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U.S. SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS  
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS  
AND CONSUMER PROTECTION

**STATEMENT OF KURT HYDE**  
**DEPUTY SPECIAL INSPECTOR GENERAL**  
**AUDIT AND EVALUATION**  
**OFFICE OF THE SPECIAL INSPECTOR GENERAL**  
**FOR THE TROUBLED ASSET RELIEF PROGRAM**

BEFORE THE  
U.S. SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS  
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS  
AND CONSUMER PROTECTION

FEBRUARY 15, 2012

Chairman Brown, Ranking Member Corker, and members of the Committee, I am honored to appear before you today to discuss compensation practices at the largest financial institutions.

The Office of the Special Inspector General for the Troubled Asset Relief Program (“SIGTARP”) is charged with conducting, supervising, and coordinating audits and investigations of the purchase, management, and sale of assets under the Troubled Asset Relief Program (“TARP”). SIGTARP’s mission is to promote economic stability through transparency, robust enforcement, and coordinated oversight. In fulfilling its mission, SIGTARP protects the interests of those who funded TARP programs – American taxpayers.

This Committee is committed to examining an important and timely issue, the historical structure of financial sector pay practices, the role that these practices played in the financial crisis, and ongoing efforts to reform financial sector pay packages. As part of its mission of transparency, SIGTARP has shed light on the details of some of the largest institutions’ pay practices and the Government’s decision-making in this area, including determinations made by the Office of the Special Master for Executive Compensation (“OSM”) on pay for companies that had received funds under TARP programs designated as “exceptional assistance.” For example, we released an audit report detailing the efforts by Federal banking regulators and Treasury to get the largest banks out of TARP. In that audit we highlighted that Bank of America Corporation (“Bank of America”) and Citigroup, Inc. (“Citigroup”) exited TARP’s exceptional assistance program known as the Targeted Investment Program, citing a desire to be outside of the jurisdiction of OSM.<sup>1</sup> In that audit, SIGTARP reported that Citigroup’s CEO told

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<sup>1</sup> SIGTARP, “Exiting TARP: Repayments by the Largest Financial Institutions” issued September 29, 2011, [http://www.sigtar.gov/reports/audit/2011/Exiting\\_TARP\\_Repayments\\_by\\_the\\_Largest\\_Financial\\_Institutions.pdf](http://www.sigtar.gov/reports/audit/2011/Exiting_TARP_Repayments_by_the_Largest_Financial_Institutions.pdf)

SIGTARP that the desire to escape management compensation restrictions was a factor in motivating Citigroup's desire to exit TARP. The report also states that Sheila Bair, then-Chairman of the Federal Deposit Insurance Corporation ("FDIC"), worried that Citigroup's request to terminate its asset guarantee, another form of exceptional assistance it received under TARP, was "all about compensation." As noted in the audit, two of Bank of America's former executives 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. Former Special Master Kenneth R. Feinberg testified before the Congressional Oversight Panel ("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.

Last month, SIGTARP published a report, "The Special Master's Determinations for Executive Compensation of Companies Receiving Exceptional Assistance Under TARP," which examined executive compensation determinations made by OSM for the Top 25 employees at seven companies receiving exceptional assistance under TARP.<sup>2</sup> SIGTARP reviewed the process designed by OSM to set pay packages and OSM's decisions on compensation for the Top 25 employees at the seven companies. 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.

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<sup>2</sup> SIGTARP, "The Special Master's Determinations for Executive Compensation of Companies Receiving Exceptional Assistance Under TARP," issued January 23, 2012, [www.sigtar.gov/reports/audit/2012/SIGTARP\\_ExecComp\\_Audit.pdf](http://www.sigtar.gov/reports/audit/2012/SIGTARP_ExecComp_Audit.pdf).

## **SIGTARP’s Review of Executive Compensation Determinations Made by the Office of the Special Master for TARP Compensation**

When Congress created 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 OSM. Kenneth R. Feinberg served as the Special Master and was succeeded by Patricia Geoghegan, who is the Acting Special Master.

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, 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 was required to determine whether compensation structures and payments were inconsistent with the TARP legislation or were otherwise contrary to the public interest by using his discretion to apply 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. Special Master Feinberg told SIGTARP that these criteria are inherently inconsistent because of conflicting goals and company-specific circumstances. He explained that the criteria are 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 COP that the clear direction given to him was that the most important goal was to get these seven companies to repay TARP.

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. 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.

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 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.

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. On October 28, 2010, Feinberg testified to the U.S. House of Representatives Committee on Oversight and Government Reform that for 2009 pay, six of the seven companies’ compensation proposal submissions would result in payments contrary to the public interest, and should, therefore, be rejected.<sup>3</sup> Special Master Feinberg testified that the companies requested excessive cash salaries and bonuses; stock compensation that could be immediately or quickly 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.

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, in 2009, AIG proposed cash raises for several of its Top 25 employees and the ability to sell stock salary immediately. 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. 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

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<sup>3</sup> The seventh company was Chrysler Financial.

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 take only \$1 in cash salary.

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 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.

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, with any additional compensation in the form of stock salary or long-term restricted stock.<sup>4</sup> In testimony to the House Committee on Oversight and Government Reform, the Special Master said that he used stock salary to

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<sup>4</sup> The economic stimulus legislation did not contain a \$500,000 cash salary limitation, nor did the Treasury rules.

encourage senior executives to remain at the companies to maximize their benefit from the profitability of the company. To tie individual compensation to long-term company success, OSM used long-term restricted stock contingent on the employee achieving specific performance criteria. 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. 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 against 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 testified before 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. Chrysler, Citigroup, and Ally executives said they would not fully follow the Special Master's determination framework after they exited TARP. 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.

## **The Role of Executive Compensation in the Financial Crisis**

In the years preceding the financial crisis, employee compensation at large financial institutions increased significantly. The Financial Crisis Inquiry Commission (“FCIC”) reports that pretax profit for the five largest investment banks doubled between 2003 and 2006 (from \$20 billion to \$43 billion), and total employee compensation at these investment banks increased from \$34 billion to \$61 billion. According to the FCIC, in 2007 Wall Street paid workers in New York approximately \$33 billion in year-end bonuses alone, and total compensation for the major U.S. banks and securities firms was estimated at approximately \$137 billion.<sup>5</sup>

Federal regulators have stated that compensation structures and practices at the largest financial institutions contributed to the financial crisis. Chairman of the Board of Governors of the Federal Reserve System (“Federal Reserve”) Ben S. Bernanke stated that compensation structures “led to misaligned incentives and excessive risk taking, contributing to bank losses and financial instability.”<sup>6</sup> Treasury Secretary Timothy F. Geithner testified before COP that executive compensation played a “material role” in causing the financial crisis because it encouraged excessive risk taking.<sup>7</sup> At the January 2010 FDIC Board meeting, then-FDIC Chairman Sheila Bair stated that “there is such an overwhelming amount of evidence” that compensation practices at the largest financial institutions were “clearly a contributor to the crisis and to the losses that we are suffering.”<sup>8</sup> In addition, in its October 2011 report on incentive compensation practices, the Federal Reserve stated that “risk-taking incentives

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<sup>5</sup> Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report*, Jan. 2011 (online at [fcic.law.stanford.edu](http://fcic.law.stanford.edu)).

<sup>6</sup> Board of Governors of the Federal Reserve System, press release (Oct. 22, 2009) (online at [www.federalreserve.gov/newsevents/press/bcreg/20091022a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20091022a.htm)).

<sup>7</sup> Congressional Oversight Panel, Testimony of Timothy F. Geithner, Secretary, U.S. Department of the Treasury, *Transcript: COP Hearing with Treasury Secretary Timothy Geithner* (Dec. 16, 2010) (online at [cybercemetery.unt.edu/archive/cop/20110402013346/http://cop.senate.gov/documents/transcript-121610-geithner.pdf](http://cybercemetery.unt.edu/archive/cop/20110402013346/http://cop.senate.gov/documents/transcript-121610-geithner.pdf)).

<sup>8</sup> Meeting of the Board of the Federal Deposit Insurance Corporation (Jan. 12, 2010).

provided by incentive compensation arrangements in the financial services industry were a contributing factor to the financial crisis that began in 2007.”<sup>9</sup> Financial institutions have also identified compensation practices as a contributing cause of the financial crisis. In a 2009 survey conducted on behalf of the Institute of International Finance, of the 37 large banking organizations engaged in wholesale banking activities that responded, 36 agreed that compensation practices were a factor underlying the financial crisis.<sup>10</sup>

One area of particular concern are incentive compensation structures for non-senior employees who can expose the firm to substantial risk that do not align the employees’ interests with those of the institution. According to the Federal Reserve’s October 2011 report, incentive compensation practices may pose safety and soundness risks if not properly structured. The Federal Reserve report stated that before the crisis, most large firms whose compensation practices were reviewed by the Federal Reserve focused only on risk-based incentives for a small number of senior highly paid employees, and no firm systemically identified the relevant employees who could influence risk.<sup>11</sup> The Federal Reserve reported in October 2011 that many of the large financial institutions have since determined that they have “thousands or tens of thousands” of employees, who individually or as a group, are able to take or influence material risks, including mortgage originators, commercial lending officers, or traders.<sup>12</sup>

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<sup>9</sup> Board of Governors of the Federal Reserve System, *Incentive Compensation Practices: A Report on the Horizontal Review of Practices at Large Banking Organizations* (Oct. 5, 2011) (online at [www.federalreserve.gov/publications/other-reports/files/incentive-compensation-practices-report-201110.pdf](http://www.federalreserve.gov/publications/other-reports/files/incentive-compensation-practices-report-201110.pdf)).

<sup>10</sup> The Institute of International Finance, Inc. (2009), *Compensation in Financial Services: Industry Progress and the Agenda for Change*.

<sup>11</sup> Board of Governors of the Federal Reserve System, *Incentive Compensation Practices: A Report on the Horizontal Review of Practices at Large Banking Organizations* (Oct. 5, 2011) (online at [www.federalreserve.gov/publications/other-reports/files/incentive-compensation-practices-report-201110.pdf](http://www.federalreserve.gov/publications/other-reports/files/incentive-compensation-practices-report-201110.pdf)).

<sup>12</sup> Board of Governors of the Federal Reserve System, *Incentive Compensation Practices: A Report on the Horizontal Review of Practices at Large Banking Organizations* (Oct. 5, 2011) (online at [www.federalreserve.gov/publications/other-reports/files/incentive-compensation-practices-report-201110.pdf](http://www.federalreserve.gov/publications/other-reports/files/incentive-compensation-practices-report-201110.pdf)).

## Efforts to Reform Executive Compensation

The onus is on the financial institutions to take efforts to reform their own executive compensation practices in a manner that restrains excessive risk taking that could threaten the safety and soundness of the institution. This is particularly true for companies designated as systemically important financial institutions (“SIFIs”). These companies have a responsibility to reduce risk taking that could trigger systemic consequences. As Federal Reserve Board Governor Daniel K. Tarullo has noted, incentive compensation arrangements should not provide employees with incentives to engage in risk taking that are beyond the institution’s capacity to effectively identify and manage. “The amounts of incentive pay flowing to employees should reflect the risks and potential losses – as well as gains – associated with their activities. Employees are less likely to take imprudent risks if their incentive payments are reduced or eliminated for activities that end up imposing significant losses on the firm.”<sup>13</sup>

In its report of decision-making by OSM, SIGTARP concluded that 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. In June 2010, one month prior to the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), Federal banking regulators issued interagency guidance “to ensure that incentive compensation arrangements at financial organizations take into account risk and are consistent with safe and sound practices.”<sup>14</sup> This guidance followed the regulators’ in-depth analysis of incentive

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<sup>13</sup> Governor Daniel K. Tarullo, “Incentive Compensation, Risk Management, and Safety and Soundness,” at the University of Maryland’s Robert H. Smith School of Business Roundtable: Executive Compensation: Practices and Reforms, Washington, DC, Nov. 2, 2009, online at [www.federalreserve.gov/newsevents/speech/tarullo20091102a.htm](http://www.federalreserve.gov/newsevents/speech/tarullo20091102a.htm).

<sup>14</sup> Guidance on Sound Incentive Compensation, Final Guidance, *Federal Register* 75:122 (25 June 2010): p. 6395 (online at [www.federalreserve.gov/newsevents/press/bcreg/20100621a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20100621a.htm)) (accessed Feb. 10, 2012).

compensation practices at 25 large banking organizations, in which the Federal Reserve found deficiencies.

The June 2010 interagency guidance does not mandate or prohibit any specific form of compensation, but is instead principle-based to allow for differences in the size and complexity of banking organizations.<sup>15</sup> The interagency guidance recognizes that while incentive compensation serves important goals, including attracting and retaining skilled staff, “these goals do not override the requirement for banking organizations to have incentive compensation systems that are consistent with safe and sound operations and that do not encourage imprudent risk-taking.”<sup>16</sup> The first principle in the guidance is that incentive compensation arrangements should balance risks and rewards so that pay takes into account risks and losses of employees’ activities, including credit, market, liquidity, operational, legal, compliance, and reputational risks. In the guidance, the Federal banking regulators outlined four non-exclusive methods to make compensation more sensitive to risk:

- adjusting performance awards to reflect the risks of employee activities;
- deferring payments of awards and adjusting actual payments to reflect risk outcomes using risk information that becomes available at different points in time;
- using longer periods for measuring the performance on which awards are based; and
- reducing the sensitivity of performance measures to short-term revenues or profits.

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<sup>15</sup> The principles include that incentive compensation arrangements should: (1) provide employees incentives that appropriately balance risk and reward; (2) be compatible with effective controls and risk management; and (3) be supported by strong corporate governance, including active and effective oversight by the organization’s board of directors. Guidance on Sound Incentive Compensation, Final Guidance, *Federal Register* 75:122 (25 June 2010): p. 6395 (online at [www.federalreserve.gov/newsevents/press/bcreg/20100621a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20100621a.htm)) (accessed Feb. 10, 2012).

<sup>16</sup> Guidance on Sound Incentive Compensation, Final Guidance, *Federal Register* 75:122 (25 June 2010): p. 6395 (online at [www.federalreserve.gov/newsevents/press/bcreg/20100621a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20100621a.htm)) (accessed Feb. 10, 2012).

Each method has advantages and disadvantages. For example, according to the guidance, compensation packages for senior executives at large institutions “are likely to be better balanced if they involve deferral of a substantial portion of the executive’s incentive compensation over a multi-year period with payment made in the form of stock” with the amount ultimately received dependent on the performance of the organization. “Deferral, however, may not be effective in constraining the incentives of employees who may have the ability to expose the organization to long-term risks, as these risks may not be realized during a reasonable deferral period.”<sup>17</sup>

Another principle contained in the guidance is that compensation structures should be supported by strong corporate governance, including active and effective oversight by the organization’s board of directors. In October 2011, the Federal Reserve reported that the 25 large banking organizations have made significant progress toward enhancing their incentive compensation arrangements, however, “every firm needs to do more.” The Federal Reserve stated that most firms still have significant work to do to achieve full conformance with the interagency guidance.

In addition to this guidance, the Dodd-Frank Act enacted July 21, 2010, requires regulations on executive compensation at financial institutions that may force companies to change their compensation practices. The Dodd-Frank Act enhances disclosure and reporting requirements and prohibits certain incentive-based payment arrangements that regulators determine encourage inappropriate risks by covered financial institutions.<sup>18</sup> The Dodd-Frank Act’s provisions on executive compensation are to be implemented in new regulations by several Federal regulators,

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<sup>17</sup> Guidance on Sound Incentive Compensation, Final Guidance, *Federal Register* 75:122 (25 June 2010): p. 6395 (online at [www.federalreserve.gov/newsevents/press/bcreg/20100621a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20100621a.htm)) (accessed Feb. 10, 2012).

<sup>18</sup> As to CEO pay, 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.

and some of those regulators have already implemented or proposed rules.<sup>19</sup> 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.<sup>20</sup> Federal regulators are also required to develop regulations that prohibit any type of incentive-based payment arrangement that the regulators determine encourages inappropriate risk. On April 14, 2011, Federal regulators published their joint proposal to ban “excessive” incentive-based compensation that may promote risky behavior or lead to material financial loss at financial institutions, but the rule is not final.<sup>21</sup> In addition, the SEC adopted regulations that give shareholders a say-on-pay advisory vote on executive compensation and “golden parachute” compensation arrangements. The Dodd-Frank Act also requires regulations for institutions designated as SIFIs. For example, the Federal Reserve recently proposed restricting executive pay and bonuses if a SIFI fails certain capital, liquidity, or stress test thresholds.<sup>22</sup> It is too early to tell whether the Dodd-Frank Act will ultimately be successful in reforming financial sector pay packages because all of the regulations required under the Dodd-Frank Act are not final and

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<sup>19</sup> The regulators required to promulgate regulations under the Dodd-Frank Act include: the Federal Reserve, the Office of the Comptroller of the Currency (“OCC”), the FDIC, the National Credit Union Administration (“NCUA”), the Securities and Exchange Commission (“SEC”), and the Federal Housing Finance Agency (“FHFA”).

<sup>20</sup> 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.

<sup>21</sup> The regulators include OCC, Federal Reserve, FDIC, NCUA, SEC, and FHFA. Available at [www.occ.gov/news-issuances/federal-register/76fr21170.pdf](http://www.occ.gov/news-issuances/federal-register/76fr21170.pdf).

<sup>22</sup> Board of Governors of the Federal Reserve System, *Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies*, 12 C.F.R. Part 252 (Dec. 20, 2011) (online at [www.gpo.gov/fdsys/pkg/FR-2012-01-05/pdf/2011-33364.pdf](http://www.gpo.gov/fdsys/pkg/FR-2012-01-05/pdf/2011-33364.pdf)).



their effectiveness remains to be seen. The regulators' strength and leadership in the area of executive compensation are critical.

Finally, the public continues to have a paramount interest in appropriate compensation structures and pay at companies in which Treasury has a significant ownership interest from a TARP investment. Only AIG, GM, and Ally remain as TARP exceptional assistance companies under OSM's oversight, and OSM will release its 2012 compensation package determinations for the Top 25 executives at these three companies in April. Taxpayers are looking to OSM and the regulators to protect them and to help reinforce the stability of the largest firms and the financial system.

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

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

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