

Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

December 24, 2009

The Honorable Timothy F. Geithner
Secretary of the Treasury
United States Department of the Treasury
Room 3330
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Mr. Secretary:

I am writing to you, on behalf of the Congressional Oversight Panel, to obtain details about important aspects of Treasury's approach to the Emergency Economic Stabilization Act of 2008 (EESA) provisions governing executive compensation at financial institutions that have received assistance under the Troubled Asset Relief Program (TARP). Appropriate and effective controls are necessary to ensure that the executive compensation arrangements at these institutions do not create incentives for the unnecessary risk of taxpayer-supplied funds.

Section 111 of EESA sets, or authorizes Treasury to set, executive compensation and corporate governance standards for TARP recipients.¹ For institutions that have received at least \$500 million in assistance, some standards apply to at least the senior executive officers² (SEOs) of those institutions. Other standards – including restrictions on bonus, retention, and incentive compensation – apply to both those officers and at least the institutions' 20 "next most highly-compensated employees" (together, "covered individuals"). These standards apply so long as assistance to their respective financial institutions remains outstanding (the "coverage period").

The executive compensation provisions give important, and unique, responsibilities to the Treasury. The Department has undertaken these duties by issuing an extensive interim final rule (the "Interim Rule") and appointing a Special Master for TARP Executive Compensation (the "Special Master") in the Interim Rule. The Special Master has in turn applied the Interim Rule to seven financial institutions that are designated as having received "exceptional financial assistance" under the TARP. (The "seven institutions" are American International Group, Bank of America, Chrysler Financial, Chrysler Group, Citigroup, General Motors, and General Motors Acceptance Corporation.)

¹ Section 7001 of the American Recovery and Reinvestment Act of 2009, Pub. L. 111-5 (2009), amended the original provisions of section 111 of EESA that dealt with executive compensation and governance. In this letter, citations are to section 111 as amended, as are references to the "statute."

² Under section 111, the senior executive officers of an institution are that institution's five most highly paid executives of a company according to disclosure rules of the United States Securities and Exchange Commission (SEC).

Staff of the Congressional Oversight Panel met with Treasury staff on November 10, 2009, to discuss the work of the Special Master as well as aspects of the Interim Rule generally. The meeting was informative and helpful, but a number of questions remain:

1. The compensation rules bar payment of any bonus, retention award, or incentive compensation other than through long-term restricted stock that cannot constitute more than one-third of the employee's total compensation and whose full vesting cannot occur while TARP assistance is outstanding (the "bonus restrictions").

a. Some commentators have expressed concern that a substantial portion of the increase in value of the restricted stock issued under the bonus restrictions could result in a windfall to covered individuals, because the stock has been granted at historic lows in each institution's stock price and any rise in that price will derive in part from public investment and the implicit cushion created by a perceived "too-big-to-fail" guarantee by federal authorities.

For example, the closing price of a share of common stock of Bank of America on February 12, 2009, when the Interim Rule went into effect, was \$5.84, and the price on December 1, 2009, was \$15.89, an increase of 172 percent; for Wells Fargo the respective numbers are \$16.70 on February 12, 2009, and \$27.99 on December 1, 2009, an increase of 67.6 percent.

Please explain the extent to which Treasury considered this issue in drafting the Interim Rule. If this issue was considered, please explain why Treasury rejected the imposition of some cap on the gain covered individuals could receive from their restricted stock.

b. Please explain the protections the Interim Rule provides against employment contract "make-up" provisions designed to avoid the effect of the bonus restrictions. During the November 10 meeting, Treasury staff explained that the Interim Rule effectively prohibits such provisions by preventing accrual of benefits to be paid after a TARP recipient exits the TARP. However, under the Financial Accounting Standards Board No. 5 (FASB 5), *Accounting for Contingencies*, in order for a liability to be accrued the amount must be both probable and estimable. Please explain how the provisions of the Interim Rule would apply under FASB 5.

c. Please explain why an economic payment equivalent to that foregone by the bonus restrictions cannot be built into a "golden parachute" payment, by formula or amount, for the period for which the bonus restrictions operate, even if the parachute payments may not be made until the end of the coverage period (or, in the case of any employee other than an SEO and the next five most highly-compensated employees, during the coverage period).

d. For financial institutions that have received at least \$25 million in TARP assistance, the number of employees subject to the bonus restrictions is set in the

statute, but the statute gives Treasury the general discretion to expand that number in the public interest.

Please explain why Treasury has not made use of that authority (other than to authorize review of the “structure of the compensation” of the next 75 most highly-compensated of the seven institutions), and the standards it has employed in deciding not to do so, in light of the fact that the Interim Rule’s definition of “highly-compensated employee” includes individuals, such as traders, who are not executive officers. Has Treasury considered extending compensation restrictions to these very senior executives, notwithstanding the fact that they are not among the very most highly compensated employees in their institutions?

e. Treasury officials explained during the November 10 meeting that the bonus restrictions are not applied to executives hired in 2009 to direct the recovery of the relevant institutions. Please explain the standards Treasury has used in applying this exception, as well as the levels of compensation that executives covered by the exception are allowed to receive. Please include in that explanation details reflecting actual compensation paid to a selected group of such employees who have become one of the five CEOs of an institution to which this exception has been applied.

f. Under the statute, restricted stock, granted under the bonus restrictions, may not fully vest during the coverage period. The Interim Rule interprets this language to permit partial vesting as TARP assistance is repaid and final vesting when TARP assistance is fully repaid. Why was repayment of TARP assistance the only relevant standard used in the Interim Rule, in light of the number of key statutory purposes – for example, increasing lending levels and strengthening banks’ capital position – for the TARP?

g. The nation’s largest financial institutions have received hundreds of billions of dollars in taxpayer assistance. The statute requires Treasury to review “bonuses, retention, awards, and other compensation” paid on or before February 11, 2009 (the date of the statute’s enactment) by any institution that has received TARP assistance to determine “whether any such payments *were inconsistent with the purposes of the statute or the TARP or were otherwise inconsistent with the public interest.*” (Emphasis supplied.)

i. Has Treasury conducted such a “look-back” review? Has it conducted such a review for any institution other than one of the seven institutions? In either case, what standards has it used, or will it use, in such a review, that are more specific than the general discretionary standards outlined in the Interim Rule?

ii. The possibility of compensation restrictions was apparent, based on the original language of section 111 of EESA, before enactment of the statute, and it is likely that protective provisions were placed into employment

contracts as a result. If Treasury has not conducted a review of such provisions for any group of relevant institutions, why has it not done so?

iii. If Treasury makes a determination described immediately above for a particular TARP recipient, it must “seek to negotiate with the TARP recipient and the subject employee for appropriate reimbursements to the Federal Government.” Has Treasury done so? Has it done so for any institution other than the seven institutions? If Treasury has not done so, please explain why not. Does Treasury have any plans do to so? If so, when?

iv. The Interim Rule gives authority to the Special Master to conduct all of the look-back reviews, not just those for the seven institutions. Please explain this expansion of the Special Master’s authority beyond the seven institutions.

2. The statute requires that the rules promulgated by Treasury bar incentives for SEOs to take “unnecessary and excessive risks that threaten the value of the [financial institution].”

a. The Interim Rule does not explain the meaning of this requirement generally. Instead it merely restates the language of the statute. Please explain why this is so.

b. The Interim Rule, however, contains an extensive explanation of the meaning and application of prohibition against “unnecessary and excessive risks” for the seven institutions (or for any other institution that seeks an advisory opinion from the Special Master). Please explain this difference in treatment, given that many recipients other than the seven institutions continue to hold large amounts of TARP assistance.

3. The statute requires a “claw-back” of bonus, retention award, or incentive compensation to a covered individual based on financial information or “other criteria” that are “found to be materially misleading.”

a. Under the Interim Rule, the claw-back provision applies in two situations:

The first is [the relevant] “employee . . . *knowingly engag[ing]* in providing inaccurate information (including knowingly failing to timely correct inaccurate information) relating to . . . [the institution’s] financial statements or performance metrics [on which the employee’s bonus compensation is based].” (Emphasis supplied.)

The second is any case in which “a financial statement or performance metric criteria is materially inaccurate [under] *all the facts and circumstances.*” (Emphasis supplied.)

b. What are the ramifications under the federal securities laws of a senior employee's provision of materially inaccurate information for the financial statement of a public company? Why is it appropriate to provide a definition for operation of the claw-back rule that requires a serious violation of the securities laws before the former rule comes into operation? The Interim Rule makes use of provisions of the regulations issued under the securities laws in a number of critical places. The Panel requests Treasury's view on this matter.

c. Except for the situation described immediately above, the Interim Rule states that whether information is materially misleading "depends on all the facts and circumstances." SEC Staff Accounting Bulletin 99 provides extensive definitions of materiality applicable to the financial disclosure of public companies. Why did Treasury not adopt this guidance as the basis for operation of the claw-back provision, especially in light of the fact that the claw-back rule and Accounting Bulletin 99 apply to the same set of financial disclosures?

4. The Interim Rule mainly relies on certifications of the compensation committee of the institutions' board of directors and of the principal executive and financial officers of the institution to assure that the terms of the Interim Rule have been observed.

a. Please explain this approach, in light of the fact that many of the compensation arrangements before the financial crisis were themselves approved by such compensation committees, senior executives, or both?

b. In the case of the compensation committee, the committee must include the certification in their required annual financial disclosures. In Treasury's view, what would be the consequences of a materially inaccurate certification under the federal securities laws?

c. What are the consequences under the federal securities laws if the certification required of an institution's CEO and CFO is materially inaccurate?

d. Would any of the certifications required by the Interim Rule be subject to audit by a public company's independent public accountants? Would they be subject to the internal control provisions of the Sarbanes-Oxley Act of 2002?

5. How will Treasury enforce the terms of the statute and the Interim Rule? What are the consequences for any institution that fails to observe those terms?

6. The Interim Rule creates the Office of the Special Master for TARP Executive Compensation.

a. Are the Special Master's decisions subject to review by the Assistant Secretary of the Treasury for Financial Stability, or by any other senior official of the Department?

- b. If not, has authority similar to that given the Special Master (*i.e.*, authority to act without review) been delegated to any other employee of the Treasury?
- c. What unique authorities has Treasury assigned to the Special Master? To the extent that the Special Master's authorities are unique, what authority does either section 111 or any other provision of EESA provide for this arrangement?
- d. Officials at the November 10 meeting confirmed that the Special Master is an uncompensated special government employee, as defined in 18 U.S.C. § 202. Who determined that such a status was appropriate for the Special Master, and what factors were considered in making that determination? What statutory and regulatory ethical provisions and restrictions, that apply to regular Treasury employees – and what additional standards – apply to the Special Master and other special government employees whom he has chosen to assist him? What restrictions will apply to the Special Master and such other employees, and any firm with which they are or become affiliated, after they leave the Treasury's employ? Has the Special Master's list of clients in his private law and consulting practice, and those of related persons subject to the ethical provisions that apply to the Special Master, been reviewed by appropriate Treasury officials to determine the absence of any conflicts of interest? If so, what has been the result of that review?

The information sought by this letter is necessary for the Congressional Oversight Panel to carry out section 125 of EESA. This information request is made pursuant to section 125(e)(3) of that Act.

The Panel seeks written responses to these questions by January 13, 2010. I would be happy to answer any questions about this letter that you may have. If you would prefer, a member of your staff may contact the Panel's Executive Director, Naomi Baum, at [REDACTED].

Sincerely,



Elizabeth Warren
Chair
Congressional Oversight Panel

Cc: Mr. Paul Atkins
Mr. Mark McWatters
Mr. Richard H. Neiman
Mr. Damon A. Silvers