of AIG’s Top 25 employees to receive stock salary ranging from \$1.3 million to \$5.1 million each. OSM generally approved these same pay packages for 2011 for AIG, which included the CEO’s same compensation as in earlier years, compensation packages of \$8 million each for two employees, compensation packages of \$7 million each for two employees, and compensation packages of \$5 million to \$6.3 million each for seven employees.

OSM’s pay determinations are not likely to have a long lasting impact at the seven TARP exceptional assistance companies or other companies. OSM’s decisions had little effect on Citigroup and Bank of America, which exited TARP, in part to escape OSM compensation restrictions. Once out of TARP, salaries and bonuses climbed. Today, only AIG, GM, and Ally remain subject to OSM’s review. CEOs at



AIG and GM told SIGTARP that they would not maintain OSM's practices once their company exits TARP. OSM has had little ability to influence compensation practices at other companies outside of the seven. Feinberg told SIGTARP that the long-term impact will likely come from regulators.

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. Treasury Secretary Timothy F. Geithner testified before COP that executive compensation played a material role in causing the crisis because it encouraged excessive risk taking.

As a nation, we are not out of the woods because many former TARP companies remain as systemically important financial institutions ("SIFIs"). These companies have a responsibility to reduce risk taking that could trigger systemic consequences, including excessive cash compensation and other compensation not tied to long-term performance. The Dodd-Frank Wall Street Reform and Consumer Protection Act requires regulations on executive compensation and other regulations for SIFIs that may force these companies to change their compensation practices. The regulators' strength and leadership in the area of executive compensation are critical. Taxpayers are looking to the regulators to protect them so that history does not repeat itself.

What SIGTARP Recommended

In this report, SIGTARP recommended that the Office of the Special Master of TARP Executive Compensation: substantiate each exception to the \$500,000 pay limit that is requested and whether the requests demonstrate or fail to demonstrate "good cause;" better document its use of market data in its calculations; and develop more robust policies, procedures, or guidelines to help ensure that its pay determination process and its decisions are evenhanded.

In commenting on a draft of this report, OSM agreed with the first two recommendations and with the importance of the third recommendation, stating that it will focus on how it can further develop policies, procedures, and guidelines. A fuller discussion of OSM's response can be found in the Management Comments section of this report.



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This report has cleared SIGTARP's Office of General Counsel disclosure review process and information determined to be restricted from public release has been redacted from this report. Redaction Legend: **(b)(4)** – 5 U.S.C. § 552(b)(4), Trade Secrets, Commercial or Financial Information.

Introduction

In the creation of the Troubled Asset Relief Program (“TARP”) in October 2008, Congress provided limits on compensation of employees at companies that received TARP assistance. In early 2009, after several major TARP recipients paid employees billions of dollars in bonuses, the President, the U.S. Department of the Treasury (“Treasury”), and Congress expressed frustration. Treasury Secretary Timothy F. Geithner said that executive compensation played a material role in causing the financial crisis because it encouraged excessive risk taking. The President announced that top executives at companies that had received exceptional assistance¹ under TARP would have cash salaries capped at \$500,000 with any further compensation paid in stock that could not be cashed in until the company paid back and exited TARP. The President also announced prohibitions on excessive severance packages and limitations on perquisites. Shortly thereafter, Congress passed economic stimulus legislation, which was amended in the Senate after the President’s announcement to add more strict limitations on compensation for TARP recipients. On June 10, 2009, Treasury issued rules to implement the legislation, and those rules created the Office of the Special Master for TARP Executive Compensation (“OSM”).² Kenneth R. Feinberg served as the Special Master until he resigned on September 10, 2010, and was succeeded by Patricia Geoghegan as Acting Special Master.

The Special Master’s authority to set pay was narrowly focused on executive compensation at seven companies that received exceptional assistance under TARP.³ These seven companies stood out from the more than 700 financial institutions that received TARP funds under the Capital Purchase Program. The amount and nature of their bailouts were considered “exceptional.” OSM’s authority is primarily limited to setting pay for the five senior executive officers (“SEOs”) and the next 20 most highly compensated employees (together known as the “Top 25”) at each of the seven exceptional assistance recipients, and approving compensation structures (rather than setting individual pay packages) for certain executive officers and the next 75 most highly compensated employees (“Top 26-100”).⁴ Special Master Feinberg testified to Congress that he had “no legal authority to make final determinations pertaining to executive compensation for any companies other than these seven,” and that “even as to

¹ Companies that participated in the following programs are classified as receiving exceptional assistance under TARP: Bank of America and Citigroup, participants in the Targeted Investment Program (“TIP”); AIG, the only participant in the Systemically Significant Failing Institutions Program; and GM, Chrysler, and their financing companies, Ally Financial (formerly GMAC), and Chrysler Financial, participants in the Automotive Industry Financing Program.

² The economic stimulus legislation did not contain a \$500,000 cash salary limitation, nor did the Treasury rules.

³ Appendix C provides a summary of the TARP assistance provided to those companies.

⁴ OSM was also tasked with conducting “look-back” reviews of bonuses, retention awards, and other compensation paid to the Top 25 employees at TARP recipients before February 17, 2009, and, where contrary to the public interest, “seek to” negotiate reimbursements to the Government. OSM found that no awards were contrary to the public interest and therefore did not “seek to” negotiate reimbursement of any of the awards.

those seven, my role in regulating pay was limited to the Top 25 as a mandatory matter.”

This report focuses on OSM’s determinations on pay for the Top 25 at the following seven companies:

- American International Group, Inc. (“AIG”)
- Bank of America Corporation (“Bank of America”)
- Citigroup Inc. (“Citigroup”)
- Chrysler Financial Services Americas LLC (“Chrysler Financial”)
- Chrysler Holding LLC (“Chrysler”)
- General Motors Corporation (“GM”)
- Ally Financial Inc. (“Ally”), formerly GMAC, Inc.

Of those seven, three are still in TARP and under OSM:

- AIG, with 77% Government ownership;
- GM, with 32% Government ownership; and
- Ally, with 74% Government ownership.⁵

The Office of the Special Inspector General for the Troubled Asset Relief Program (“SIGTARP”) initiated an evaluation of the process designed by OSM to set pay packages and OSM’s decisions on compensation for the Top 25 at the companies that received exceptional assistance under TARP. Under this evaluation, SIGTARP assessed the criteria used by OSM to evaluate and make determinations on each company’s executive compensation and whether OSM consistently applied criteria for the determinations made in 2009, 2010, and 2011.

SIGTARP conducted this evaluation between November 2009 and December 2011, and in accordance with the “Quality Standards for Inspection and Evaluation” established by the Council of the Inspectors General on Integrity and Efficiency. For a discussion of the evaluation’s scope and methodology, see Appendix A.

⁵ Percentages for the three companies are as of December 31, 2011.

Background

In creating TARP through the Emergency Economic Stabilization Act of 2008 (“EESA”), as amended, Congress explicitly provided limits on executive compensation at TARP recipient companies and authorized the Secretary of the Treasury to set standards for executive compensation. EESA’s restrictions have changed over time by regulations, amendments, and notices.⁶

In early 2009, the press reported that several TARP recipients paid out billions of dollars in bonuses to executives and employees.⁷ The bonuses were criticized by the Comptroller of New York. On January 28, 2009, the Comptroller of New York announced that for 2008, Wall Street firms (including TARP recipients) paid \$18.4 billion in bonuses to employees working in New York City and said, “There needs to be greater transparency and accountability in the use of these [TARP] funds...taxpayers ought to know if these funds were used to buy corporate jets.” The press reported that the Comptroller urged the Administration to examine the issue.⁸ The President called these bonuses “shameful.”⁹

On February 4, 2009, the President announced a \$500,000 cap on salaries for top executives of TARP companies that received exceptional assistance, with any further compensation paid in stock that could not be cashed out until TARP was repaid. The President also announced that the companies would have to disclose publicly and justify all of the perks bestowed upon executives, and that the U.S. Government (“Government”) was putting a stop to massive severance packages. The President also said:

“In order to restore trust, we’ve got to make certain that taxpayer funds are not subsidizing excessive compensation packages on Wall Street. We all need to take responsibility. And this includes executives at major financial firms who turned to the American people, hat in hand, when they were in trouble, even as they paid themselves customary lavish bonuses. As I said last week, this is the height of irresponsibility. It’s shameful. And that’s exactly the

⁶ On October 14, 2008, Treasury announced TARP executive compensation rules focused on limiting compensation tied to risk, prohibiting golden parachutes, and providing that under certain conditions bonuses may have to be repaid. It also limited companies from taking a tax deduction for salaries to senior executive officers in excess of \$500,000.

⁷ White, Ben, “What Red Ink? Wall Street Paid Hefty Bonuses,” *The New York Times*, 01/28/2009, <http://www.nytimes.com/2009/01/29/business/29bonus.html>, accessed 12/06/2011.

⁸ White, Ben, “What Red Ink? Wall Street Paid Hefty Bonuses.” See footnote 7 above for further details.

⁹ In late July 2009, New York Attorney General Andrew Cuomo reported the original nine TARP recipients paid approximately \$32.61 billion in 2008 bonuses: Citigroup paid \$5.33 billion, Bank of America paid \$3.30 billion, Merrill Lynch paid \$3.60 billion, Goldman Sachs paid \$4.82 billion, JPMorgan Chase paid \$8.69 billion, Morgan Stanley paid \$4.48 billion, Wells Fargo & Co. paid \$977.50 million, Bank of New York Mellon paid \$945 million, and State Street Corp. paid \$469.97 million.

kind of disregard of the costs and consequences of their actions that brought about this crisis... what gets people upset – and rightfully so – are executives being rewarded for failure, especially when those rewards are subsidized by U.S. taxpayers, many of whom are having a tough time themselves.”

That same day, Treasury issued guidance proposing various limitations on compensation arrangements.¹⁰

Congress Passed Legislation Limiting TARP Executive Compensation

Congress expressed its frustration through legislation. At the time of the President’s announcement, Congress was considering an economic stimulus bill that had passed in the U.S. House of Representatives. The bill as passed did not contain TARP executive compensation restrictions. On February 2, 2009, the Senate began consideration of the bill, which became the American Recovery and Reinvestment Act of 2009 (the “Recovery Act”). On February 4, 2009, Senator Ron Wyden and Senator Olympia Snowe offered an amendment to the Recovery Act bill requiring TARP recipients to repay cash bonuses in excess of \$100,000. In his statement on the Senate floor, Senator Wyden stated, “Last week, Americans were horrified to hear the news that Citigroup and other companies receiving taxpayer money from the Troubled Asset Relief Program were paying their employees billions and billions of dollars in bonuses.” Although the Wyden-Snowe amendment did not make it into the final Act, Senator Christopher Dodd proposed an amendment that he described as applying stronger restrictions on executive compensation for TARP recipients. Senator Dodd, detailing the restrictions on the Senate floor, stated, “This will encourage the companies to use the TARP funds for the purposes they were intended and assure the American taxpayers that their funds are being used properly.”

The Recovery Act, enacted on February 17, 2009, amended EESA. The Recovery Act restricts bonuses for one to 25 employees, among other actions, depending on the amount of TARP investment, unless paid in restricted stock that did not exceed one-third of total compensation. The Recovery Act’s bonus prohibition excludes payments required to be paid pursuant to written employment contracts executed on or before February 11, 2009. The Recovery Act prohibits golden

¹⁰ The proposed guidance applied to all TARP companies; it proposed more strict executive compensation rules for TARP companies that received exceptional assistance. For the seven exceptional assistance TARP companies, the guidance proposed a \$500,000 cash salary cap and bonuses only in restricted stock; enhanced clawback of bonus provisions; prohibited golden parachutes for the top five senior officers; and limited golden parachutes for the next 25 executives to one year’s salary. The guidance also proposed that each company develop a luxury expenditure policy for perquisites such as airplane use, office renovations, parties, and conferences.

parachutes for senior executive officers and the next five most highly compensated employees (“Top 10”), requires TARP companies to have “say on pay” through a non-binding shareholder vote on compensation, and provides that Top 25 employees pay back bonuses if based on criteria later proven to be materially inaccurate.

In March 2009, Congress and the public were angered that AIG had paid \$168 million in retention awards to around 400 employees of its Financial Products unit (“AIGFP”).¹¹ The press reported that people were picketing the homes of AIG executives and that some employees were threatened.¹² Congress held hearings on proposals to tax the retention awards, and AIG asked the employees to return voluntarily 50% of the awards.

On June 10, 2009, Treasury announced the Interim Final Rule (“IFR”), which implemented the Recovery Act and consolidated all TARP executive compensation restrictions into a single rule. The IFR also prohibited employees from fully transferring restricted stock while the company is in TARP. The compensation restrictions generally applied to a TARP recipient’s CEOs and next most highly compensated employees.

Creation of the Office of the Special Master

Through the IFR, Treasury created OSM, headed by the Special Master, but gave it limited scope. OSM’s powers were generally limited to setting pay packages for the Top 25 employees and to reviewing compensation structures for the Top 26-100 employees of the seven companies that received exceptional assistance under TARP. In accordance with the IFR, under a “safe harbor,” OSM approval was not required for proposed annual compensation structures of no more than \$500,000 (apart from long-term restricted stock, as defined in the IFR) for employees in the Top 26-100. The Special Master must determine whether compensation structures and payments are inconsistent with EESA or are otherwise contrary to the public interest. In doing so, the Special Master must apply six principles and use discretion to determine the appropriate weight or relevance of those principles depending on the facts and circumstances or when principles conflict. The circumstances may include the role of the employee, the situation of the TARP recipient within the marketplace, and the amount and type of TARP assistance. In summary, the IFR principles say:

¹¹ For further details on AIG’s executive compensation structure, see SIGTARP’s report “Extent of Federal Agencies’ Oversight of AIG Compensation Varied, and Important Challenges Remain,” issued on October 14, 2009.

¹² One example is “Protestors visit lavish homes of AIG execs,” MSNBC, 03/21/2009, http://www.msnbc.msn.com/id/29815906/ns/business-stocks_and_economy/t/protesters-visit-lavish-homes-aig-exec/, accessed 12/10/2011.

- **Risk** – the compensation structure should avoid incentives to take unnecessary or excessive risks that could threaten the value of the TARP recipient;
- **Taxpayer Return** – the compensation amount and structure should 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 success and, ultimately, its ability to repay TARP obligations;
- **Appropriate Allocation** – the compensation structure should appropriately allocate compensation between components such as salary and short-term and long-term incentives;
- **Performance-Based Compensation** – an appropriate portion of the compensation should be based on performance metrics over a relevant period;
- **Comparable Structures and Payments** – the compensation amount and structure should be consistent with those for persons in similar positions or roles “at similar entities that are similarly situated;” and
- **Employee Contribution to TARP Recipient Value** – the compensation structure and amount should reflect the current or prospective contributions of an employee to the value of the TARP recipient.

Special Master Feinberg told SIGTARP that these criteria are inherently inconsistent because of conflicting goals and company-specific circumstances. He explained that the criteria intended for institutions to remain competitive and to promote employee retention but do not allow for compensation structures similar to those of some market participants because they are deemed to be excessive and not performance based over the long term. On October 21, 2010, Feinberg testified before the Congressional Oversight Panel (“COP”) that the clear direction given to him was that the most important goal was to get these seven companies to repay TARP. He also testified, “Congress felt that the single most important thing I could do is get those seven companies to repay the taxpayer...Secretary Geithner made that clear. Congress made that clear. The Administration made that clear. And we succeeded, with three of those companies already repaying.”

Feinberg told SIGTARP that political perception “very much” played a role in his decisions. He said he was mindful of Congress’ intent, the oversight that Congress would conduct, and that U.S. House of Representatives Committee on Financial Services Chairman Barney Frank and U.S. Senate Banking, Housing, and Urban Affairs Committee Chairman Christopher Dodd had spoken frequently on the Congressional goals and intent.

Feinberg said he was pressured by TARP companies and Treasury officials. He told SIGTARP that TARP companies placed pressure on him to let the companies pay executives enough to keep them from quitting, and that Treasury officials placed pressure on him to let the companies pay executives enough to ensure companies would remain competitive and be able to repay TARP funds. Feinberg testified to the House Committee on Financial Services, “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.” Feinberg told SIGTARP that every day he was pressured to soften his stance and that Government officials reminded him that the companies had large obligations to repay the taxpayers. On October 21, 2010, Feinberg told COP, “...we heard over and over again that if we didn’t provide competitive pay packages, those top officials would leave and go elsewhere...they might even go to China. Everybody was going to go to China to work if these companies lost these officials. They’re still there. Eighty-five percent of these specific individuals whose pay by statute we regulated are still there.”

For one company (AIG), Feinberg told SIGTARP that he was pressured by other Treasury officials, specifically the Office of Financial Stability (“OFS”), which administers TARP, that he needed to be careful, that AIG owed Treasury a fortune and Treasury did not want it to go belly up.¹³ Despite this pressure, Feinberg told SIGTARP that no one trumped his decisions.

OSM was aware of media and public attention, although Feinberg told COP that there was a relative lack of interest from the public when it came to GM and Chrysler – almost all of the media and public attention was on Bank of America, Citigroup, and AIG. Part of that had to do with how much higher compensation was at Wall Street companies, relative to GM and Chrysler, which he described as like Earth and Mars. He said “... I think ... the top three people of the 25 at Citigroup got more compensation before we arrived than all 25 people at GM, which was, to me, a little bit astounding.”

¹³ AIG owed the Government \$69.8 billion at that time. For details regarding the Government’s investment in AIG and the firm’s recapitalization plan, see Appendix D.

OSM's Executive Compensation Determination Process

The companies determined their Top 25 employees per IFR specifications that this group must include the five publicly disclosed CEOs (chief executive officer ("CEO"), chief financial officer ("CFO"), and the next three most highly compensated employees), and the next 20 most highly compensated employees. Because the IFR includes in the Top 25 any of those employees who were employed on the first day of the year but who left before OSM issued its determination on pay packages, some of the companies under OSM had fewer than 25 employees subject to OSM's pay package determinations. This circumstance most affected AIG and Bank of America, each of which had only 13 employees out of the Top 25 remaining for OSM's 2009 determinations (see Table 1).

TABLE 1

NUMBER OF TOP 25 EMPLOYEES WHO RECEIVED PROSPECTIVE PAY DETERMINATIONS			
Company	2009 (Based on 2008 Compensation)	2010 (Based on 2009 Compensation)	2011 (Based on 2010 Compensation)
AIG	13	23	23
Bank of America	13	N/A	N/A
Citigroup	21	N/A	N/A
Chrysler	25	24	25*
Chrysler Financial	22	25	N/A
GM	20	25	25
Ally	23	24	25
Total	137	121	98

Note: *Chrysler lost its designation as an exceptional assistance recipient on July 21, 2011, when Treasury sold its remaining stake in the company to Fiat. However, that transaction occurred after the Special Master issued Chrysler a determination letter on April 1, 2011, covering 25 employees.
Source: SIGTARP review of OSM determinations.

Annually, the companies proposed pay packages for the Top 25 employees. In August 2009, the seven companies proposed 2009 pay levels for the Top 25 employees. On October 28, 2010, Feinberg testified to the U.S. House of Representatives Committee on Oversight and Government Reform that six of the seven companies' compensation proposal submissions would result in payments contrary to the Public Interest Standard, and should, therefore, be rejected.¹⁴ Special Master Feinberg testified that the companies requested excessive cash salaries and bonuses; stock compensation that could be immediately or quickly

¹⁴ The seventh company was Chrysler Financial.

redeemed; “perks” such as private airplane transportation, country club dues, and golf outings; excessive levels of severance and retirement benefits; and compensation that did not take into account future cash awards already scheduled to be paid based on contracts that existed prior to current compensation regulations.

OSM had many discussions with the companies regarding their proposed pay packages. However, one company stood out. Feinberg told SIGTARP that in 2009, 80% of his headaches came from AIG. AIG was the only one of the seven where other senior Treasury officials intervened in OSM’s process. AIG was also the company that had received the biggest Government bailout and, as of January 14, 2011, the Government owned approximately 92% of the company.

OSM Determined Pay for the Top 25 Employees in a Three-Step Methodology

Using the principles laid out in the IFR and what Feinberg called “prescriptions” developed by OSM, OSM established a three-step methodology to set pay, which included cash salary, stock salary, and long-term restricted stock, for the Top 25 employees at each of the seven TARP exceptional assistance recipients.

First, OSM sets total compensation on the OSM prescription that it should generally not exceed the 50th percentile of total compensation for similarly situated employees. The first step in the formula was to determine each employee’s total compensation by basing it on the 50th percentile compensation level for the employee’s position, scope, and responsibilities relative to what their peers in comparable positions are earning. To determine the 50th percentile, OSM uses the U.S. Mercer Benchmark Database and Equilar’s Total Compensation Report¹⁵ to determine whether the market data submitted by the seven TARP companies were reasonable.¹⁶

Second, OSM sets cash salaries using an OSM prescription that generally salaries should not exceed \$500,000 per year, except for good cause shown. OSM determines cash salary by assessing the market data, the prior years’ compensation, the importance of the position and individual, the risk that an

¹⁵ Equilar’s Total Compensation Report contains data for the top five positions disclosed publicly. Mercer’s Benchmark Database provides compensation data categorically, by asset class, industry, and types of positions.

¹⁶ In 2009, OSM also relied on the advice of two academic experts, Lucian A. Bebchuk, the William J. Friedman & Alicia Townsend Friedman Professor of Law, Economics, and Finance, and Director of the Program on Corporate Governance, Harvard Law School; and Kevin J. Murphy, the Kenneth L. Trefftz Chair in Finance in the Department of Finance and Business Economics at the USC Marshall School, professor of business and law in the USC Law School, and professor of economics in the USC Economics Department.

employee would leave, and any unique circumstances. While 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, the Special Master said that he was not influenced by the President's statements on salary. The decision to limit cash salaries to \$500,000 and to increase the proportion of compensation in the form of stock, Feinberg said, was his decision to strike a balance between reducing excessive risk and providing enough compensation to keep employees' "skin in the game." In testimony before COP, Feinberg stated that OSM came up with the \$500,000 figure based on the packages submitted by companies, empirical evidence, and a sense of what Congress and Treasury intended in the statute and regulations. In testimony before the House Committee on Financial Services, Feinberg said that he made exceptions to that limit for "good cause," and he told SIGTARP that those exceptions varied by company.

OSM officials told SIGTARP that in some instances, the \$500,000 cash salary cap resulted in an increase in base salary for some employees. For example, OSM restructured pay for some Citigroup employees who were paid cash salaries of approximately \$200,000 and received substantial cash bonuses. OSM officials told SIGTARP that they felt that if they limited those employees to the same salary with the bonus paid only in stock that was not available for a number of years, the employees would not be appropriately compensated and would leave. OSM officials told SIGTARP that to ensure employee retention, they made some concessions on cash salary, but weighted pay more heavily on long-term performance through stock salary. In other instances, OSM adjusted an employee's salary to just below \$500,000. GM officials told SIGTARP that OSM would adjust some employees' salaries so that they cascaded to just under \$500,000, such as \$495,000, \$490,000, \$485,000, and \$480,000.

Third, OSM determines how much of the remaining compensation would be paid in stock salary with a value dependent on the company's future success and long-term restricted stock. OSM determined the amount of stock salary and long-term restricted stock by deducting the cash salary (generally up to \$500,000) from total compensation. The Recovery Act limited long-term restricted stock to one-third of the employee's total pay. Accordingly, OSM calculated the amount of long-term restricted stock, and the remainder of the compensation package was stock salary.

In testimony to the House Committee on Oversight and Government Reform, the Special Master said that he used stock salary to encourage senior executives to remain at the companies to maximize their benefit from the profitability of the company. Although the stock vests each pay cycle, it is generally redeemable only in three equal annual installments, beginning on the second anniversary of the grant date.

To tie individual compensation to long-term company success, OSM used long-term restricted stock contingent on the employee achieving specific performance criteria.¹⁷ Long-term restricted stock does not fully vest until the repayment of TARP financial assistance.¹⁸ 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.

After using the three-step process to determine pay packages for the Top 25, OSM communicated those packages in annual determination letters sent to the companies and published online on October 22, 2009, March 23, 2010, and April 1, 2011.¹⁹ The 2009 determinations by the Special Master set the process that OSM would use in the future for the 2010 and 2011 determinations. Four of the companies have repaid TARP's exceptional assistance.²⁰ Today only AIG, GM, and Ally remain under OSM's exceptional assistance rules.

Getting Out from Under the Special Master's Purview Was a Factor for Repayment of TARP Exceptional Assistance by Bank of America and Citigroup

In December 2009, Bank of America and Citigroup exited TARP's Targeted Investment Program ("TIP"), one of the exceptional assistance programs, citing a desire to be outside the jurisdiction of OSM. SIGTARP's September 29, 2011, audit report "Exiting TARP: Repayment by the Largest Financial Institutions," reported that Citigroup's CEO told SIGTARP that the desire to escape management compensation restrictions was a factor motivating Citigroup's desire to exit TARP. The report also says that Sheila Bair, then-Chairman of the Federal

¹⁷ The Special Master said that each company's independent compensation committee had to have an active role in both the design of incentives and the review and measurement of performance metrics.

¹⁸ For the stock to vest, employees must provide services to the TARP recipient for at least two years after the date the stock is granted. The stock can become transferable, or payable in the case of restricted stock units in 25% installments for each 25% installment of TARP funds repaid.

¹⁹ OSM also issued supplemental determinations in response to pay proposals for new CEOs for AIG, Ally, Chrysler, and GM, a new CFO for GM, and a new AIG Chief Risk Officer. Two supplemental determinations were in response to official reconsideration requests – one submitted by AIG in relation to its 2009 Top 25 determination and the other submitted by GM in relation to its 2010 determination over the structure of compensation of GM's Top 26-100 employees. OSM issued a supplemental determination to GM in response to GM's request for approval to replace long-term restricted stock grants with stock salary for 2009 for two of its Top 25 employees. On December 20, 2010, OSM issued a supplemental determination to Chrysler in relation to two employees who decided not to retire and who were seeking grants of stock salary and long-term restricted stock. All determinations and supplemental determinations are available online at www.financialstability.gov.

²⁰ Bank of America and Citigroup repaid TARP's exceptional assistance in December 2009. In May 2010, Chrysler Financial repaid TARP. In July 2011, Chrysler exited TARP when Treasury sold its remaining ownership interest in Chrysler to Fiat.

Deposit Insurance Corporation, worried that Citigroup's request to terminate its asset guarantee, another form of assistance it received under TARP, was "all about compensation."

Two of Bank of America's former executives also told SIGTARP that executive compensation was an important factor in the firm's decision to repay TARP. One of the executives told SIGTARP that executive compensation was a major factor behind the firm's repayment decision and that the company did everything possible to get out from under the executive compensation rules. Special Master Feinberg testified before COP that one of the things he learned as Special Master was the desire of these companies to get out from under Government regulation. Specifically he was referring to Citigroup and Bank of America wanting to get out from under TARP and OSM's restrictions.

SIGTARP Found that OSM's Methodology and Criteria Were Not Documented Until After the Fact, and that Documentation Lacked Detail

Although OSM created general "prescriptions," OSM did not at the beginning of the process have pre-established criteria and methodology for applying those prescriptions. OSM's methodology and criteria for applying its prescriptions were not established until after October 22, 2009, when OSM issued its first set of determinations and based them on the process that had just taken place. OSM's methodology and criteria were explained in several different documents – the institution-specific determination letters, a "fact sheet" summarizing some key steps and decisions, and a three-page document issued several months later – but the documents did not completely lay out OSM's process, methodology, and criteria. For example, OSM's methodology document was incomplete in that OSM did not establish meaningful criteria for granting exceptions to prescriptions such as when an employee could be paid more than \$500,000 in cash salary. With the methodology incomplete and lacking meaningful criteria, the seven companies faced surprises and unpredictability in OSM's process. Some companies told SIGTARP that OSM's criteria were constantly evolving, and it was not clear how the criteria would be applied. Some companies told SIGTARP that they were not aware that there would be a \$500,000 salary cap or that they could request exceptions to it. Some companies told SIGTARP that they were not aware of certain criteria until hours or days before OSM issued its first determination letters. The methodology does not address how OSM determined the peer group for the 50th percentile of total compensation for similarly situated employees, nor does it explain how OSM arrived at the 50th percentile as a reasonable limit to set. In addition, the document lacks meaningful criteria for establishing the amount of stock salary.

Analysis of the Special Master's Executive Compensation Determinations

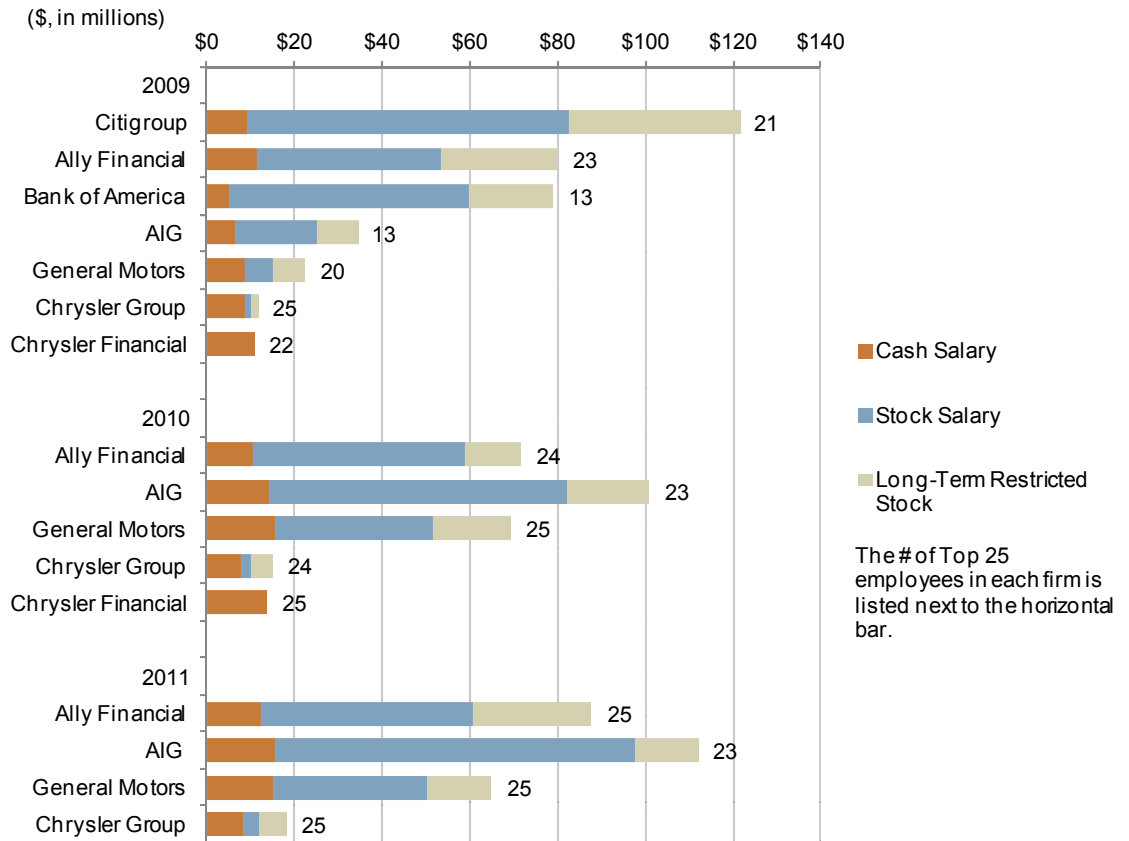
This section analyzes the decisions made by the Special Master in setting pay packages for the Top 25 employees from 2009-2011. It also discusses OSM's application of the \$500,000 cash salary cap and its uses of stock salary and market data for targeting pay at the 50th percentile.

There were variations among pay packages set by the Special Master that were largely a product of conflicting goals and differences in the companies under OSM's jurisdiction. OSM faced difficulty in setting pay packages that would rein in excessive executive compensation while still attracting and retaining key employees in order to meet his number one goal of ensuring that the companies repaid taxpayers' TARP investment. Special Master Feinberg explained to SIGTARP that EESA, as amended by the Recovery Act, is inconsistent because it intends for institutions to remain competitive and promote employee retention, but it does not allow certain compensation structures similar to other companies because they are deemed excessive and not performance based over the long term.

In addition to the conflicting goals under which he operated, Special Master Feinberg told SIGTARP that he applied criteria with a "healthy dose of discretion" for company-specific circumstances that caused results to vary among companies. The total compensation each company's group of Top 25 employees received, as illustrated in Figure 1 on the following page, differed significantly. These differences may be due to the number of Top 25 employees in each company,²¹ variation in the companies' sizes and industries, and because some companies had unique circumstances. For example, Chrysler Financial was liquidating and had no stock to offer employees, and GM had stock but was emerging from bankruptcy while preparing for an initial public offering.

²¹ AIG and Bank of America had only 13 employees remaining from their Top 25 groups in 2009 when the October 22, 2009 determinations were issued. Other companies that year had between 20 and 25 employees in their Top 25 groups at that time. In 2010 and 2011, Top 25 groups varied, but to a lesser extent.

FIGURE 1
2009-2011 TOTAL DIRECT COMPENSATION APPROVED BY OSM FOR TOP 25
EMPLOYEES AT EXCEPTIONAL ASSISTANCE TARP COMPANIES



Note: This chart depicts all the pay packages approved by the Special Master over the 2009 to 2011 period. Total direct compensation includes cash salary, stock salary, and long-term restricted stock as determined by OSM.
Source: SIGTARP analysis of the Special Master's determinations.

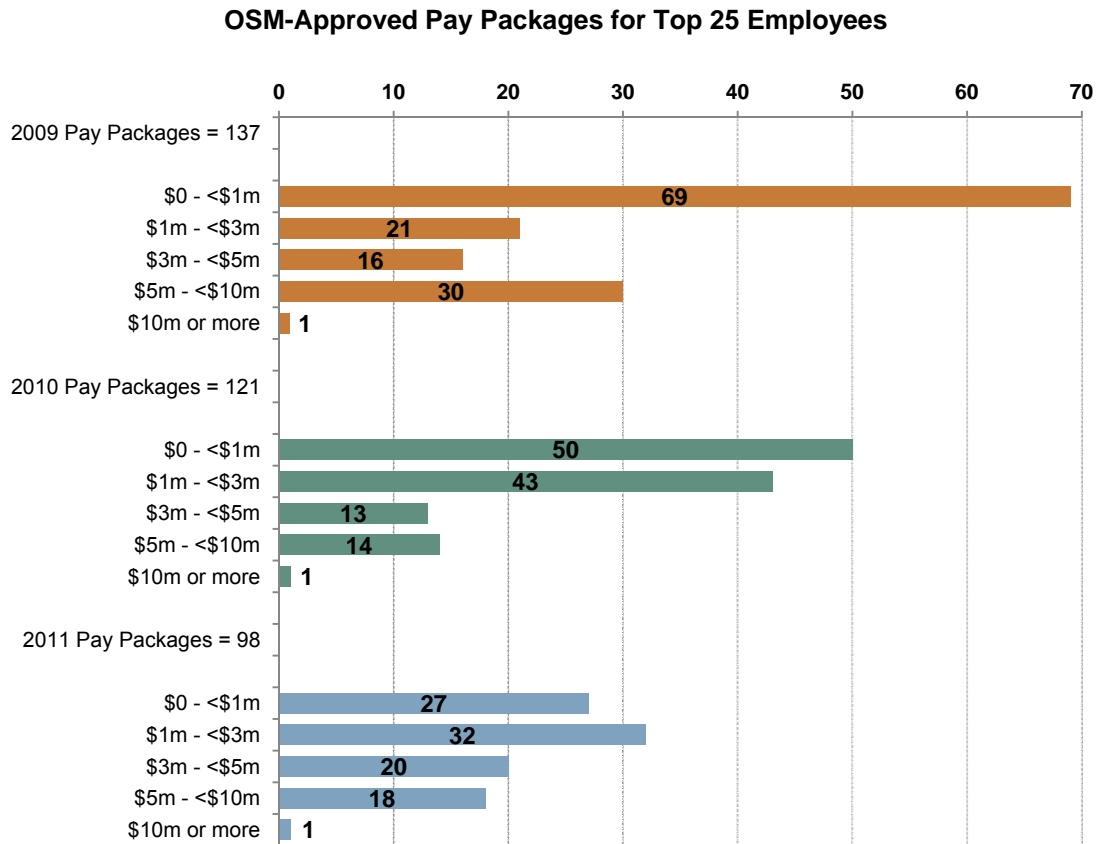
OSM approved sizable pay packages. According to OSM, it approved pay packages worth \$5 million or more over the 2009 to 2011 period for 49 individuals. Year after year, OSM approved for AIG CEO Robert Benmosche the largest compensation package of all approved by OSM – \$10.5 million in total pay, including the largest cash salary – \$3 million. OSM approved other sizable pay packages. In 2009, OSM approved a Bank of America employee to receive \$9.8 million in total pay, consisting of \$500,000 in cash salary and the remaining \$9.3 million in stock salary. That same year, OSM approved a pay package for Ally CEO Michael Carpenter of \$9.5 million, with \$950,000 in cash salary, \$5.4 million in stock salary, and \$3.1 million in long-term restricted stock. In 2010, OSM approved GM's CEO Ed Whitacre to earn the most compensation after Benmosche. The compensation package approved for the CEO of GM in 2010 was \$9 million in total pay, consisting of \$1.7 million in cash salary,

\$5.3 million in stock salary, and \$2 million in long-term restricted stock. The same pay package was approved for Dan Akerson, who succeeded Whitacre as CEO of GM. In 2011, OSM approved for Ally's CEO Carpenter and GM's CEO Akerson the second- and third-largest compensation packages. Carpenter received \$9.5 million in total pay, consisting of \$8 million in stock salary and \$1.5 million in long-term restricted stock, and Akerson's pay package remained unchanged at \$9 million as set in the prior year.

OSM also approved, for employees who were paid \$5 million or more in total pay, significant compensation in stock. In 2009, OSM approved total stock compensation for those employees, including both stock salary and long-term restricted stock, in amounts ranging from \$4.2 million to \$9.3 million. In 2010, OSM approved these employees to receive between \$4.3 million and \$8 million,²² and in 2011, OSM approved them to receive between \$4.3 million and \$9.5 million in total stock pay. Figure 2 on the following page shows OSM-approved pay packages by size.

²² The \$8 million compensation package was for Ally CEO Carpenter. Carpenter also received \$1.5 million in incentive restricted stock units as part of an aggregate \$12.5 million approved by OSM to be allocated by Ally's compensation committee to Top 25 employees.

FIGURE 2
OSM-APPROVED PAY PACKAGES ANNUALLY BY SIZE

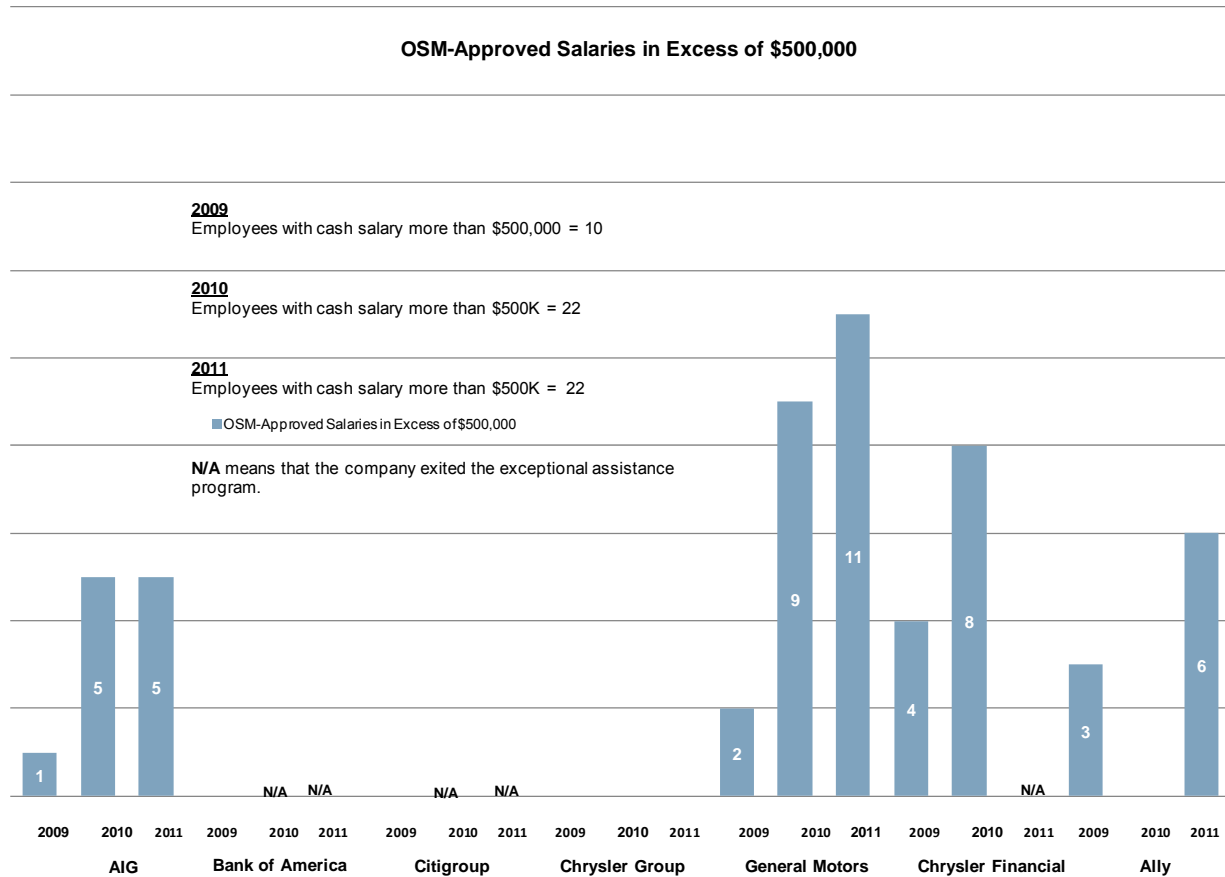


Note: The number of Top 25 employees who received a pay package in that range is listed in the horizontal bar. This chart depicts all the pay packages approved by the Special Master over the 2009 to 2011 period.
Source: SIGTARP analysis of the Special Master's determinations.

The Special Master Allowed Some Employees To Be Paid Cash Salaries of more than \$500,000

The Special Master allowed employees to be paid more than \$500,000 in cash salary. The Special Master's prescriptions require a showing of "good cause" for an employee to be paid more than \$500,000 in cash. In 2009, the Special Master approved 10 employees at TARP exceptional assistance companies to be paid cash salaries of more than \$500,000. In 2010 and 2011, OSM allowed 22 employees to be paid cash salaries of more than \$500,000. Figure 3 shows the number of employees approved by the Special Master to be paid more than \$500,000 in each year.

FIGURE 3
EMPLOYEES AT EXCEPTIONAL ASSISTANCE TARP RECIPIENTS APPROVED BY THE
SPECIAL MASTER TO BE PAID CASH SALARIES IN EXCESS OF \$500,000



Note: This chart depicts all of the approved cash salaries of more than \$500,000 over the 2009-2011 period. The number of employees approved to receive cash salaries in excess of \$500,000 is listed in the vertical bars.
Sources: SIGTARP analysis of companies' proposed cash-based salaries and the Special Master's determinations.

In 2009, the Special Master approved cash salaries of more than \$500,000 for AIG's CEO, two GM employees, three Ally employees, and four Chrysler Financial employees. Bank of America, Citigroup, and Chrysler requested but did not receive relief from the \$500,000 cash salary cap. In 2010, the Special Master approved cash salaries of more than \$500,000 for five AIG employees, eight Chrysler Financial employees, and nine GM employees. Chrysler did not request any salaries over \$500,000 and the Special Master that year denied Ally's request for relief for five employees. In 2011, the Special Master approved cash salaries of more than \$500,000 for five AIG employees, six Ally employees, and 11 GM employees. Chrysler did not request any salaries over \$500,000.

The Special Master Consistently Approved Cash Salaries in Excess of \$500,000 for the CEO of Each Company Who Asked, with the Exception of Bank of America's CEO, Who Had Announced His Retirement

The Special Master approved cash salaries in excess of \$500,000 for CEOs of institutions that had received exceptional assistance under TARP. Every institution that requested relief from the \$500,000 cash salary cap for its CEO received OSM approval, except for Bank of America's CEO, who had announced his retirement. The Special Master did not approve any compensation for Bank of America's CEO because the CEO would receive a substantial retirement package. Citigroup CEO Vikram Pandit voluntarily agreed in a Congressional hearing to take a \$1 salary with no bonus until Citigroup returned to profitability. Fiat paid Chrysler CEO Sergio Marchionne approximately €4.8 million in total compensation because he was also the CEO of Fiat S.p.A. The CEO's pay from Fiat was outside of OSM's jurisdiction, but OSM approved \$600,000 in stock salary for the CEO's role as a Director. SIGTARP found that for seven CEOs, the Special Master approved cash salaries of more than \$500,000, with some of them receiving these salaries for multiple years, as illustrated in Table 2 on the following page.

TABLE 2

PAY PACKAGES APPROVED BY THE SPECIAL MASTER OF CEOs OF TARP RECIPIENTS RECEIVING EXCEPTIONAL ASSISTANCE

	2009		2010		2011
AIG	Benmosche		Benmosche		Benmosche
Cash Salary	\$3,000,000		\$3,000,000		\$3,000,000
Stock Salary	4,000,000		4,000,000		7,500,000
Long-Term Restricted Stock	3,500,000		3,500,000		0
Total Direct Compensation	\$10,500,000		\$10,500,000		\$10,500,000
GM	Henderson		Whitacre^b	Akerson^b	Akerson
Cash Salary	\$950,000		\$1,700,000	\$1,700,000	\$1,700,000
Stock Salary	2,421,667		5,300,000	5,300,000	5,300,000
Long-Term Restricted Stock	1,815,000		2,000,000	2,000,000	2,000,000
Total Direct Compensation	\$5,186,667		\$9,000,000	\$9,000,000	\$9,000,000
Ally	de Molina	Carpenter^c	Carpenter^c		Carpenter
Cash Salary	\$850,000	\$950,000	\$0		\$0
Stock Salary	4,491,667	5,415,000	8,000,000		8,000,000
Long-Term Restricted Stock	2,816,667	3,135,000	0		1,500,000
Total Direct Compensation	\$8,158,334	\$9,500,000	\$8,000,000		\$9,500,000
Chrysler	Marchionne^a		Marchionne^a		Marchionne
Cash Salary	\$0		\$0		\$0
Stock Salary	\$600,000		0		0
Long-Term Restricted Stock	0		0		0
Total Direct Compensation	\$600,000		\$0		\$0
Chrysler Financial	Gilman		Gilman		^d
Cash Salary	\$1,500,000		\$1,650,000		
Stock Salary	0		0		
Long-Term Restricted Stock	0		0		
Total Direct Compensation	\$1,500,000		\$1,650,000		
Bank of America	Lewis		^d		^d
Cash Salary	\$0				
Stock Salary	0				
Long-Term Restricted Stock	0				
Total Direct Compensation	\$0				
Citigroup	Pandit		^d		^d
Cash Salary	\$1				
Stock Salary	0				
Long-Term Restricted Stock	0				
Total Direct Compensation	\$1				

a Chrysler CEO Sergio Marchionne received approximately €4.8 million in 2009 and approximately €3.5 million in 2010 from Fiat S.p.A.

b In 2010, there was only one pay package totaling \$9 million for both GM CEOs Whitacre and Akerson.

c According to OSM, Ally CEO Carpenter did not receive \$9.5 million in 2009 because his 2009 compensation was prorated. In 2010, Ally's compensation committee received OSM approval to allocate \$12.5 million in long-term restricted stock to Top 25 employees. Carpenter received \$1.5 million of that total.

d Bank of America and Citigroup were not subject to OSM after 2009. Chrysler Financial was not subject to OSM after 2010.

Sources: SIGTARP analysis of OSM documentation and the Special Master's determinations.

In 2009, 2010, and 2011, the Special Master approved a \$3 million cash salary for AIG CEO Benmosche. According to OSM, Benmosche was a particularly crucial hire at a time when AIG faced a multitude of challenges and he was brought in to lead the company that had received the greatest amount of Government assistance.²³ OSM also told SIGTARP that Benmosche's compensation package was reasonable relative to the market. On October 2, 2009, in a supplemental determination, OSM set Benmosche's total compensation package at \$10.5 million, consisting of \$3 million in cash salary, \$4 million in stock salary that could not be sold for at least five years, and an annual incentive award of \$3.5 million in long-term restricted stock units. His actual incentive award was prorated to reflect the portion of the year he was employed by AIG, and thus he received approximately \$1.4 million of the \$3.5 million.²⁴

In 2009, the Special Master approved a cash salary of \$950,000 for GM's interim CEO, Fritz Henderson, as well as \$2.4 million in stock salary and \$1.8 million in long-term restricted stock. OSM told SIGTARP that this was necessary to align Henderson's salary with other auto industry CEOs. In 2010 and 2011, the Special Master approved for GM's outgoing CEO Whitacre²⁵ and incoming CEO Akerson²⁶ total pay packages of \$9 million, consisting of cash salaries of \$1.7 million cash salaries, stock salaries of \$5.3 million, and long-term restricted stock of \$2 million. The Special Master justified Whitacre's salary on the basis that he was an outside hire who came out of retirement, while OSM determined that Akerson would receive the same annualized compensation as the outgoing CEO.

In 2009, the Special Master approved a cash salary of \$1.5 million for Chrysler Financial Chairman and CEO Thomas F. Gilman. OSM said that he, along with other Chrysler Financial executives, filled an essential role during the company's wind-down. In 2010, OSM approved a \$150,000 increase in Gilman's cash salary to \$1.65 million because stock was not appropriate for employees of a company that would be liquidated.

In 2009, the Special Master approved a cash salary of \$850,000 for Ally's outgoing CEO, Al de Molina, who had announced his resignation, as well as \$4.5 million in stock salary and \$2.8 million in long-term restricted stock.²⁷ For Ally's then-new CEO, Carpenter, OSM approved a \$950,000 cash salary, \$5.4 million in stock salary, and \$3.1 million in long-term restricted stock. OSM told SIGTARP that it approved these salaries because de Molina needed to be

²³ As of December 31, 2011, Treasury's equity ownership in AIG was 77%.

²⁴ In May 2010, AIG disclosed in a Securities and Exchange Commission filing that Benmosche had substantially achieved or exceeded his target performance level needed to earn his incentive award.

²⁵ Ed Whitacre was GM's CEO from December 2009 through August 2010.

²⁶ Dan Akerson became GM's CEO, effective September 1, 2010.

²⁷ Al de Molina announced his resignation in November 2009.

retained and Carpenter was a newly hired senior executive officer. In subsequent years, Carpenter's cash salary was reduced to \$0 because Ally's compensation committee requested that all of the CEO's compensation be based on the long-term equity value of the company. Accordingly, based on one of the firm's financial disclosures, for 2010, the CEO's 2009 cash salary of \$950,000 was discontinued and the CEO's stock salary was increased by an equal amount.

The Special Master Was Inconsistent in Approving Cash Salaries in Excess of \$500,000

SIGTARP found that the Special Master was inconsistent in applying OSM's prescription to limit cash salaries to \$500,000 except for "good cause" shown. OSM lacked documentation supporting why it provided employees cash salaries of more than \$500,000. The Special Master told SIGTARP that it was always his decision to approve cash salaries of more than \$500,000 based on names, circumstances, and empirical data. He told SIGTARP that he never told companies to choose which employees would receive cash salaries of more than \$500,000.

The Special Master said, in looking for evidence, companies might say, "we need this guy" and argue reasons why. He also said there was open communication with the companies about the importance of those employees. However, instead of looking at each person to determine "good cause," the Special Master allowed Ally and GM to choose which employees would receive more than \$500,000. Ally executives told SIGTARP that OSM gave them a "ballpark number" of two to four employees who could be paid more than \$500,000 in cash salary and that the CEO selected the employees. For GM, in a February 27, 2010, email, the Special Master corresponded with OSM staff after a call from GM executives to consider eight employees for cash increases for salaries greater than \$500,000. The Special Master questioned the OSM staff: "Can we (should we?) permit GM to go above \$500,000 with a few? ... Which ones? Or should I just get to her and tell her we can't do it?" OSM staff responded to the Special Master: "With respect to GM, we told them a maximum of five above \$500K and four at \$500K. We left it to them to decide which individuals would be taken down to comply with these restrictions." SIGTARP found that OSM approved nine GM pay packages in 2010 that contained cash salaries of more than \$500,000.²⁸ In 2011, OSM approved cash salaries of more than \$500,000 for 11, or 44% of GM's Top 25 employees.

²⁸ CEOs Whitacre and Akerson each received pay packages totaling \$9 million with cash salaries of \$1.7 million.

Ally CEO Carpenter told SIGTARP that the \$500,000 annual cash salary limit was constraining: “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...this individual is in their early 40s, with two kids in private school, who is now considered cash poor. The reduction in monthly cash expenses would take at least two years to monetize value via stock salary...We were concerned that these people would not meet their monthly expenses due to the reduction in cash.”

In making these decisions, Feinberg was aware of political risk, telling SIGTARP that there was a combination of data refinement plus anecdotal evidence minus political risk. Ally officials told SIGTARP that public perception was possibly a reason the Special Master granted only two to three exceptions. Ally officials also said that the Special Master was concerned that a majority of the Top 25 employees were part of the problem that resulted in the bailout.

According to OSM, the Special Master relied on the companies to provide justifications for all individual compensation proposals, including proposals for cash salaries above \$500,000. However, SIGTARP found that OSM’s justifications for cash salaries it approved in excess of \$500,000 lacked detail. For example, for 2011, several of OSM’s justifications were “No Change”²⁹ and “Critical to Turnaround.”³⁰

With Limited Justifications, OSM Approved Cash Salaries of more than \$500,000 for Employees of AIG, GM, Chrysler Financial, and Ally

In 2010, OSM approved a \$1.5 million cash salary for one AIG employee because, according to OSM, it was important to retain this employee. That same year, OSM approved \$700,000 in cash salary for three AIG employees who were considered to be crucial. In 2011, OSM kept the same \$700,000 cash salary for two of those AIG employees. OSM also approved a cash salary of \$1.8 million for one AIG employee and a cash salary of \$975,000 for another AIG employee, both of whom were deemed crucial to the company’s turnaround.

In 2009, OSM approved a cash salary of \$750,000 for one GM employee because OSM considered the employee crucial to retain. The next year, OSM approved cash salaries between \$600,000 and \$900,000 for four GM employees whom

²⁹ “No Change” was the rationale for three AIG employees who each received \$700,000 or more in cash salary and four GM employees who each received \$580,000 or more in cash salary.

³⁰ “Critical to Turnaround” was the rationale for one AIG employee who received \$1.8 million in cash salary and six Ally employees who each received \$550,000 or more in cash salary.

OSM considered crucial to GM's turnaround and who were given additional responsibilities regarding the company's restructuring. In 2011, OSM approved cash salaries ranging from \$578,024 to \$900,000 for 10 GM employees. Some of the employees were considered crucial, took on additional responsibilities, and received significant promotions.

In 2009, OSM approved cash salaries of approximately \$1.4 million, \$800,000, and \$600,000 for three employees of Chrysler Financial, which was liquidating. According to OSM, it approved these salaries for these employees because the company viewed them as filling essential roles during the company's wind-down. In 2010, the company proposed 20% cash salary increases over 2009 approved levels for all Top 25 employees, which would have resulted in 14 employees whose cash salaries would have exceeded \$500,000. According to OSM, cash salaries were appropriate for Chrysler Financial employees because the company would liquidate and needed to give employees incentives to remain at the firm. OSM approved a 10% increase in cash compensation as opposed to the 20% raise requested. Company executives told SIGTARP they believed OSM's decision to allow 10% raises as opposed to the 20% requested was due to public perception. They also said they did not request a reconsideration because of potential negative publicity and for not wanting to "rock the boat." Seven employees received between \$539,000 and approximately \$1.5 million each.

In 2009, OSM allowed one Ally employee to be paid cash salary of \$600,000 on the basis that the employee was considered crucial. In 2010, no Ally employees were paid more than \$500,000 in cash. In 2011, OSM approved cash salaries ranging from \$550,000 to \$600,000 for six Ally employees deemed crucial to the company's turnaround. One of those employees was a new hire, while four of them had been with the company for fewer than two years.

The Special Master's Criteria of Using the 50th Percentile Pay Level for Similarly Situated Employees and the Selection of Peer Groups Were Not Based on Substantive Due Diligence

OSM used the 50th percentile to set pay packages under an IFR policy that says compensation structures should reflect the need for TARP recipients to remain competitive, to retain and recruit talented employees who will contribute to the TARP recipient's future success, and ultimately to repay TARP obligations. The Special Master told SIGTARP that the 50th percentile level of compensation was an "obvious" starting point and an "appropriate" level of compensation to balance the need to retain and attract employees. Other OSM officials called the 50th percentile "reasonable." According to OSM, the 50th percentile allowed the companies to be paid similar to other financially distressed companies and that a

target below the 50th percentile would have risked that the companies would be at a competitive disadvantage in the marketplace.

Although OSM consulted with academics and an executive compensation expert, that consultation yielded differing opinions. OSM did not broaden its due diligence to look at how similarly situated companies paid their employees. SIGTARP found no documentation that OSM researched empirical evidence of pay levels at companies that may have been similarly situated, such as companies in Chapter 11 reorganization, conservatorship, liquidation, or those in turnaround. When asked in testimony whether he considered that the firms would have gone bankrupt without Government bailouts and if he took into account that CEOs of bankrupt firms don't get paid a lot, the Special Master said that OSM looked at all of the variables to try and come up with a pay package that was appropriate in light of competitive pressures.

OSM's methodology was not created until after OSM issued its first set of determinations. The methodology says the 50th percentile balanced the fact that recipients were financially distressed companies and the fact that the recipients needed to remain competitive in the marketplace, but it does not address how OSM arrived at the 50th percentile target for compensation. OSM officials told SIGTARP that some of the companies thought they should be higher than the 50th percentile, but OSM officials did not feel this was "appropriate." OSM officials told SIGTARP that the seven companies did not have a great argument that they were better than the 50th percentile because, "If they were better than the 50th percentile, they wouldn't be having discussions with OSM in the first place." Given OSM's explanations of "obvious," "reasonable," and "appropriate," and OSM's lack of any documentation of the selection of these criteria, it appears that OSM's selection of the 50th percentile was based on OSM staff's experience with setting executive compensation rather than on empirical evidence.

There is a debate surrounding OSM's use of the 50th percentile. COP issued a February 2011 report that states that while the 50th percentile is an intuitively appealing middle ground, the Special Master presented no evidence that it is the appropriate level of pay for a firm to remain competitive. COP was critical of OSM for saying that it looked at distressed companies, but did not consider market data on pay for turnaround specialists. COP also says that it is unclear how many distressed companies were considered and the impact they had on OSM's calculations.

University of Southern California ("USC") Professor Kevin J. Murphy,³¹ who served as a consultant for OSM, shared his concerns with OSM about using the

³¹ Kevin J. Murphy is the Kenneth L. Trefftz Chair in Finance in the Department of Finance and Business Economics at the USC Marshall School, professor of business and law in the USC Law School, and professor of economics in the USC Economics Department.

50th percentile as a basis for approving compensation. He said that targeting the 50th percentile does not provide information on how the peer groups were chosen, what companies are in the peer groups, or how the various components of pay were defined, calculated, and added together to form total compensation. Murphy, who testified before COP that the pay restrictions for TARP recipients were value destroying, even suggested that the 50th percentile target may be too low to attract executives to financially troubled companies.

SIGTARP Was Unable To Analyze Whether the Special Master Consistently Applied the 50th Percentile Criteria Because OSM Did Not Maintain Adequate Documentation

SIGTARP was unable to analyze OSM's application of the 50th percentile pay level for similarly situated employees because OSM did not maintain complete records of the market-based data that factored into its determinations. Since OSM did not maintain those records showing how it determined the 50th percentile for each position in each company, SIGTARP could not determine whether OSM's 50th-percentile analysis was based on similarly situated employees for comparison, how closely pay determinations aligned with those comparisons, and whether OSM consistently applied those comparisons.

An AIG official told SIGTARP that AIG was not aware of the market data used by OSM. He said he was surprised when OSM rejected the market data submitted by AIG in which AIG compared itself to other large companies at the 75th percentile for salary targets. Although AIG did not know what market data OSM used, the AIG official told SIGTARP that it apparently measured AIG against a different universe of firms and AIG disagreed with that universe of firms.

AIG Pushed for Excessive Raises in Cash Salaries for Its Top 25 Employees and Pushed Against Pay in AIG Stock

This section discusses how the Special Master arrived at determinations for AIG as well as the unique circumstances and issues surrounding OSM's process to set pay at AIG.

OSM told SIGTARP that it faced a different experience working with AIG than with the other six companies. The Special Master stated that AIG constituted 80% of his headaches throughout the 2009 pay determination process. AIG did not have a good handle on its data, could not identify its Top 25 employees, and was the only company that did not agree to renegotiate cash compensation grandfathered through prior employment contracts. OSM said AIG's vast size and the lack of connection between subsidiaries made it difficult for AIG to determine its Top 25 employees.

In 2009, AIG requested excessive increases in cash salaries and was against pay in the form of stock due to concerns over the value of AIG common stock. As a basis for setting pay, AIG wanted to compare itself to Goldman Sachs, JPMorgan Chase & Co., and Morgan Stanley, presumably because those companies paid employees more than AIG did, and AIG also wanted to compare its business unit heads to CEOs of other companies. OSM ruled that these were not reasonable comparisons for AIG. Other senior Treasury officials were significantly involved in AIG's pay determination process, but not for other companies. In 2010, AIG again requested cash salary increases and pushed against pay in AIG common stock. In 2011, AIG proposed that five employees be approved to receive more than \$500,000 in cash salary and requested stock salary in the form of AIG common stock or common stock units.

Before the Creation of OSM, AIG Faced Congressional and Public Anger After Paying Millions of Dollars in Retention Awards to AIGFP Employees Post-Bailout

AIG's compensation was an issue before OSM was established. As detailed in SIGTARP's October 14, 2009, audit report, "Extent of Federal Agencies' Oversight of AIG Compensation Varied, and Important Challenges Remain," after AIG was bailed out by the Government, it paid millions of dollars in retention payments to around 400 employees of its Financial Products unit

("AIGFP"), whose losses contributed to the need for Government intervention.³² Approximately half of the total retention awards were distributed to around 400 employees in two installments: nearly \$56 million in retention awards in December 2008 and approximately \$168 million in March 2009. Approximately 62% of AIGFP employees received retention awards of \$100,000 or more. The retention payments were made under pre-Recovery Act contracts and were outside the jurisdiction of OSM.

In March 2009, Congress and the public expressed anger over the \$168 million in AIG award payments, particularly because AIGFP was the group whose financial losses largely led to AIG's need for large-scale Government intervention. Congress held hearings and introduced legislation to tax the awards. There was significant media coverage, including news that protestors visited homes of AIG employees and some employees received threats. The situation became so heated that AIG asked AIGFP employees who received retention awards of more than \$100,000 to return 50% of the award received. Ultimately, AIGFP employees paid back or waived more than \$45 million that employees pledged to return to the firm.³³

These early retention awards are important to understand the work of the Special Master as they related to AIG because under the contracts, \$198 million in awards was scheduled for payment in March 2010. Feinberg told SIGTARP that AIG posed a huge political problem when it paid out the bonuses to AIGFP employees. He added that "politically, AIG was a nightmare" because it had a huge problem with grandfathered contracts, bonuses, and severance. For OSM's 2009 determinations, five of AIG's Top 25 employees worked for AIGFP and were eligible for retention awards. In addition, AIG also had to make cash awards to other AIG Top 25 employees under pre-Recovery Act contracts. The Special Master took the retention awards into consideration when setting pay for the Top 25 because AIG would not renegotiate the contracts and planned to pay the awards as scheduled. SIGTARP recommended that OSM consult with the Federal Reserve Bank of New York ("FRBNY") for input because it was heavily involved in AIG executive compensation issues.

³² This audit report addresses the extent of the knowledge and oversight by Federal Reserve and Treasury officials over AIG compensation programs, and, specifically, retention payments to AIGFP. The report also addresses the extent to which AIGFP retention payments were governed by the executive compensation restrictions or by preexisting contractual obligations, the outstanding AIG compensation issues requiring resolution, and Federal Government actions to address them. AIGFP's primary business was trading in derivatives of stocks and other securities. Of the \$25 billion in losses that AIG announced in the third quarter of 2008, \$19 billion came from AIGFP's losses on one type of derivative called credit default swaps. These conditions led to the unprecedented Government bailout of AIG.

³³ Eight employees in AIG's Top 25 pledged to repay \$22.1 million in AIGFP retention awards. In the end, those eight employees reimbursed AIG \$15.8 million.

OSM told SIGTARP that it faced a different experience working with AIG than with the other six companies. The Special Master stated that AIG constituted 80% of his headaches throughout the 2009 pay determination process. AIG did not have a good handle on its data due to its vast size and many subsidiaries, could not identify its Top 25 employees, and was the only company that did not agree to renegotiate cash compensation grandfathered through prior employment contracts.

AIG Employees Declined Request To Restructure Upcoming Retention Awards Under Pre-Recovery Act Employment Contracts

Although OSM could not require TARP companies to stop payment of future awards under contracts that existed prior to the Recovery Act, OSM pushed AIG, Bank of America, and Citigroup to restructure voluntarily future cash awards into stock.³⁴ However, AIG did not agree. Bank of America and Citigroup, on the other hand, restructured future awards so that when the awards with salary exceeded \$500,000, the balance was payable in stock salary and long-term restricted stock. Feinberg told SIGTARP that the companies “understood the potential for Congressional uproar had they not.” In 2009, 11 AIG employees were scheduled to receive retention awards and other payments. In 2010, 18 AIG employees were scheduled to receive retention awards and other payments. The largest of these payments in both years was approximately \$4.7 million.

Jim Millstein, Treasury’s then-head of restructuring for AIG, was heavily involved in the discussions regarding AIG’s retention awards. Millstein told SIGTARP that it was not a particularly smooth operation with the Special Master and AIG initially because AIG’s human resources function was in disarray with each subsidiary controlling its own data on executive compensation. Millstein told SIGTARP that he looked at each grandfathered contract and worked on what was in the jurisdiction of OSM to change. In the end, AIG did not take away any of the upcoming awards.

³⁴ The Recovery Act mandated that OSM conduct a “look-back” at post-TARP bonuses, retention awards, golden parachutes, and other awards paid to the Top 25 employees at all TARP recipients pursuant to contracts entered into before the Recovery Act and, where contrary to EESA, TARP, or the public interest, “seek to negotiate” reimbursement to the Government. OSM focused this review on the Top 25 executives who earned more than \$500,000 per year because Feinberg felt that anything less than \$500,000 a year was highly unlikely to be contrary to the public interest. OSM found that 17 TARP recipients, including Bank of America, Citigroup, and AIG, made payments of \$1.7 billion that were considered “disfavored.” Special Master Feinberg testified before COP that the awards were “inappropriate because they were taking taxpayer money and feathering their own nest.” Despite finding the awards inappropriate and disfavored, OSM found that no post-TARP payments were contrary to the public interest because then-existing rules allowed the payments, and the payments were largely from companies that had repaid TARP. Therefore, OSM concluded that it had no authority to “seek to negotiate” reimbursement to the Government.

AIG CEO Robert Benmosche explained to SIGTARP the reasoning for AIG's decision not to restructure the awards in 2009: "I got a message that Ken [Feinberg] had a desire to take away retention payments. I had to make sure my people got paid. ... I had 10 senior executives that lost \$168 million in pay. We had people that were completely wiped out when the stock fell. ... The stock didn't have any value to the employees, as these people were getting stock that they couldn't sell because it was not vested. Ken Feinberg wanted to be able to tell Congress that no retention payments would be paid. But the retention payments were the only way to pay and keep people. They were not retention payments per se, but they were bonuses that they would have normally got. ... [AIG]FP was the primary cause, but everybody lost. I told him you can't cut salaries so much and put pensions in long-term stock – people need something to live on ... We succeeded in keeping all retention payments. The penalty was very low salaries."

In 2009, AIG Proposed Excessive Cash Raises for Its Top 25 Employees and Proposed Treating Heads of AIG Subsidiaries as CEOs

The fact that AIG's CEO felt that OSM penalized AIG with very low salaries is not surprising, given that in August 2009, AIG proposed excessive cash raises for its Top 25 employees that generally exceeded the 50th percentile of amounts paid to employees in similar roles at similar companies. OSM told SIGTARP that AIG wanted to compare itself to Goldman Sachs, JPMorgan, and Morgan Stanley. In its August 2009 submission to OSM, AIG also proposed that employees be able to cash out immediately 50% of any stock salary received, and that compensation for AIG subsidiary heads be calculated in the 50th to 75th percentile of CEOs of other companies.

A senior AIG official told SIGTARP that AIG had a practice of paying its employees high salaries with very limited incentive compensation. AIG did not stray from that practice in its 2009 proposal for the Top 25 employees. According to an internal OSM document, AIG proposed to the Special Master cash salary increases from 20% to 129% over 2008 cash salaries for one group of AIG employees. The document stated that these proposed salaries were larger than previously discussed with OSM and were unjustified by the comparative data. The document also stated that for another group of employees, AIG proposed cash salary increases ranging from 84% to 550% that were also too high and unjustified. In addition to the cash raises proposed by AIG for Top 25 employees, the document also stated that AIG proposed that 50% of its stock salary be sellable immediately, which would have increased guaranteed cash amounts for certain employees by 55%, to 317%.

AIG also proposed compensation for the heads of AIG subsidiaries comparable to the 50th to 75th percentiles of CEOs of other companies. OSM rejected AIG's proposal to treat these employees as CEOs, explaining to SIGTARP, "When you are the CEO of a [subsidiary], your responsibilities are substantially different than if you are the CEO of a public company." OSM said that it took a hard-line stance that each of the seven companies had only one CEO who should be paid like a CEO.

The Special Master Set Salaries for AIG Top 25 Employees in 2009

For 2009, OSM approved only five of the 13 employees in AIG's Top 25 to receive total compensation of cash and stock of more than \$1 million. OSM approved new AIG CEO Benmosche's pay package of \$10.5 million (\$3 million in cash salary, \$4 million in AIG common stock, and \$3.5 million in restricted stock tied to achieving performance measures). OSM approved total compensation packages for four AIG employees at approximately \$4.3 million, \$4.7 million, \$5.7 million, and \$7.1 million (including cash salaries ranging from \$350,000 to \$450,000). These employees were scheduled to also receive cash retention awards that year of up to \$2.4 million.³⁵

At the time OSM was determining pay for AIG, 11 of the 13 employees in AIG's Top 25 were scheduled to receive cash retention awards and other payments in 2009 of up to approximately \$4.7 million. OSM told SIGTARP that it considered these awards when setting the employees' compensation. Special Master Feinberg testified before the House Committee on Financial Services that for AIG for 2009, he refused to adopt AIG's proposed cash salaries, "which, in light of the retention payments, would have resulted in an excessive level of cash compensation."

For five AIGFP employees who were scheduled to receive 2009 cash retention awards up to approximately \$4.7 million, OSM froze cash salaries at 2007 levels (\$100,000 to \$177,799) and gave them no stock. For non-AIGFP employees who would receive retention awards up to \$2.4 million, OSM set the employees' cash salaries below 2007 levels (\$350,000 to \$450,000). Table 3 is a side-by-side look at the compensation approved by the Special Master as well as the retention awards AIG employees were scheduled to receive under prior Recovery Act contracts.

³⁵ Kris Moor, President of AIG's Chartist subsidiary, was scheduled to receive a \$2.4 million retention award. David Herzog, AIG's CFO, was scheduled to receive a \$1.5 million retention award.

TABLE 3

2009 AIG TOP 25 TOTAL COMPENSATION APPROVED BY THE SPECIAL MASTER AND AUTHORIZED CASH RETENTION AWARDS AND OTHER PAYMENTS SCHEDULED TO BE PAID UNDER PRE-RECOVERY ACT CONTRACTS

AIG Employees	Cash Salary	Stock Salary	Long-Term Restricted Stock	Authorized Cash Retention Awards and Other Payments	Total ^[1]
1	\$3,000,000	\$4,000,000	\$3,500,000	Information Redacted (See note) (b)(4)	
2	350,000	100,000	225,000		
3	125,000	–	–		
4	177,799	–	–		
5	425,000	–	–		
6	125,000	–	–		
7	350,000	3,104,167	833,333		
8	144,000	–	–		
9	100,000	–	–		
10	450,000	4,691,667	2,000,000		
11	425,000	–	–		
12	450,000	3,258,333	1,000,000		
13	375,000	3,566,666	1,750,000		
Total	\$6,496,799	\$18,720,833	\$9,308,333	\$22,180,000	\$57,705,965

[1]: In addition to retention awards, there was one authorized payment for carried interest.

Note: In response to a draft of the AIG-specific portions of this report, AIG raised concerns about the inclusion of individual cash retention and other cash award data on the grounds that it was confidential financial information that had not previously been publicly disclosed and that disclosure of individual awards could harm AIG. SIGTARP is cognizant that the United States taxpayers currently own a significant percentage of AIG and thus out of an abundance of caution has worked with AIG to make redactions of individual employee award data outside of OSM's determinations.

Sources: SIGTARP analysis of data from AIG and OSM.

SIGTARP found that Millstein intervened in the Special Master's process to set the pay package for AIG CFO David Herzog.³⁶ Millstein told SIGTARP that his primary focus was to "keep AIG together." Millstein told SIGTARP that he [Millstein] was a facilitator/mediator between AIG and the Special Master. He weighed in on OSM's 2009 pay determination for AIG CFO Herzog, telling the Special Master that if AIG did not retain its CFO, it risked a credit rating downgrade. He advised the Special Master that AIG needed to keep Herzog by possibly adding a little more cash, and a little more total compensation. In response, Millstein said, the Special Master gave some concession to AIG's request for additional compensation, and the CFO remained at AIG.

³⁶ FRBNY Executive Vice President Sarah Dahlgren told SIGTARP that she may have asked for an exception to the \$500,000 cash salary cap for AIG CFO David Herzog. She also told SIGTARP that she asked OSM to treat the CEO of AIG subsidiary Chartis, who was a second- or third-tiered executive, at a higher peer group than OSM had benchmarked. However, these requests did not influence the Special Master, who kept Herzog under the cap and did not treat the Chartis CEO as a CEO. Dahlgren told SIGTARP that the Special Master did not consider her assessment for a specific AIG executive.

AIG Received Consideration for a Different Form of Stock Salary for 2009

Feinberg told SIGTARP that AIG was anti-stock salary and wanted to pay employees in cash. In its August 2009 compensation proposal, during the height of contentious negotiations between AIG and the Special Master, AIG requested that employees be able to cash out immediately 50% of any salary paid in AIG common stock, and proposed receiving stock salary amounts ranging from \$250,000 to \$4.6 million for employees. AIG proposed not to receive any incentive awards in long-term restricted stock tied to achievement of performance measures. OSM pushed back, making clear that immediately sellable stock was not allowable, and insisting that part of the employees' pay be vested over a period of time.

AIG enlisted the help of Treasury officials Millstein and the Assistant Secretary for Financial Stability, Herbert Allison. In an interview with SIGTARP, AIG CEO Benmosche said that he told Millstein that the process was dysfunctional, that AIG had a lot of concerns, and people would leave. He also told SIGTARP that he asked Millstein to talk to Treasury and Feinberg to figure out the executive compensation determination process.

Feinberg told SIGTARP that OFS stressed that the stock salary and grandfathered contracts would jeopardize AIG. Feinberg told SIGTARP that he was pressured by other senior Treasury officials and was told to be careful, that AIG owed a fortune, and that Treasury did not want it to go belly up.³⁷ He further stated that Treasury officials felt those amounts were relatively small compared to the Government's exposure in AIG. Despite these pressures, Feinberg said that no one trumped his decisions.

³⁷ For details regarding the Government's investment in AIG and the firm's recapitalization plan, see Appendix D.

AIG and Treasury Officials Created a Phantom (Basket) Stock for Six AIG Employees

Feinberg told SIGTARP that in his 2009 discussions with AIG related to stock salary, AIG officials indicated that its common stock was essentially worthless.³⁸ Feinberg said that to his surprise, this belief was shared by the Federal Reserve and Treasury's OFS. Whether the stock had value or not, it was volatile. Between the release of the IFR on June 15, 2009, and OSM's 2009 AIG determination on October 22, 2009, AIG's adjusted stock price ranged from \$7.94 per share to \$42.09. Feinberg testified before COP that he "tried to work something out in conjunction with AIG's suggestion that the stock, the common stock, wasn't worth enough to appropriately compensate top officials. But we worked out a compromise with the Federal Reserve, with AIG, with the Office of Financial Stability."

SIGTARP found that then-Assistant Treasury Secretary Allison's communication with AIG officials over compensation was quite significant and starkly contrasted with almost no involvement in compensation with the other six companies. Allison had weekly telephone conversations with AIG CEO Benmosche and AIG's then Chairman of the Board during the height of OSM's 2009 determination process. Allison told SIGTARP that there were times when he was contacted by AIG top management who told him they were concerned that the Special Master's decisions would cause great reactions in keeping people. Allison told SIGTARP that Feinberg was "tamping down" at AIG's board.

Allison said that he voiced his concerns to the Special Master that AIG's stock had a lot of volatility and questioned whether it would be a reliable instrument of value to retain and motivate employees. He said that stock salary needed to have value and be linked to performance. He also said that he thought that AIG's stock was not very valuable and said, "...trading can go one way one day, the other another... Could it be worth something? Yeah, it could. Could it be worthless? Yeah, depends on what happens with the company." Allison also told SIGTARP that he "was there from the standpoint of protecting assets and taxpayers" and "There was a ton of money invested and you don't want to see it thrown away."

Treasury's Millstein had a heavy hand in OSM's decision on AIG stock. He told SIGTARP that he helped develop a new "phantom stock" that did not exist, was independent of AIG's balance sheet, and the value of which was based on the book value of four AIG subsidiaries. Millstein helped create this phantom stock (also called a basket stock), even though AIG's common stock was trading on the

³⁸ AIG's prior General Counsel told SIGTARP that management viewed AIG's stock as having less value than other companies' stocks and that AIG did not know if the firm would survive, and did not know what its stock was worth. These facts bring to light why AIG's initial proposal to OSM requested that half of the executives' stock salary be immediately sellable.

market at an adjusted price of \$20.42 per share on August 14, 2009, the same day that AIG submitted its proposal to OSM to receive immediately sellable common stock. He said that those subsidiaries had some measure of value and that it was the best option. The four subsidiaries – American International Assurance Co. Ltd. (“AIA”), American Life Insurance Co., Chartis, and AIG Domestic Life & Retirement Services Group – were identified by OSM as those that AIG, Treasury, and FRBNY identified as crucial to the future of the company. However, a stock based on the values of AIG subsidiaries may not sufficiently reflect losses sustained at AIGFP or reflect AIG’s massive Government assistance.

The Special Master also consulted with FRBNY, which had been handling AIG’s compensation issues prior to OSM. FRBNY Executive Vice President Sarah Dahlgren told SIGTARP that she learned from participating in AIG compensation committee meetings of employee concerns about the potential for future dilution or price volatility if the Government were to sell off its ownership rapidly. Dahlgren and another FRBNY official told SIGTARP that they were concerned that if senior management left, it could trigger a potential downgrade, based on statements to them by the rating agencies.

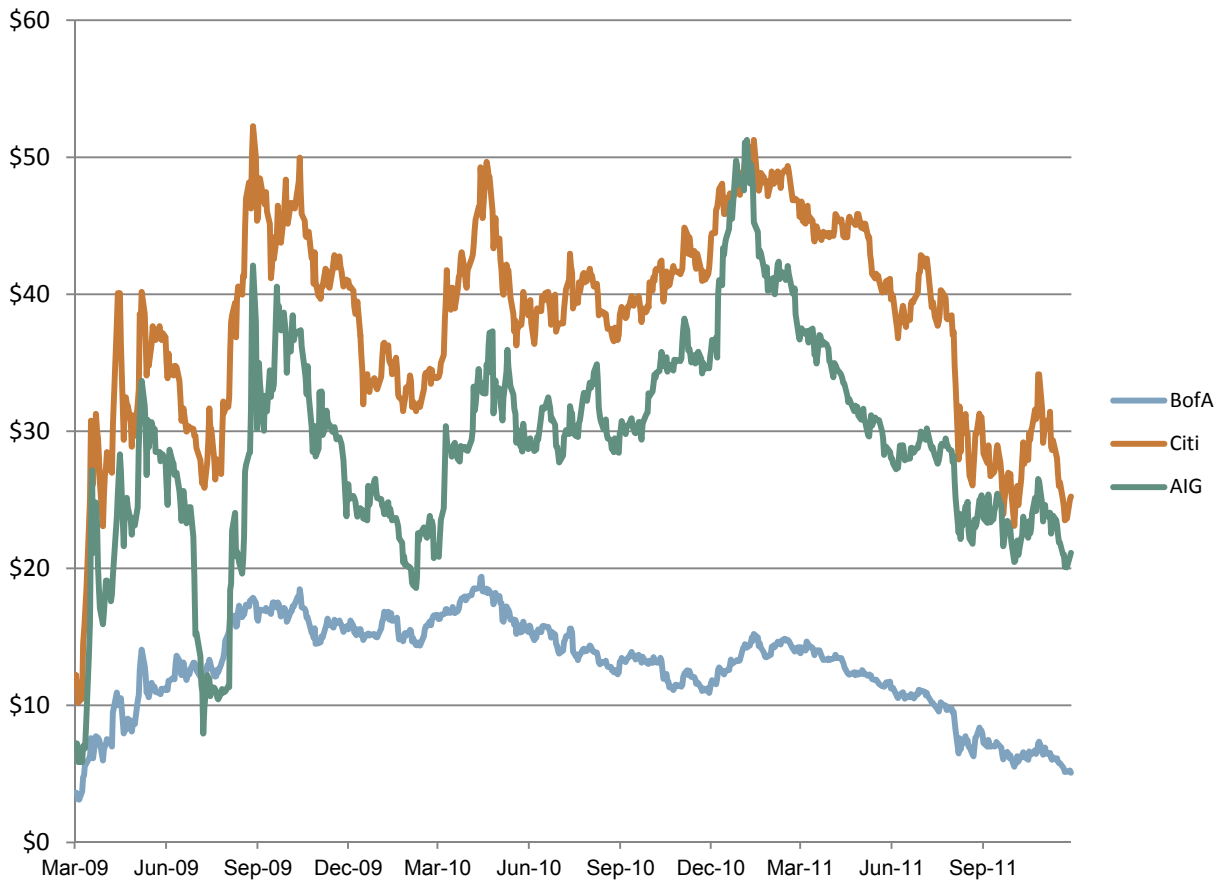
AIG CEO Benmosche opposed the phantom stock because it would send the wrong message to AIG subsidiaries. That opposition is illustrated in a September 28, 2009, email among OSM staff that referred to a discussion with an AIG attorney: “Bob Benmosche has found that the subsidiaries are not working well together – for example, some subsidiaries are hoarding cash to shore up their own balance sheets, rather than conveying the cash to the parent, where it is badly needed – and that Bob has concluded that subsidiary stock would exacerbate that problem...Bob is adamantly opposed to the use of subsidiary stock, he [an AIG attorney] said that a very high-level OFS business-level conversation would need to be had to move Bob from that position.” On the day of this email, AIG’s stock was trading at an adjusted price of \$38.66 per share. Benmosche told SIGTARP that a problem with the phantom stock was that it assumed AIG would divest all companies, but he did not know how to define value in Chartis and AIA when those entities were sold. Despite Benmosche’s concerns, OSM approved the new phantom stock salary for AIG, citing “the principle that AIG must be able to maintain and attract the necessary employees to remain competitive in the marketplace.”³⁹ However, for all of the work that went into creating this phantom stock, OSM applied it to only six AIG employees, including the CEO.

OSM’s use of a phantom stock for AIG employees’ compensation stands in contrast to OSM’s treatment of other companies that were also facing volatility in their stock price.

³⁹ According to OSM, the value of each subsidiary was to be determined on the basis of an adjusted book value measure that excluded extraordinary events.

Citigroup officials told SIGTARP that the most significant decision by the Special Master was the use of stock salary. However, Citigroup had no intention of staying under the Special Master's purview beyond 2009. Citigroup officials explained to SIGTARP that their approach for dealing with the Special Master's decision to use stock salary was to reassure employees that this would be a short-term process and that they should hang on despite the drop in price. AIG, Citigroup, and Bank of America's adjusted stock prices are illustrated in Figure 4.

FIGURE 4
CLOSING DAY STOCK PRICES FOR PUBLICLY TRADED COMPANIES THAT RECEIVED
EXCEPTIONAL ASSISTANCE FROM 3/2009 THROUGH 11/2011



Source: SIGTARP analysis based on data from Yahoo Finance. Stock prices adjusted for stock splits.

The Special Master Changed the Form of Stock Compensation for Six AIG Employees from Phantom Stock to AIG Common Stock

Shortly after OSM issued its determinations paying AIG's Top 25 in the phantom stock, AIG CEO Benmosche enlisted the help of senior Treasury officials Millstein and Allison to deal with the Special Master. Beyond his weekly communication with AIG, Allison attended two key meetings with AIG's executives to discuss compensation. In November 2009, after the first determination was issued, he met in New York City with Special Master Feinberg and AIG's Board of Directors and CEO. Allison said that because of miscommunication, AIG's board felt the Special Master was not aware of its challenges and that there was an issue of a lack of trust. Benmosche told SIGTARP that he told Allison after the board meeting that "this cannot continue," "it was ridiculous," and "that the Government is too involved and nothing makes sense." Benmosche also said he told Allison that he was running out of patience, Allison asked him to "give me time," and Benmosche told him he had a month, from November to December.

Benmosche also told SIGTARP that he met with FRBNY's Dahlgren and her team and asked them to tell Treasury to be flexible. He also told SIGTARP that he warned Dahlgren, "If you want to get your money back, you had better fix this." In December 2009 in Washington, D.C., AIG CEO Benmosche met with Special Master Feinberg, an OSM staff member, Allison, and Millstein. While this meeting took place after OSM's October 22, 2009, determination, Benmosche told SIGTARP that this meeting was about 2009 pay because there were unresolved issues in play, particularly surrounding the pay of AIG's President and the CEO of one of AIG's subsidiaries. Allison also told SIGTARP that the purpose was to finalize OSM's AIG pay determinations.

Subsequent to this meeting, in a December 21, 2009, supplemental determination letter to AIG, the Special Master reversed his written October 22, 2009, determination letter granting phantom stock to AIG employees and instead granted AIG's new request to pay employees with AIG common stock. The supplemental determination said that common stock would provide employees with incentives to maximize the value of AIG and, therefore, its ability to repay the taxpayer.

In 2010, AIG Proposed Cash Salary Increases and Again Pushed Back Against Executive Pay in AIG Common Stock, Requesting Instead an Alternative Form of Stock Salary

On January 3, 2010, *The New York Times* reported in an interview with Feinberg that AIG thought its stock was worthless and that Feinberg agreed that AIG employees would get a form of phantom stock reflecting only four AIG operating units that were profitable and not part of AIG's downfall. Feinberg told SIGTARP that in 2010, after the article, AIG was even more reluctant to take stock salary. In addition, AIG had entered into an agreement to sell some of the subsidiaries that were in the basket stock.

On January 15, 2010, AIG submitted its 2010 proposal including cash salary increases and requested another alternative form of stock salary that, according to AIG's 2010 determination letter, reflects the value of common stock and "hybrid securities." At this time, AIG's stock was trading at an adjusted price of \$23.51. OSM approved this new form of stock compensation, along with cash salaries, for all but one AIG employee.

With significant turnover in employees who fell within the Top 25, AIG proposed excessive cash salaries, citing the desire to keep 2009 salaries (\$350,000 to \$1.5 million) for those new to the Top 25 designation. AIG proposed that nine of its Top 25 employees be paid more than \$500,000 in cash salary. For three employees, AIG proposed cash raises that would result in 100% to 140% increases over 2009. AIG proposed stock salaries based on the hybrid basket stock ranging from \$200,000 to \$7.7 million for certain new Top 25 employees. For three employees who were part of AIG's 2009 Top 25, AIG proposed stock salary increases between 65% and 87% over 2009 OSM-approved pay. For these three employees, OSM found this amount was excessive in comparison to similarly situated peers and inconsistent with public interest. AIG also proposed to limit long-term incentive awards to 10% of total 2010 compensation, but OSM rejected the request.

OSM approved large compensation packages for AIG employees in 2010, even though 18 of the employees were scheduled to receive up to \$4.7 million in retention awards and other payments. In 2009, OSM gave approval that five employees could be paid compensation of more than \$1 million in cash and stock, and the other eight fell well under that. However, in 2010, of AIG's Top 25, OSM approved 21 of 22 employees to receive between \$1 million and \$7.6 million (and \$10.5 million for CEO Benmosche), with 17 of those pay packages exceeding \$3 million.

OSM approved cash salaries of more than \$500,000 for five AIG employees, including a \$3 million cash salary for AIG's CEO Benmosche, \$700,000 for Kris

Moor, AIG's Executive Vice President for General Insurance, and \$1.5 million, \$1 million, and \$700,000 for other AIG employees. With respect to other employees, OSM approved them to receive more than \$500,000 because they were considered "critical." OSM approved 12 of AIG's 23 employees to be paid cash salaries between \$442,874 and \$500,000 and also approved for all but three employees more than \$1 million in stock (between \$1.3 million and \$5.1 million).

In 2010, AIG proposed that four AIGFP employees be paid cash salaries of \$500,000 and stock salaries ranging from \$2 million to \$3 million that could be cashed out after one year. OSM rejected the proposal to sell stock salary after one year and also refused to give AIGFP employees, with the exception of one employee, \$500,000 cash salaries. The Special Master ruled that the proposed salaries, combined with upcoming retention awards, would be inconsistent with the public interest, and he generally froze salaries at 2007 levels. However, despite freezing AIGFP cash salaries, OSM approved four AIGFP employees to receive more than \$3 million in stock salary, and two AIGFP employees to receive \$758,067 and \$1.3 million in stock salary. In contrast, in 2009, OSM approved only cash salaries frozen at 2007 levels with no additional compensation for AIGFP employees.

However, 18 AIG employees were scheduled to receive retention awards and other payments, including the six AIGFP employees. Despite freezing the AIGFP cash salaries, OSM approved large pay packages of cash and stock for employees receiving retention awards and other payments up to approximately \$4.7 million.

Table 4 is a side-by-side look of the compensation approved by the Special Master as well as the awards these employees were scheduled to receive under grandfathered contracts that existed prior to the Recovery Act.

TABLE 4

2010 AIG TOP 25 TOTAL COMPENSATION APPROVED BY THE SPECIAL MASTER AND AUTHORIZED CASH RETENTION AWARDS AND OTHER PAYMENTS SCHEDULED TO BE PAID UNDER PRE-RECOVERY ACT CONTRACTS

AIG Employees	Cash Salary	Stock Salary	Long-Term Restricted Stock	Authorized Cash Retention Awards and Other Payments [1]	Total [2]
1	\$3,000,000	\$4,000,000	\$3,500,000	Information Redacted (See note) (b)(4)	
2	450,000	4,062,500	1,500,000		
3	700,000	3,050,000	1,250,000		
4	177,799	3,322,201	–		
5	241,933	758,067	–		
6	125,000	3,468,750	–		
7	495,000	4,485,000	1,020,000		
8	450,000	3,062,500	–		
9	450,000	1,437,500	625,000		
10	100,000	3,500,000	–		
11	1,000,000	3,000,000	–		
12	495,000	3,731,250	1,375,000		
13	700,000	5,000,000	1,900,000		
14	1,500,000	2,520,000	1,980,000		
15	475,000	2,156,250	875,000		
16	495,000	3,656,250	850,000		
17	500,000	1,300,000	–		
18	475,000	4,568,750	–		
19	495,000	5,149,000	1,156,000		
20	312,500	–	–		
21	475,000	2,967,932	854,000		
22	442,874	2,117,126	640,000		
23	400,000	800,000	1,150,000		
Total	\$13,955,106	\$68,113,076	\$18,675,000	\$36,346,503	\$141,069,768

[1] In addition to retention awards, there were authorized payments under AIG's Senior Partners plan.

[2] Total includes a payment for carried interest to one employee.

Note: In response to a draft of the AIG-specific portions of this report, AIG raised concerns about the inclusion of individual cash retention and other cash award data on the grounds that it was confidential financial information that had not previously been publicly disclosed and that disclosure of individual awards could harm AIG. SIGTARP is cognizant that the United States taxpayers currently own a significant percentage of AIG and thus out of an abundance of caution has worked with AIG to make redactions of individual employee award data outside of OSM's determinations.

Sources: SIGTARP analysis of data from AIG and OSM.

In 2011, AIG Proposed Cash Salaries in Excess of \$500,000 for Five Employees and Proposed Compensation in the Form of AIG Common Stock

On January 14, 2011, Treasury restructured (also called recapitalized) the Government's ownership interests in AIG that would eventually lead to AIG's repayment of debts owed to FRBNY and Treasury holding approximately 92% of AIG common stock, which Treasury could sell into the market. In its January 31, 2011, proposal to OSM, AIG stated that in light of the recapitalization plan, it proposed the use of AIG common stock for 2011 stock salary, and OSM agreed.

AIG's 2011 proposal for pay of its Top 25 employees was markedly different from its proposals in the two prior years, for the most part proposing what OSM had approved in 2010. AIG only proposed cash salaries in excess of \$500,000 for five employees, the same number of employees who were approved to receive more than \$500,000 in cash salary in 2010. AIG again proposed that compensation in long-term restricted stock tied to performance measures be limited to 10% of total compensation.

OSM approved AIG CEO Benmosche to have the same \$10.5 million compensation package that was approved in 2009 and 2010 on the basis that it was the same compensation he had previously received. For the rest of AIG's Top 25 employees, OSM approved total compensation packages of cash and stock that, with one exception, ranged from \$2.5 million to \$8 million.⁴⁰ Of these pay packages, OSM approved \$8 million in total compensation for two AIG employees, \$7 million in total compensation for two additional AIG employees, and \$5 million to \$6.3 million in total compensation for seven AIG employees.

Of these total compensation packages, OSM approved cash salaries proposed by AIG including salaries over \$500,000 for five employees, the same number of employees approved to receive more than \$500,000 in 2010. The cash salaries approved by OSM over \$500,000 include: a \$3 million cash salary for AIG CEO Benmosche, a cash salary of \$1.8 million for Peter Hancock, CEO of AIG's Chartis subsidiary, \$700,000 for Kris Moor, Vice Chair of Chartis, and \$700,000 and \$975,000 for the remaining two employees.

OSM also approved cash salaries of \$500,000 for 10 AIG employees, cash salaries of \$400,000 to \$495,000 for seven AIG employees, and a cash salary of \$125,000 for one AIG employee. In approving AIG's proposed cash salaries, OSM found that "in general, the proposed cash salaries target the 50th percentile of cash salaries paid to persons in similar positions or roles at similar entities."

⁴⁰ OSM approved total compensation for one AIG employee at \$1.5 million.

OSM also approved the cash raises for two employees on the basis of “enhanced responsibilities and expanded roles of the affected employees.” In setting cash salaries, OSM did not need to consider retention awards under pre-Recovery Act contracts because there were none scheduled. In addition to the cash salaries, OSM approved significant compensation to AIG’s Top 25 in the form of stock salary and long-term restricted stock.⁴¹

AIG also proposed that employees receive AIG common stock for 2011 stock salary, in light of the company’s recapitalization plan. OSM approved AIG’s request, ruling that AIG’s common stock is consistent with the structure of stock salary payable by the other exceptional assistance recipients.⁴² The company also proposed that most employees receive long-term restricted stock representing 10% of their total 2011 compensation. However, OSM generally ruled that the 10% proposal failed to satisfy the IFR’s principle that an appropriate portion of compensation should be performance based.⁴³

⁴¹ OSM rejected AIG’s proposed stock salaries and reallocated stock salary between stock salary and long-term restricted stock. However, for some AIG employees, OSM did approve a lower allocation of long-term restricted stock.

⁴² The 2011 determination letter says that in certain cases, the Special Master concluded that proposed stock salary amounts were not justified and that a portion of compensation should be reallocated from stock salary to long-term restricted stock.

⁴³ The 2011 determination letter says that in the case of certain employees, OSM acknowledged that a lower allocation of long-term restricted stock was appropriate.

Impact of the Special Master's Determinations on the Exceptional Assistance Recipients

This section discusses the impact of the Special Master's determinations on the exceptional assistance recipients. In testimony to the House Committee on Oversight and Government Reform, Special Master Feinberg said that while his authority did not go beyond the seven exceptional assistance companies, he hoped that his compensation determinations would be used as a model by other companies.

Maintaining the Special Master's Framework

Special Master Feinberg testified to Congress that he determined a new compensation regime be implemented for the seven companies that received exceptional assistance under TARP. The regime he envisioned was a replacement of guaranteed compensation with performance-based compensation designed to tie the individual executive's financial opportunities to the long-term overall financial success of each company. He also envisioned that short-term profits would give way to longer-term financial stability and success. He told Congress that he hoped that his individual compensation determinations would be used, in whole or in part, by other companies in modifying their own compensation practices. He testified that he believed that his determinations were a useful model to guide others.

Chrysler, Citigroup, and Ally executives said they would not fully follow the Special Master's determination framework after they exited TARP. Chrysler executives told SIGTARP that the company executives' mentality was, "Let's get through this." The executives also said that the firm's cash compensation was not competitive and the company would be unable to retain employees at its current compensation levels.

Citigroup's then-Vice Chairman Edward J. Kelly, III, told SIGTARP that there were important principles that emerged from OSM's determinations, and that the company would maintain items such as clawbacks, deferred compensation, and performance tests. But the executive also said that company executives were less certain whether the company would use stock salary as a form of deferred compensation. Ally CEO Carpenter said he agreed with paying for long-term performance, but that certain clawbacks are not realistic.

Bank of America CEO Brian T. Moynihan told SIGTARP that the company enhanced compensation in early 2010 and assessed best practices of the industry. He said the company did not necessarily follow the Special Master's practices after it exited TARP, but that some of OSM's components were involved. He said the company already had a robust compensation structure with clawbacks. He also told SIGTARP the company did away with the Special Master's \$500,000 cash salary limit because it limited the company's ability to attract and retain qualified executives.

GM and AIG executives were much less nuanced in their dissents with OSM's framework: GM CEO Whitacre said that GM would not maintain any of the Special Master's practices once the company exits TARP. AIG CEO Benmosche said 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.

Companies' Ability To Recruit and Retain

OSM reported in its March 23, 2010, press release, which accompanied the Special Master's 2010 Top 25 determinations, that 84% of executives included in the Special Master's 2009 Top 25 determinations remained in the Top 25 for 2010 and were subject to the Special Master's 2010 Top 25 determinations. While the Special Master advertised this retention rate as a success, the rate itself has little meaning because it reflects only five of the seven companies and does not account for employees who departed companies before the 2009 determinations.

The Special Master commented that OSM had data to prove that 85% of the individuals who had threatened to leave in 2009 stayed in 2010. OSM calculated the retention rate by comparing the number of Top 25 employees who remained employed by their companies from 2009 to 2010. The figure does not include Bank of America and Citigroup, both of which repaid in 2009 and could not be factored into the analysis.

OSM provided the data for Table 5 on the following page, which shows the number of Top 25 employees who remained at the companies for both years.

TABLE 5

RETENTION DATA				
Company	Top 25 Employees Subject to 2009 Determinations	2009 Top 25 Employees Departed by 2010	Employees Remaining in 2010	Retention Rate of Top 25 Employees
AIG	13	5	8	62%
Chrysler	25	2	23	92%
Chrysler Financial	22	5	17	77%
GM	22	2	20	91%
Ally	22	2	20	91%
Total	104	16	88	85%

Source: Treasury.

While the Special Master publicized OSM's retention rate as a success in keeping executives in their seats, the numbers do not tell the whole story. A GM executive told SIGTARP that the drama surrounding executive compensation – with citizens protesting at the homes of executives from companies that received Government assistance, such as AIG – is one reason that some people did not apply for jobs at GM. He said that certain potential candidates for GM's CFO position did not interview with the firm because of the executive compensation rules.

AIG's CEO told SIGTARP: "You don't always lose people, but you lose their hearts and minds. Sometimes people just sit at their desks and watch it burn to the ground because they don't have a better job. Sometimes, people do go out the door. ... So maybe no one left, but if they are not creative in their thinking, we will lose." AIG's then-Chairman of the Board even complained that OSM's rules made little sense and hurt the firm. In a February 2010 Chairman's Message to shareholders, he wrote: "While we can pay the vast majority of people competitively, on occasion, [OSM's] restrictions and [the Special Master's] decisions have yielded outcomes that make little business sense. For example, in some cases, we are prevented from providing market competitive compensation to retain some of our own most experienced and best executives. This hurts the business and makes it harder to repay the taxpayers."

Bank of America's CEO told SIGTARP that the pay determinations were shortsighted and that he was disappointed in the pay restrictions. He said that the determinations were unfair to the executives, and that Bank of America would be unable to keep talented and loyal personnel.

Citigroup CEO Pandit told SIGTARP that “keeping the team together... was a big deal for management.” He said that some employees in the top tiers of the firm left Citigroup, and he acknowledged that executive compensation restrictions might have been a contributing factor. Citigroup’s then-Vice Chairman Kelly told SIGTARP that executive compensation was a barrier to hiring and retaining qualified managers and well-known traders. A Citigroup official told SIGTARP that out of Citigroup’s Top 25 employees, the company lost only a few employees.

OSM’s Limited Effect on Citigroup and Bank of America

OSM’s decisions had a limited effect on the executive compensation practices of Citigroup and Bank of America after they exited TARP. Both companies were subject to the Special Master’s determinations from October 22, 2009, through December 31, 2009. Citigroup officials told SIGTARP that from the beginning, Citigroup’s perspective was that it would be subject only to the Special Master’s determinations for 2009. Once the two banks exited the exceptional assistance program TIP, and OSM’s regulations disappeared, salaries and bonuses climbed. For example:

- Under the Special Master in 2009, the annual stock salary for Citigroup’s Top 25 employees ranged from \$0 to approximately \$5.7 million each. However, as reported by COP, after exit, annual stock salary for Citigroup’s named officers ranged from \$4.2 million to \$9 million each.
- The Special Master approved for Citigroup’s Top 25 group in 2009 \$39.5 million in long-term restricted stock. After exit, COP said that just the top 15 executives received a combined \$50 million in stock bonuses.
- Long-term restricted stock under the Special Master totaled \$19.3 million for Bank of America’s Top 25. After exit, according to COP, just four of its executive officers received long-term incentive awards totaling \$35.7 million. SIGTARP also found that one of those executives received a 70% salary increase in two steps after Bank of America exited TARP, but within eight months after his second raise, he left the firm under a realignment strategy that “simplified” the management structure.

Beyond TARP: Dodd-Frank Act's Executive Compensation Provisions

When SIGTARP asked Special Master Feinberg whether he believed that the companies would adopt elements of OSM's determinations when they are no longer under OSM purview, he answered, "No." He also said that the long-term impact will likely come from the regulators or other authorities.

On July 21, 2010, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), which enhances disclosure and reporting requirements and prohibits certain incentive-based payment arrangements that regulators determine encourage inappropriate risks by covered financial institutions. Specifically, the Dodd-Frank Act requires public companies to disclose in public filings: (1) the median total annual compensation of all employees other than the CEO; (2) the annual total compensation of the CEO or equivalent position; and (3) the ratio between the median compensation of all employees and the CEO's total compensation. The Dodd-Frank Act also requires that public companies make clear disclosures on executive compensation to shareholders in materials for the annual meeting of shareholders, and non-binding shareholder votes to approve executive compensation and certain golden parachutes.

The Dodd-Frank Act's provisions on executive compensation are to be implemented in new regulations by several Federal regulators, and some of those regulators have already implemented or proposed rules.⁴⁴ The Dodd-Frank Act requires that the new Federal regulations require certain financial institutions to disclose the structures of all incentive-based compensation sufficient to determine whether the compensation structure provides an executive officer, employee, director, or principle shareholder with excessive compensation, fees, or benefits, or could lead to material financial loss.⁴⁵ Federal regulators are also required to develop regulations that prohibit any type of incentive-based payment arrangement that the regulators determine encourages inappropriate risk.

⁴⁴ The regulators required to promulgate regulations under this provision of Dodd-Frank include: Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision (agency was abolished in October 2011), the National Credit Union Administration Board, the Securities and Exchange Commission, and the Federal Housing Finance Agency.

⁴⁵ Covered financial institutions include: Depository institutions or depository institution holding companies, broker-dealers, credit unions, investment advisors, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and other financial institutions that the appropriate Federal regulators, jointly, by rule, determine should be treated as covered. However, the requirements do not apply to covered financial institutions with assets of less than \$1 billion.

Conclusions and Recommendations

Treasury created OSM in June 2009 in a charged atmosphere after several major TARP recipients paid billions in bonuses causing a public outrage that resonated with the Administration and Congress. Calling the payment of the bonuses “shameful,” the President on February 4, 2009, announced that the Government would cap the cash salaries of top executives at companies that received “exceptional assistance” under TARP at \$500,000. For seven companies, the amount and nature of their bailout were considered “exceptional.” They were AIG, Bank of America, Citigroup, General Motors, Chrysler, Chrysler Financial, and Ally. Congress also reacted to the bonuses by amending pending Recovery Act legislation to further restrict compensation for top employees of TARP recipients. The Recovery Act’s bonus restrictions did not apply to future awards promised under employment contracts that existed prior to February 11, 2009. In March 2009, after reports that AIG paid \$168 million in employee retention awards under pre-Recovery Act contracts, people picketed the homes of AIG executives, and some employees were threatened. OSM was created in the aftermath of this tumultuous time to rein in excessive compensation at TARP companies. Kenneth Feinberg originally served as the Special Master.⁴⁶ However, OSM’s authority was narrowly limited to setting pay for the Top 25 employees, and approving compensation structures for the Top 26-100, at the seven exceptional assistance TARP companies. OSM’s work had little effect on Citigroup and Bank of America, which quickly exited TARP, in part to avoid OSM’s restrictions. AIG, GM, and Ally currently remain under OSM’s oversight, and lessons learned could affect both how they are treated by OSM and how taxpayers are protected in the event of a future crisis.

SIGTARP found that the Special Master could not effectively rein in excessive compensation at the seven companies because he was under the constraint that his most important goal was to get the companies to repay TARP. Although generally he limited cash compensation and made some reductions in pay, the Special Master still approved total compensation packages of cash and stock in the millions. The Special Master was operating under inherently inconsistent principles. 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. Feinberg testified before Congress that “Congress felt that the single most important thing I could do is get those seven companies to repay the taxpayer. ... Secretary Geithner made that clear. Congress made that clear. The Administration made

⁴⁶ Feinberg was succeeded by Patricia Geoghegan, who currently serves as Acting Special Master.

that clear.” He also testified that the tension between reining in executive compensation while allowing necessary compensation was a very difficult task.

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 partial Government ownership, the companies argued that their proposed pay packages were necessary to retain or attract employees who were crucial to the company paying back TARP. For example, in 2009, AIG proposed cash raises for several of its Top 25 employees and the ability to sell stock salary immediately. Ally officials also pushed for high pay, despite knowing that Feinberg was concerned that a majority of the company’s Top 25 employees were part of the problem that resulted in Ally’s need for a bailout. 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.” In a few rare instances, the companies took it upon themselves to limit pay. In 2010, Ally’s board told the new CEO that he would be paid stock but no cash. Citigroup’s CEO told Congress that he would only take \$1 in cash salary.

Under conflicting principles and pressures, despite reducing some pay, 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 over the 2009 to 2011 period for 49 individuals. In trying to keep the companies competitive, the Special Master told SIGTARP that the “obvious” starting point was to set total compensation at the 50th percentile for similarly situated employees. The decision to use the 50th percentile appeared to be based on OSM staff’s experience with setting executive compensation rather than on empirical evidence. Attempting to keep employees’ “skin in the game,” OSM apportioned total pay between cash and stock, using what Feinberg called a “prescription” that cash salaries should not exceed \$500,000, except for good cause.⁴⁷ According to OSM, in some instances it was appropriate to increase cash salary. Although OSM developed general prescriptions, OSM did not have any established criteria

⁴⁷ OSM approval was not required for proposed annual compensation structures of no more than \$500,000 (apart from long-term restricted stock, as defined in the IFR) for employees in the Top 26-100.

for applying those prescriptions at the beginning of the process. Because there were so many differences in the companies' situations, companies pushed back on the general prescriptions and OSM made many exceptions to the general prescriptions on a case-by-case basis.

Some companies pushed back on OSM by claiming that their compensation should be higher than the 50th percentile. The companies' beliefs may relate to what has been called the "Lake Wobegon Effect," named after radio host Garrison Keillor's fictional hometown, where "all the children are above average." OSM officials told SIGTARP, "If they were better than the 50th percentile, they wouldn't be having discussions with OSM in the first place." Although there is debate over whether the 50th percentile is appropriate, SIGTARP was unable to determine whether OSM consistently applied the 50th percentile criterion because OSM did not maintain complete records of the market-based data it used.

SIGTARP found that although the Special Master created a prescription that cash salaries should not exceed \$500,000 except for good cause, companies proposed that their employees be paid higher cash salaries, claiming that the employees were critical to the company's success. For 10 employees in 2009, and 22 employees in 2010 and 2011, GM, Chrysler Financial, Ally, and AIG convinced OSM to approve cash salaries greater than \$500,000 each.⁴⁸ With the exception of Bank of America's retiring CEO, the Special Master approved cash salaries in excess of \$500,000 for the CEO of each company who asked for a higher salary and approved millions of dollars in CEO stock compensation. SIGTARP also found that OSM was inconsistent in approving cash salaries in excess of \$500,000. For at least GM and Ally, OSM picked a "ballpark number" of employees who could be paid more than \$500,000 in cash and left it to the companies to choose those employees. According to GM officials, for some employees, OSM adjusted salaries down to just under \$500,000.

AIG's proposed compensation for its Top 25 employees did not reflect in any way the unprecedented nature of AIG's taxpayer-funded bailout and the fact that taxpayers owned a majority of the company. AIG's proposed compensation was excessive. In 2009, AIG wanted cash salary raises ranging from 20% to 129% for one group of employees and from 84% to 550% for another group. AIG proposed high cash salaries, even though all but two of the 13 employees⁴⁹ in the Top 25 were scheduled to receive significant retention awards and other payments under pre-Recovery Act contracts. AIG proposed pay comparable to Goldman Sachs, JPMorgan, and Morgan Stanley.⁵⁰ In 2010, AIG again proposed significant

⁴⁸ Not all four companies received approval for cash salaries greater than \$500,000 each year.

⁴⁹ Often the "Top 25" in a company had fewer than 25 employees because some had left the company.

⁵⁰ AIG also proposed that heads of its business units be paid in the 50th to 75th percentile of pay for CEOs of other companies, which OSM rejected. SIGTARP was unable to test whether the 50th percentile was appropriately applied to AIG because of the lack of OSM documentation.

increases in cash salaries, and asked that nine employees be paid more than \$500,000 in cash, and that three employees receive cash raises of 100% to 140% over the salaries approved by OSM in 2009.

Feinberg told SIGTARP that AIG was anti-stock salary and wanted to pay employees in cash. Feinberg said that in his 2009 discussions with AIG, AIG officials indicated that its common stock was essentially worthless. Feinberg told COP that AIG common stock “wasn’t worth enough to appropriately compensate top officials.” Feinberg told SIGTARP that OFS stressed that the stock salary and grandfathered contracts would jeopardize AIG. Feinberg told SIGTARP that he was pressured by other senior Treasury officials and was told to be careful, that AIG owed a fortune, and that Treasury did not want it to go belly up.⁵¹ He further stated that Treasury officials felt those amounts were relatively small compared to the Government’s exposure in AIG. Despite these pressures, Feinberg said that no one trumped his decisions.

CEO Benmosche explained to SIGTARP the reasoning for AIG’s decision not to restructure the awards in 2009: “I got a message that Ken [Feinberg] had a desire to take away retention payments. I had to make sure my people got paid. ... I had 10 senior executives that lost \$168 million in pay. We had people that were completely wiped out when the stock fell. ... The stock didn’t have any value to the employees, as these people were getting stock that they couldn’t sell because it was not vested. Ken Feinberg wanted to be able to tell Congress that no retention payments would be paid. But the retention payments were the only way to pay and keep people. They were not retention payments per se, but they were bonuses that they would have normally got ... [AIG]FP was the primary cause, but everybody lost. I told him you can’t cut salaries so much and put pensions in long-term stock – people need something to live on ... We succeeded in keeping all retention payments. The penalty was very low salaries.”

Senior Treasury officials helped AIG develop a “phantom” stock based on AIG’s valuable subsidiaries. Although Treasury officials were involved to protect taxpayers’ investment in AIG, AIG stood out as the only one of the seven companies in which senior Treasury officials intervened in OSM’s process. It appeared to be due to the sheer size of the Government’s investment and requests by AIG’s CEO that the officials intervened. Feinberg approved the use of phantom stock for stock salary as part of six employees’ pay packages in 2009, citing the need for employee retention. Feinberg then agreed to AIG’s request to use AIG common stock for stock salary. In 2010, AIG requested approval to use something other than AIG common stock, proposing a hybrid security. In 2011, AIG proposed using AIG common stock for pay, citing Treasury’s plans to

⁵¹ For details regarding the Government’s investment in AIG and the firm’s recapitalization plan, see Appendix D.

restructure the Government's investment in AIG from preferred stock to common stock, and later sell the common stock in the market.

In 2009, OSM approved total compensation of cash and stock of more than \$1 million each for five AIG employees. This included the largest pay package and cash salary ever approved by the Special Master – a \$10.5 million pay package for AIG's new CEO that included a \$3 million cash salary. OSM approved compensation ranging from \$4.3 million to \$7.1 million each for four AIG employees who that year were also scheduled to receive cash retention awards of up to \$2.4 million. For the other eight AIG employees, OSM approved pay packages that fell well under \$1 million. OSM was tough on employees of AIGFP, the unit whose losses contributed to the need for Government intervention. For five AIGFP employees who were scheduled to receive retention awards of up to approximately \$4.7 million, OSM froze their salaries at 2007 levels and gave them no stock.

In 2010, OSM also cut AIG's proposed salaries, but compared to 2009, approved much larger compensation packages for AIG's Top 25 employees, despite the fact that 18 of these employees were scheduled to receive retention awards and other payments under pre-Recovery Act contracts. In 2010, OSM approved 21 of AIG's 22 employees to receive between \$1 million and \$7.6 million, with 17 of those pay packages exceeding \$3 million. OSM also approved \$10.5 million in compensation for CEO Benmosche. OSM approved cash salaries over \$500,000 for five employees, and cash salaries ranging from \$442,874 to \$500,000 for 12 employees. OSM approved all but three of AIG's Top 25 employees to receive stock salary ranging from \$1.3 million to \$5.1 million each. Although OSM still froze salaries for AIGFP employees at 2007 levels, OSM approved four AIGFP employees to be paid more than \$3 million in stock salary, and two AIGFP employees to receive \$758,067 and \$1.3 million in stock salary. OSM generally approved these same pay packages for 2011 for AIG, which included the CEO's same compensation as in earlier years, compensation packages of \$8 million each for two employees, compensation packages of \$7 million each for two employees, and compensation packages of \$5 million to \$6.3 million each for seven employees.

OSM's pay determinations are not likely to have long lasting impact at the seven TARP exceptional assistance companies or other companies. OSM's jurisdiction is fleeting, disappearing once the firm is no longer a recipient of exceptional assistance under TARP. It is already clear that OSM's decisions on compensation had little effect on two of the nation's largest banks. After being subject to OSM's review from October 22, 2009, to December 31, 2009, Citigroup and Bank of America exited TARP, in part to escape OSM's compensation restrictions. Once out of TARP, salaries and bonuses climbed. According to a report by COP, Citigroup paid its named officers annual stock salary ranging from

\$4.2 million to \$9 million each and the top 15 executives received a total of \$50 million in stock bonuses. Bank of America discarded the \$500,000 cash salary cap and increased the cash salary of its CEO and other executives. Bank of America paid four of its executive officers a total of \$35.7 million in long-term incentive awards.

Despite once hoping to change the compensation regime at the seven companies and have his determinations serve as a useful model for other companies, Feinberg told SIGTARP that he did not expect that the seven companies would adopt elements of OSM's compensation determinations when they are no longer under TARP. Today, only AIG, GM, and Ally remain subject to OSM's review. CEOs at AIG and GM told SIGTARP that they would not maintain OSM's practices once their company exits TARP. OSM has had little ability to influence compensation practices at other companies outside of the seven. Feinberg told SIGTARP that the long-term impact will likely come from regulators.

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. Treasury Secretary Timothy F. Geithner testified before COP that executive compensation played a material role in causing the crisis because it encouraged excessive risk taking.

As a nation, we are not out of the woods because many former TARP companies remain as systemically important financial institutions ("SIFIs"). These companies have a responsibility to reduce risk taking that could trigger systemic consequences, including excessive cash compensation and other compensation not tied to long-term performance. The Dodd-Frank Act requires regulations on executive compensation and other regulations for SIFIs. These regulations may force these companies to change their compensation practices, but the regulations required under the Dodd-Frank Act are not final, and their effectiveness remains to be seen. 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.

Recommendations

1. To ensure that the Office of the Special Master for TARP Executive Compensation consistently grants exceptions to the \$500,000 cash salary cap, the Office of the Special Master should substantiate each exception requested and whether the requests demonstrate or fail to demonstrate “good cause.”
2. The Office of the Special Master should better document its use of market data in its calculations. At a minimum, the Office of the Special Master should prospectively document which companies and employees are used as comparisons in its analysis of the 50th percentile of the market, and it should also maintain records and data so that the relationship between its determinations and benchmarks are clearly understood.
3. The Office of the Special Master should develop more robust policies, procedures, or guidelines to help ensure that its pay determination process and its decisions are evenhanded. These measures will improve transparency and help the Office of the Special Master consistently apply the Interim Final Rule principles of “appropriate allocation,” “performance-based compensation,” and “comparable structures and payments.”

Management Comments

Treasury through the Office of the Special Master for TARP Executive Compensation provided an official written response to this report in a letter dated January 20, 2012, which is reproduced in full in Appendix G. OSM's letter states that SIGTARP's report "provides a useful and detailed historical review of OSM's efforts." OSM states it is succeeding in achieving its mission and restates comments previously made public in OSM releases.

OSM agreed with SIGTARP's first two recommendations and said that it will memorialize in its records its justification for approving or disapproving each specific request for a cash salary in excess of \$500,000, and that it already has begun to preserve the market data on which it relies. As to SIGTARP's third recommendation, OSM asserted that SIGTARP's report insufficiently acknowledges the policies, procedures, and guidelines that OSM developed and outlined in its Top 25 determination letters and accompanying fact sheets for each of 2009, 2010, and 2011. OSM stated that it "will carefully focus on how it can further develop and articulate its policies, procedures, and guidelines."

SIGTARP's report explicitly acknowledges those documents, by stating "OSM's methodology and criteria were explained in several different documents – the institution-specific determination letters, a 'fact sheet' summarizing some key steps and decisions, and a three-page document issued several months later – but the documents do not completely lay out OSM's process, methodology, and criteria." Each of these documents must be pieced together to determine OSM's methodology, and even then the documents do not completely set forth OSM's process, methodology, and criteria. For example, it is not clear in any of those documents how OSM determines a similarly situated company. Those documents also do not address OSM's criteria for approving cash salaries over \$500,000. Clear policies, procedures, and guidelines that set forth the rationale for OSM's decision making promote consistency and accountability, and are necessary in order to permit effective oversight.

OSM's letter response makes three statements with which SIGTARP strongly disagrees: (1) the report fails to highlight the use of stock-based compensation; (2) the report mischaracterizes OSM's \$500,000 guideline on cash salaries; and (3) the report incorrectly describes OSM's decisions with respect to stock salary at AIG and other companies.

First, in many instances, the report states that OSM used stock-based compensation. The report states that OSM tried to shift compensation packages “away from large cash salaries and toward stock.” The report describes OSM’s three-step methodology, stating, “To tie individual compensation to long-term company success, OSM used long-term restricted stock contingent on the employee achieving specific performance criteria.” OSM’s specific determinations that included stock-based compensation are described in detail in the report.

Second, the report does not mischaracterize OSM’s \$500,000 guideline on cash salaries. According to its letter response, OSM claims a mischaracterization on the basis that “the \$500,000 target was a discretionary guideline that OSM adopted, not a provision of any statute or regulation.” However, this statement is not contrary to anything in the report. Further, OSM stated in its response, “When companies requested executives be paid cash salaries above \$500,000, OSM required justifications for each individual case, and, without exception, made the final decision on the amount of each element of compensation after a detailed review and analysis.”

The report does not mischaracterize the \$500,000 figure by stating that it was a provision of a statute or regulation or that it was not in OSM’s discretion. The report explicitly states on page 1, “The economic stimulus legislation did not contain a \$500,000 limitation, nor did the Treasury rules.” The report states that OSM developed what Special Master Feinberg called a “prescription,” explicitly stating, “OSM set cash salaries using an OSM prescription that generally salaries should not exceed \$500,000 per year, except for good cause shown.” The report states, “The decision to limit cash salaries to \$500,000 and to increase the proportion of compensation in the form of stock, Feinberg said, was his decision to strike a balance between reducing excessive risk and providing enough compensation to keep employees’ ‘skin in the game.’” The report also states, “Special Master Feinberg told SIGTARP that he applied criteria with a ‘healthy dose of discretion’ for company-specific circumstances.”

The report also does not mischaracterize OSM’s decision making on cash salaries over \$500,000. The report states, “The Special Master told SIGTARP that it was always his decision to approve cash salaries of more than \$500,000, based on names, circumstances, and empirical data.” However, as stated in the report, “Ally executives told SIGTARP that OSM gave them a ‘ballpark number’ of two to four employees who could be paid more than \$500,000 in cash salary and that the CEO selected the employees.” This process is also borne out in internal OSM e-mails. In one email noted in the report, Special Master Feinberg questioned OSM

staff: “Can we (should we?) permit GM to go above \$500,000 with a few? ... Which ones? Or should I just get to her and tell her we can’t do it?” As stated in the report, “OSM responded to the Special Master: ‘With respect to GM, we told them a maximum of five above \$500K and four at \$500K. We left it to them to decide which individuals would be taken down to comply with those restrictions.’” To the extent that OSM engaged in detailed analysis and review of these individuals picked by the companies, the report found a lack of documentation supporting why OSM approved the salary. There was a lack of detail in the justification, with several of OSM’s justifications listed as “No Change” and “Critical to Turnaround.” OSM has agreed to remedy these findings by agreeing to SIGTARP’s first recommendation.

Third, contrary to OSM’s assertions, the report correctly describes OSM’s decisions with respect to stock salary at AIG and the other companies. According to its letter, OSM’s basis for that assertion was that OSM “did not dictate the form that the stock salary would take.” OSM also states in its response that five of six companies proposed using common stock as part of the compensation packages, that AIG “proposed different structures of AIG stock salary,” that “all of these structures complied with Treasury’s rule,” and that “ultimately the company used a hybrid stock salary structure only for 2010.” These statements are not contrary to any statement in the report. The report does not say that OSM dictated the form that the stock salary would take, or that the salary structures did not comply with Treasury’s rule. The report brings transparency to the fact that it was AIG and other Treasury officials who came up with the form of AIG stock salary, not Special Master Feinberg. For example, the report notes that Jim Millstein, Treasury’s then-head of restructuring for AIG, told SIGTARP that he helped develop a “phantom stock,” which did not exist, for purposes of stock-based compensation, even though AIG had common stock. The report does not find that the phantom stock was contrary to any Treasury rule, but rather refers to the phantom stock as a “different form of stock salary,” the very description OSM gave in their response to this evaluation. Although the report makes it clear that ultimately the company only used a hybrid stock salary for 2010, it also discusses that OSM initially approved the phantom stock salary for six AIG executives in a written letter of October 22, 2009, that OSM published. In a December 21, 2009, supplemental determination letter to AIG, the Special Master granted AIG’s new request to pay the employees with AIG common stock.

Appendix A – Scope and Methodology

We performed this evaluation under the authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978, as amended. SIGTARP reviewed the Special Master's decisions on executive compensation at companies receiving exceptional financial assistance from the U.S. Government. Pursuant to the June 2009 Interim Final Rule, the Special Master must review proposed compensation structures and payments for senior executive officers and the 20 next most highly compensated employees. Our specific reporting objectives were to assess the criteria used by the Office of the Special Master for TARP Executive Compensation ("OSM") to evaluate executive compensation, and assess whether the criteria were consistently applied to all companies that received exceptional assistance. We performed work at SIGTARP in Washington, D.C. We also conducted field interviews with current and former Government officials and executives from companies that received exceptional financial assistance, in Washington, D.C., Florida, North Carolina, Michigan, and New York. SIGTARP conducted this evaluation between November 2009 and December 2011. The scope of this evaluation covered the Special Master's Top 25 determination process for 2009, 2010, and 2011.

To assess the criteria used by OSM to evaluate executive compensation, we reviewed the Emergency Economic Stabilization Act of 2008, the American Recovery and Reinvestment Act of 2009, and Treasury's Interim Final Rule. SIGTARP also reviewed testimony of the Special Master to identify other key rules that the Special Master used in the compensation determination process. Through interviews with the Special Master and OSM staff, and executives of companies that received exceptional financial assistance, SIGTARP documented the Special Master's Top 25 determination process and evaluated how the criteria were used by OSM. We also requested OSM's policies and procedures to determine the extent to which policies and procedures existed and to evaluate sufficiency.

To assess whether the criteria were consistently applied to all companies that received exceptional financial assistance, SIGTARP analyzed how OSM applied three key prescriptions: to limit cash salaries that employees would receive to \$500,000, unless OSM had good cause for providing employees cash salaries that went above this limit; to ensure OSM tied non-cash compensation to performance and delivered other compensation in stock; and to limit employees' total direct compensation to not more than the median level of total compensation for employees in similar companies who have similar jobs. SIGTARP also reviewed OSM's 2009, 2010, and 2011 determination letters and analyzed compensation data on a company-by-company basis. SIGTARP, through interviews with company executives, also evaluated the impact determinations had on the companies, whether the executive compensation restrictions affected company executives' decisions to repay Government assistance, and whether OSM's framework would elicit lasting change in compensation practices of the companies that were under OSM's jurisdiction, and have since exited TARP.

SIGTARP conducted this evaluation in accordance with the "Quality Standards for Inspection and Evaluation" established by the Council of the Inspectors General on Integrity

and Efficiency. Those standards require that SIGTARP plan and perform the evaluation to obtain evidence sufficient to provide a reasonable basis for findings and conclusions based on the evaluation objectives. SIGTARP believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the evaluation objectives.

Limitations on Data

SIGTARP relied upon Treasury to identify and provide email communication or documents related to the compensation determination process. It is possible that the documentation provided by Treasury did not reflect a comprehensive response to SIGTARP's documentation requests, potentially limiting SIGTARP's review.

Use of Computer-Processed Data

SIGTARP did not use computer-processed data during this evaluation. SIGTARP obtained data from determination letters that are available to the public on Treasury's website.

Internal Controls

To assess internal controls over OSM's determination process, SIGTARP interviewed OSM staff. SIGTARP also requested OSM's policies and procedures and reviewed the documentation to determine the extent to which policies and procedures existed, and whether internal controls were reasonable and effective.

Prior Coverage

On August 19, 2009, SIGTARP issued audit report 09-003, "Despite Evolving Rules on Executive Compensation, SIGTARP Survey Provides Insights on Compliance." This report addresses the efforts of TARP recipients to comply with executive compensation restrictions and plans to comply with subsequently enacted changes in requirements. On October 14, 2009, SIGTARP issued audit report 10-002, "Extent of Federal Agencies' Oversight of AIG Compensation Varied, and Important Challenges Remain." This report addresses the extent of knowledge and oversight by Federal Reserve and Treasury officials over AIG compensation programs and, specifically, retention payments to the AIG Financial Products ("AIGFP") unit. The report also addresses the extent to which executive compensation restrictions or preexisting contractual obligations governed AIGFP retention payments, and the outstanding AIG compensation issues requiring resolution, and Government actions to address them.

Appendix B – Principles of Treasury’s June 2009 IFR

Principle	Definition
Risk	The compensation structure should avoid incentives to take unnecessary or excessive risks that could threaten the value of the TARP recipient, including incentives that reward employees for short-term or temporary increases in value, performance, or similar measure that may not ultimately be reflected by an increase in the long-term value of the TARP recipient. Accordingly, incentive payments or similar rewards should be structured to be paid over a time horizon that takes into account the risk horizon so that the payment or reward reflects whether the employee’s performance over the particular service period has actually contributed to the long-term value of the TARP recipient.
Taxpayer Return	The compensation structure, and amount payable where applicable, should 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.
Appropriate Allocation	The compensation structure should appropriately allocate the components of compensation such as salary, short-term and long-term incentives, as well as the extent to which compensation is provided in cash, equity, or other types of compensation such as executive pensions, 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. The appropriate allocation may be different for different positions and for different employees, but generally, in the case of an executive or other senior-level position, a significant portion of the overall compensation should be long-term compensation that aligns the interest of the employee with the interests of shareholders and taxpayers.
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 TARP recipient 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. The appropriate allocation and the appropriate performance metrics may be different for different positions and for different employees, but generally a significant portion of total compensation should be performance-based compensation, and generally that portion should be greater for positions that exercise higher levels of responsibility.

**Comparable
Structures
and Payments**

The compensation structure, and amount 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.

**Employee
Contribution
to TARP
Recipient
Value**

The compensation structure, and amount payable where applicable, should reflect the current or prospective contributions of an employee to the value of the TARP recipient, 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 TARP recipient.

Appendix C – TARP Expenditures to Seven Companies That Received Exceptional Assistance

TARP EXPENDITURES TO THE SEVEN COMPANIES			
Institution	Investment Program	Expenditure	Description of Initial Expenditure
American International Group	Systemically Significant Failing Institutions	\$67.8 billion	Preferred stock with warrants
Bank of America	Capital Purchase Program	\$25 billion	Preferred stock with warrants
	Targeted Investment Program	\$20 billion	Preferred stock with warrants
Citigroup	Capital Purchase Program	\$25 billion	Preferred stock with warrants
	Targeted Investment Program	\$20 billion	Trust preferred securities with warrants
General Motors	Automotive Industry Financing Program	\$49.5 billion	Debt obligation with additional note
	Auto Warranty Commitment Program	\$0.4 billion	Debt obligation with additional note
	Auto Suppliers Support Program	\$0.3 billion	Debt obligation with additional note
Chrysler	Automotive Industry Financing Program	\$12.5 billion	Debt obligation with additional note, zero coupon note, and equity
	Auto Warranty Commitment Program	\$0.3 billion	Debt obligation with additional note
	Auto Suppliers Support Program	\$0.1 billion	Debt obligation with additional note
Ally Financial (formerly GMAC)	Automotive Industry Financing Program	\$17.2 billion	Convertible preferred stock, preferred stock, and trust preferred securities with exercised warrants, and debt obligation
Chrysler Financial	Automotive Industry Financing Program	\$1.5 billion	Debt obligation with additional note

Source: SIGTARP's Quarterly Report to Congress, October 27, 2011.

Appendix D – AIG's Government Assistance and Recapitalization Plan To Exit TARP

AIG received Government assistance through Treasury's Systemically Significant Failing Institutions Program and from the Federal Reserve Bank of New York ("FRBNY"), as follows:

- On November 25, 2008, Treasury made an initial \$40 billion investment in AIG with the purchase of preferred stock and warrants, and on April 17, 2009, Treasury committed to fund an equity capital facility under which AIG could draw down up to \$29.8 billion⁵² in exchange for additional preferred stock and additional warrants.
- In September 2008, FRBNY extended an \$85 billion revolving credit facility to AIG (later changed to \$60 billion) and later lent \$43.8 billion to two special purpose vehicles ("SPVs")⁵³ established to purchase mortgage-backed securities and collateralized debt obligations.
- On March 2, 2009, Treasury and the Federal Reserve announced a restructuring of Government assistance to AIG that was designed to strengthen the company's capital position. The measures included an authorization for FRBNY to acquire up to \$26 billion of preferred equity interests in two SPVs formed to hold American International Assurance Co., Ltd. ("AIA") and American Life Insurance Company ("ALICO"), two of AIG's largest foreign life insurance subsidiaries.
- On December 1, 2009, FRBNY received \$16 billion in preferred equity interests in the AIA SPV and \$9 billion in the ALICO SPV.
- On December 8, 2010, AIG announced it signed a Master Transaction Agreement regarding a series of integrated transactions to recapitalize AIG.
- On January 14, 2011, AIG completed the series of integrated transactions contemplated under the Master Transaction Agreement to recapitalize AIG with FRBNY and Treasury, including the repayment and termination of FRBNY revolving credit facility, the repurchase and exchange of the SPV preferred equity interests, and the exchange of the series of preferred stock held by Treasury for a new series of preferred stock, Series G, with a related \$2 billion drawdown right, and AIG common stock.
- On May 27, 2011, AIG and Treasury completed the registered public offering of 100 million and 200 million shares of AIG common stock, respectively, at \$29 per share, and the Series G preferred stock and related drawdown right were canceled. As a result of the offering, the

⁵² \$2 billion was canceled for a total of \$27.8 billion in expenditures.

⁵³ FRBNY created Maiden Lane II, an SPV to which FRBNY lent \$19.5 billion to fund the purchase of residential mortgage-backed securities from several AIG subsidiaries. FRBNY created Maiden Lane III, an SPV to which FRBNY lent \$24.3 billion to buy from AIG's counterparties collateralized debt obligations that underlie credit default swap contracts written by AIG.

ownership interest of Treasury was reduced from approximately 92.2% to approximately 76.7% of AIG common stock.

Appendix E – Acronyms and Abbreviations

Acronym/Abbreviation	Definition
AIA	American International Assurance Co., Ltd.
AIG	American International Group, Inc.
AIGFP	AIG Financial Products unit
ALICO	American Life Insurance Company
Ally	Ally Financial Inc., formerly GMAC, Inc.
Bank of America	Bank of America Corporation
CEO	chief executive officer
CFO	chief financial officer
Chrysler	Chrysler Holding LLC
Chrysler Financial	Chrysler Financial Services Americas LLC
Citigroup	Citigroup Inc.
COP	Congressional Oversight Panel
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
EESA	Emergency Economic Stabilization Act of 2008
FRBNY	Federal Reserve Bank of New York
GM	General Motors Corporation
IFR	Interim Final Rule
OFS	Office of Financial Stability
OSM	Office of the Special Master for TARP Executive Compensation
Recovery Act	American Recovery and Reinvestment Act of 2009
SEOs	senior executive officers
SIFIs	systemically important financial institutions
SIGTARP	Office of the Special Inspector General for the Troubled Asset Relief Program
SPV	special purpose vehicles
TARP	Troubled Asset Relief Program
TIP	Targeted Investment Program
USC	University of Southern California

Appendix F – Evaluation Team Members

This evaluation was conducted and the report was prepared under the direction of Kurt Hyde, Deputy Inspector General for Audit and Evaluation, and Kimberley A. Caprio, Assistant Deputy Special Inspector General for Audit and Evaluation, Office of the Special Inspector General for the Troubled Asset Relief Program.

Staff members who conducted the evaluation and contributed to the report include Craig Meklir, Clayton W. Boyce, Michelle Mang, Meredith McDaniel, Daniel Ben-Zadok, and Vonda Batts.

Appendix G – Agency Comments



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

January 20, 2012

Christy L. Romero
Deputy Special Inspector General
For the Troubled Asset Relief Program
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Re: Response to SIGTARP's Draft Audit Report: "The Special Master's
Determinations for Executive Compensation of Companies Receiving
Exceptional Assistance Under TARP"

Dear Ms. Romero:

I write in response to your draft audit report, *The Special Master's Determinations for Executive Compensation of Companies Receiving Exceptional Assistance Under TARP*, dated January 17, 2012. The Department of the Treasury (Treasury) appreciates the Special Inspector General's (SIGTARP's) review of the Office of the Special Master for TARP Executive Compensation's (OSM's) compensation determinations for companies receiving exceptional assistance under the Troubled Asset Relief Program (TARP). This letter provides Treasury's official response to the SIGTARP audit report.

The Office of the Special Master

In response to the financial crisis, Congress passed legislation—the Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009—that imposed restrictions on compensation for all companies receiving assistance under TARP to help ensure taxpayer funds did not subsidize compensation packages that encouraged excessive risk-taking. In June 2009, Treasury promulgated rules implementing this legislation.¹ The rules created OSM and charged it with reviewing and approving the compensation of the top 25 executives at the seven companies that received exceptional TARP assistance.²

The Treasury rules required OSM to apply six principles in making its compensation determinations, and gave the Special Master discretion to apply them to each individual set of facts and circumstances.³ OSM often had to balance these principles to achieve its goal—to

¹ See the June 10, 2009 Interim Final Rule, TARP Standards for Compensation and Corporate Governance.

² Those firms were Ally Financial (formerly GMAC), AIG, Bank of America, Chrysler, Chrysler Financial, Citigroup, and GM.

³ The principles included: avoiding incentives to take excessive risk, maximizing the company's ability to repay the taxpayer, appropriately allocating the components of compensation, using performance-based compensation,

construct compensation packages that not only limited executive pay and discouraged excessive risk-taking, but also enabled companies to recruit and retain executives so the seven companies could remain competitive and ultimately repay the taxpayer.

In general, OSM's determinations resulted in compensation packages that shared certain qualities and characteristics: a relatively limited amount of cash salary, usually not to exceed \$500,000; stock salary that vested on each payroll date but that could only be transferred over a three- or four-year period; and a limited amount of stock-based incentive compensation that was dependent on performance goals and continued service with the company. OSM has posted all its determinations and fact sheets online, for public review, at www.financialstability.gov (click on "Executive Compensation").

OSM's Achievements

The facts clearly demonstrate that OSM has succeeded in achieving its mission. Our office was effective at limiting compensation at the seven companies over which it had authority, while ensuring the companies were well-positioned to pay back the taxpayers' investments.

- OSM cut average cash compensation for the top 25 executives at the seven companies that received exceptional TARP assistance by more than 90 percent.
- OSM reduced average total compensation for the top 25 executives at the seven companies by more than 50 percent.
- Overall, more than 80 percent of compensation for the top 25 executives at the covered firms was payable in the form of stock-based compensation.⁴ This helps ensure compensation is tied to long-term performance.
- More than 74 percent, or \$260 billion, of the \$350 billion disbursed or committed to the firms OSM oversaw through TARP and, in the case of AIG, the Federal Reserve Bank of New York (FRBNY) has already been returned to taxpayers.⁵
- Four of the seven companies that received exceptional assistance – Bank of America, Citigroup, Chrysler Financial and Chrysler – have exited TARP entirely.
- And we have already begun exiting our investments in Ally Financial, AIG, and GM.

OSM's work also helped lay the foundation for broader reforms to executive compensation by Congress, federal regulators, and global financial leaders.

employing pay structures and amounts that are consistent with those at comparable entities, and basing pay on an employee's contribution to the value of the TARP recipient enterprise.

⁴ This figure excludes Chrysler Financial (where unique circumstances precluded the use of stock compensation).

⁵ This total includes investments in AIG of \$69.8 billion by TARP and \$112 billion by FRBNY for a total of approximately \$182 billion.

The Dodd-Frank Wall Street Reform and Consumer Protection Act requires public companies to give shareholders a “say on pay” and strengthens compensation committees’ independence. The Dodd-Frank Act also requires federal regulators jointly to develop regulations that prohibit any incentive-based payment arrangements that the regulators determine encourage inappropriate risk. The regulators have proposed rules including a requirement that financial institutions having more than \$50 billion in assets defer at least 50 percent of incentive compensation of executive officers over three years and make the deferred amount subject to downward adjustment during that period. Effective implementation of these provisions is critical to helping prevent irresponsible risk-taking in the financial sector going forward.

Internationally, the G-20 has endorsed standards intended to align compensation practices with long-term value creation and financial stability, and these standards are being implemented worldwide.

SIGTARP’s Report

Your report provides a useful and detailed historical review of OSM’s efforts. However, three specific areas raise concerns:

- *The report fails to highlight the most important structural feature of OSM’s compensation packages—the use of stock-based compensation that ties pay to performance.* In nearly all cases where OSM reviewed an individual’s compensation, OSM required that a significant portion of compensation be in the form of stock salary. This emphasis on long-term stock-based compensation rather than guaranteed cash helped link compensation to long-term performance.
- *The report mischaracterizes OSM’s \$500,000 guideline on cash salaries.* The \$500,000 target was a discretionary guideline that OSM adopted, not a provision of any statute or regulation. When companies requested executives be paid cash salaries above \$500,000, OSM required justifications for each individual case and, without exception, made the final decision on the amount of each element of compensation after a detailed review and analysis. In instances where cash salary was permitted to exceed the guideline, OSM required that stock tied to long-term performance make up the vast majority of overall compensation. Other than Chrysler Financial, the executives who were permitted cash salaries above \$500,000 received, on average, 77 percent of their 2009 total direct compensation in the form of stock. They received 79 percent and 81 percent of their total direct compensation in the form of stock in 2010 and 2011, respectively.
- *The report incorrectly describes OSM’s decisions with respect to stock salary at AIG and the other companies.* OSM mandated that six of the seven exceptional assistance companies use stock salary as a large component of their pay packages. But it did not dictate the form that the stock salary would take. Five of the six companies proposed to use common stock as the basis of their stock salary and OSM approved their proposals. AIG and its advisors proposed different structures of AIG stock salary in light of the challenges facing the company; it was not clear that AIG would survive rather than be broken up. All of these structures complied with the Treasury rule. Ultimately, the

company used a hybrid stock salary structure only for 2010, and used common stock in all other years. Officials at Treasury and FRBNY worked with AIG to restructure the company and, as a result, assistance (originally \$182 billion) is down to \$50 billion by Treasury and \$16.5 billion from FRBNY, and the government now has a pathway to exit.

SIGTARP's Recommendations

Your report offers three recommendations. We agree with your first recommendation. OSM will memorialize in its records its justification for approving or disapproving each specific request for a cash salary in excess of \$500,000. We also agree with your second recommendation. OSM already has begun to preserve the independent market data on which it relies to evaluate the market data submitted by the companies.

As for your third recommendation, we agree that it is important to have policies and procedures in place, but think that your report insufficiently acknowledges the policies, procedures, and guidelines that OSM developed and outlined in its top 25 determination letters and accompanying fact sheets for each of 2009, 2010 and 2011, which are publicly available at www.financialstability.gov. Nevertheless, OSM will carefully focus on how it can further develop and articulate its policies, procedures, and guidelines.

Thank you for the opportunity to respond to the report. OSM has benefitted from the input we have received from the SIGTARP team over the course of the audit review, and we appreciate the insights you have provided.

Sincerely,



Patricia Geoghegan
Acting Special Master
for TARP Executive Compensation

SIGTARP Hotline

If you are aware of fraud, waste, abuse, mismanagement, or misrepresentations associated with the Troubled Asset Relief Program, please contact the SIGTARP Hotline.

By *Online Form*: www.SIGTARP.gov

By *Phone*: Call toll free: (877) SIG-2009

By *Fax*: (202) 622-4559

By *Mail*:

**Hotline: Office of the Special Inspector General
for the Troubled Asset Relief Program**
1801 L Street., NW, 3rd Floor
Washington, D.C. 20220

Press Inquiries

If you have any inquiries, please contact our Press Office:

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Obtaining Copies of Testimony and Reports

To obtain copies of testimony and reports, please log on to our website at www.SIGTARP.gov.

