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AIG BONUSES: AUDIT REPORT OF THE SIGTARP

HEARING

BEFORE THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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AIG BONUSES: AUDIT REPORT OF THE SIGTARP

WEDNESDAY, OCTOBER 14, 2009

HOUSE OF REPRESENTATIVES,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The committee met, pursuant to notice, at 10:10 a.m., in room 2154, Rayburn House Office Building, Hon. Edolphus Towns (chairman of the committee) presiding.

Present: Representatives Towns, Issa, Cummings, Kucinich, Tierney, Clay, Watson, Connolly, Quigley, Kaptur, Norton, Kennedy, Van Hollen, Cuellar, Murphy, Welch, Foster, Speier, Driehaus, Burton, Mica, Duncan, McHenry, Bilbray, Jordan, Flake, Fortenberry, Chaffetz, Schock, Luetkemeyer, and Cao.

Staff present: John Arlington, chief counsel—investigations; Lisa Cody, investigator; Brian Eiler and Neema Guliani, investigative counsels; Linda Good, deputy chief clerk; Jean Gosa, clerk; Adam Hodge, deputy press secretary; Carla Hultberg, chief clerk; Marc Johnson, assistant clerk; Mike McCarthy, deputy staff director; Leah Perry, senior counsel; Jason Powell, counsel and special policy advisor; Jenny Rosenberg, director of communications; Joanne Royce, senior investigative counsel; Mark Stephenson, senior policy advisor; Alex Wolf, professional staff member; Lawrence Brady, minority staff director; John Cuaderes, minority deputy staff director; Rob Borden, minority general counsel; Jennifer Safavian, minority chief counsel for oversight and investigations; Frederick Hill, minority director of communications; Adam Fromm, minority chief clerk and Member liaison; Kurt Bardella, minority press secretary; Seamus Kraft, minority deputy press secretary; Christopher Hixon, minority senior counsel; Brien Beattie and Mark Marin, minority professional staff members.

Chairman TOWNS. Good morning.

I would like to welcome a new member to the committee, on the minority side, Representative Joseph Cao represents the Second District of Louisiana. How do you pronounce that?

Mr. CAO. It is like cow with a G.

Chairman TOWNS. After consultation with the ranking member and pursuant to committee rule 8, I am assigning him to the Federal Workforce Committee. I welcome the gentleman and look forward to his contribution.

I yield to the ranking member of the committee, the gentleman from California, Congressman Issa.

Mr. ISSA. Thank you, Mr. Chairman. Before we start this important hearing, I think it is important to have our newest Member seated.

Representative Cao asked for this committee, competed for this committee, made the case for why the things that happen in his home parishes in Louisiana are so critically related to this committee, and I agree with him. This committee, of course, after Hurricane Katrina, certainly has been down to his District a lot. But, more importantly, this is a Member who has requested it because he believes that this committee has an important part in routing out waste, fraud, and abuse in Government.

Mr. Chairman, I would ask unanimous consent after the vote that he have a moment just to speak.

Chairman TOWNS. I will yield to him 2 minutes at this time.

Mr. CAO. Thank you, Mr. Chairman.

I would like to thank the ranking member for the opportunity and the honor to serve. I am very honored to be on this committee in order to serve to make sure that we, as a body, as the Government, work and function in a very effective and efficient manner.

I know that after Hurricane Katrina we experienced a tremendous amount of fraud and waste down there at the District. One of the messages that I campaigned on when I was running for U.S. Congress was to make sure that we operate at the Governmental level in a very ethical fashion, so I am glad to be able to serve on this committee to make sure that everything that we do here as a Body to be transparent and to be more and ethical.

So with that I yield back my time, Mr. Chairman. Thank you very much.

Chairman TOWNS. I thank the gentleman. We are delighted to have you on the committee and look forward to working with you. This is a very active committee. Of course, we are certain that you will fit in well.

Just over a year ago the U.S. economy lurched toward near ruin. Venerable financial institutions staggered toward collapse and the market was in free-fall. Americans were stunned as their savings disappeared overnight, the value of their homes plummeted, and their jobs disappeared. To save the economy from going from recession to depression, the Federal Government launched the largest bailout of private companies in history. America's leading financial firms were on life support when the Treasury Department injected them with hundreds of billions of dollars of taxpayers' money.

AIG, once the largest insurance company in America, became the single largest recipient of bailout dollars. AIG was the victim of one of its own divisions, AIG's Financial Products, which engaged in the risky and unregulated trading that many blamed for the company's collapse.

The American taxpayers came to the rescue with an $85 billion bailout of AIG last September. That was followed by more money in October. More again in November. And still more in March of this year. In the end, the Federal Government had committed $180 billion to save AIG.

Americans were justifiably outraged when they learned shortly thereafter that AIG was paying $165 million in bonuses to executives at the very division that caused the collapse of the company.

But even that figure pales before what the Special Inspector General learned in the course of his audit, which he is releasing at our hearing today.

Not long after the last administration had shoveled $85 billion into the failing giant, Federal Reserve officials learned that AIG's units planned to distribute a combined total of $1.7 billion in bonuses and other extraordinary compensation. That is the justification for giving bonuses to people who drove their firm off a cliff and very nearly crashed the U.S. economy. Wasn't there something seriously out of whack here? This does not make a lot of sense to me.

It turns out it wasn't always that way at AIG. The SIGTARP audit found that AIG's compensation used to be weighted toward long-term incentives that were payable only at retirement. In other words, they used the classic golden handcuffs. But in 2007, when losses began to mount, AIG new management decided to update their compensation plans. The golden handcuffs were replaced by golden envelopes. The era of instant gratification had arrived at AIG. Long-term incentives were rejected in favor of short-term gains.

Don't get me wrong: Americans don't resent people who make a lot of money. We all want to make a lot of money. But what infuriates people is when bosses at bailout companies, virtual wards of the State, continue to rake in millions, in effect, our millions. That is the problem.

It just doesn't seem right that people who caused this tragedy should be so richly rewarded. You know, this is sort of unusual. Generally, when people are rewarded, it is the fact that they have done a fantastic job and they receive extra benefits for doing a great job. You are not generally rewarded when you are taking the company down the wrong road.

Unfortunately, this is still very much an issue. AIG's current bonus proposal is under review by the Treasury Department's Special Master, Ken Feinberg. We will be hearing from Mr. Feinberg 2 weeks from now at our second hearing on executive compensation.

Today we welcome back Special Inspector General Neil Barofsky, who just completed his audit of AIG's compensation. Perhaps today we will shed additional light on what many American taxpayers are asking: why didn't the Federal Government impose pay concessions on bailout companies? Why were huge bonuses paid to executives of firms that would now be bankrupt but for a taxpayer bailout? How much more in lavish bonuses will the American taxpayer be required to foot? What have we learned about executive compensation and corporate performance from our experience with AIG?

Again, I want to thank Mr. Barofsky for appearing here today and for the outstanding work that he has done.

[The prepared statement of Chairman Edolphus Towns follows:]

HOUSE COMMITTEE ON
OVERSIGHT & GOVERNMENT REFORM

OPENING STATEMENT OF
CHAIRMAN EDOLPHUS TOWNS

AIG Bonuses:
Audit Report of the Special Inspector General For TARP

October 14, 2009

Good morning and thank you all for being here.

Just over a year ago the US economy lurched toward near ruin. Venerable financial institutions staggered toward collapse and the market was in freefall.

Americans were stunned as their savings disappeared overnight, the value of their homes plummeted and their jobs disappeared.

To save the economy from going from recession to depression, the Federal Government launched the largest bailout of private companies in history. America's leading financial firms were on life-support when the Treasury Department injected them with hundreds of billions of dollars of taxpayer money.

AIG, once the largest insurance company in America, became the single largest recipient of bailout dollars. AIG was the victim of one of its own divisions - AIG Financial

Products - which engaged in the risky and unregulated trading that many blame for the company's collapse.

The American taxpayers came to the rescue with an $85 billion bailout of AIG last September. That was followed by more money in October, more again in November and still more in March of this year. In the end, the federal government had committed $180 billion dollars to save AIG.

Americans were justifiably outraged when they learned shortly thereafter that AIG was paying $165 million in bonuses to executives at the very division that caused the collapse of the company.

But even that figure pales before what the Special Inspector General learned in the course of his audit, which he is releasing at our hearing today.

Not long after the last Administration had shoveled $85 billion into this failing giant, Federal Reserve officials learned that AIG units planned to distribute a combined total of **$1.75 billion** in bonuses and other extraordinary compensation.

What is the justification for giving bonuses to people who drove their own firm off a cliff and very nearly crashed the US economy? Wasn't there something seriously out whack here?

It turns out it wasn't always that way at AIG. The SIGTARP's audit found that AIG's compensation used to be weighted toward long-term incentives that were payable only at retirement. In other words, they used the classic "golden handcuffs."

But in 2007, when losses began to mount, AIG's new management decided to "update" their compensation plans. The golden handcuffs were replaced by golden envelopes. The era of instant gratification had arrived at AIG. Long-term incentives were rejected in favor of short-term gains.

Don't get me wrong - Americans don't resent people who make a lot of money. We all want to make money.

But what infuriates people is when bosses at bailed out companies – virtual wards of the state - continue to rake in millions – in effect, *our millions.* It just doesn't seem right that the people who caused this tragedy should be so richly rewarded.

Unfortunately, this is still very much an issue. AIG's current bonus proposal is under review by the Treasury Department's Special Master, Ken Feinberg. We will be hearing from Mr. Feinberg two weeks from now at our second hearing on executive compensation.

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Perhaps today we will shed additional light on what many American taxpayers are asking:

- Why didn't the federal government impose pay concessions on bailed out companies?

- Why were huge bonuses paid to executives of firms that would now be bankrupt, but for a taxpayer bailout?

- How much more in lavish bonuses will the American taxpayer be required to foot?

- What have we learned about executive compensation and corporate performance from our experience with AIG?

Again, I want to thank Mr. Barofsky for appearing before us today and I look forward to his testimony.

# # # #

Chairman TOWNS. At this point I would like to yield 5 minutes to the committee's ranking member, Mr. Issa of San Diego, CA.

Mr. ISSA. Thank you, Mr. Chairman. And thank you for holding this hearing on SIGTARP's audit today. I look forward to the Special IG's testimony and his report.

Mr. Chairman, I believe examining the Federal Government's role in AIG bonus is important and it must be done by this committee. It is clear that this committee, having broad jurisdiction and the willingness to do oversight, cannot be discounted.

As you might imagine, I would say that financial services should have helped prevent this and overseen it every step of the way, as should the New York Fed. But you also find that today I am concerned that the era of political bankruptcies is just beginning.

We certainly as a committee cannot continue to ignore vital issues—and I will ask about these—related to the role of Fannie Mae and Freddie Mac, the bailouts of General Motors and Chrysler, and the future of FHA. I know this committee will not shrink from its duty.

Last March the American people learned that employees of AIG Financial Products [FP], the very division responsible for making the bets that sank the company, were getting hundreds of millions of dollars in retention payments for what ultimately had been their failure. AIG's CEO told us that the company needed to retain AIGFP employees because they had technical skills to unwind the company's risky investments in order to pay back the taxpayers; however, it is clear that it was not about paying back the taxpayers. In fact, during the so-called unwinding, that $180 billion, much of it went to paying 100 percent on the dollar for, in fact, credit defaults or insurance programs which would not have ordinarily in bankruptcy been paid full. And, more important, the Treasury made a decision, at the very time in which mark to market was on everyone's lips, not to, in fact, purchase these credit defaults at their market. You had pieces of paper which were floating around at a market rate of 20 or 30 cents on the dollar or more, and, in fact, we paid 100 cents on the dollar.

Many people during this hearing will probably not have realized that AIG was a conduit for paying Goldman Sachs and others billions of dollars at 100 cents on the dollar when, in fact, that paper would ordinarily have been discounted considerably; meaning permanently these people who got $168 million in retention bonuses were part of a larger political bankruptcy that led to the higher price being paid, in fact, 100 cents on the dollar when, in fact, the market rate was a fraction of that.

Mr. Chairman, I might point out this went on under the Bush administration. This is not something that this President did anything but inherit. I hope that we will recognize that what we are doing here today is talking about a pattern of mistakes that I will characterize mostly as political bankruptcies being run by the Government.

The pattern of rewarding failure during the Bush administration, unfortunately, appears to continue during the current administration. Rather than learning from the mistakes of his predecessor, President Obama has entangled the Federal bureaucracy across the private sector. Rather than letting failed companies fail through a

bankruptcy system, we constantly are putting money in and then political influence.

Mr. Chairman, General Motors was a political bankruptcy. Chrysler was a political bankruptcy. The American people and their kids and grandkids will pay the price.

The lesson we ought to take from the story of AIG retention bonus today is: rewarding failure through a policy of bailouts and circumventing the rule of law and ordinary procedures within bankruptcy cost the taxpayers far more than if, in fact, we had back-stopped what we were obligated to back-stop; if we had said to the bankruptcy court, you determine what portion the Federal Government should pay and the American people will step up to the plate. However, no one, no one on either side of this dias, for a moment believes that 100 cents on the dollar would have been what the American people would have paid. Tens of billions of dollars were paid out because this was a political bankruptcy and not handled by a Federal judge, as our law requires.

Mr. Chairman, I thank you for your indulgence and yield back.

[The prepared statement of Hon. Darrell E. Issa follows:]

EDOLPHUS TOWNS, NEW YORK
CHAIRMAN

DARRELL E. ISSA, CALIFORNIA
RANKING MINORITY MEMBER

ONE HUNDRED ELEVENTH CONGRESS

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Statement of Rep. Darrell Issa, Ranking Member

AIG Bonuses: Audit of the Special Inspector General

October 14, 2009

Mr. Chairman, thank you for holding this hearing on SIGTARP's audit of the federal government's management of the AIG bailout and the federal government's knowledge of the AIG retention bonuses.

I believe examining the federal government's role in the AIG bonuses is important, and as you've said before, Mr. Chairman, we need to examine everything related to the financial crisis. We cannot continue to ignore vital issues like the role of Fannie Mae and Freddie Mac, the bailouts of General Motors and Chrysler, and the future of the FHA.

Last March, when the American people learned that employees of AIG Financial Products, the very division responsible for making the bets that sank the company, were getting hundreds of millions of dollars in retention payments, they were understandably upset.

AIG's CEO told us that the company needed to retain the AIGFP employees because they had the technical skills to unwind the company's risky investments in order to pay back the taxpayers. However, it still seems unconscionable to ordinary Americans, who are losing their jobs and their homes, that AIG was apparently rewarding failure and using taxpayer money to do it.

But wasn't rewarding failure the outcome of the bailout policies all along? AIG was able to use taxpayer money to pay bonuses to its employees because the Treasury Department and the Federal Reserve chose to circumvent ordinary bankruptcy procedures in order to bail out a company that actually deserved to fail.

AIG was a political bankruptcy, a shotgun wedding between AIG and the American taxpayer, with Uncle Sam holding the shotgun. The original sin here was not AIG rewarding failure by paying AIGFP employees $168 million in retention bonuses in March of this year. The real crime was that the federal government rewarded AIG's failure by bailing it out to the tune of $180 billion of taxpayer money.

If the Bush Administration had adhered to the rule of law and allowed AIG to go through the established bankruptcy channels, it is very likely that we would not have seen these bonuses paid out in full. The claims of AIGFP's employees would have been evaluated alongside the claims of all of AIG's other creditors, by an impartial judge according to established legal principles. It is unlikely that the retention bonuses would have been paid in full, nor would we have seen AIG's counterparties like Goldman Sachs paid 100 cents on the dollar.

This pattern of rewarding failure, begun by the Bush Administration, has accelerated under President Obama. Rather than learning from the mistakes of his predecessor, President Obama has entangled the federal bureaucracy across the private sector, rather than letting companies that deserve to fail actually do so.

General Motors was a political bankruptcy, Chrysler was a political bankruptcy, and the American people and their kids and grandkids are going to have to pay the price.

The lesson we ought to take from the story of AIG retention bonuses today is this: rewarding failure through a policy of bailouts and circumventing the rule of law has negative consequences. If we don't like what happens when we give taxpayer money to private companies, than we should stop giving taxpayer money to private companies.

Thank you Mr. Chairman.

Chairman TOWNS. I thank the gentleman for his opening statement.

Anyone seeking recognition at this time? The gentleman from Maryland, Mr. Cummings, is recognized for 3 minutes for an opening statement.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

As I listened to Mr. Issa I could not help but remember—and I hope we don't get amnesia—that it was a Republican President and a Mr. Paulson who was appointed by President Bush, who came to this Congress saying that the sky was falling. Come on. Give me a break. And what this Congress did, and mainly Democrats trying to help this President get us out of this mess, was to do something that we did not like: to hold our nose and to address this issue the way we did. So let's not get amnesia here.

The fact still remains that we have a lot to do. I've said many times, starting back in December 2008, AIG has not been truly honest with the Congress or the United States of America. I have met with Mr. Liddy, after I wrote a letter to him, and he constantly told me, the former chairman, he constantly told me about bonuses, and every time he never gave us all the information.

After my letter of December 1st, Mr. Liddy responded a few days later that it would be 168 employees receiving these payments in amounts between $160,000 and $4 million. Mr. Liddy and I then exchanged a series of letters and even sat down face-to-face to discuss the issue, and I explicitly asked that AIG be a good corporate citizen. Mr. Liddy assured me that AIG would be just that.

Well, AIG cutoff all communications, and later we learned that it was 4,500 people, not 160 people, would be receiving bonuses and retention payments totaling, as the chairman has already said, over $1 billion. Further, around 400 employees at the Financial Products division, which is the very division that brought AIG down and brought the country down, as far as I am concerned, we found out that they were getting $450 million in so-called retention payments. The same Financial Products division that brought AIG to its knees would be rewarding its traders' reckless risk-taking with enormous corporate payouts to stick around and undo their handiwork.

National unemployment was 8.5 percent when this happened. It stands to reason that there were very talented people out of work, traders on Wall Street, that might have been able to do this work without hundreds of millions of dollars in retention payments.

Mr. Chairman, I see my time is running out, but I want to be very, very clear. I think we have done the best that we can do, and we are going to have to continue to be vigilant. Nobody likes what AIG did, and this report certainly does not shed a brilliant, wonderful light about what they did.

I want to thank you, Mr. Barofsky, for all that you have done, because you have presented yourself in a very forthright way and we appreciate it, and we will continue to work with you to try to make sure we get to the bottom of these bonuses and these junkets and whatever.

Mr. Chairman, thank you for your indulgence.

Chairman TOWNS. I would like to thank the gentleman from Maryland for his statement.

Anyone else seeking recognition? The gentleman from Indiana, Mr. Burton.

Mr. BURTON. Real briefly, Mr. Chairman, I am glad you are holding these hearings. I think it is extremely important that we look into this very thoroughly.

I think this should also include other issues of great significance and importance. There have been allegations that there has been special treatment given to some Government officials regarding loans at Countrywide. We had a hearing on that at some point in the past. During that hearing, we asked the chairman of Countrywide a great many questions about preferential treatment, and it has been in the papers a lot.

I hope—and I know the ranking member shares our position on this—I hope that we will have a very thorough investigation on not just AIG but other things where there might have been some corruption.

Chairman TOWNS. Anyone else seeking recognition? The gentleman from Ohio, Mr. Kucinich.

Mr. KUCINICH. Thank you very much, Mr. Chairman, for holding this hearing. I think that those Members who are concerned about the conduct of people in the Senate or in the House, we understand that the purpose of this committee, Government Oversight, is to monitor the activities that are going on in the private sector and in Government, but the rules of the House require that the structure that has been set up by the House, which is the Ethics Committee, be used, and that this committee is not the appropriate place to start going after other Members of Congress. Once we start that, what else are we going to do in this committee?

The American people are relying on us to be able to try to straighten out this economy and to make Wall Street accountable. Now, whatever flaws Members of Congress may have—and all of us do—I think that the Ethics Committee is the appropriate venue for those. If people have complaints to bring, they ought to do that. But to keep trying to bring it up in this committee, to challenge the conduct of other Members of Congress, be they in the House or in the Senate, I think——

Mr. BURTON. Would the gentleman yield?

Mr. KUCINICH [continuing]. I think actually what it does is it slows the momentum that we need to build, bipartisan, that we need to build——

Mr. BURTON. Would the gentleman yield?

Mr. KUCINICH [continuing]. To be able to accomplish the goals of this committee.

Mr. BURTON. Would my colleague yield?

Mr. KUCINICH. I will in a minute. This committee has to deal with over $13 trillion in spending that has been put out there by the Treasury and by the Fed.

I think my colleagues on the other side certainly know that I haven't pulled any punches when it has come to the administration at all, nor will I. I will not. But come on, we can't use this committee to snipe at each other all the time. We've got to focus, keep our eye on the ball. I'm glad we are having a hearing on AIG bonuses, but we need to go a lot deeper.

Mr. BURTON. Would the gentleman yield?

Mr. KUCINICH. I will yield.

Mr. BURTON. What I said in my remarks was that there have been allegations that some Government officials—I didn't mention Members of Congress—some Government officials may have gotten preferential treatment from places like Countrywide. When I was chairman, we followed it where it led for 6 years. So I am not talking about Congressmen, but I am talking about people in Government who have very high positions who may have preferential treatment in order to do things.

I think we need to investigate that. I don't know that it is going to——

Mr. KUCINICH. Reclaiming my time.

Mr. BURTON. I don't know that it is going to mean to Members of Congress, but——

Mr. KUCINICH. Reclaiming my time, I want to say that there were some investigations that Mr. Burton had when he was chairman, Mr. Burton, that I supported. But the one thing I thought was important when you were chairman, and it is important when Mr. Towns is chairman, is that, look, we follow investigations wherever they lead, but if someone wants to imply expressly or otherwise that there are people that we have to look at within the Congress of the United States, I say that is what the Ethics Committee is all about.

Mr. BURTON. Would the gentleman yield?

Mr. KUCINICH. My time is expired, but I think that we are going to put this on the table here and either put it to rest or this committee is going to end up becoming an armed camp going against each other. I don't think we need to do that. Let's keep our eye on the ball. Let's challenge Wall Street. Let Mr. Barofsky get a chance to tell us what he has found and make these firms on Wall Street accountable, and if there is anybody in the Government holding hands with them, you know, let's look at them, too.

Chairman TOWNS. The gentleman's time has expired.

Mr. Mica of Florida.

Mr. MICA. Thank you, Mr. Chairman.

Let me just say for the record, again we hear blame it on Bush. I think our ranking member did indicate that some of the crisis did start during the Bush administration. The TARP was created partially under the Bush administration. At least half of the funds were left to the current administration.

I believe if we just look at what we are doing here today, we are looking at the distribution on Friday, March 13, 2009—that is this year, this administration—when AIG began distributing $165 million. That is when we had a significant amount of TARP money into this. We are here today to hear report of the Special Inspector General on that money from that account in this year. That is why we are here. People had their hands in the cookie jar during this administration, and we need to find out what took place and how the taxpayer once again got ripped off.

This $165 million is only part of nearly two-thirds of a billion of bonuses that I want to hear about that were used or abused or misused by AIG.

I would like to yield to our ranking member, if I may.

Mr. ISSA. I thank the gentleman.

For my friend and colleague from Ohio, Mr. Kucinich, please understand that our request to continue on the Countrywide investigation recognizes that, first of all, the Senate Ethics Committee has made it clear that the recipients on the Senate side that are known about committed no ethical violations as recipients. That clearing is a clearing very narrowly of the recipients, not of the company that clearly was spending millions of dollars through a discount program to curry favor.

I have offered the chairman and would reiterate the offer to the chairman that we could redact any—and I repeat any—any and all loans related to Members of Congress, and I would happily investigate the question of what did they want to do with Franklin Raines, what did they want to do with the Postmaster General, what did they want to do with a key Republican staffer on the Financial Services Committee to provide VIP loans; not what did those people do in return. What I am most concerned with is what did Countrywide want and, if possible, what did they get, but, most importantly, what did they want.

For the chairman's and the subcommittee chairman's edification, please understand Mr. Kucinich, I have been told that no laws were violated under existing statutes by Countrywide. That begs the question for the American people should there have been a law, and if there is not a law don't we have an obligation to say do we want to have corporate America providing in secret millions of dollars in discounts to high-ranking Government officials in the future, because if we do nothing then the status quo is it is ethically and legally allowed.

Chairman TOWNS. The gentleman from Florida's time has expired.

Anyone else seeking recognition? The gentlewoman from California.

Ms. WATSON. Thank you so much, Mr. Chairman. This is a very important and significant hearing. I am going to take my full 5 minutes, but I would like to yield a minute——

Chairman TOWNS. It is 3 minutes, ma'am.

Ms. WATSON. Three minutes. OK. I would like to yield a minute to Mr. Kucinich.

Mr. KUCINICH. I want to thank the gentlelady, just to respond to my colleague, and that is that, look, I don't hold any grief for anybody who is doing anything wrong, especially Members of Congress, but we had better be careful about using our positions to promote innuendo or to inadvertently smear someone else's name.

I yield back.

Ms. WATSON. At the beginning of 2008 AIG was the world's largest insurance company, with operations in 130 countries and more than $1 trillion in assets; yet, by the end of 2008 AIG was relying on $150 billion in Federal money for its survival as a result of the complex derivatives being pedaled in their Financial Products division. Despite the fact that it was the self-destructive business practices driven by short-term gain rather than long-term sustainability of the Financial Products division, which resulted in the Government owning 79.9 percent of the business, it was revealed in March that these same employees would be receiving $165 million in so-called retention bonuses. I don't understand, if you are

doing your job and you do it satisfactorily, why do you have to have a bonus? You are being paid for doing your job.

So this revelation has rightly stoked outrage on behalf of the American taxpaying public. In this recession, Americans outside of Wall Street have seen their jobs, their savings, and their sense of security diminished, while those responsible for the reckless business practices that led to the crisis receive rescue funds from the Government and bonuses completely unrelated to the market performance of their employer or the actual caliber of their work.

I sincerely hope—and I want to thank our witness—that we will have the necessary information. This is the Oversight Committee, and we need to be watching with a close eye to how we handle taxpayers' money.

I am very, very pleased that we have this opportunity, Mr. Chairman, to hear from our witness.

Thank you.

Chairman TOWNS. Thank you. I would like to thank the gentlewoman from California for her statement.

Anyone seeking recognition? Congressman McHenry from North Carolina?

Mr. MCHENRY. Thank you, Mr. Chairman. I would like to yield my time to the ranking member.

Mr. ISSA. Thank you, Mr. Chairman.

Just for the record, if we look at AIG going into the pre-bankruptcy period, it is commonly stated that they had over $1 trillion in assets. Reviewing the June 2008 financials, what you discover is to get $1 trillion you have almost $400 billion worth of the value of bonds that have not been sold. So if you have ever had a kited value on a balance sheet, it is when you say you have a trillion, but then you have $400 billion worth of assets that are basically if somebody would buy my bonds. That is probably more telling of the fact that the underlying assets were going to go down, but that asset was already effectively zero unless somebody wanted to pay for it.

Further, because there was a further comment by Mr. Kucinich, let's understand that if, in fact, because there was a Member of Congress, two Senators, actually, involved in receiving Countrywide loans, if that is our basis to say it is innuendo if we want to go after an organization that dumped onto the American people not billions but trillions in total and has cost the American people hundreds of billions of dollars worth of losses because of their action in coordination with the GSEs, then I think we miss the whole point of how can we say we can't go there. This side of the aisle certainly would be more than happy to do any and all limitations in the documents so that we were not looking at Members of Congress but looking only at Countrywide.

But today there are boxes of documents sitting at Bank of America which Bank of America said they would like to give us but for reasons of not being sued by individuals involved in that whose names would be on it they wanted to have a subpoena, and yet we won't give one.

I might mention that this committee asked and received the same company, Bank of America, a waiver on attorney-client privilege in order to get the full facts related to Merrill Lynch. If we

can not only subpoena but demand and negotiate a waiver of attorney-client privilege, how could we not at least look at the documents related to what did now B of A but then Countrywide individuals attempt to do to influence Government actions that led to hundreds of billions of dollars of loss to the American people.

I yield back.

Chairman TOWNS. The gentleman from North Carolina. Anyone else seeking recognition?

[No response.]

Chairman TOWNS. Let me just say, before we move forward, to the gentleman from California, that this is not a super Ethics Committee. The Ethics Committee has its role and its function and I think they will do a good job, but I don't see, in terms of this committee—and I must say to the gentleman who served here as the Chair of this committee, and I must admit I enjoyed working with him, he may have probably set a record in terms of the amount of subpoenas that he issued, but he did not subpoena anybody from the Congress. I think we need to just think about it. And let's put it all in the proper perspective so we can move forward, and let's not lose sight of the bigger picture. We are talking about companies that received TARP money, Government money, and then just sort of, like, gave it to people who really didn't perform well. And then when questioned they said it is retention. Why would you keep somebody that is not performing well? You wouldn't do it on your staff.

On that note I yield back.

The gentleman from Massachusetts.

Mr. TIERNEY. I will yield my time.

Chairman TOWNS. Yes.

Mr. KUCINICH. Mr. Chairman, I came here today to talk about AIG, and I assume that we will listen to Mr. Barofsky in a minute to hear about AIG. I appreciate the work that he has done. But I also think that this committee ought to be cautious about using this committee as a platform to go after other Members. That is what the Ethics Committee is about if there is a question about the conduct of other Members. Sometimes we on this side are in the majority, sometimes you on the other side are in the majority, so we have to be careful from our respective positions about setting a precedent here that would inevitably lead to calls in the future to issue subpoenas for other House Members that are involved in similar controversies.

We have to realize we are setting a precedent with what we do here, and I just ask my friends—and you are my friends—on both sides of the aisle to be cautious about what you are advocating here, because if we want to start subpoenaing mortgage records in an investigation that deals with improper influence, we want to start subpoenaing mortgage records of Members of Congress, this committee does that and doesn't leave that up to Ethics, than what is to stop us from subpoenaing financial contributions and to start asking people to give testimony under oath about the financial contributions that they got from certain interests? This is why. This is not the work that this committee ought to be doing. If we start investigating each other—and I assume there would be a lot of op-

portunities that we can all have doing that—we wouldn't be doing anything else. It would just be a partisan morass.

So let's lift our eyes a little bit higher than that. That is not in any way to dismiss the gravity of any improper conduct anywhere by anyone, but it is to say that we create a structure in our system here to deal with questions about the conduct of Members of Congress.

If there is a problem and that structure is not working properly, then Members of Congress have to account for that and we have to make it work. But we can't be using this committee for the purposes of trying to bring down each other. It is just not right.

So, Mr. Barofsky, today we are going to talk about AIG I assume and we are going to talk about the bonuses and what we can do to stop a practice from, when the American people gave all this money out, to make sure that their money is not being mis-spent, so I thank you for being here and just want to say welcome.

Chairman TOWNS. Thank you very much.

Mr. Fortenberry of Nebraska, yield 3 minutes.

Mr. FORTENBERRY. Thank you, Mr. Chairman. I would like to yield as much time as he would like to consume to Mr. Issa.

Mr. ISSA. I thank the gentleman.

Mr. Kucinich, you are my friend and fellow Clevelander and I would hope that what I say now you hear so that you don't have to give an answer that is completely off what I said previously again.

I am perfectly willing to have the subpoena include no Members of Congress, none, none of their records, none of their mortgages. This is not about Members of Congress, the House or the Senate. The Senate Ethics Committee has already spoken that there was no violation for receiving these by two Senators. We don't need to look further. That has been done. However, I hope the gentleman will realize that Countrywide did this for a reason. Countrywide individuals, including a whistleblower, have already told us that they intended to influence for the benefit of Countrywide and its ability to, now we know, put toxic loans onto the books of the GSEs. That is, in fact, what happened.

So, Mr. Barofsky, I appreciate your indulgence. It is very clear that is not what this hearing is about today, but on Thursday when I request a subpoena, which I notice the chairman, I would hope that everybody would allow for a straight up or down vote on the merits of the request for subpoena. That request will be narrow. We do not want to investigate Members of Congress. Other committees may do that. What we want to do is we want to know what was it that internal memos and documents related to other people in and out of Government, what were they trying to achieve, why did they give tens of millions or hundreds of millions of dollars of discount to a broad array of people.

We are not interested in the people they didn't want influence from and we are not interested in Members of Congress. I might say, when we are saying on this side of the aisle we don't want anything to do with the Members of Congress, we are more than happy to look toward Countrywide, because Countrywide is the organization that has led, more than any other single organization, to the loss of billions of dollars of American taxpayer money.

So although Mr. Barofsky can do a good job cleaning up after the flood and trying to deal with the liquidity of the market and so on, we have an obligation to make sure this never happens again. And this will happen again if corporate America is allowed to bribe people around Government in order to get them either to do things for them or, in this case, turn a blind eye to billions of dollars, tens and hundreds of billions of dollars, of toxic loans being put onto the backs of the American people through these GSEs which had the full faith and credit of the American people. That is what it is about, and it is more important that we make sure it doesn't happen again than, in fact, whether $165 million went to a group of people who are now unemployed.

That is what we are here talking about. Mr. Kucinich, you are my friend. I hope you hear this time: I do not want in this subpoena to ask for anything related to Members of Congress, but I cannot allow this to continue, us seeing no evil when, in fact, we know there was evil.

I yield back.

Chairman TOWNS. Moving forward, we will turn now to the sole witness, Mr. Neil Barofsky, the Special Inspector General for the troubled asset relief program, whose office has just completed an audit of the hundreds of millions of dollars of retention bonuses AIG has already paid and the millions more it expects to pay.

It is committee policy that we swear in all of our witnesses, please stand and raise your right hand.

[Witness sworn.]

Chairman TOWNS. Let the record reflect that he answered in the affirmative.

Let me just say that you know the rules. We generally give you 5 minutes, but we are going to give you 10, and then of course go into questions and answers, because we think your report is just so valuable that you need additional time, so 10 minutes.

STATEMENT OF NEIL M. BAROFSKY, SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM, OFFICE OF THE SPECIAL INSPECTOR GENERAL

Mr. BAROFSKY. Thank you, Mr. Chairman. I will try to stay under that.

Mr. Chairman, Ranking Member Issa, members of the committee, it is a privilege and honor to return to testify before this committee and discuss with you today the audit that we released this morning into the circumstances surrounding AIG Financial Products payment of approximately $168 million in retention bonuses to more than 400 employees earlier this year.

Last fall policy decisions were made by the policymakers at Treasury and the Federal Reserve that a failure of AIG would have such a high systemic cost that it was worth the unprecedented bailout and use of taxpayer dollars to save that company. The Federal Reserve went first.

In September it gave a line of credit of $85 billion to AIG and followed that by sending teams in to take a close, long, hard look at AIG's executive compensation structure. What they found was a mess. More than 600 different programs, some entitled bonuses, some deferred compensation, some retention plans affecting more

than 50,000 employees, programs so diverse and decentralized that AIG senior executives, themselves, weren't involved in the approval of many of these plans and didn't have a full sense of what they were. A mess so sprawling that even as we concluded our audit late this summer executives at the Federal Reserve Bank of New York, at AIG, and the Fed's consultants still did not have their arms wrapped around the entire AIG executive compensation structure.

The Fed—and by the Fed I am referring to the Federal Reserve Bank of New York—looked at executive compensation from its unique perspective. It looked at the amount of money involved and concerned whether bleeding of cash would impact AIG's ability to repay its loan. They looked to see whether the structure had perverse incentives that would encourage executives to make decisions that would be not in the best interest of the company and, most importantly from the Fed's perspective, inhibit the ability to repay the loan.

Treasury, on the other hand, paid scant attention to the executive compensation structure. Other than discovering and figuring out who the 50 or so employees that would be subject to its executive compensation restrictions that were included in the November $40 billion TARP bailout, Treasury did little more. As a result, when the March 2009, earlier this year, AIG Financial Products retention payments came through, Treasury didn't know about them until 2 weeks beforehand, and they didn't know the scope of those payments, that they were going to apply not just to essential personnel, but also to non-essential, people who worked in the mail room, in the kitchen, in the file room.

Our audit concludes that this was a failure. It was a failure of oversight by Treasury, which essentially abdicated its role in favor of allowing the Federal Reserve, notwithstanding the fact that the Fed had different interests and different concerns than Treasury, as reflected perhaps most clearly by the fact that its agreement with AIG included no provisions relating to executive compensation.

Our audit also concludes that Secretary Geithner did not find out, did not learn of these bonus payments until just days before they were made, but this, too, is a failure. It is a failure of communications and it was a failure of management.

Executives and senior officials at FRBNY knew about these bonus payments back in the fall of 2008 when Secretary Geithner was then president of FRBNY, but none of them alerted him or elevated this issue, according to our audit's findings, notwithstanding the explosive nature and controversial nature of the payments.

At Treasury, they didn't find out until 2 weeks before, but even then it took them 10 days to elevate this issue to the Secretary's level, even though the Fed had warned them, when they notified them about the size of these payments, of the intense press and congressional concern about them, and said, in their words, that they were not going to be easy for Treasury and Fed to defend.

Based on these failings, our audit contained three recommendations. First, when we were conducting our audit we learned that the special master, Kenneth Feinberg, while doing his evaluation of AIG's executive compensation, had not been in touch with FRBNY officials, even though he spent the better part of a year

studying AIG's executive compensation and spent a lot of resources on hiring consultants. We made a recommendation, and after receiving a draft version of this report we have been informed that Treasury has adopted this recommendation and Mr. Feinberg is now dealing with his counterparts at the FRBNY.

We also make two recommendations looking forward. First, that in the future if Treasury is going to be making this type of investment, this type of bailout of a company, that it have policies in place to make sure that there is going to be a comprehensive and not ad hoc review of the executive compensation and other politically sensitive issues so that they know in advance when these issues are lurking around the corner.

Second, to the extent that Treasury continues to rely on other Federal agencies or other entities to conduct its compliance for it, to outsource its oversight, that it do so with policies in place, a plan in place, for if there is anything that we have learned from this audit and the circumstances of March of this year, a failure to give clear directions and have a clear communication protocol with an oversight entity that is doing the oversight for you is a recipe for the disastrous consequences and results that we saw earlier this year.

Mr. Chairman, ranking member, members of the committee, that concludes my opening statement for today and I look forward to answering any questions that you may have.

Thank you.

[The prepared statement of Mr. Barofsky follows:]

EXTENT OF FEDERAL AGENCIES' OVERSIGHT OF AIG COMPENSATION VARIED, AND IMPORTANT CHALLENGES REMAIN

SIGTARP-10-002
OCTOBER 14, 2009

SIGTARP

Office of the Special Inspector General for the Troubled Asset Relief Program

Summary of Report: SIGTARP-10-002

Why SIGTARP Did This Study

The unfolding U.S. financial crisis in fall 2008 resulted in large-scale Federal assistance to many U.S. financial institutions, such as the American International Group, Inc. ("AIG"). Much of this assistance came from the Treasury Department's Troubled Asset Relief Program ("TARP"), with significant assistance also from the Federal Reserve Bank of New York ("FRBNY"). The FRBNY provided the initial Federal assistance to AIG in the form of an $85 billion secured line of credit in September 2008, but it did not impose specific restrictions on executive compensation in connection with its funding. In contrast, Department of the Treasury ("Treasury") officials placed executive compensation restrictions on AIG personnel as it made an initial investment of $40 billion in AIG in November 2008 under authority of the 2008 Emergency Economic Stabilization Act ("EESA"). Considerable Congressional and public outcry resulted from AIG making $168 million in retention award payments to a large group of its employees in March 2009. Questions existed regarding AIG's compliance with executive compensation restrictions and the extent to which Federal officials had advance knowledge of the payments. This report addresses:

- What was 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?
- To what extent were AIGFP retention payments governed by executive compensation restrictions or pre-existing contractual obligations?
- What are the outstanding AIG compensation issues requiring resolution, and what Federal Government actions are needed to address these issues?

What SIGTARP Recommends

SIGTARP recommends that: Treasury and FRBNY officials work collaboratively on future compensation decisions affecting both institutions' ability to be repaid by AIG for their federal assistance. SIGTARP also makes recommendations for improving Treasury oversight of institutions in which Treasury makes a substantial ownership investment. (See body of report for specific details.)

In commenting on a draft of this report, Federal Reserve Board and Treasury officials stated that they concurred with SIGTARP's recommendations.

October 14, 2009

EXTENT OF FEDERAL AGENCIES' OVERSIGHT OF AIG COMPENSATION VARIED, AND IMPORTANT CHALLENGES REMAIN

What SIGTARP Found

When FRBNY officials began examining AIG's executive compensation structure in the fall of 2008, they found a staggeringly complex, decentralized system consisting of hundreds of separate compensation and bonus plans. Over time, they identified 620 AIG bonus programs totaling approximately $455 million for 51,500 employees, 13 retention plans allocating about $1 billion to almost 5,200 personnel, and deferred compensation of approximately $311 million for about 5,400 employees. In early October 2008, FRBNY officials learned that these programs were about to expend $1 billion in retention, bonus, and deferred compensation payments. The magnitude of retention awards to AIGFP was also first discussed with a FRBNY official in early October 2008, and others soon afterwards. During this time, FRBNY officials began focusing on compensation issues, especially after learning that AIG's corporate management had limited oversight of compensation programs across the company. Treasury officials also focused on executive compensation provisions while structuring assistance to AIG in November 2008, but available information indicates that their monitoring of AIG compensation was often limited to receiving periodic information largely provided by FRBNY officials. Although broadly aware of the existence of contractually required retention and bonus payments in November 2008, there is little to indicate that Treasury officials took steps to assess the totality of AIG's compensation. Instead, they focused on identifying an expanded group of executives who would be subject to executive compensation restrictions. Senior Treasury officials did not become aware of details of the AIGFP retention payments until late February 2009. Currently, both FRBNY and Treasury officials are involved in monitoring AIG compensation and changes to those compensation programs, although not necessarily in concert.

Based on available information, the March 2009 AIGFP retention payments were consistent with the law in place at the time the payments were made and AIG's contractual obligations to the Government. These payments were not prohibited under EESA and the American Recovery and Reinvestment Act ("ARRA") and were subsequently excluded from the executive compensation regulations announced in the Federal Register in June 2009. Further, the retention awards were not affected by executive compensation restrictions that were placed on 57 AIG executives as part of the TARP assistance agreement. Several legal opinions concluded that the retention awards were contractually binding payments. Nevertheless, the public outcry over the announced retention payments and well-publicized threats to individual executives, prompted AIG executives to ask AIGFP to return a portion of the awards voluntarily. Collection has been incomplete due to certain employees leaving AIG and reported concerns of employees who remain at AIG regarding the status of future payments under the AIGFP retention plan.

Employee retention may be affected by AIG's structuring of future compensation, which will be informed by the Treasury-appointed Special Master to review pay decisions under its revised guidelines. Balancing the size of future payments, many of which are considered contractually required, against the need to offer incentives to attract and retain key employees is a challenge. Retention efforts are reportedly heightened in AIGFP, because the Special Master has informally advised AIG not to pay the full $198 million of the pending promised retention payments. Meanwhile, FRBNY officials have a great deal of experience in unraveling AIG's compensation structures, and have offered their help; the Special Master reportedly has recently initiated contact with them following SIGTARP's recommendation that he do so.

OFFICE OF THE SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM
1801 L STREET NW
WASHINGTON, D.C. 20220

October 14, 2009

MEMORANDUM FOR: The Honorable Timothy F. Geithner, Secretary of the Treasury
The Honorable Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System
Mr. William C. Dudley, President, Federal Reserve Bank of New York

SUBJECT: Extent of Federal Agencies' Oversight of AIG Compensation Varied, and Important Challenges Remain (SIGTARP-10-002)

We are providing this audit report for your information and use. It discusses the Federal Reserve and Treasury Department oversight of American International Group, Inc. compliance with executive compensation restrictions that were imposed as a condition to receiving financial assistance under the Troubled Asset Relief Program. The Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") initiated this audit due to significant congressional interest, highlighted by written requests of Senator Charles E. Grassley and Representative Elijah Cummings who had concerns about retention awards paid to certain AIG employees in March 2009. SIGTARP conducted this audit as Project 0005 under the authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general of the Inspector General Act of 1978, as amended.

We considered the written comments from the Federal Reserve Board, Federal Reserve Bank of New York, and Treasury; the comments are addressed in the management comments and audit response section of the report. Their full responses are included in Appendices G and H.

We appreciate the courtesies extended to the SIGTARP staff. For additional information on this report, please contact Mr. Barry W. Holman (Barry.Holman@do.treas.gov / 202-622-4633) or Jim Shafer (James.Shafer@do.treas.gov / 202-927-9334).

Neil M. Barofsky
Special Inspector General
for the Troubled Asset Relief Program

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EXTENT OF FEDERAL AGENCIES' OVERSIGHT OF AIG COMPENSATION VARIED, AND IMPORTANT CHALLENGES REMAIN

SIGTARP REPORT 10-002 **October 14, 2009**

Introduction

Between the spring and early fall of 2008, the United States witnessed an escalating crisis in the financial markets. Some institutions found themselves so exposed that they were threatened with failure—and some failed—because they were unable to raise needed capital as the value of their portfolios declined. By September 2008, the ramifications of the financial crisis included:

- the failure of financial institutions, such as Lehman Brothers, that had played critical roles in the financial markets
- increased losses of individual savings
- diminished corporate investments
- further tightening of credit that would exacerbate the emerging global economic slowdown

As this crisis unfolded, agencies such as the Federal Reserve and the Department of the Treasury ("Treasury") took numerous actions to stabilize financial markets and financial institutions. As the situation worsened, Congress enacted the Emergency Economic Stabilization Act of 2008 ("EESA").[1] This program provided authority for up to $700 billion in aid to financial institutions under the Troubled Asset Relief Program ("TARP"). Initial TARP investments injected equity capital into banking institutions, beginning in October 2008, under the Capital Purchase Program. The overall TARP program subsequently expanded to include many other initiatives.

Even before passage of EESA and the authorization of TARP, the financial crisis of 2008 had already taken its toll on American International Group, Inc. ("AIG") — a large, complex, insurance and financial services institution that had deteriorated rapidly and was unable to access the capital markets, causing it to potentially fail to meet billions of dollars in obligations. In particular, AIGFP, an AIG subsidiary, had incurred significant financial losses. In response to the likely systemic implications and the potential for significant adverse effects on the economy of a disorderly failure of AIG, and with the encouragement of Treasury, on September 16, the Federal Reserve Board authorized the Federal Reserve Bank of New York ("FRBNY") to lend up to $85 billion to assist AIG in meeting its obligations and to facilitate the orderly sale of some of its businesses. On October 8, the Federal Reserve announced an additional program under

[1] P.L. 110-343, October 3, 2008.

which it would lend up to an additional $38 billion to finance investment-grade, fixed-income securities held by AIG. This latter assistance was repaid in full by AIG and terminated on December 12, 2008. On November 10, 2008, the Federal Reserve announced the restructuring of the Government's financial support to AIG in order to facilitate its ability to complete its restructuring process.[2] Subsequently, in November 2008, Treasury purchased $40 billion of newly issued AIG preferred shares under TARP's Systemically Significant Failing Institutions ("SSFI") program. The $40 billion took some of the pressure off the initial Federal Reserve line of credit, allowing the Federal Reserve to reduce, from $85 billion to $60 billion, the total amount available under the credit facility. As part of this restructuring, AIG agreed to the imposition of various restrictions with respect to its payment of dividends, its repurchase of AIG stock, severance payments to senior officials, the payment of bonuses, lobbying, and expenses.

On March 2, 2009, the Federal Reserve announced authorization of up to $8.5 billion in loans secured by life insurance cash flows from designated blocks of policies established by domestic life insurance subsidiaries of AIG. Likewise, on April 17, 2009, Treasury established an equity capital facility, from which AIG will be able to access up to $29.8 billion in return for preferred shares in AIG. As part of the equity capital agreement, AIG also agreed to the imposition of various restrictions with respect to its payment of dividends, its repurchase of AIG stock, severance payments to senior officials, the payment of bonuses, lobbying, and expenses. On June 25, 2009, AIG and the FRBNY announced that they had entered into an agreement whereby AIG would reduce its debt to the FRBNY by $25 billion by contributing the equity of two subsidiaries, American International Assurance Company, Ltd. (AIA) and American Life Insurance Company (ALICO), to separate special purpose vehicles (SPVs) in exchange for preferred and common interests in the SPVs. The FRBNY will receive preferred interests in the AIA SPV of $16 billion and in the ALICO SPV of $9 billion.

In March 2009, the Congress and the public expressed significant concerns over reports of AIG making approximately $168 million in retention award payments to a large group of its employees at AIGFP. Questions quickly surfaced over such payments being made by a company receiving large-scale Government financial assistance, and in particular, payments to staff at AIGFP, the group whose financial losses largely had led to the need for federal assistance. Questions also arose concerning the extent to which Federal officials had advance knowledge of the payments and whether those payments complied with executive compensation restrictions that had been imposed on AIG as a condition of its assistance from Treasury.

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[2] As AIG continued to experience problems in the fall of 2008, and, to avoid a credit rating downgrade and to prevent an AIG bankruptcy, the Federal Reserve authorized FRBNY to lend up to $30 billion to a limited liability company formed as a Special Purpose Vehicle ("SPV") that bought assets from AIG's counterparties in exchange for terminating the credit default swap contacts. The SPV, called Maiden Lane III, LLC ("ML III") was funded with loans from the Federal Reserve and a relatively small equity investment from AIG. ML III initially borrowed $24.3 billion from FRBNY in the form of a senior loan, which was adjusted to include an additional $0.3 billion at the end of 2008. AIG also provided $5 billion in equity, for a total of $29.6 billion. These funds were used, in effect, to purchase CDOs at "par" or face value from AIG's counterparties. In connection with this purchase, each counterparty agreed to terminate its credit default swap contracts with AIGFP. No TARP funds were directly used in the ML III transaction. The ML III transaction will be addressed in an upcoming SIGTARP audit report dealing with counterparty payments.

Background

AIG is a global organization employing approximately 106,000 domestic and international employees and doing business in more than 130 countries as of June 30, 2009. AIG primarily offers a broad spectrum of insurance and asset management services, with employees working in these principal business lines:

- Financial Services
- Asset Management
- Life Insurance & Retirement Services
- General Insurance

The Financial Services business encompasses AIGFP, whose primary business is trading in derivatives of stocks, bonds, credit, and commodities as well as energy trading and trading in the foreign exchange markets. Derivatives are financial instruments that "derive" their value from something else (residential mortgage-backed securities, commercial mortgage-backed securities, *etc.*). AIG's financial woes were largely a result of AIGFP's position as underwriter of one type of derivative, credit default swaps,[3] which sustained substantial losses in 2008. AIGFP's credit default swap exposure on multi-sector collateralized debt obligations[4] alone accounted for approximately $19 billion of the almost $25 billion in losses AIG announced in the third quarter of 2008. These conditions led to the Federal Government providing AIG financial assistance in order to prevent a failure of the company and avoid potential market disruptions as the financial crisis facing the U.S. and world markets unfolded. The initial funding and subsequent infusions led to an approximately 80 percent interest in AIG being owned by the Federal Government.[5]

Federal Requirements for Executive Compensation

Important differences have existed between conditions placed on AIG by FRBNY and the Treasury Department as they relate to restrictions on executive compensation. FRBNY's credit

[3] A CDS is a contract where the seller receives a series of payments from the buyer in return for agreeing to make a payment to the buyer when a particular credit event outlined in the contract occurs (for example if the credit rating on a particular bond or loan is downgraded or if it goes into default). It is commonly thought of as an insurance product where the seller is providing the buyer insurance against the failure of a bond. The buyer, however, does not need to own the asset covered by the contract, which means it can serve essentially as a "bet" against the underlying bond.

[4] A CDO is a financial instrument that entitles the purchaser to some portion of the cash flows from a portfolio of assets, which may include bonds, loans, mortgage-backed securities, or other CDOs.

[5] Treasury's June 17, 2009 report entitled "*FINANCIAL REGULATORY REFORM, A New Foundation Rebuilding Financial Supervision and Regulation*," notes that if a large interconnected bank holding company or other nonbank financial firm nears failure during a financial crisis, there are only two options: obtain emergency funding from the U.S. government as in the case of AIG, or file for bankruptcy. It states that neither of these options is acceptable for managing the resolution of the firm efficiently and effectively in a manner that limits the systemic risk with the least cost to the taxpayer. It thus recognizes the need for new tools and options for managing financial crises. It states that among the tools that should be made available to Treasury would be the ability to establish conservatorships or receiverships for failing firms. Then, in choosing among available tools, the report proposes that Treasury should consider the effectiveness of an action for mitigating potential adverse effects on the financial system or the economy, the action's cost to the taxpayers, and the action's potential for increasing moral hazard.

agreement established covenants with which AIG must comply, such as compliance with laws, use of proceeds, and minimum liquidity thresholds. None of the covenants directly restrict executive compensation, but FRBNY had flexible authority under its lending agreements with AIG that stipulated that FRBNY officials shall be "reasonably satisfied in all respects with the corporate governance of the Borrower." This lending condition grants monitoring authority to FRBNY officials over AIG's operational processes and internal controls.

In contrast, the Treasury Department imposed specific compensation conditions affecting senior executives employed by all TARP recipients generally, and AIG specifically in November 2008. Those conditions and others were guided by requirements explicitly stated or developed pursuant to authority granted to the Treasury under EESA. For TARP recipients under the initial capital injection program (known as the Capital Purchase Program), those requirements were generally related to structuring compensation programs to avoid undue risks that would threaten the value of financial institutions, to limiting tax deductibility of executive compensation, to limiting compensation for departing employees, and to provisions for recovering certain payments. See Appendix B for details concerning these requirements, including changes over time.

After Treasury determined that AIG would require Federal financial assistance above that previously provided by the Federal Reserve, Treasury, employing authorities available under EESA, imposed greater compensation restrictions than those imposed on financial institutions participating in the CPP. Accordingly, Treasury's agreement with AIG imposed the following executive compensation conditions that went beyond those placed on CPP participants:

- limits on severance payments, or "golden parachutes," to Senior Partners[6]
- restriction of the total bonus, retention payment, and severance payment to any Senior Partner with respect to 2009 to no more than 3.5 times base salary plus 2008 target annual bonus
- limits of Senior Executive Officers ("SEOs") and Senior Partners' 2008 and 2009 bonus pools to the average of 2006–2007 bonus pools paid (excluding quarterly and supplemental bonus)
- restrictions on payment of bonuses or future cash performance awards to SEOs and Senior Partners out of TARP funds
- restrictions on payments of electively deferred compensation out of TARP funds

The first four restrictions covered 57 employees, which was far greater than the number subject to the executive compensation restrictions under the Capital Purchase Program. The last restriction applied to all AIG employees.

[6] The executive personnel participating in AIG's Senior Partners Plan were identified as Senior Partners for purpose of the November 25, 2008, agreement.

Objectives

This report addresses the extent to which Federal officials were aware of the magnitude of AIG's compensation programs, including the March 2009 AIGFP retention payments, and whether those payments complied with executive compensation restrictions associated with TARP assistance. Specifically, the report addresses the following questions:

- What was the extent of knowledge and oversight by Federal Reserve and Treasury Department officials over AIG compensation programs and, specifically, AIG retention award payments to its Financial Products group personnel?
- To what extent were AIGFP retention payments governed by executive compensation restrictions or pre-existing contractual obligations?
- What are the outstanding AIG compensation issues requiring resolution, and what Federal Government actions are needed to address these issues?

For a discussion of the audit scope and methodology, as well as a summary of prior coverage, see Appendix A. For information on Treasury's restrictions on executive compensation and how they have changed over time, see Appendix B. For a timeline of FRBNY and Treasury officials' knowledge about key AIG compensation matters, see Appendix C. For an example of the award letter granting AIGFP employees the retention awards, see Appendix D. For a complete list of acronyms used in this report, see Appendix E. For the audit team members, see Appendix F. For copies of management comments from the Federal Reserve Board/FRBNY and Treasury, see Appendices G and H.

FRBNY Officials Had Early Involvement in AIG Compensation Decisions, Whereas Treasury Officials Had Far More Limited Involvement

This section provides insights regarding the knowledge of FRBNY and Treasury officials about AIG compensation issues in general and the AIGFP retention program and payments in particular. In the fall of 2008, AIG's compensation structure was being increasingly recognized, internally and externally, as being so decentralized as to make it difficult to get a complete overview of all programs and pending payments. Because of its ongoing contact with AIG, the Federal Reserve staff was in a better position than Treasury officials to appreciate quickly the challenges Federal entities would face in understanding AIG's compensation programs. That fall, after the Federal Reserve had begun providing financial assistance to AIG, but before the Treasury had begun providing such assistance, FRBNY officials began to raise concerns over compensation issues with AIG corporate officials. Both FRBNY and AIG corporate officials have struggled over time to fully understand and document the details of the varied compensation plans within AIG. Even so, detailed knowledge regarding those plans and future payments accrued slowly, based on available documentation provided to SIGTARP. Although FRBNY officials were a periodic source of some information to Treasury staff on AIG compensation issues, available information indicates that senior Treasury officials, over time, were not significantly engaged in the oversight of AIG and, as such, did not gain knowledge of the March 2009 AIGFP payments until shortly before their distribution. Since then, Treasury officials have become more engaged with AIG on compensation issues, along with FRBNY.

Decentralized Decision Making Limited AIG Corporate Management's Knowledge of Its Compensation Plans

AIG's approach to compensation has historically been extremely decentralized. According to officials at AIG, its corporate headquarters generally did not control or approve compensation packages of some of its business units, instead granting authority to those business units to develop and approve their own compensation programs and payment decisions. Moreover, the lack of a centralized management information system hampered collection of consolidated information on such plans.

According to AIG officials, their former long-time CEO, Maurice Greenberg, had managed AIG for more than 35 years during a time that the company had compensation plans weighted toward long-term incentives that were payable generally only at retirement. Key employees were required to remain with AIG until retirement to be vested in their stock-based awards. This practice was employed to deter employees from leaving the company and is commonly referred to as a "golden handcuff." The plans were designed to reward employee longevity. AIG's financial losses since late 2007, however, have reportedly erased most of the value of those potential awards.

By 2008, AIG officials reported that they were taking steps to update compensation plans based on then current industry practices and to address the effect of the financial losses on compensation programs. According to AIG management, they believed that past compensation plans were not meeting the needs of its employees, that financial losses were reducing the compensation available to employees at retirement, and that the combination of these were causing employee retention problems. Some of these plans, including those of AIGFP, were modified during 2007 and 2008 to provide incentives to retain employees whose deferred compensation had been significantly reduced by company financial losses. Those changes were especially significant when, according to AIG estimates, there were losses of at least $5 billion during each quarter between the fourth quarter of 2007 and the third quarter of 2008. AIG's quarterly losses culminated in a loss of approximately $62 billion during the fourth quarter of 2008. During this same time period, AIG officials estimate that AIG employees who held AIG stock lost more than $1 billion in share value. As of March 2009, AIGFP employees alone reportedly had lost around $790 million in future compensation tied to the company's financial performance. AIG officials stated that AIG's deteriorating financial performance created uncertainty about future compensation levels and job stability, so it used its compensation plans to provide incentives for employees to remain at AIG.

AIG stated that, as of March 2009, its approximately 630 compensation plans covering its 106,000 domestic and international employees[7] consisted of bonus payments and retention awards, plus there were a number of deferred compensation balances accrued by employees. The plans were designed for both employees of AIG's business units, or subsidiaries, as well as employees of AIG's corporate holding company.

- **Bonus payments.**[8] According to information developed by AIG officials, among the 620 corporate and business unit bonus programs, there were around 51,500 employees participating in 374 plans that allocated about $455 million in awards for service performed during 2008, which could be paid in increments by December 31, 2009.[9]
    - Bonus pool managed by AIG Corporate - According to information obtained by the compensation consulting practice of Ernst & Young, LLP, the consultant contracted by FRBNY, employees receiving bonuses through the corporate bonus pool received payments totaling approximately $122 million and ranging from approximately $25,000 to just more than $1 million. Data provided by AIG shows that about 98 percent of bonuses awarded to corporate employees were $100,000 or less. According to information provided by AIG

[7] The number of employees is based on data as of June 30, 2009.
[8] Bonus is generally defined as a stock or cash payment for meeting or exceeding performance expectations. However, the structure of such payments in AIG could vary by facts and circumstances present at individual business unit and location, nationally and internationally.
[9] The number of employees and amounts paid and payable under the bonus, retention, and deferred compensation plans are based on unaudited data received from AIG or unaudited data provided by AIG to Ernst & Young, LLP, as of March 20, 2009. The number of participants and amounts distributed under the bonus program do not include approximately 236 plans across AIG pursuant to which employees earn varying amounts based on sales and commissions on those sales or the nine plans governing payments required by local governments of the various countries within which AIG operates. Nor do these numbers reflect plans that pay amounts based on ownership interests on investments in certain products or real estate investments.

to Ernst & Young, LLP, approximately 96 percent of the corporate bonus pool was to be paid by June 1, 2009, with less than $5 million remaining to be paid by December 31, 2009.

- Bonus pools managed by business units - Of the approximately $330 million bonus pool managed by business units in 2008, Ernst & Young, LLP had not obtained complete details of the amounts remaining to be paid under the business unit bonus awards as of the date of SIGTARP's review, due to AIG's inability to collect the business unit data. However, AIG officials provided data on the average bonus scheduled to be awarded to employees in each of by the various business units. See Table 1 for details.

Table 1: Average 2008 Bonus Payments by AIG Business Unit (in dollars)

Business Unit	Average Award
Financial Services	$4,994
Domestic Life and Foreign Life Operations	$5,050
Foreign General Insurance Operations	$5,074
Property Casualty Group	$5,403
Retirement Services Operations	$11,889
Asset Management	$51,026

Source: AIG responses submitted for the record relating to the March 18, 2009, testimony of Edward Liddy before the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises.

- **Retention payments.**[10] AIG and FRBNY officials stated that there are 13 corporate and business unit retention plans as of March 20, 2009, that have allocated awards totaling a little more than $1 billion to almost 5,200 personnel that could be paid through 2010 or upon the sale of a business unit.
  - Corporate and business unit personnel, excluding AIGFP personnel - According to information provided to Ernst & Young, LLP, these retention awards total approximately $617 million for corporate employees and employees in business units other than AIGFP. The total awards divided across total award recipients averages approximately $130,000 and ranges from $500 to $4 million for corporate employees and employees in business units other than AIGFP. According to information provided to Ernst & Young, LLP, approximately 40 percent of retention awards due to all corporate and personnel in business units other than AIGFP were paid or to be paid before June 1, 2009, with approximately $363 million due on or after June 1, 2009 or upon the sale of a particular AIG business.

[10] Retention payments are generally defined as payments for remaining employed until an established date. However, this definition does not necessarily apply to all of AIG's retention programs, of which at least one plan provided payments in the event an employee was subject to an involuntary reduction in force.

- AIGFP personnel – According to information provided by Ernst & Young, LLP, AIGFP retention awards total approximately $475 million and would be distributed over a period of two years. AIGFP retention awards were reportedly not designed to reward employees solely based on performance, and the awards were not necessarily designed to increase with an employee's level of responsibility. Rather, the awards were designed to retain all AIGFP employees who would wind down the complex trades and/or continue AIGFP's general operations. Approximately half of the total retention awards were distributed to around 400 employees in two installments: nearly $69 million in retention awards in December 2008 and approximately $168 million in March 2009. According to AIG officials, individual awards paid in March 2009 ranged from $700 for one File Administrator to more than $4 million for one Executive Vice President, with total awards divided across total award recipients averaging just over $400,000. Within that range, AIG's data indicates that award amounts varied greatly. For example, $7,700 was awarded to one Kitchen Assistant, $59,500 to one Assistant Vice president, $87,500 for one Senior Administrative Assistant, $100,000 to one Vice President, and $980,000 to one Managing Director. Approximately 62 percent of AIGFP employees received retention awards greater than $100,000, according to data provided by AIG. The retention awards paid in March 2009 range from as little as 1 percent of a recipient's base salary to as great as 36 times base salary. Awards paid in March 2009 averaged 2.5 times total base salary. Distribution of the remaining $198 million is expected in March 2010, although the exact total would decrease if there is further loss of employees.

- **Deferred compensation.**[11] According to AIG, there was a total of approximately $275 million in deferred compensation payments distributed from 5,200 participant accounts[12] between January 2009 and September 2009 to AIG employees actively employed with AIG as of December 31, 2008. The deferred compensation balances were established outside of the approximately 630 compensation programs, the balances had grown over the years, and were historically not made until retirement or resignation. According to AIG officials, the $275 million in payments were made prior to these employees retiring or resigning given the substantial losses in their account balances that occurred due to AIG's financial losses. Additional losses to these amounts would likely have occurred should AIG have gone into bankruptcy, and early payments would avoid that risk. According to senior AIG officials, because the balances represented compensation already earned, the deferred compensation payments do not represent discretionary or performance-based awards. According to an AIG official, employees who were retired as of December 31, 2008 will continue to receive a distribution from their accounts based on the terms agreed-upon at their retirement.

AIG's Chief Human Resource Officer stated that many business units reportedly had authority to approve compensation plans for most staff on their own. Those plans may or may not have been reported to corporate headquarters. That same AIG official also stated some units had their own

[11] Deferred compensation is generally defined as a voluntary or involuntary deferral of pay to be distributed at a later date than when earned.

[12] According to an AIG official, the number of participant accounts does not represent the number of employees with a deferred compensation account, as an employee could have multiple deferred compensation accounts.

Compensation Committees to approve their compensation programs. Per information from AIG officials, AIG's corporate-level Compensation and Management Resources Committee approved corporate compensation programs as well as the compensation decisions for about 20 highly compensated executive officers, called "purview employees."

AIG Corporate officials told us that they have been unable to obtain a full understanding of their compensation plans because AIG does not have an integrated information system to show such data. According to AIG officials, approximately 60 different payroll systems housed data for the various plans and there was no integrated system to provide corporate management centralized compensation information to facilitate oversight. Also, the business units are subject to various compensation laws governing AIG's business in more than 130 countries and jurisdictions. AIG officials told us that certain foreign governments impose additional compensation laws with which AIG is required to comply, further adding to the complexity of the various compensation plans. This autonomy, the lack of a requirement to obtain corporate headquarters' approval, disparate compensation information systems, and various compensation regulations hindered the AIG corporate headquarters from obtaining an aggregate knowledge of compensation decisions.

AIG officials stated that after the March 2009 AIGFP retention payments were made, the corporate headquarters implemented a policy that all compensation plans would be reviewed by the Corporate Compensation and Management Resources Committee. However, at the time we completed our field work, AIG and Federal officials told us that they were still working to obtain a complete understanding of the many compensation plans implemented by AIG business units.

FRBNY Officials Developed Early Interest in AIG Compensation Issues and Provided Periodic Information to Treasury

Within fifteen days of signing its September 22, 2008, credit agreement with AIG, a team of FRBNY officers, including Senior Vice Presidents, Vice Presidents, and supervision staff, moved on-site at AIG to assess the magnitude of the company's funding and liquidity needs, to understand its financial condition, and to assess broader risk management issues at the company. According to FRBNY officials, the team's primary focus was on stabilizing the company and addressing imminent risk issues. On September 19, 2008, FRBNY officials engaged Ernst & Young, LLP as a consultant to assist in analyzing these risk issues. In the course of its work, FRBNY officials began obtaining information on the magnitude of pending corporate retention payments and severance awards. Further questions were triggered shortly thereafter when these FRBNY officials learned about AIG's plans to pay more than $1 billion in retention awards, bonuses, and deferred compensation across its corporate unit and various business units. The $1 billion included three separate retention plans, bonuses for employees working for businesses that eventually would be sold, deferred compensation balances such as the ones created under a 15-year-old deferred compensation plan, and compensation for certain senior executives to be paid between September 2008 and June 2009. By mid-fall 2008, FRBNY received documentation highlighting limited information about additional AIG plans, including at least $600 million in impending deferred compensation and bonus pools to AIGFP employees, but

available documentation indicates no further details on the timing of those payments were disclosed by AIG at that time.

An October 10, 2008, letter from an FRBNY Senior Vice President to AIG's Vice President of Global Compensation and Benefits expressed concerns about AIG's proposed payments, including the additional strain these compensation expenses would have on AIG's already tight liquidity position, emphasized by AIG's recent need for Federal financial assistance. In addition, FRBNY senior officials questioned the number of employees potentially receiving these payments, the incentives relative to base salary, and the period over which severance would be paid. For example, their concerns included the severance benefits for one executive departing in 2008 whose benefits would continue for a two-year term. In October 2008, FRBNY broadened the engagement scope of Ernst & Young, LLP to compensation issues, and with its assistance, spent the next several months influencing changes to future compensation decisions, ultimately resulting in restructuring of the 2008 bonus for Senior Partners. The restructuring made a portion of the bonus distribution contingent on making sufficient progress in reorganizing the company and repaying Federal financial assistance, as well as decreasing the 2008 bonus pool 30 percent below 2007 levels. FRBNY officials' influence also led to increased oversight of compensation decisions by AIG's Compensation and Management Resources Committee.

Knowledge Regarding the Magnitude of AIGFP Retention Plan Details Unfolded Slowly

Although the FRBNY on-site team had frequent interactions with AIG officials, details of the magnitude of AIGFP retention awards evolved over a period of several months according to FRBNY officials. At the end of September 2008, AIG briefed a FRBNY Senior Vice President about the structure of the AIGFP retention plan. A FRBNY Vice President received a similar briefing a few days later on October 1, 2008, including details about the total payments. A broader group of FRBNY officials leading the on-site team, including a Senior Vice President and Vice President, recall that they were not informed about the magnitude of AIGFP retention payments until November 11, 2008. Available information indicates Treasury's Counselor to the General Counsel's Office and an Attorney Advisor did not know about the March 2009 proposed payments until the end of February 2009. Treasury's Office of Financial Stability Chief Investment Officer and a Risk Manager also became aware of the retention payment details around this time based on available information received by SIGTARP. See below for a more complete discussion regarding the extent of Treasury's advance knowledge of the retention payments; also see Appendix C for additional information and timelines associated with FRBNY's and Treasury's knowledge of overall AIG compensation matters.

FRBNY officials, including a Senior Vice President and a Vice President who were leading the on-site team, identified early-on that derivative transactions executed by AIGFP traders were a source of risk to AIG's financial health. FRBNY staff believed, however, that those same traders were needed to manage and, in some cases, negotiate to end the complex deals. Thus, early discussions on compensation and retention structures for AIGFP employees began between AIG and FRBNY officials. On September 29, 2008, AIG executives met with FRBNY officials to explain AIGFP compensation and retention plans, including the formal descriptions and guidelines for the AIGFP Deferred Compensation, AIGFP Special Incentive, and AIGFP

Employee Retention Plans. The AIGFP 2008 Employee Retention Plan was created in December 2007 to provide incentives for employees to stay at AIGFP in light of the impact that accounting losses on the derivative transactions would have on employee compensation tied to AIGFP's financial performance. FRBNY officials wanted to determine if the AIGFP Employee Retention Plan was structured in a way that motivated traders to delay selling assets, which would create an accounting loss, in order to avoid having those losses impact their incentive compensation. According to a FRBNY Vice President, a telephone call between an AIG senior official and an FRBNY Vice President on October 1, 2008, reportedly minimized FRBNY officials' concerns after AIG reported that the retention plan excluded, or in some cases limited, the impact certain accounting losses would have on the bonus pool, thus diminishing the incentive of traders to make decisions not in the best interests of AIGFP simply to avoid a reduction in their retention awards.

As stated before, the AIGFP retention awards were not necessarily designed as a typical bonus, based on performance. Rather, as described by AIG, they were designed to retain all of the employees in the unit that would wind down the complex trades and/or the general operations of AIGFP. For example, awards went to employees who were not essential to winding down the trades, such as $7,700 to a Kitchen Assistant, $700 to a File Administrator, and $7,000 to a Mailroom Assistant. During the same meeting, AIG officials verbally disclosed the retention amounts of approximately $319 million for 2008 and $333 million for 2009. Each of these award pools, according to AIG, would be distributed by March 15, 2009 and March 15, 2010, respectively, over a two-year period to AIGFP employees. Of these amounts, approximately $100 million each year would be tied to AIGFP's financial performance and deferred to future periods, with employees expected to receive a net award amount of more than $200 million for each of the two award years. FRBNY officials indicate the award balances were not highlighted as an area of concern at that time, because FRBNY officials were focused on identifying and understanding other risks that could impact AIG's ability to repay the financial assistance provided by FRBNY. Further, while FRBNY officials expressed concern to AIG about the plans being overly broad, it is unclear whether FRBNY officials knew that the recipients of the payments would include non-essential AIGFP support employees who could presumably be replaced easily, such as a Kitchen Assistant and a Mailroom Assistant.

Although there were ongoing discussions between AIG and FRBNY officials between October 1, 2008 and November 11, 2008, available documentation does not indicate additional discussion or disclosure of AIGFP retention award amounts until November 11, 2008. Earlier, AIG officials told FRBNY officials on October 24, 2008, that 30% of the AIGFP retention awards would be accelerated from March 2009 to December 2008 in a broader document summarizing retention and incentive programs across AIG. No dollar amounts for the AIGFP retention awards, however, were described in this October 24, 2008, summary. Subsequently, on November 11, 2008, FRBNY and Ernst & Young, LLP, officials were present during a meeting of AIG's Compensation and Management Resources Committee where they reportedly heard for the first time a discussion of the AIGFP retention programs that included specific amounts to be distributed under the AIGFP Employee Retention Plan.

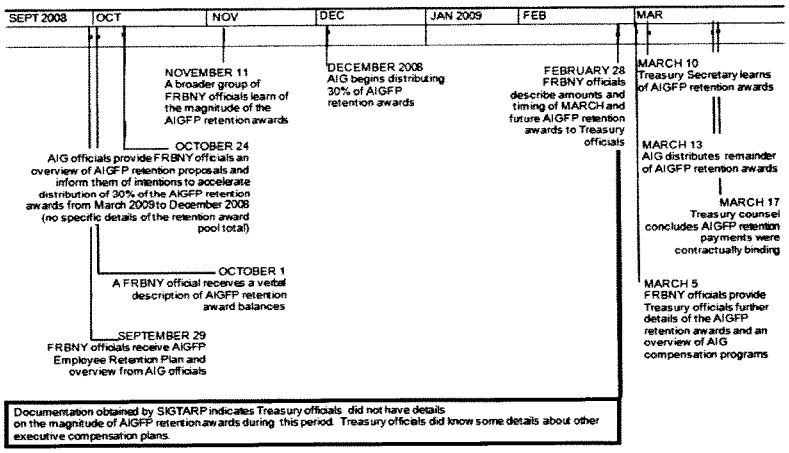
After spending several months studying AIG compensation, Ernst & Young, LLP was able to provide to the FRBNY Vice President leading their on-site team a summary of AIG

compensation programs they had learned about through March 5, 2009, as well as the balances and general timing of distribution of the AIGFP retention awards based on information provided by AIG to Ernst & Young, LLP. On February 28, 2009, FRBNY officials e-mailed Treasury's internal counsel the amounts and timing of the AIGFP retention awards, noting that the issue had "garnered press and Congressional attention" and warning that "it will not be easy for Treasury and the Fed to defend." The e-mail also promised more detailed information, which was later e-mailed to Treasury internal counsel on March 5, 2009. Despite the strong language of the e-mail, a Treasury official told SIGTARP that the e-mail did not raise any flags in Treasury.

Treasury Officials Became More Fully Aware of AIGFP Retention Payments Shortly Before Their Distribution in March 2009

While generally aware of the existence of retention awards, available information indicates that Treasury officials were not aware of the magnitude and timing of the March 2009 AIGFP retention awards until February 28, 2009. Further, available information indicates that their broader knowledge and oversight of AIG compensation plans was far less than that of FRBNY officials and was reliant on what FRBNY officials shared with them. Figure 3 shows a timeline regarding when both FRBNY and Treasury officials became aware of details surrounding the AIGFP retention awards.

Figure 3: Timeline of FRBNY and Treasury Officials' Knowledge of AIGFP Retention Awards



Source: SIGTARP analysis of AIG, FRBNY, and Treasury correspondence.

Treasury officials were present for a time at AIG as early as September 2008 along with FRBNY officials and interacted with FRBNY officials and AIG executives at that time, but Treasury's

involvement subsequently became more sporadic. Subsequent turnover of Treasury personnel left a temporary gap in Treasury oversight. Treasury officials became involved in AIG again in late October 2008, this time working on structuring terms of Treasury's $40 billion November 2008 TARP assistance to AIG. Treasury officials began discussions with AIG, via the outside counsel representing both Treasury and FRBNY, concerning the number of executives who would be subject to executive compensation restrictions.

Due to the extraordinary nature of the Government's investment in AIG, Treasury officials decided to substantially increase the number of AIG executives subject to EESA executive compensation restrictions beyond the five that would be covered under CPP, and their attention was quickly focused on identifying these individuals. A final decision was made to place the restrictions on approximately 70 executives.[13] Of that pool, 57 executives actually signed the November 2008 agreement on compensation restrictions; the others had left the company. However, available information indicates the decision on the number of executives was made with Treasury neither directly coordinating with FRBNY officials nor initiating requests for compensation data that FRBNY officials had gathered. Available documentation and discussions with available Treasury officials indicate that their primary efforts during this time focused on developing the executive compensation conditions and identifying the number of executives subject to those conditions, without an independent, broader assessment of compensation practices and obligations that would have identified a larger number of highly paid employees.

Available information also indicates that between the fall of 2008 and late February 2009, Treasury provided little direct oversight and, as a result, had limited knowledge of AIG compensation plans as a whole. For example, Treasury officials, including the Counselor to the General Counsel, became aware of at least $600 million in **bonus** and **deferred compensation** for AIGFP employees on October 26, 2008, which did not include any amounts intended for AIGFP retention awards. According to AIG Senior Vice President, Human Resources, the deferred compensation was reportedly never actually distributed to AIGFP employees because they were tied to AIGFP financial performance, which declined to such an extent by the fall of 2008 to eliminate the payments completely. Treasury officials, including the Counselor to the General Counsel received other details of severance packages for 48 AIG senior executives on November 7, 2008, as part of determining the compensation conditions to place on AIG executives. Treasury officials also reportedly had very limited staff time devoted to AIG compensation issues during that time. As a result, available information indicates the Counselor to Treasury's General Counsel and Attorney Advisor did not become aware of the timing and magnitude of the AIGFP retention payments that would be paid out on March 13, 2009, until late February 2009.

While senior FRBNY officials were aware of these payments during Secretary Geithner's term as President of the FRBNY, there is no indication in documentation received by SIGTARP or in discussions with FRBNY and Treasury officials regarding to what extent, if any, that Secretary Geithner was aware of the balances and timing of distribution of the AIGFP retention awards before March 10, 2009. While available information indicates Treasury officials became aware of these payments on February 28, 2009, there is no indication they informed Secretary Geithner

[13] The 70 executives represented the five senior executive officers as well as 65 other senior executives who participated in AIG's Senior Partner compensation plan.

until March 10, 2009. Once informed, Secretary Geithner reportedly contacted former AIG CEO Edward Liddy regarding AIG's compensation plans and his concerns with the magnitude of the pending AIGFP retention awards. Since that time, and leading up to the appointment of its Special Master for compensation, Treasury has become more involved with AIG compensation decisions. In March 2009, Treasury established an equity capital facility, from which AIG would be able to access up to $29.8 billion in return for preferred shares in AIG. While the deal, which was not signed until April 17, 2009, required AIG to repay $165 million over a period of five years in an effort to recoup the AIGFP retention awards, no new executive compensation restrictions were placed on AIG and future AIGFP retention award payments went unaddressed. The deal required AIG to comply with new executive compensation regulations that were later issued in June 2009. Shortly after the March retention award distributions, AIG officials began deferring approval of compensation decisions for individuals receiving greater than $250,000 to Treasury officials, with Treasury rendering a "no objection" decision for cases requiring "acute and immediate" attention.

The March 2009 Retention Payments Were Subject to Pre-existing Contractual Obligations and Not Executive Compensation Restrictions

This section presents information on the extent to which AIGFP retention payments were governed by Federal executive compensation restrictions or pre-existing contractual obligations. Based on available information, the AIGFP retention payments were consistent with the law and AIG's contractual obligations to the Government. They were not prohibited under EESA, the American Recovery and Reinvestment Act of 2009 (ARRA), or the post-ARRA legislative changes restricting executive compensation payments. Also, these payments were not governed by executive compensation restrictions that were placed on AIG executives as part of the TARP assistance agreement. Several legal opinions concluded that the payments were contractually required. While there was no effort initially to negotiate reductions to the payments, AIG executives asked Financial Products employees to voluntarily return a portion of the payments after public outcry over the compensation. Although AIG received a commitment from some employees to repay a portion of the retention awards, collection has been incomplete due to certain employees leaving AIG and reported concerns of employees who remain at AIG regarding the status of future payments under the AIGFP retention plan.

AIGFP Retention Payments Were Not Governed by Executive Compensation Restrictions

The March 2009 retention payments are not governed by executive compensation conditions outlined under EESA, Treasury guidelines, or ARRA. First, the March 2009 payments were retention awards based on 2008 plans, which are outside the scope of executive compensation restrictions imposed by Treasury. Second, the plans were exempted under ARRA, which explicitly stated that it did not apply to agreements in place prior to February 11, 2009. Moreover, Treasury's June 2009 interim final rules similarly state that payments accrued or made before June 15, 2009, based on a written employment agreement, are not subject to its executive compensation restrictions. The AIGFP Employee Retention Plan was offered in writing to employees during the first quarter of 2008, and all of AIG's 13 retention plans were offered to employees before February 11, 2009.

Executive compensation conditions placed on AIG as part of Treasury's November 2008 agreement applied to 57 AIG executives. SIGTARP examined the listing of the approximately 400 AIGFP personnel receiving the March 2009 retention payments and found that the recipients did not include any of the 57 persons covered under the TARP agreement restrictions. Moreover, the AIGFP retention pay recipients were not designated as Senior Executive Officers or Senior Partners, nor were any of them the five most highly compensated officers or participants in AIG's Senior Partners plan—categories of employees covered under Treasury guidelines applicable to AIG at the time the payments were made.

Legal Opinions Support Conclusions That the March 2009 Retention Payments Were Contractually Binding

AIGFP employees signed award letters from AIG accepting the terms of the AIGFP 2008 Employee Retention plan. See Appendix D for an example of the award letter. Several government and private parties reviewed the enforceability of the March 2009 retention payments, determining that they were legally binding. First, on March 16, 2009, one of AIG's outside counsels, Paul Hastings, Janofsky, & Walker, LLP, determined that the payments were contractually required and furnished this opinion to AIG and FRBNY general counsel. Second, according to Treasury, in early March 2009, Treasury officials asked another outside counselor, Davis, Polk & Wardwell, who serves as counsel to both Treasury and FRBNY regarding the AIG transactions, to discuss measures that could be taken to prevent the payments from being made. Although they did not provide any written opinion, the outside counsel reportedly communicated to Treasury officials that the retention awards appeared on their face to be contractually binding. Third, shortly after the AIGFP retention payments were distributed to employees, the Treasury Secretary asked the Department of Justice to investigate whether there was a legal basis to recoup the retention awards. The Department of Justice, on March 27, 2009, concluded that there was a low likelihood that alternatives to paying the bonuses would have much legal merit.[14]

While efforts could have been undertaken to achieve pay reductions through negotiations, AIG senior officials told SIGTARP they did not believe that was an option at the time given the contractual obligations and the need to retain those employees. Following the public outcry over the payments made in March 2009 and subsequent congressional legislative efforts to heavily tax the payments, however, AIG officials noted that options for negotiations became more viable.

Efforts Are Underway To Recoup a Portion of the March 2009 Retention Payments

Following the March 2009 AIGFP payments, subsequent congressional hearings, public outcry over the retention payments, and extensive media coverage, along with well-publicized threats to individual employees once details of payments were made public, AIG executives asked certain AIGFP personnel to return voluntarily a portion of the awards. AIG executives stated that they asked personnel who received AIGFP retention awards greater than $100,000 to return 50 percent of the award received. According to AIG officials, as of August 31, 2009, there had been pledges to repay approximately $45 million before taxes and actual repayments of a little more than $19 million before taxes had been made. These same officials state that additional progress to recoup the full amount pledged is subject, in part, to reaching agreement on the extent to which the second portion of the retention awards will be paid, as promised, in March 2010. Although a senior AIG official states future awards totaling approximately $198 million[15] are

[14] The Treasury Inspector General is conducting a separate analysis of the legal grounds for AIG bonus payments and the potential for recouping such payments.

[15] AIGFP retention awards totaled approximately $198 million as of August 31, 2009. The total that will be paid is subject to any changes in the terms of the retention agreements, as well as the number of employees present at the time of distribution.

supposed to be paid in March 2010 as part of the contractual AIGFP retention agreements, AIG officials indicated that they are working to propose new compensation arrangements to AIGFP employees in light of the negative fallout surrounding the March payments. Discussions between AIG and the Special Master regarding the terms of new compensation agreements are ongoing. AIG officials state that changes to the terms of the previously agreed-upon retention awards have created significant compensation uncertainty within AIGFP. As discussed more fully below, this is just one of the outstanding challenges AIG faces in structuring future compensation decisions that retain employees and comply with executive compensation regulations.

AIG's Continuing Employee Retention and Compensation Issues

This section discusses key AIG compensation issues that may affect employee retention and future decisions by the Special Master. AIG faces difficult challenges in balancing the size and timing of future compensation payments, some of which are considered by corporate and government officials to be contractually binding, while also complying with new restrictions on compensation. According to AIG and FRBNY officials, the loss of key employees in AIGFP and other business units could damage AIG's ability to retain customers and sell some of its companies, which are essential factors in repaying the Federal Reserve and Treasury. Recognizing a linkage of past pay decisions to future pay decisions, AIG reportedly has been in discussions with the Office of the Special Master concerning $198 million in future retention payments due to AIGFP employees. The complexity of AIG compensation issues are such that they are likely to require considerable attention of AIG management and Federal officials for some time to come. FRBNY officials, who have had far more detailed experience in examining AIG compensation issues than Treasury officials, are reportedly willing to share knowledge gained regarding AIG's compensation programs with the Special Master in understanding AIG compensation structures and retention challenges. The Office of the Special Master reportedly has recently initiated contact with FRBNY officials following SIGTARP's recommendation that he do so.

AIG Cites Unresolved Compensation Challenges To Retain and Recruit Key Employees

Although new TARP executive compensation regulations issued on June 15, 2009, will bring some certainty to compensation at AIG, the company reportedly has already lost many employees. According to AIG officials, these regulations do not resolve the need to structure compensation to retain and recruit key talent or to maintain a competitive compensation program relative to peer firms, which are not subject to the new regulations. AIG officials state AIG businesses not associated with AIGFP retention payments or financial losses generated by AIGFP credit default swaps have suffered employee turnover because of lost business volume and the negative stigma now associated with the AIG moniker. As a result of the compensation uncertainty, AIGFP and other business units reportedly have suffered hundreds of resignations, which AIG and FRBNY management believe potentially impact the company's ability to operate effectively, and ultimately, to repay Federal assistance.

AIG documentation indicates that dozens of Directors and Officers have resigned across the Commercial Insurance, Worldwide Life Insurance, Investments, and Financial Products businesses. According to senior AIG officials, the requirement to comply with the compensation regulations is another challenge they face relative to their competitors. AIG officials stated that their competitors are successfully recruiting AIG employees, potentially putting those peer firms not subject to the compensation regulations at a competitive advantage in attracting talent. AIG

officials have expressed the view that these resignations are affecting the AIG enterprise at large, but losses are reported to be particularly acute within AIGFP. Losing AIGFP employees is seen by AIG leadership as a significant risk. Because of their institutional knowledge, these employees are considered by AIG as key to finishing the unwinding of the complex derivatives book of business, estimated to be about $1.3 trillion in notional amount as of June 30, 2009. AIG officials emphasized that effectively retaining and recruiting quality staff throughout their organization directly relates to AIG's ability to repay the Federal Reserve and Treasury Department for the Government's investments in AIG.

Special Master's Decisions May Address Some of AIG's Compensation Challenges, but AIG Management Must Still Make Difficult Decisions

The appointment of the Special Master as part of the June 15, 2009, interim final compensation regulations and his subsequent determinations will clarify some decisions on AIG's compensation, but AIG management will still have to make difficult decisions on compensation issues that are outside of the regulations' scope. The Special Master will review the proposed compensation structures, including payments made pursuant to those structures, for the senior executive officers and the 20 next most highly-compensated, as well as the proposed compensation structure for the next 75 most highly-compensated employees. In addition, the Office of the Special Master stated the Special Master has authority to issue an advisory opinion with respect to payments outside of his scope if formally requested in writing by a TARP recipient. The Office of the Special Master states that under the interim final regulations, though, the Special Master is expressly permitted to consider certain prior payments in the course of decisions related to prospective compensation structures.

As noted earlier, according to AIG officials, resolution of the prior pay decisions are clearly linked to future pay decisions. Therefore, upon the Special Master's appointment, AIG began discussions with him with respect to the remaining AIGFP employee retention payments as well as other base pay issues. Although the final outcome of the Special Master's review and approval of these payments is not known, there are ongoing discussions between AIG and the Special Master regarding the amount of the remaining retention payments that will be distributed. Although the Office of the Special Master indicates AIG has not formally requested in writing an advisory determination for the remaining AIGFP retention payments, Treasury's Special Master has informed AIG management that the total of $198 million should be reduced. The Office of the Special Master has not indicated by how much this amount is to be reduced. Further, the Office of the Special Master stated that the Special Master has indicated that full repayment of $45 million in pledged amounts will be required by those individuals subject to Special Master review. According to AIG management, collecting repayments for the total $45 million will be difficult because some of the more than 400 employees originally receiving retention awards and who said they would repay are no longer with the company.

In a letter reportedly sent on July 20, 2009, to the seven firms receiving exceptional TARP assistance, the Office of the Special Master requested a voluminous amount of compensation data with respect to the proposed compensation structures and payments for the senior executive

officers and 20 most highly compensated employees of each recipient. For AIG to gain approval for its proposed compensation packages that fall within the new regulations, the Special Master will review whether AIG proposals are consistent with pay at competitor institutions and that they align with appropriate performance metrics, among other factors. According to the Office of the Special Master, information on the compensation packages of the senior executive officers and 20 most highly-compensated executives[16] was due to the Special Master by August 14, 2009. As of August 31, 2009, AIG received notification from Treasury that their application was considered substantially complete, thus triggering the beginning of the Special Master's sixty-day review. AIG also has to submit information to the Special Master on the compensation structures for the next 75 most highly compensated employees, which is due within 120 days of the issuance of interim final regulations.

FRBNY also has a significant stake in the compensation decisions made by the Special Master. It has developed an extensive body of knowledge and analysis about AIG's compensation programs, retention problems, and overall governance as part of its due diligence performed since signing the credit agreement with AIG in September 2008. FRBNY officials are currently monitoring AIG management's efforts to modify and develop future compensation packages that would require the Special Master's approval. FRBNY officials told us they are willing to work with the Special Master, and the Special Master reportedly has recently initiated contact with them based upon SIGTARP's recommendation.

[16] This would generally include the 5 Senior Executive Officers and 20 other most highly compensated employees.

Conclusions and Recommendations

Conclusions

When FRBNY officials began examining AIG's executive compensation structure after making substantial loans to AIG in the fall of 2008, they found a complex, decentralized system consisting of more than 630 separate compensation and bonus plans covering more than 50,000 employees and involving expected payments of more than $1.75 billion. FRBNY officials quickly began examining the extent of AIG's compensation obligations: FRBNY engaged a compensation consultant on September 19, 2008 and made specific inquiry to AIG management on October 10, 2008. The magnitude of retention awards due to employees of AIGFP—the AIG entity most responsible for AIG's financial problems—was first discussed with a FRBNY official in early October 2008, and a broader group of FRBNY officials learned of the award balances in November 2008. Although they learned of the size of the impending payments and their timing, among other things, it is unclear whether FRBNY officials knew that thousands of dollars in payments would go to non-essential AIGFP support employees, such as the kitchen and mailroom assistants.

In contrast to FRBNY, there is nothing to indicate that Treasury Department officials took any independent steps to assess broadly the amount or scope of AIG's compensation obligations. Treasury officials were engaged in executive compensation-related discussions with AIG in October and November 2008 to formulate the executive compensation restrictions that would be imposed upon AIG senior management in connection with the $40 billion TARP investment in AIG in November 2008. However, Treasury made no broader assessment of AIG's compensation practices and essentially relied upon what it was told by FRBNY. Moreover, we saw little indication that the knowledge being developed by FRBNY about AIG's compensation obligations was being passed along to Treasury in any systematic way: although Treasury officials had some general knowledge of AIGFP bonus and deferred compensation payment obligations as early as October 2008, there is no indication that senior Treasury officials were aware of the details of the March 2009 AIGFP payments until February 28, 2009.

In sum, Treasury did not conduct direct oversight of AIG's executive compensation prior to March 19, 2009, but chose instead essentially to defer to FRBNY. This, coupled with Treasury's subsequent limited communications with FRBNY with respect to that issue, has meant that Treasury invested $40 billion of taxpayer funds in AIG, designed AIG's contractual executive compensation restrictions, and helped manage the Government's majority stake in AIG for several months, all without having any detailed information about the scope of AIG's very substantial, and very controversial, executive compensation obligations. Treasury's failure to discover the scope and scale of AIG's executive compensation obligations, in particular at AIGFP, potentially resulted in a missed opportunity to avoid the explosively controversial events and created considerable public and Congressional concern over the retention payments. At the same time, Treasury's recent report with recommendations for reform to reduce the risk of future financial crises and to strengthen the ability of regulators to address any future crises that may occur seemingly recognizes the need for an improved framework for decision-making and additional options to manage crises such as those confronting AIG with the least cost to the taxpayer.

While SIGTARP saw no indication that Secretary Geithner had personal knowledge of the AIGFP bonuses until March 10, 2009, three days before they were paid, this too suggests a failure of communication. In light of the political sensitivities associated with the bailout of AIG, both as President of FRBNY and subsequently as Secretary of Treasury, it was necessary that Secretary Geithner be informed by his staff, in a timely manner, of such sensitive and significant information so that he could have sufficient time to explore possible solutions. For example, shortly after the payments were made, Treasury announced a commitment to provide an additional $30 billion in support to AIG that may have provided an opportunity to compel the renegotiation of the AIGFP retention payments. His lack of knowledge until the eve of the payment of the bonuses represents a failing at both FRBNY and Treasury to identify adequately the significance of an issue that had been identified as one that would "not easy for the Fed and Treasury to defend" and to inform their leadership.

From a legal perspective, the payments made to AIGFP were not inconsistent with the executive compensation restrictions in AIG's agreement with Treasury or with the statutory restrictions contained in ARRA. The contractual restrictions, for example, applied only to AIG's top approximately 57 executives, none of whom were recipients of the AIGFP retention payments. The restrictions in ARRA, meanwhile, expressly do not apply to plans in place prior to February 11, 2009.

With respect to the ongoing review of executive compensation at AIG, the Special Master indicated that he wants future AIGFP retention payments to be reduced, and though not binding, this may risk further employee turnover and a smaller recovery of voluntary repayments of the 2009 AIGFP retention awards. Because FRBNY employees are advising AIG on future compensation packages and have knowledge about AIG employee retention concerns, such information, if considered by the Special Master, could potentially provide an additional dimension to his evaluations and decisions regarding AIG's prior and future pay decisions. Without this coordination, FRBNY officials may advise AIG officials on changes to AIG compensation plans that will be rejected by the Special Master. We do not believe that this is in the best interest of the Government or AIG. It should be noted that, based on SIGTARP's audit work and after receipt of a draft report that contains this recommendation, the Office of the Special Master has agreed to and reportedly has initiated contact with FRBNY officials.

Looking forward, legitimate concerns exist over large bonus and retention payments to corporate employees of organizations that are now supported by large-scale financial assistance from the Federal Government, particularly at firms such as AIG, which, but for the Government's extraordinary intervention, would be in bankruptcy. At the same time, the uncertainty of future compensation levels poses a challenge for AIG in retaining personnel that will assist in winding down certain businesses, spinning off strong businesses for initial public offerings, and maintaining operations at any portion of the company that remains.

Recommendations

In light of FRBNY's ongoing involvement in monitoring and advising AIG on compensation issues, SIGTARP recommends that the Secretary of the Treasury direct the Special Master to work with FRBNY officials in understanding AIG compensation programs and retention

challenges before developing future compensation decisions that may affect both institutions' ability to get repaid by AIG for Federal assistance provided.

SIGTARP also recommends that Treasury establish policies to guide any similar future decisions to take a substantial ownership position in financial institutions that would require an advance review so that Treasury can be reasonably aware of the obligations and challenges facing such institutions. This includes not only those obligations or challenges of a financial sort that could negatively impact taxpayers' economic returns, but also obligations or challenges that implicate public policy issues (such as the obligation to pay large bonuses to the very entities that caused the financial problems in the first instance, as in the case of AIG) that could negatively impact the credibility of the TARP and Treasury itself.

SIGTARP further recommends that Treasury also establish policies to guide decision making in determining whether it is appropriate to defer to another agency when making TARP programming decisions where more than one Federal agency is involved. In making those oversight determinations, Treasury should bear in mind that its role under EESA, as the primary manager of TARP, carries with it certain obligations to protect taxpayer interests, to promote transparency and to foster accountability to the American people and to Congress, and as has been plainly demonstrated in this report, other agencies, operating with different missions and under different legal and regulatory frameworks, may not have the same priorities. Moreover, to the extent that Treasury chooses to rely on another agency to provide oversight over TARP-related activities, SIGTARP recommends that Treasury establish controls to ensure that effective communication takes place so that Treasury can carry out its own oversight role.

Management Comments and Audit Response

SIGTARP received official written responses to this report from both the Federal Reserve Board and Treasury's Office of Financial Stability. Technical and informal comments from these agencies were also incorporated as appropriate.

While SIGTARP's recommendations are directed at corrective actions needed by Treasury, the Federal Reserve Board stated that it stands ready to work with the Treasury Department's Special Master to implement our first recommendation of working with and taking advantage of the knowledge gained by the Federal Reserve regarding AIG compensation programs. In fact, Federal Reserve officials verbally clarified that conversations in this regard began approximately in the past two weeks following SIGTARP's recommendation. See Appendix G for the full response.

Treasury agreed with all three of SIGTARP's recommendations and has acknowledged that they are already working with the Federal Reserve in implementing the first recommendation. See Appendix H for the full response.

Appendix A — Scope and Methodology

We performed the audit under 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. The report addresses the following objectives:

- What was the extent of knowledge and control by Federal Reserve and Treasury Department officials over AIG compensation programs, and specifically, AIG retention award payments to its Financial Products Group personnel?
- To what extent were AIGFP retention payments governed by executive compensation restrictions or contractual obligations?
- What are the outstanding AIG compensation issues requiring resolution, and what Federal Government actions are needed to address these issues?

We performed work at AIG corporate headquarters in New York City, the Federal Reserve Bank of New York office in New York City, the Office of Financial Stability, Department of Treasury headquarters, and Federal Reserve Board headquarters, in Washington, DC. The scope covered Federal oversight of AIG executive compensation from September 2008 through June 2009. This performance audit was performed in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We completed our review between March 2009 and September 2009. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To assess the extent to which Federal Reserve and Treasury officials were aware of and exerted control over AIG's compensation plans, we reviewed relevant supporting documentation and e-mail correspondence among officials at Treasury, the Federal Reserve Board, FRBNY, AIG, and other entities, including outside law firms, regarding executive compensation. We also interviewed officials of those entities. Key documentation included the FRBNY's September 2008 credit agreement with AIG and Treasury's November 2008 and March 2009 TARP agreements with AIG. We also obtained and reviewed studies performed by contractors regarding the scope of compensation plans at AIG.

To assess the extent to which the March 2009 retention payments were governed by executive compensation restrictions, we reviewed the following:

- Emergency Economic Stabilization Act of 2008
- 31 CFR Part 30 for Capital Purchase Program participants
- Notice 2008 — Programs for Systemically Significant Failing Institutions
- November 25, 2008, agreement between Treasury and AIG
- February 2009 comments on executive compensation from the Obama Administration

- American Recovery and Reinvestment Act of 2009
- interim final executive compensation regulations of June 15, 2009

In addition, we reviewed the 2008 AIGFP Employee Retention Plan and management's communication of the plan to AIGFP employees. SIGTARP compared the names of the 57 AIG personnel subject to the November 2008 TARP agreement's executive compensation restrictions to employees who received awards under the AIGFP Employee Retention Plan. We also reviewed legal opinions rendered by AIG's outside counsel and the Department of Justice on whether the March 2009 retention awards were contractually binding. We obtained an oral summary of the verbal opinion rendered by Treasury's outside counsel.

To assess what Federal Government actions are needed to address outstanding AIG compensation issues, we interviewed AIG executives and Treasury officials. Moreover, we reviewed the interim final executive compensation regulations, documentation on AIG employee turnover, and documentation of individual compensation decisions deferred by AIG to Treasury.

Use of Computer-processed Data

To perform this audit, we used unaudited data provided by AIG on the amounts awarded under various incentive programs and on the employees receiving AIGFP 2008 Employee Retention Plan awards. The extent to which we captured the universe of incentive programs and the AIGFP 2008 Employee Retention Plan award recipients is subject to the completeness and accuracy of AIG's systems.

Internal Controls

As part of the review of Federal oversight of AIG executive compensation restrictions, we obtained and assessed information on AIG's governance of its compensation decisions, which is one component of the control environment. We also evaluated the Federal Reserve and Treasury internal control initiatives that were in place to oversee AIG executive compensation programs and decisions.

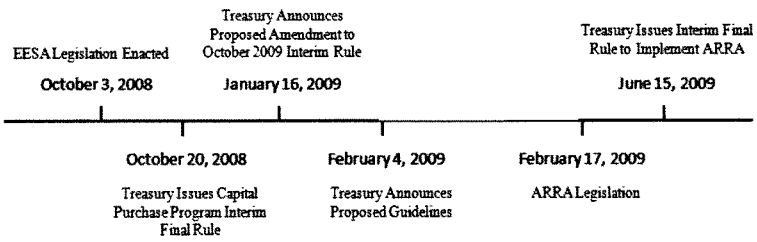
Prior Coverage

GAO, Report No. 09-490T, "*Federal Financial Assistance, Preliminary Observations on Assistance Provided to AIG,*" March 2009.

Appendix B — Treasury Restrictions on Executive Compensation

From the outset of TARP, all financial institutions directly participating in TARP and under an ongoing obligation to Treasury were expected to abide by the requirements for executive compensation set forth in EESA and applicable Treasury regulations and guidance. Since EESA was enacted, additional regulations, amendments, and notices on executive compensation have been issued. Figure 1 illustrates the changes in executive compensation restrictions set forth by Congress and Treasury over time.

Figure 1: Timeline for TARP Executive Compensation Limitations



Source: SIGTARP Analysis of TARP Executive Compensation Guidance

Section 111 of EESA, as originally enacted, required that all financial institutions that sell troubled assets to the Treasury under TARP abide by certain rules on executive compensation intended to avoid unnecessary and excessive risks, to provide for recovery of bonus and incentive payments based on criteria later proven to be materially inaccurate, and to impose restrictions on excessive departure pay (known as golden parachutes) to senior executive officers. On October 20, 2008, Treasury issued an interim final rule implementing the EESA restrictions on executive compensation. This interim final rule established the original standards for executive compensation for institutions participating in the Capital Purchase Program ("CPP"). The primary provisions are described below:

- **Excessive risk:** Incentive compensation for senior executive officers was required not to encourage unnecessary and excessive risks that threaten the value of the financial institution. The financial institution's compensation committee, or a committee acting in a similar capacity, was required to review the incentive compensation arrangements with its senior risk officers within 90 days of Treasury's purchase of preferred shares under the CPP.

- **Tax deductibility:** The institution could not deduct more than $500,000 of executive compensation for each senior executive officer based on limitations set forth under Section 162(m)(5) of the Internal Revenue Code.
- **Clawback:** SEO bonus and incentive compensation was required to be subject to a clawback, i.e., the recovery of any bonus or incentive compensation paid to a senior executive officer if statements of earnings, gains, or other criteria are later proven to be materially inaccurate.
- **Golden parachute:** Golden parachute payments were prohibited for senior executive officers. A golden parachute is defined as "any payment in the nature of compensation to (or for the benefit of) a senior executive officer made on account of an applicable severance from employment to the extent the aggregate present value of such payment equals or exceeds an amount equal to three times the senior executive officer's base amount."

These restrictions covered the institution's SEOs, defined as the Chief Executive Officer, Chief Financial Officer, and the three most highly-compensated executive officers. The restrictions were to apply for as long as Treasury held an equity or debt position in the institution.

On January 16, 2009, Treasury announced proposed amendments to its October 2008 interim final rule to include requirements for reporting and recordkeeping with respect to the executive compensation standards for CPP recipients. The January announcement stated that these regulations would be effective on the date they were published in the *Federal Register*. However, because of the transition of administrations and the resulting hold on all new regulatory actions, these amendments were never published in the *Federal Register*; therefore, they were never put into force.

Additional uncertainties about executive compensation restrictions flowed from proposed guidance announced on February 4, 2009, and differing requirements enacted later that month. On February 4, 2009, Treasury proposed restrictions that, among other things, generally sought to limit the future annual compensation of senior executives of TARP recipients to $500,000, in addition to grants of long-term restricted stock and long-term incentive awards (or in the case of TARP recipients that did not receive exceptional assistance, to have this limit waived through a shareholder vote on compensation and to increase the number of senior officers covered by the clawback and golden parachute provisions). Treasury also proposed that the guidelines would not apply retroactively to existing investments or to previously announced programs, but would apply to newly announced programs. Before the February 2009 guidance could be fully implemented, however, the American Recovery and Reinvestment Act ("ARRA") was signed into law on February 17, 2009. ARRA amended EESA requirements related to executive compensation, including these provisions:

- specifying what constitutes a golden parachute payment and the executives subject to a prohibition on such payments
- adding additional specificity to employees subject to clawback provisions
- limiting incentive compensation to one-third of selected employees' total compensation (The number of employees affected depends on the amount of TARP funding received.)

- specifying categories of employees who would be subject to incentive compensation restrictions, depending on the amount of TARP assistance received by the institution
- requiring institutions receiving TARP assistance to provide for a non-binding shareholder vote on executive compensation packages, the so-called, "Say on Pay" requirement

ARRA Required Treasury To Issue Implementing Regulations

On June 10, 2009, Treasury announced its latest interim final rule to implement the executive compensation requirements outlined in ARRA. The interim final rule was to be effective on June 15, 2009, the date published in the *Federal Register*, and will be finalized after consideration of comments received during a 60-day comment period. According to Treasury officials, the latest Interim Final Rule attempts to harmonize requirements in ARRA and prior guidance from Treasury and to make the following changes to previous interim rules or proposed guidance:

- The annual compensation limit of $500,000 proposed by Treasury in February 2009 was not retained.
- Bonus payments to senior executive officers[17] and to a specified number of the most highly compensated employees of TARP recipients were limited to one-third of total compensation.[18]
- The golden parachute prohibition will now extend beyond SEOs to include the next five most highly compensated individuals, and the definition of a golden parachute includes any and all payments made at the time of departure or change in control for services not performed.
- The clawback requirement applies to the SEOs and the next 20 most highly compensated individuals.

Although the above provisions generally apply to all TARP programs, the interim final rule established separate requirements for institutions receiving exceptional assistance under the Targeted Investment Program ("TIP"), Systemically Significant Failing Institutions Program ("SSFI"), and the Automotive Industry Financing Program ("AIFP"), as noted below.[19] The rule also created an Office of the Special Master for TARP Executive Compensation within Treasury. For the TARP recipients receiving exceptional assistance,[20] the Special Master will review compensation payments and structures for the SEOs and the next 20 most highly compensated

[17] A "named executive officer" of a TARP recipient is defined under Federal securities law to generally include the principal executive officer ("PEO"), principal financial officer ("PFO"), and the next three most highly compensated employees.

[18] The rule defines "most highly compensated" employees by reference to total annual compensation as calculated under federal securities regulations, in order to most accurately capture the amounts earned by these executives each year. The number of most highly compensated employees covered by the limit depends on the amount of financial assistance the company has received.

[19] The restrictions do not apply to those institutions that have repaid their TARP funds while Treasury still holds warrants to purchase the common stock of those institutions.

[20] The seven companies are American International Group, Bank of America, Citigroup, General Motors, General Motors Acceptance Corporation, Chrysler Financial, and Chrysler.

employees at each institution. In addition, he will be reviewing compensation structures for executive officers and the next 75 most highly compensated employees of TARP recipients receiving exceptional assistance. According to Treasury, this is to ensure that compensation is structured to protect taxpayer interests and to promote long-term shareholder value.

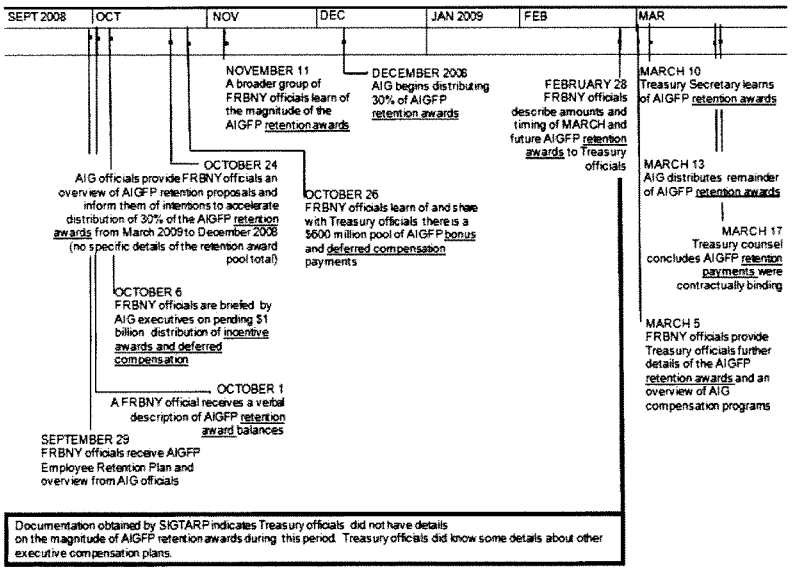
Furthermore, the Special Master is granted a "look-back" authority to review, for all TARP recipients, certain payments between the closing date of the contract with the TARP recipient and February 17, 2009 (the date of ARRA's enactment). The reviews will cover all bonuses, retention awards, and other compensation paid to the 5 SEOs and the next 20 most highly paid employees. This look back assessment will be conducted to determine whether any such payments were inconsistent with the purposes of TARP or were otherwise contrary to the public interest. The Special Master may then seek to negotiate for appropriate reimbursements.

The Special Master is also authorized to provide advisory opinions regarding the application of the interim final rule to particular payments and compensation plans. These opinions may be issued at the request of the participating TARP recipient or by the Special Master at his own initiative.

Appendix C — Timeline of FRBNY and Treasury Officials' Knowledge of Key AIG Compensation Matters

At the end of September 2008, AIG first briefed FRBNY officials about the structure of the AIGFP retention plan, including details about the total payments provided to one FRBNY official a few days later. Shortly thereafter, FRBNY officials became aware of $1 billion in pending compensation and incentive payments, and they expressed concerns to AIG executives. It was not until November 11, 2009, however, that a broader group of FRBNY officials recall being informed about the magnitude of AIGFP payments. Treasury officials received periodic updates on AIG compensation, primarily from FRBNY officials, but did not know about the March 2009 AIGFP retention payments until the end of February 2009. Figure 2 shows a timeline of when FRBNY and Treasury officials became aware of details surrounding AIG compensation.

Figure 2: Timeline of FRBNY and Treasury Officials' Knowledge of Key AIG Compensation Matters



Source: SIGTARP analysis of AIG, FRBNY, and Treasury correspondence.

Appendix D — AIGFP Employee Retention Award Letter

SCHEDULE 1

Confirmation and Acknowledgement

Name of Covered Person: _____
Member of Senior Management Team: _____ Yes or No _____

Compensation Year	Previous Guarantee	Buy-Out Amount	Guaranteed Retention Award
2008			
2009			

I acknowledge that I have received, read and understood the AIG Financial Products Corp. 2008 Employee Retention Plan (the "Employee Retention Plan") and that my participation in the Employee Retention Plan, including any payment of a Guaranteed Retention Award to me under the Employee Retention Plan, will be subject to the terms of the Employee Retention Plan, which provide in part that payment of Guaranteed Retention Awards (i) is subject to continued employment to the extent provided pursuant to Section 3.04, and (ii) is subject, if I participate in the Deferred Compensation Plan (as defined in the Employee Retention Plan), to deferral and, to the extent deferred, shall become an unsecured subordinated liability of AIG Financial Products Corp. to me and my Beneficiaries.

I further acknowledge that my right to receive any Guaranteed Retention Award under the Employee Retention Plan is separate from and independent of any Notional Bonus Amount I might receive for 2008 or 2009, as that term is defined in the Deferred Compensation Plan, and that, to the extent the portion of any Guaranteed Retention Award or any additional Notional Bonus Amount is subject to deferral as a Stock-Indexed Deferral, I waive any claim that such deferred amount would be subject to, or payable to me pursuant to, the Deferred Compensation Plan without reference to the terms of the Employee Retention Plan.

In the event that I should die prior to receipt of all Guaranteed Retention Awards to which I am entitled under the Employee Retention Plan, I hereby direct that, pursuant to Section 2.01(c) of the Employee Retention Plan, all amounts due to me under the Employee Retention Plan be distributed as follows:

Proportion	Name of Beneficiary(ies)
_____	_____
_____	_____
_____	_____

_____ Signature of Covered Person

_____ Date

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Appendix E — Acronyms

Acronym	Definition
AIGFP	American International Group, Inc., Financial Products Corp.
ARRA	American Recovery and Reinvestment Act of 2009
EESA	Emergency Economic Stabilization Act
FRBNY	Federal Reserve Bank of New York
SEOs	Senior Executive Officers
SIGTARP	Special Inspector General for the Troubled Asset Relief Program
SSFI	Systemically Significant Failing Institutions
TARP	Troubled Asset Relief Program

Appendix F — Audit Team Members

This report was prepared and the review was conducted under the direction of Barry Holman, Audit Director, Office of the Special Inspector General for the Troubled Asset Relief Program.

The staff members who conducted the audit and contributed to the report include:

Alisa Davis

Trevor Rudolph

James Shafer

Kamruz Zaman

Appendix G — Management Comments from the Federal Reserve Board and the Federal Reserve Bank of New York

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

SCOTT G. ALVAREZ
GENERAL COUNSEL

October 9, 2009

Mr. Neil Barofsky
Special Inspector General
for the Troubled Asset Relief Program
1801 L Street, NW
Washington, DC 20220

Dear Mr. Barofsky:

Thank you for the opportunity to comment on your draft audit report dated September 30, 2009, and titled *Extent of Federal Agencies' Oversight of AIG Compensation Varied, and Important Challenge Remain.*

The draft report focuses on one aspect of federal regulators' involvement with American International Group, Inc. ("AIG") since September 16, 2008: the monitoring and oversight of AIG's retention payment and bonus policies and practices. We concur with the report's conclusions that the Federal Reserve Bank of New York ("FRBNY") had early involvement in monitoring AIG compensation decisions; that the March 2009 retention payments were subject to pre-existing contractual obligations; and that AIG continues to face employee retention and compensation issues.

Although none of the recommendations are directed toward the Federal Reserve or FRBNY, the first recommendation does address the interaction between the Special Master for TARP Executive Compensation and the FRBNY. In accordance with that recommendation, we stand ready to share our knowledge of AIG compensation practices with the Special Master and, in fact, have been doing so. It is important to note, however, that the Special Master has complete responsibility and statutory authority over decisions under the Treasury's interim final regulation regarding compensation payments and programs. As a creditor, the Federal Reserve's authority over AIG compensation programs is limited and does not include responsibility for, nor expertise in applying, the standards that govern the Special Master's decisions.

Sincerely,

Appendix H — Management Comments from Treasury

ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 9, 2009

Neil M. Barofsky
Special Inspector General
Office of the Special Inspector General for the Troubled Asset Relief Program
1500 Pennsylvania Ave., NW, Suite 1064
Washington, D.C. 20220

RE: SIGTARP Official Draft Report

Dear Mr. Barofsky:

Thank you for giving the Department of the Treasury (Treasury) the opportunity to review and comment on your official draft audit report regarding federal agencies' oversight of AIG compensation. We welcome your comments and suggestions as Treasury continues to strengthen oversight of financial institutions participating in programs established under the Emergency Economic Stabilization Act.

Treasury concurs with your three recommendations contained in the audit report, and has taken specific actions, or will be taking actions, to implement your recommendations. We have provided below an overall summary response for each recommendation, and will provide a supplemental response letter at a later date describing actions we are taking to insure that your particular concerns are addressed.

***SIGTARP Recommendation:** The Treasury Secretary should direct the Special Master to work with Federal Reserve Bank of New York officials in understanding AIG compensation programs and retention challenges before developing future compensation decisions that may affect both institutions' ability to receive repayment of Federal assistance from AIG.*

The Office of the Special Master has spoken to Federal Reserve Board and Federal Reserve Bank of New York (FRBNY) officials on numerous occasions in recent weeks to take advantage of FRBNY's knowledge of AIG's compensation programs and retention challenges.

***SIGTARP Recommendation:** Treasury should establish policies to guide any similar future decisions to take a substantial ownership position in financial institutions that would require an advance review so that Treasury can be reasonably aware of the obligations and challenges facing such institutions.*

Treasury has no present intention of taking a substantial percentage ownership position in any additional financial institution. Nevertheless, Treasury intends to develop policies and protocols that can be used, subject to applicable time constraints, in evaluating potential TARP investments in institutions requiring exceptional assistance.

Additionally, the current Administration has proposed legislation to create a new regulatory regime that will allow for better monitoring, mitigation and responses to risks in the financial system. The proposed regime would include "resolution authority" for large and interconnected financial firms during extraordinary times, and would require strict governance and control procedures over these firms.

SIGTARP Recommendation: ***Treasury should establish policies to guide decision making in determining whether it is appropriate to defer to another agency when making TARP programming decisions where more than one Federal agency is involved. To the extent that Treasury chooses to rely on another agency to provide oversight over TARP related activities, Treasury should establish controls to ensure that effective communication takes place so that Treasury can carry out its own oversight role.***

Treasury agrees with the importance of effective communication when various Federal agencies have a role in executing TARP programs, and Treasury has developed a framework and plan for internal control over TARP.

Treasury maintains broad oversight of all TARP programs. Treasury has coordinated with other Federal agencies when executing certain programs in order to leverage platforms that are currently in place at these agencies. For example, Treasury has worked extensively with the FRBNY to develop appropriate controls and oversight mechanisms for the Term Asset-Backed Securities Loan Facility. Treasury will continue to work closely with other federal agencies that are involved in TARP programs to ensure that Treasury can carry out its oversight role.

We share your commitment to oversight for all TARP's programs, and communication with all Federal agencies that are part of the coordinated effort to stabilize our financial system. Thank you for your continuing efforts to help us improve our programs.

Sincerely,

Herbert M. Allison, Jr.
Assistant Secretary for Financial Stability

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, 6th Floor
Washington, D.C. 20220

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

Chairman TOWNS. Thank you very much for your statement, and thank you for the work that you have done. You have done a superb job, and we thank you for it.

Let me begin by saying AIG is now proposing to pay another $198 million in bonuses, so we have history repeating itself. Shouldn't those bonuses be reduced, given the poor performance of the company?

Mr. BAROFSKY. I think these are exactly the issues that Mr. Feinberg is now grappling with, is looking at these bonus payments, not just within respect to Financial Products but in the overall picture of AIG's bonus situation. There is an opportunity that is here because of the advance knowledge that really didn't exist last time because it took so long for senior officials at Treasury to know about them until just days beforehand. But I think those are very important considerations that are going to be addressed.

Chairman TOWNS. I know after the media got onto the situation last year, during the spring, the uproar over AIG's bonuses, AIG announced that its executives had agreed to return $45 million. How much of that really was collected?

Mr. BAROFSKY. As of the conclusion of our audited field work in August it was $19 million had been collected.

Chairman TOWNS. Less than 50 percent?

Mr. BAROFSKY. Less than 50 percent.

Chairman TOWNS. If I read your report correctly, some of these executives are refusing to give back the money unless they can get commitment that they are going to get the bonus the next year, so they are holding it in ransom.

Mr. BAROFSKY. I think it was described to us as a wait and see attitude. They want to see what they are going to be getting after Mr. Feinberg conducts his review of the $198 million next March before they commit or fulfill their commitment to pay back the bonuses. I think that is correct.

Chairman TOWNS. What about those that left the company?

Mr. BAROFSKY. AIG has noted that it would be difficult for them to enforce collecting the money for those that have left the company.

Chairman TOWNS. You know, the media has focused on the $165 million of bonuses AIG paid out in March, but is not it true that shortly after the AIG bailout last September the Federal Reserve learned that AIG had planned to pay over $1.7 billion in bonuses and retention plans?

Mr. BAROFSKY. That is correct, Mr. Chairman. Across all the different programs affecting approximately 50,000 AIG employees worldwide, that is the approximate number. I say it is an approximate number because, as I mentioned, even today they still don't have—or at least as we concluded our audit work—they still don't have their arms wrapped around all the various AIG bonus and retention and deferred compensation structures.

Chairman TOWNS. Right. Why didn't the last administration extract any bonus concessions out of AIG in return for the $85 billion bailout?

Mr. BAROFSKY. Well, the Federal Reserve put no restrictions in. They view themselves as a creditor, as opposed to having made an

investment, and the only provision in their agreements related to general governance issues, which is what they use to take a look at AIG's bonus structure, and why they focus on issues related to paying back money. And this is one of the criticisms of our report.

When Treasury outsourced its oversight to the Federal Reserve, Federal Reserve had a far different interest and approach to executive compensation than what Treasury had to do as an investor on behalf of the Government people. So their concerns were based on getting money to pay back the loan but didn't focus on the issues that this Congress, when it enacted the TARP, required Treasury to consider when using TARP funds.

Chairman TOWNS. Right. Is it true that AIG's management still does not have a complete picture of AIG's different bonus and retention obligations? Did AIG ever really know where all the money was going?

Mr. BAROFSKY. As of the time we concluded our audit work, that is correct. They did not know. This was an incredibly decentralized system. It was, as I mentioned in my testimony, a mess.

Chairman TOWNS. Right. I knew Treasury and the New York Feds have been on the ground for months at AIG. Have they taken any steps to address this problem?

Mr. BAROFSKY. The Federal Reserve, to its credit, when it came in in September recognized what a mess it was, and they hired an outside consultant, Ernst and Young, who has assisted them in getting their arms wrapped around these programs. Some of the basic data took 5 or 6 months to pull out of human resources. So they have been making an effort and have committed resources, but the task is such an enormous one, but they have been trying to get their arms wrapped around these issues.

Chairman TOWNS. Is it fair to say, based on your audit, that there was a breakdown in communications between Treasury, of course, and the Federal Reserve regarding AIG's plan?

Mr. BAROFSKY. I think that would be kind to have it as a breakdown. I think that they were essentially, after Treasury invested the $40 billion, communications were virtually non-existent.

Chairman TOWNS. Right. And then I think my final question before I yield: are Treasury's pay restrictions truly enforceable? How hard would it be for TARP recipients to circumvent the bonus restrictions, if they just said we are not going to do it and started looking for ways and methods?

Mr. BAROFSKY. It is particularly difficult with agreements like this that were executed prior to February 11, 2009, which is the cutoff date in ARRA, which set forth these restrictions.

But on the flip side, we have to remember that we are also, with respect to AIG, we own 80 percent of the company, and I think sometimes it is important for the Federal Government to recognize the leverage that is associated with having such a significant ownership interest when seeking to renegotiate these payments.

Chairman TOWNS. Right.

I now yield 5 minutes to the gentleman from California, Mr. Issa.

Mr. ISSA. Thank you, Mr. Chairman.

I have called this a political bankruptcy and I stand by that. Had a genuine bankruptcy occurred, is not it true that all these contracts would have been immediately void or voidable?

Mr. BAROFSKY. Mr. Issa, I am not a bankruptcy expert, so I am not sure, but certainly——

Mr. ISSA. Has someone mentioned that to you at some point?

Mr. BAROFSKY. No, no. I don't want to be definitive, but I am pretty sure that a bankruptcy would certainly impact those types of contractual obligations.

Mr. ISSA. You know, I fly United Airlines back and forth every week, so I sit and stand with the flight attendants who watched their obligation for their pension be shut off the day they went into bankruptcy and what they got was pennies on the dollar, so I'm very familiar in that sense with how broad bankruptcy can be, even if I hadn't had to deal with it in my own business life.

But looking forward, the special master, Mr. Feinberg, he is going to make these decisions, the pay czar, if you will. Are you going to have full access and oversight as the IG of his decision process?

Mr. BAROFSKY. Absolutely. That is clearly within our jurisdiction.

Mr. ISSA. The next time we have you back or in an interim report if you can, can you do us a favor, I believe on both sides of the aisle, and de-aggregate, if you will, $165 million and all these numbers, and give us the amount that would be fair and reasonable that should be paid that would be paid, if you will, in somebody else's opinion, and/or the amount of people whose bonuses are not in question.

I bring this up for a moment. I am not trying to say that we shouldn't have done a better job. As a matter of fact, the second half of what I am going to ask is very much about that. But is not it true that $165 million, some of those people should have gotten what they got, and some of those people got relatively small bonuses compared to others; is not that true?

Mr. BAROFSKY. I think that is a difficult question to answer because of the policy implications. As you noted, if there was a bankruptcy it is likely that none of these people would have received any bonuses. What the value of these individuals is really beyond the scope of our work. It would be difficult for me to answer that question.

Mr. ISSA. OK. Well, hopefully you will be able to do it in some future time.

Would you also, every time we get a report, give us the base pay of the individuals relative to bonus so that we know over the covered period how much they made in pay. In other words, if you pay $1 billion in salaries and you have $165 million in bonuses, you have 16.5 percent bonus. On the other hand, if you pay $100 million in base pay and $165 million in bonuses you have 165 percent. We need to know that. I think it is going to help this committee understand, or at least the American people understand the magnitude, because I believe up until now we have been dealing with these, first of all, small numbers compared to the trillions that are still floating around in the risk pool, and we probably have been stepping on some individuals who simply—sort of the janitor's bonus for not leaving and letting the toilets back up. You know, perhaps we should look at those as not all equal.

Let me go to one other question, though, because, you know, when you talked about abrogating responsibility to the Fed, you

really abrogated it—or we abrogated it as a Government through Treasury to Mr. Geithner; is not that true?

Mr. BAROFSKY. He was the president of FRBNY at this time, yes.

Mr. ISSA. And the question for us here today is: what did he know and when did he know it and why didn't he know it if today he is the Treasury Secretary? Was he inept? And I am going to go through a quick set of questions for you.

My understanding is your investigation only went up to the senior vice president, probably AIG relationship monitoring. That would be the highest level that was interviewed; is that roughly right?

Mr. BAROFSKY. As far as interviews are concerned, I know we did talk to the senior vice president level, but I also personally spoke to higher ranking members at FRBNY.

Mr. ISSA. OK. So if the senior vice president in the area that we think over risk management would have been the person to talk to, if above that you have an executive vice president, today it is Sandy Krueger, above that you have a first vice president, today it is Christine Cumming, above that you have a president. And, of course, above that you have the Board of Directors and the chairman of the Board, and above that you had Tim Geithner.

How do we know today that no one in that chain knew—we assume many of them did—and that none of them talked to Mr. Geithner? In other words, in your opening statement you said, well, the Fed didn't know. Well, how do we know they didn't know if these individuals haven't been personally interviewed to find out if they spoke to anyone at the Fed, Federal Reserve Bank of New York, including Mr. Geithner?

Mr. BAROFSKY. When we do our review we obviously request a broad range of documents, we ask to speak to a broad range of people, we ask to be identified a broad range of people, and in this audit, like all our audits, we talk to senior people at the Federal Reserve, as well as at Treasury, as well as at AIG, and one of the questions that we asked was: was communications up and to the then president, current Secretary, Mr. Geithner. We review those documents. We talk to a number of individuals. We talk to the individuals that we think are necessary.

As far as Secretary, himself, he has publicly made statements about the time of his knowledge, and we saw nothing in our report or in our interviews that would indicate that he was not being truthful. From our perspective this is a significant failing in management, but I also think it is important to note—and this is sort of what gets to one of our recommendations—is that the Federal Reserve did not view, until very recently—I mean until recently before the payments were made—didn't really view these as much of a big deal. They were looking at this purely from a dollars and cents perspective of $165 million, which, while significant, was a drop in the bucket compared to their over-arching concern, which was paying back the debt. They were not concerned, and that is the problem about Treasury outsourcing this, because while Treasury may have been and would have been required to have been more sensitive to these issues, the Federal Reserve was looking at this from a creditor, and $168 million from a creditor's perspective just wasn't that much of a concern.

So I am confident that audit team took the steps that were necessary to answer that question. It is a question that I wanted them to answer about when Mr. Geithner became aware of this.

And I would also like to note that we share our information and drafts of this audit report and we check in both formally and informally to make sure that we have our facts right. There is nothing that could prevent individual officials at the Federal Reserve from lying to us. There is nothing that could prevent them from withholding documents that we requested. But we saw no indication of any of those things occurring, and I stand by my audit team's work on this and in their belief that we didn't see anything that indicated that he knew before March 10th.

Mr. ISSA. Thank you, Mr. Chairman.

Chairman TOWNS. The gentleman's time has expired.

I yield 5 minutes to the gentleman from Maryland, Mr. Cummings.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

Thank you, Mr. Barofsky. You talked during your opening statement about this failure to communicate somewhere between Treasury and the Federal Reserve. Who is dropping the ball there? I guess what I am trying to do is trying to figure out how do we make sure that there is communication that needs to happen. I mean, so how would you remedy that? I looked at your recommendations and you seem to talk about a plan, but how do you think we ought to try to deal with that?

Mr. BAROFSKY. I think the issue is that, once the decision was made that the Federal Reserve was going to take the lead of doing oversight and doing compliance, there wasn't any protocol established. There wasn't any communication. What types of things are we interested? What types of things are we looking at? Whether it was because of a lack of resources or a lack of commitment, the Fed was sort of left off to its own.

What we recommend is to learn the lesson here and to establish, first of all, in any extent possible Treasury should directly be involved in providing oversight when it is TARP money. This is Treasury's responsibility ultimately. But in those circumstances where it is decided to outsource, there has to be established plans, policies, and procedures. Treasury needs to identify for the Federal Reserve what are the issues that it wants it to followup on, and then they have to maintain and followup. Set guideposts. Set milestones. Make it a priority to have that level of communication.

I think ultimately it is difficult to assign blame squarely on one entity or the other, but ultimately it was Treasury's responsibility to provide oversight for the first $40 billion.

Mr. CUMMINGS. Now, in my discussions and letters with Mr. Liddy, exchange of letters with Mr. Liddy, the former CEO, he used all kinds of terms like retention payments, bonus payments, and he didn't use these words, but he did say that they needed to keep certain employees for winding down. They were the only people that could wind down.

It seems like it was all kinds of reasons why they were keeping these folks, but then, when I see that we have an unemployment rate of 8.5 and we are supposed to believe that AIG would not have been able to replace—and I do have a lot of empathy for kitchen

assistants and mail room assistants getting $7,000 bonuses, and we are supposed to believe that AIG Financial Products could have unwound the problem trades without so-called crucial employees, retaining them, I'm talking about the big, big money. As you know, it was not lightweight bonuses. These people got some nice, nice, nice funds.

So, I mean, in your research did you find that there was a need to keep folks on? It seems like it is such a wide range of folks who were getting bonuses. And when you get down to the mail room, when you've got millions upon millions of people unemployed in our country, you have to wonder.

Mr. BAROFSKY. Congressman, I think you are absolutely accurate. I don't think that it is defensible to suggest that if AIG did not pay a retention payment to a mail room employee or a kitchen assistant that employee, A, would necessarily leave and, if that employee left, whether it would be difficult to replace that position, given the state of the economy.

But I also think the first part of your statement, this also is a problem with transparency. I, too, was left with the impression after the hearings and all the public announcements that these payments were going to those who were necessary and involved to unwind these complex transactions, and it was one of the things that surprised me the most as I saw the audit work come in, that this was essentially to every single employee at Financial Products.

Here the failure of transparency goes to what we were discussing just a moment ago: the fact that Treasury had outsourced this and wasn't aware of this information meant that it couldn't be transparent about these payments because they didn't have that knowledge.

As I have discussed in other reports and I will be discussing in my quarterly report, which I will be discussing with this committee next week, there is a cumulative effect from these failures of transparency.

Mr. CUMMINGS. No doubt about it. And the question becomes I think AIG was just ingenuous, at best, and outright deceptive, at worst, because I am going to tell you, based upon all the communications I got, and then to find out this kind of information, what that means is somebody simply was not telling the truth. I think that is why the American people got so upset about this and will get even more upset, because they feel that they have been—you know, they think they are doing one thing, but yet still they are losing their houses, their homes, their savings, and everything while other people are getting these bonuses and saying they are supposed to be retention payments when really a lot of these people did not fit that category.

Mr. BAROFSKY. I think so. And I would throw one other possibility in there, which is just incompetence. The list that we received that put the positions with the bonus payments, that was something AIG had to create. It wasn't a document that existed beforehand, that they created in response to our audit. So it may be that we were the first person to even ask the question of who were the people who actually got these bonuses and what their jobs were. But I don't know. I don't know which category it fits within.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

Chairman TOWNS. Thank you very much.

I now yield 5 minutes to the gentleman from Indiana, Mr. Burton.

Mr. BURTON. Thank you, Mr. Chairman. I just have a couple of questions, then I will yield to Mr. Issa.

Mr. Issa mentioned that it would have been better, in many of our opinions, if we had let all these problems go through the regular bankruptcy procedures, but there were decisions made by the administrations to bail out a number of these companies.

When the bailout procedures took place, there evidently was no provisions put in those agreements that said that, since the Government is loaning that money or spending that money to buy stock in those companies, that the Government has the right to review the bonus procedures, was there?

Mr. BAROFSKY. No. Absolutely not. Very limited circumstances for a limited number of employees.

Mr. BURTON. There are a lot of people that believe we are not out of the woods yet as far as the economy is concerned. In the event that this comes up again in the not-too-distant future and that we don't go down the bankruptcy court route, could we put in those agreements that the Government is bailing out an industry, could we put in those agreements a specific language that would say that the Government has to review and approve any bonuses before they are given?

Mr. BAROFSKY. It certainly would be a possibility.

Mr. BURTON. Well, that is the one thing I would like to point out. I was not for the bailouts and did not vote for them, but it seems to me if we were going to do that and we were going to take the taxpayers' money, we certainly should have had provisions in there that controlled the way that money was going to be spent because it was taxpayers' money. And when you talk about these huge bonuses, it seems to me they could have put a lid on some of that.

But we should have gone through the bankruptcy procedure, in my opinion.

With that, let me yield to my colleague.

Mr. ISSA. Thank you. I thank the gentleman for yielding.

I want to ask from this side of the aisle, because I think your answer was good and I want to make sure both sides have asked it, if I understand correctly you said everyone got a bonus, and clearly, in your opinion, not everyone needed to get a bonus in order to be retained or, if they weren't retained because they didn't get a bonus, they could have been replaced, including, as Mr. Cummings I think alluded to, you know, basic clerical personnel who had no special skills; is that correct?

Mr. BAROFSKY. I do believe that.

Mr. ISSA. So very clearly somebody who made the decision to give these bonuses made a decision that was in the best interest of making everyone happy and not the best interest of the American taxpayers or even AIG; is that correct?

Mr. BAROFSKY. I think that at the time these contracts were entered into it was before the Government bailout, but ultimately yes, the decision was made not to try to renegotiate these payments and go forward with them. That is correct.

Mr. ISSA. OK. I want to go back down a track for a moment. You made a decision not to speak or speak directly with some people in the chain of command who may have talked to somebody at the New York Fed about these bonuses prior to the document production. And I know you said sometimes people withhold documents. But if I understand correctly, individual members of the board, the then president, the first vice president, and the executive vice president that were in place at that time may not have been asked, Did you speak to anyone at the Fed or even at Treasury about these bonuses prior to the date you currently know of; is that correct?

Mr. BAROFSKY. I don't have the exact list of people that my audit team interviewed; however, again, I think we followed this information to its appropriate conclusion with those——

Mr. ISSA. Then can I ask that as a supplemental—and I will put it in writing if you need it—that each of these individuals who were in place at that time be asked, What did you know? When did you know it? And who did you tell? That each of those people, if they haven't been asked personally, not document production but personally, if they knew about it and/or if they spoke to anyone at the Fed, if each of these people could be interviewed either through interrogatories or actual interviews and you could get back to us so we could be satisfied that these people who, to me, logically are part of the trail that has to be followed, have been followed?

Mr. BAROFSKY. If you would send us a letter I would be happy to forward that communication on to the Federal Reserve and FRBNY and be happy to report back to you the responses.

Mr. ISSA. OK. And then, last, if we had gone through ordinary bankruptcy, obviously FP would not have made everybody whole unless the Government threw the money in. But let me ask one final question. The individuals who received the greatest amount of these bonuses, the ones that really trigger our inquiry today, they negotiated basically paying 100 cents on the dollar. Where was the expertise in unwinding used to pay less than 100 cents on the dollar when, in fact, these products in their market, those who unloaded these products prior to getting 100 cents on the dollar, unloaded them from anywhere from a nickel or a dime up to maybe forty cents on the dollar. Where was that expertise used, if anywhere?

Mr. BAROFSKY. That is a tremendously important question, and we are going to be addressing it in an audit that we are going to be putting out next month that studies the counter-party payments and the decision by the Federal Reserve to pay 100 cents on the dollar, so I look forward to sharing that audit with you and, of course, would be happy to come back and testify about that audit.

Mr. ISSA. Thank you.

Thank you, Mr. Chairman.

Chairman TOWNS. The gentleman's time has expired.

The gentleman from Ohio, Mr. Kucinich.

Mr. KUCINICH. Thank you very much.

Mr. Barofsky, when did the last administration become aware of AIG bonus and retention plans? Was it before or after the $85 billion bailout?

Mr. BAROFSKY. It would have been after the September bailout, the September infusion of $85 billion from FRBNY.

Mr. KUCINICH. On page 11 of your audit report you state that the New York Fed spent months after October 2008 influencing changes to future compensation decisions. Exactly what influence did they have over AIG compensation decisions, and did the officials make the decisions for AIG?

Mr. BAROFSKY. We are going to be studying that issue a lot more closely on corporate governance. It is an audit that we have pending right now, we are doing in connection with GAO.

Mr. KUCINICH. OK.

Mr. BAROFSKY. It is going to really look at the Government's role in making those types of governance decisions.

Mr. KUCINICH. Thank you. Now, during this period did officials from the Federal Reserve use their influence to try and streamline AIG's compensation structure so it would be easier to understand and manage?

Mr. BAROFSKY. Yes. They worked with AIG, with a consultant, to get a better sense of what the entire structure was and advising AIG to make a better, more comprehensible structure.

Mr. KUCINICH. During the testimony in front of the House Committee on Financial Services on March 24, 2009, Secretary Geithner and Chairman Bernanke both admitted that they had seen AIG's SEC filing and knew a great deal of information in the public domain regarding AIG's excessive bonus programs; however, neither of them claim to have known about the retention bonus plans for AIGFP employees until March 10, 2009. Now, have you examined AIG's SEC filing in early September 2008? And if so, were the retention bonus plans for AIGFP employees included in that filing?

Mr. BAROFSKY. Generally speaking I think that they would have been aware of those bonus plans. I think the testimony was the specific size and scope of the amounts that went out in March 2009, earlier this year.

Mr. KUCINICH. Well then, given Mr. Geithner's heavy involvement in the bailout of AIG as the president of the Federal Reserve Bank of New York, now Mr. Barofsky, it is really hard to believe that he wasn't informed of the retention bonuses for AIGFP employees prior to March 10th, especially since they were awarded retention bonuses of $69 million in December 2008. Was Mr. Geithner informed of the bonus plans? And if not, why not?

Mr. BAROFSKY. I think we have not seen evidence that he was informed of the size and scope of these retention plans. As to the why not, I think that he should have been. I think it was a failure, again, as I said before, a failure of management. The one explanation I would offer is the one I offered earlier, which is, to a certain extent, the Federal Reserve officials who were looking at this just didn't identify it as significant an issue as it really was, and that may have contributed to that failure to raise it up.

Mr. KUCINICH. I think it is very important for Members to regard closely what Mr. Barofsky just said, because there is legislation in another committee that would give the Fed even broader jurisdiction in matters relating to the economy, and they can't even handle simple things like being able to keep track of bonuses that are

going out the door at a time that they are being asked and the Fed is being asked to pump money into the economy to prop up the AIGs of the world.

Now, Mr. Barofsky, did you come across any information that would explain why these Federal Reserve Bank of New York officials did not immediately inform Mr. Geithner about the payments? Why didn't they tell him?

Mr. BAROFSKY. What they explained to us was, in substance, they didn't think it was such a big deal. The $168 million was a drop in the bucket. Their concern, their focus, was on repaying——

Mr. KUCINICH. Think about that bucket.

Mr. BAROFSKY. No, it is a big bucket. But their concerns were misplaced. I mean, frankly, this was sort of the problem of the outsourcing of oversight to an entity that just doesn't have the political sensitivities, particularly at that time, that you would expect from Treasury, of looking at this not from just a dollars-and-cents of moving the beads on the abacus, but more fundamental questions that we are addressing, which is: is it fair? Is it right to give $168 million to the very individuals responsible for driving that company into the hole that it was that put it on the brink of bankruptcy.

Mr. KUCINICH. Thank you, Mr. Barofsky.

Mr. Chairman, the Constitution of the United States makes it very clear that the power to coin money and regulate the value thereof is reserved to the Congress. Now, we gave that away in the Federal Reserve Act of 1913. But we had better look twice before we consider giving the Federal Reserve any more power, and we should also consider whether or not it is time for Congress to try to make up for some of the damage that was done to the American people by outsourcing our money supply and the supervision of it to the Federal Reserve. They can't keep track of small matters, let alone large matters. Time for us to start thinking about changing the direction we have with that institution.

I thank you. I yield back.

Chairman TOWNS. Thank you very much. I thank the gentleman from Ohio for his statement.

I now yield 5 minutes to the gentleman from Tennessee.

Mr. DUNCAN. Thank you very much, Mr. Chairman.

I agree with the comments that most of the people have made here today, Mr. Burton and Mr. Kucinich both, and I think there is widespread agreement, and I think almost all of the American people just think these bonuses are ridiculously excessive. But we are talking today more specifically about the AIG bonuses.

The AIG bailout funds, according to the time line and sheet, the briefing that we have been given, totaled $180 billion; is that correct?

Mr. BAROFSKY. The total commitments add up to $180 billion.

Mr. DUNCAN. I mean, that is a mind-boggling figure that nobody can really humanly comprehend, but some banks and companies have paid back some of the bailout money. Do you know how many have paid back, of the companies or the banks or the firms that got bailouts?

Mr. BAROFSKY. The precise number will be in our quarterly report next week. I don't have the number at my fingertips. It is

about $70 billion or so, but I don't remember the exact amount of what it is right now.

Mr. DUNCAN. How much of the $180 billion has AIG paid back?

Mr. BAROFSKY. I think the total amount that is outstanding, according to GAO's most recent report, is about $120 billion outstanding of the $180 billion.

Mr. DUNCAN. So $120 billion. And the bonuses that we are talking about, they wanted to pay $243 million in bonuses; is that correct?

Mr. BAROFSKY. For AIGFP it was about $60 million in December, the $168 in this March, and another $198 that is due next March.

Mr. DUNCAN. So how much is that in total?

Mr. BAROFSKY. It is a little bit over $400 million.

Mr. DUNCAN. So it is $400 million. In one of our papers it was talking about just the $243 million. What is the largest of those bonuses? How large are those bonuses?

Mr. BAROFSKY. I believe that they went up to $4 million for an individual.

Mr. DUNCAN. For an individual, $4 million. And then in your report it says that the Treasury put down these rules and said the annual compensation limit of $500,000 proposed by February 2009 was not retained; that is correct?

Mr. BAROFSKY. That is correct.

Mr. DUNCAN. And then bonus payments to senior executive officers are limited to one-third of total compensation. What is the highest compensation that is being received by somebody at AIG at this time?

Mr. BAROFSKY. I'm not sure AIG overall. I know recently the pay package for the new CEO of AIG was recently approved, and I think that could be, with incentives, of up to $10 million.

Mr. DUNCAN. Was how much?

Mr. BAROFSKY. It is $10 million with various incentives, if he meets all his incentives. I think that is approximately the number. I don't have the number right before me.

Mr. DUNCAN. Well, I agree with all these others that these bonuses—first of all, these bailout funds shouldn't have been paid, we shouldn't have gone in this direction, but even National Review Magazine had an editorial comment, and they said that they ordinarily wouldn't be in favor of the Government being involved in the compensation of any private business, but when a business had accepted a bailout money, that they sought justification for limiting salaries and bonuses in that situation. I certainly agree with that, and I think about 99.9 percent of the American people agree with that and feel that these bonuses have been ridiculous and excessive.

Thank you very much.

Chairman TOWNS. I thank the gentleman from Tennessee.

I now yield 5 minutes to the gentlewoman from California, Ms. Watson.

Ms. WATSON. Thank you very much.

According to an article in the Wall Street Journal yesterday, the moves made by Kenneth Feinberg, the special master for compensation at the Treasury Department, to more clearly tie compensation to long-term performance are aimed squarely at salaries,

not bonuses, which are restricted by rules passed by Congress earlier this year. Do you agree with the Wall Street journal's assessment that there is a legal differentiation between an executive's salary and their bonuses, and that Kenneth Feinberg's authority is limited only to their salary?

Mr. BAROFSKY. I think that I would really defer to his office for their current definition of their authority, but I think that his jurisdiction and scope is fairly broad. There are certain legal limitations that he is operating under. For example, bonus programs or programs that were executed prior to February 11th are specifically exempted from the statute of being controlled by the executive compensation restrictions that are in EESA as amended. But with that said, there is an amount of leverage that comes from being a significant equity owner of these companies, and I think that Mr. Feinberg views his role broadly and will be making advisory opinions beyond just the scope of what is completely spelled out in the statute.

Ms. WATSON. Recent news reports have stated that Mr. Feinberg is planning to shift a portion of an employee's annual salary into stock that cannot be accessed for several years to better tie pay to performance in the financial sector; however, some have made a counter argument that making stock a part of an executive's annual salary creates an incentive to boost the stock price in the short term rather than focus on long-term shareholder value. Do you agree that tying compensation to stock will create this counterintuitive short-term incentive?

Mr. BAROFSKY. I think a lot of that depends on the terms and conditions that are associated with the bonus payment. I think that is a legitimate concern, but perhaps it is one that can be addressed by the way the restrictions are spelled out.

Ms. WATSON. You know, in your opening statement you said it was a mess. That is why we are trying to get detailed with it, because it is a mess. And, as I said before, it is like trying to unscramble rotten eggs. So can you recommend any other guidance for how to structure compensation so that it encourages reasonable and sustainable work performance?

Mr. BAROFSKY. I think what we will do and what we will continue to do is to try to bring as much transparency to this process. It is ultimately not our role to make the policy decisions, but it is our role to bring as much transparency to the decisionmaking process so that you, the policymakers in Congress and the policymakers in the Executive have all this information available to them to evaluate those decisions and tweak them, whether it is through different policies and procedures by Treasury or through legislation of this body. We will continue to fulfill that role.

Ms. WATSON. And according to your report, despite promises from AIG that they would attempt to recover some of the $165 million worth of bonuses paid in March, so far they have only recovered $19 million of the $45 million they asked recipients to repay, and apparently part of the problem is that some employees resigned so they could keep their money instead of returning it. So can you explain why, if AIG was contractually obligated to pay the bonuses as part of retention bonus plans agreed on in January

2008, the employees are not obligated to continue working for AIG in order to receive the extra money?

Mr. BAROFSKY. In the agreements, once they receive their retention payment they can leave, and that way, if they quit, they wouldn't be able to receive the future retention payments of 2010. However, if they are fired, and they are fired not for cause, they still are actually entitled to receive retention payments, and approximately 50 or so of those who received the retention payments in March of this year were not working at AIGFP at the time they received those payments because they fell into that category of people who had been fired but not for cause.

Ms. WATSON. So they are sticking to the contract, rather than the thought of trying to repay us who bailed them out that money. The employees left and so their performance is no longer there for anyone to review, but they have the money and got away with it?

Mr. BAROFSKY. That is correct.

Chairman TOWNS. The gentlewoman's time has expired.

Ms. WATSON. Well, I will continue at another time. Thank you.

Chairman TOWNS. OK. I now yield 5 minutes to the gentleman from North Carolina, Mr. McHenry.

Mr. MCHENRY. Thank you, Mr. Chairman.

Mr. Barofsky, thank you again for your testimony. We have seen a good bit of you as of late here on Financial Services, as well, which I am a member of. Thank you for your frank and honest testimony.

You know, let's rewind a little bit. I know the ranking member had some questions about who you interviewed and that whole process, but it is clear you did not interview Secretary Geithner?

Mr. BAROFSKY. My audit team interviewed Secretary Geithner on a number of different audits. I don't believe that they asked questions about this specific issue during that interview.

Mr. MCHENRY. OK. Did your investigators interview Sarah Dahlgren, who was Geithner's top bank supervisor at the New York Fed?

Mr. BAROFSKY. Yes, we did.

Mr. MCHENRY. Yes?

Mr. BAROFSKY. Extensively.

Mr. MCHENRY. OK. Were any questions posed to her whether or not her boss was informed of this?

Mr. BAROFSKY. Yes. And she informed us that she had not informed then President Geithner.

Mr. MCHENRY. OK. As then president of the New York Fed Geithner?

Mr. BAROFSKY. Yes.

Mr. MCHENRY. The Treasury staff, did they report that they provided then Secretary Geithner with this information?

Mr. BAROFSKY. Not until March 10th.

Mr. MCHENRY. Not until March 10th. OK. So it seems either a colossal failure of administration through either error or omission, or willful ignorance in some cases, and it seems to me that Secretary Geithner is a pivotal player here as both the head of the New York Fed, which had direct action, is that correct——

Mr. BAROFSKY. Yes.

Mr. MCHENRY [continuing]. With the AIG bailout in the fall of last year.

Mr. BAROFSKY. That is correct.

Mr. MCHENRY. That is correct. And he was a key decisionmaker in the winter and spring of this year about the AIG bonuses, as well; is that correct?

Mr. BAROFSKY. Yes, he was clearly, from the time as the president of FRBNY, there was a brief period of time where he recused himself from matters after then President-Elect Obama identified him as the future Secretary of Treasury until he became Secretary of Treasury. He had recused himself from some of those matters. But other than that window, basically from September until the present in one job or the other he was the head of an organization that was involved in the bailout of AIG.

Mr. MCHENRY. OK. And, according to your report, the Treasury failed in its oversight of AIG compensation generally; is that true?

Mr. BAROFSKY. That is correct.

Mr. MCHENRY. OK. So it is kind of interesting to me, as a part of an oversight panel, that we have as Secretary of the Treasury someone who not only failed in his oversight and actions about the bonuses as Secretary of the Treasury, but in his job immediately before that—and he did recuse himself as of November 24th when the President nominated him. You are correct. But it also seems to me that he failed as head of the New York Fed in terms of having oversight of this. In fact, these bonuses and these retention payments were a matter of public disclosure to the SEC by AIG. So it was in the public purview by then, was it not?

Mr. BAROFSKY. Yes. I think, much like if anything goes wrong in my organization I am responsible and it is my failure, since we are criticizing both the Federal Reserve and the Treasury for failures of communication, management, and oversight, of course, he is ultimately responsible.

Mr. MCHENRY. Certainly. Well, I appreciate your frank testimony there. You have been a straight shooter all along, which I don't think—it is not a partisan issue. I mean, both parties are involved in this chaos, it seems to me. But additionally you have oversight over the pay czar, the special master for compensation, Ken Feinberg's operation; is that correct?

Mr. BAROFSKY. Yes.

Mr. MCHENRY. Their operation in terms of reworking these retention bonuses, could that have a negative impact on the Government's repayment of funds from AIG?

Mr. BAROFSKY. It is possible. One could envision a scenario that, if there really is one person who is so important, so vital to unwinding these transactions and has such a level of information and a decision is made that results in that person leaving, it is theoretically possible. Now, whether those facts are true or whether it will play out that way, I don't know. I am not in a position to say. But it is certainly at least theoretically possible.

Mr. MCHENRY. Does your office have a plan for oversight of this pay czar and their operations?

Mr. BAROFSKY. We have a number of audits under consideration as we staff up. One of them that I certainly have discussed with my audit staff will be an audit of the pay czar. We are not an-

nouncing it yet. We want to sort of see what happens, and that way we can better structure the audit, make sure that we ask the right questions and do it in a correct way. But I do anticipate that we will be auditing that process. Almost certainly.

Mr. MCHENRY. Thank you, sir. Thank you for your testimony.

Chairman TOWNS. The gentleman's time has expired.

I now yield 5 minutes to the gentlewoman from Washington, DC, Ms. Eleanor Holmes Norton.

Ms. NORTON. Thank you, Mr. Chairman, for these important followup hearings on this matter of great concern to this committee.

Sir, I am intrigued by the legal basis for your conclusion that AIG was required by law to distribute these bonuses. Now, my concern comes from not only my own specific concern, but one that has also been voiced by the attorney general of the State of New York, Andrew Cuomo. Understand that I am trained as a lawyer to respect the sanctity of contracts, so I don't ask this question lightly. But nor, I think, did Andrew Cuomo ask it lightly, and he apparently sent a letter to the chairman of Financial Services, Mr. Frank, in which he takes on your conclusion that these bonuses were legally required. I could not help but smile at a line in his letter that he wondered whether AIG attorneys "considered the argument that it is only by the grace of the American taxpayers that members of Financial Products even have jobs."

Now, I was intrigued by Attorney General Cuomo's analysis, and I wonder if you considered his arguments before drawing your own conclusions. For example, AIG, which by contract apparently was to pay people certain salaries. They seem not to have had trouble renegotiating those salaries, which surely weren't orally pronounced. They renegotiated those contracts, but when it came to these retention bonuses the law didn't allow such renegotiation or change. I wonder if you could indicate your view of these arguments, some of which are in Mr. Cuomo's correspondence.

Mr. BAROFSKY. Sure. I think there are two different parts here. First is whether this was a legally binding contract. Based on what we report on is the different legal opinions that Treasury received: AIG counsel, from its own counsel, from Department of Justice.

Ms. NORTON. I know the conclusion, sir.

Mr. BAROFSKY. No, no. May I continue? The second part of your question, which is a far different one, was: could they have renegotiated? And I think the answer to that question was: of course they could have renegotiated. They could——

Ms. NORTON. Should they have?

Mr. BAROFSKY. I think the fact that right now—I will answer that question by what is going on right now, which is basically Mr. Feinberg is encouraging them to renegotiate, and they, as we detail in our audit, they are——

Ms. NORTON. Well, should they have renegotiated—you know, this is what caused outrage. This is what is making it hard for more funds to come through here. Let's hope we don't have another rolling crisis here.

Mr. BAROFSKY. Right, and I think that is——

Ms. NORTON. And if they are doing that now, does that not indicate that they should have renegotiated these bonuses rather than arguing that by law they had to pay them? Because if by law they

don't have to pay them now, how could they have by law had to pay them then?

Mr. BAROFSKY. And I think your point is very well made, especially when you look at the bailout in context. Certain times we say contracts are inviolable and this is a binding, legal contract and therefore it has to be followed, but if you look at it in context with other parts of the bailout, whether the auto industry, whether it is contracts with auto dealers or contracts with debt holders, sometimes contracts are compelled to be renegotiated and terms are changed.

So I think your concern is right and should not confuse our finding that, while this was, indeed, a binding contract—there was an offer and consideration and performance, three elements of any contract—that is not to say that was the correct move to just say that this is a binding, legal contract, here's your check, thank you very much. That is not our conclusion at all, and I think——

Ms. NORTON. What is your conclusion? I mean, I don't know why you would simply have endorsed their conclusion that, well, these were legally binding contracts, and then you cite others who found those contracts. I want you to know that the American people say, are you crazy? Would these people, for example, have had any bonuses had they lost their jobs, which they retained by the grace of the taxpayers? So your answer seems to be that yes, they could have renegotiated them. I don't know why that wasn't your conclusion in the report so that people would have understood there is real oversight going on here, that there were alternatives, that people losing their jobs and their bonuses here can expect that people in high places who had their money would also be required to do so.

Mr. BAROFSKY. Our conclusions I think make pretty clear, and we point out that, first of all, we were asked the question, we answer the question, was this a legally binding contract, and the answer to that question is based on these various people that it is. But the question that you are asking is why didn't we suggest what are the alternatives. The answer is that we do in our audit. We specifically note one opportunity that was lost as far as Government leverage was the fact that $30 billion more of taxpayer money was coming down the pike in March 2009, and this would have been an opportunity to go back and compel a renegotiation. So I think that——

Ms. NORTON. So that leverage, which was in the hands of management——

Mr. CUMMINGS [presiding]. The gentlelady's time has expired.

Ms. NORTON [continuing]. Was not used on behalf of the taxpayers.

Mr. BAROFSKY. Yes, and I think that your concerns are addressed in our audit report. We do report, as we are required to do, on the basic legality of whether or not there was a contract, but I think our audit makes clear that just because that was a legally binding contract didn't mean that there were not other alternatives available to AIG and the Federal Government that didn't take place, and that these options are still on the table and are being pursued with respect to the next traunch of payments in March 2010.

Mr. CUMMINGS. Mr. Bilbray.

Mr. BILBRAY. Thank you, Mr. Chairman.

I would like to just echo the frustration of the Delegate from the Federal District over how a lot of this was handled. I guess we have just got to be reminded this is exactly the problem with big government thinking that we are going to use that to hold big business accountable and the taxpayer and the little guy seems to get stomped in the long run, and so I do echo the Delegate's frustration there.

At this time, Mr. Chairman, I would like to yield my time to the ranking member from California.

Mr. ISSA. I thank the gentleman.

You know, your oversight and your testimony time and time again are critical, and sometimes the most critical part is when we revisit what you previously had been working on and perhaps not satisfied. The last time you were before us you had deep concerns in your previous report, and particularly as to the public/private investment program, and particularly as to the absence of a firewall and self-dealing, including, I guess, Black Rock, who is being paid on one side and can still invest on the other. Have changes been implemented so that those concerns are less? And if so, could you tell us how?

Mr. BAROFSKY. Overall, no. There have been some changes. We are going to detail them in our report that is coming out next week. But walls have not been implemented.

Mr. ISSA. So self-dealing is still possible with taxpayers' money?

Mr. BAROFSKY. It is an extreme risk, and absent these ethical walls it maintains a strong risk that we are going to be paying very careful attention to.

Mr. ISSA. Have you reviewed Secretary Paulson's telephone records that have now been released?

Mr. BAROFSKY. I personally have not.

Mr. ISSA. We looked at them briefly, and what we discovered was that his phone logs show that he was talking to obviously Secretary Geithner a great deal, but also to now President Barack Obama. It appears from those records as though the transition had occurred by November; that, in fact, the majority of the calls were being made to the incoming administration not to the outgoing. Would that surprise you?

Mr. BAROFSKY. Those events occurred before I was even sworn in, so I——

Mr. ISSA. But you are now looking back on who knew what and when did they know it and how the mistakes continued to be made. Is that an area that you think is within your purview to continue looking at?

Mr. BAROFSKY. If it is related to a specific TARP issue, absolutely. We saw no indication that anyone at Treasury, including Secretary Paulson, knew about these AIG bonus payments at that time, so that wouldn't have been part of this audit. But it is certainly within the scope of potential future audit products. Absolutely.

Mr. ISSA. Now I want to followup on what Delegate Norton had said, because I think what she hit on and your answer needs one more, if you will, filling out.

Even though there is billions of dollars more coming from the Federal Government, don't we at the dias have, if you will, a self-fulfilling prophecy? We have determined at that time this is too big to fail and the Government will put any and all money in necessary, so if the Government did not put in more money at the time when they could have used it as leverage, if they said, look, if we don't get negotiated-down costs we are not going to put the money in, wouldn't that basically have said, you go into bankruptcy if you don't do it, and didn't the employees basically all know that was a false statement if we had made it, that we had written a blank check, we had given the President and the Fed walking-around money that was virtually unlimited?

Mr. BAROFSKY. I think that there is certainly a lot to that statement. I do think there is a tremendous amount of leverage when you are going to continue to make additional payments and put in conditions, and I think a good example of that is in the auto industry, where the Federal Government through the TARP had made billions and billions of dollars of support to Chrysler and to General Motors but then went back with the threat of bankruptcy to force very significant concessions.

Mr. ISSA. But in that case, of course, we ultimately put them in bankruptcy after we had had the political bankruptcy. I know that is not within your direct testimony today, but is not it true basically that we put money in that we will never get back in a political bankruptcy before the actual bankruptcy occurred, or, if you will, the sale of Chrysler to Fiat and the whole re-funding of General Motors?

Mr. BAROFSKY. I share your skepticism about the likelihood of getting that money back, the early money back.

Mr. ISSA. And, by the way, just as an old car guy, do you actually think that Fiat has technology that Chrysler didn't have?

Mr. BAROFSKY. That is well beyond the scope of any current audit product that we have.

Mr. ISSA. Thank you, but I figured it was worth a smile. Thank you.

I yield back.

Mr. CUMMINGS. Thank you.

Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman.

Thank you so much for being here, Mr. Barofsky.

Mr. BAROFSKY. Thank you.

Mr. CLAY. For the better part of the year it has been painfully evident to the American people that AIG has been due an audit. After using taxpayer dollars to bail out an insurance company that was once the largest in the country and possibly in the world, AIG used those same taxpayer dollars to reward the culprits of its corporate collapse. We cannot afford to be frivolous with the hard-earned income of our citizens.

Following the decline of AIG's stock value in 2007, employee compensation packages were adjusted to account for the loss in value of existing plans. These changes reflect AIG's ability to negotiate compensation benefits with its employees and suggests that AIG could have done the same in light of its Federal assistance. Why did bonuses and retention awards continue to be included in

compensation packages even after AIG received the Federal bailout from the pockets of American taxpayers? Why did that persist?

Mr. BAROFSKY. That is a vitally important question. The explanations that we have received that we report in our audit was essentially what we have heard, which is this notion of the sanctity of the contract, but I could not agree more with your statement that of course there was an opportunity to renegotiate these agreements, both then and as is going on right now.

Mr. CLAY. According to your findings, the 2008 bonus plan for senior partners was restructured in October of last year. According to this new plan, a portion of the bonuses would be paid only if the company had been sufficiently reorganized, progressed, and repaying Federal moneys and cut the 2008 bonus pool by 30 percent. How many of these stipulations were met?

Mr. BAROFSKY. I'm not sure how many of those stipulations had actually been met on that issue. That is outside the AIGFP issue but on the TARP bonus structures. I think, though, a lot of those rules and restrictions had been superseded by ARRA and by the mid-June Treasury regulations, and I think that the decisions about the pay plans for the top 100 employees at AIG are going to be determined by Mr. Feinberg. But I can followup and get more information on that.

Mr. CLAY. And could you tell us how much of the $150 billion Federal rescue package has been repaid?

Mr. BAROFSKY. Right now the current amount outstanding to AIG is about $120 billion.

Mr. CLAY. I see. Retention payments to AIGFP, what justification has AIG given regarding the payment retention awards to the FP division, the division central to AIG's demise?

Mr. BAROFSKY. The two arguments that have been advanced are, one, again, that this was a binding legal agreement and therefore they were compelled to do so. The second argument is that employees at AIGFP, some of them were essential because of their unique knowledge, to unwinding the complex transactions that occurred. As noted earlier, neither one of these arguments is entirely satisfying.

Mr. CLAY. Yes. And, I mean, it even got to the absurdity of retention awards being paid to non-essential staff, including almost $8,000 to a kitchen assistant and $7,000 to a mail room assistant. What was the justification for that?

Mr. BAROFSKY. We are still waiting to get our justification for that. I think, again, that falls back into the first point, that these were legally required under contract is the justification. Again, it is not one that we share or find particularly satisfying, but that is the explanation.

Mr. CLAY. Were the retention programs successful in retaining these employees?

Mr. BAROFSKY. Certainly there are a number. They are still AIGFP employees. Whether or not they are still there because of these retention payments or because of the realities of the job market or maybe the realities of having AIGFP on your resume may not make you the most attractive potential employee, it is difficult to determine.

Mr. CLAY. Can you share with the committee how many resigned despite receiving a retention award?

Mr. BAROFSKY. I don't have that number right at hand, but I am sure it is a number we can find out.

Mr. CLAY. Would you get it to us, please? I thank you for your response and I yield back.

[The information referred to follows:]

AL USE ONLY UNTIL RELEASED BY THE
HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

QUESTIONS FOR THE RECORD FROM NEIL BAROFSKY

SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM

FROM OCTOBER 14, 2009 HEARING

February 3, 2010

Questions for The Honorable Neil M. Barofsky, Special Inspector General, Troubled Asset Relief Program, from Congressman Lacy Clay:

1. At that hearing Rep. Clay asked that the SIGTARP report back to the Committee regarding "how many [employees] resigned despite receiving retention awards."

Answer:

According to the Assistant General Counsel and Global Anti-Corruption Officer with the American International Group, Inc. As of October 31, 2009, 30 people who had previously received awards under the Employee Retention Plan (ERP) resigned during 2009, thereby forfeiting any additional awards under the ERP. After October 31, 2009, there has been one additional resignation. This individual also forfeits any additional awards under the ERP.

Mr. CLAY. Thank you, Mr. Chairman.

Mr. CUMMINGS. Thank you very much.

I now yield 5 minutes to the gentleman from Missouri, Mr. Luetkemeyer.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Thank you, Mr. Barofsky, for your testimony today. It is very compelling. I appreciate your thoroughness.

I am just kind of curious. I know that in the stimulus package, I think it was Senator Dodd at the request of someone in the administration, put in there the continued authorization to pay these bonuses; is that not correct?

Mr. BAROFSKY. I think the provision you are referring to is the one that made it so that any agreement that had been signed prior to February 11, 2009 would not be subject to the ARRA restrictions that were incorporated into EESA.

Mr. LUETKEMEYER. OK.

Mr. BAROFSKY. So that is correct, that part.

Mr. LUETKEMEYER. Do you have any information as to why that would have been in there? Did they need that in order to be able to pay these bonuses legally, or were there concerns on their part that they are not legal otherwise so they put this in there?

Mr. BAROFSKY. I am not familiar with the legislative intent of why that provision was put in there.

Mr. LUETKEMEYER. OK. Did it have any impact on your audit?

Mr. BAROFSKY. It had an impact to the extent that it really made it very clear that these would have been exempt and carved out of any of the EESA restrictions.

Mr. LUETKEMEYER. OK. So, in other words, it emphasized the fact that they wanted to make these bonuses available or be able to be paid to their executives; is that correct?

Mr. BAROFSKY. There would be no TARP restriction on making these payments.

Mr. LUETKEMEYER. OK. Thank you.

What is the percentage right now that the Government actually owns of AIG? Did you say 80 percent? Is it still 80 percent?

Mr. BAROFSKY. It is slightly under 80 percent.

Mr. LUETKEMEYER. OK. Since we the people own that, do we have a representative on this board of directors?

Mr. BAROFSKY. Right now the Government's ownership interest is managed by trustees, three independent trustees.

Mr. LUETKEMEYER. Are they represented on the board of directors?

Mr. BAROFSKY. I think they advise the board of directors. I don't know if they are actually on the board of directors.

Mr. LUETKEMEYER. So we don't have representation on a board that we own 80 percent of?

Mr. BAROFSKY. I think that is correct. I think we do not have—the Government does not have representatives on the board of directors. I am not 100 percent sure, but I can find out.

Mr. LUETKEMEYER. Why do we not have representatives on the board of directors?

Mr. BAROFSKY. I think the decision was made to manage the Government's interest through these trustees instead.

Mr. LUETKEMEYER. OK.

Mr. BAROFSKY. But, again, I'm not sure we don't have representatives on the board of directors, but I will find out.

Mr. LUETKEMEYER. OK. And right now we have a gentleman, Mr. Feinberg, who is the pay czar who is going to oversee the payment of future bonuses; is that correct?

Mr. BAROFSKY. Yes, that is true.

Mr. LUETKEMEYER. What authority does he have to do that? Where does he get his authority from?

Mr. BAROFSKY. His authority basically arises out of ARRA, which we were discussing earlier, and the Treasury regulations that were issued resulting out of ARRA, which set forth the executive compensation restrictions and set forth this procedure for Mr. Feinberg. So it ultimately draws from the statute.

Mr. LUETKEMEYER. So they supersede any contractual obligations that AIG might have with its employees?

Mr. BAROFSKY. That is going to be one of the challenges that Mr. Feinberg has because no, it would not. For example, it wouldn't trump the future retention payments that are due in March 2010. ARRA still exempts those from EESA's restrictions. AIG has asked for and he can provide an advisory opinion on them, but ultimately those remain to be binding contracts. But, of course, he can make recommendations. He can take into account past compensation, making future compensation decisions——

Mr. LUETKEMEYER. So we really haven't solved the problem yet if we have a pay czar who doesn't have the authority to oversee the bonuses and we don't have a representative on the board of directors who can direct that these recommendations be taken seriously. Is that a fair assessment?

Mr. BAROFSKY. It may very well be. I think that my understanding is from statements AIG has made to us and as they say publicly that they are working very closely with Mr. Feinberg, and certainly we are all hopeful that AIG will follow those recommendations. If not I'm sure——

Mr. LUETKEMEYER. I take that as an affirmation of my statement.

Mr. BAROFSKY. Yes.

Mr. LUETKEMEYER. Thank you, sir.

Very quickly, as my time expires here, you have made a couple of recommendations in your report and we are just kind of curious as to whether Treasury has implemented those. One is that Treasury continues to hide information about the value of assets in its portfolio. Have they started coming clean? Have they started to make more available, more transparent, what their assets are and the value of those assets?

Mr. BAROFSKY. No. They are going to be publishing as part of GAO's annual financial statement for the TARP, they will be publishing under the Credit Reform Act valuations of the portfolio. That is an annual process. They have not adopted our recommendation of sharing with the American people their internal valuations they receive on a monthly basis. I scheduled a meeting with them actually tomorrow. They are going to give us a briefing on their justifications and explanations as we continue to press for that recommendation to be adopted.

Mr. LUETKEMEYER. Now you made several recommendations in your report. What do you feel in your estimation is the most important recommendation that you can make? And have whoever you need to be able to address it, have they addressed it? And if they have, fine; if they haven't, why not?

Mr. BAROFSKY. I think it is difficult to say because each TARP program is different, but I think our biggest over-arching recommendations which relate to transparency, in particular on requiring TARP recipients to report on how they are using the TARP funds. It is fundamentally important for a number of reasons, including it fuels a lot of the cynicism.

The failure to adopt this recommendation I think fuels a lot of the cynicism that the American people have toward this program, this perception that the TARP is a black hole. I think it is a very unfortunate decision on Treasury's part. The decision was made by the last administration and continues with this administration, and it is one that we continue to press for, but I think that is one of the most significant failings because it is indicative of a basic attitude toward transparency that we find is lacking in the TARP program.

Mr. LUETKEMEYER. I appreciate your remarks.

Thank you, Mr. Chairman. I yield back.

Chairman TOWNS [presiding]. The gentleman's time has expired. Thank you very much.

I now yield 5 minutes to the gentlewoman from Ohio, Ms. Kaptur.

Ms. KAPTUR. Thank you, Mr. Chairman.

Welcome, Mr. Barofsky.

Mr. BAROFSKY. Thank you.

Ms. KAPTUR. Thank you for your work.

Could you please restate for the record to the best of your ability how much taxpayer money has been put at risk through the funding of the TARP at Treasury, and also any estimate you might have of the dollars that have been put at risk through the fed, which total into the trillions, I am told. Can you clarify that for the record?

Mr. BAROFSKY. Sure. I don't have those numbers at my fingertips right now. In our last audit report we put out an estimate of the total amount of money that was related to the financial crisis outstanding, and in that we totaled it to be approximately $3 trillion across the Federal Government, and we had breakdowns with the Federal Reserve and Treasury in that quarterly report. I don't have those numbers at my fingertips, but they are reflected in that report.

Ms. KAPTUR. All right. I thank you. You know, I am in awe and simultaneously in utter disgust at how Wall Street and the money elites in our country take care of one another, to the point of wrapping their tentacles around the entire Federal Government of the United States of America. That takes a lot of power.

We have 15 million people unemployed. We have millions and millions of people being kicked out of their homes. And yet we witness this egregious behavior by those who continue to receive these bonuses, and really an arrogant disregard for the republic and its citizenry.

In your testimony on page 16 you accurately state that the plans for these bonuses at AIG and AIG's financing risk division were exempted under the American Recovery and Reinvestment Act this year, which explicitly stated that it did not apply to agreements on bonuses in place prior to February 11, 2009. Who could have had the power to insert that provision? I am going to ask your staff to please provide for the record the exact language of the provision that did that in the Recovery Act.

And I would like you to venture an opinion on who drafted that language and how did it get in that major recovery bill which included our unemployment benefit extensions, it included the Medicaid payments to the States. People can disagree whether they like the Recovery Act or not, but to have that provision in there, it wasn't in the House bill. How did that get in there?

Mr. BAROFSKY. My understanding is that Senator Dodd introduced the amendment that reflects that language.

Ms. KAPTUR. And basically what is the net effect of that language?

Mr. BAROFSKY. The net effect of that language is that the TARP does not prohibit these types of bonus payments if the bonus plan was offered prior to that date.

Ms. KAPTUR. That is unbelievable that this could happen in our country and that Members of Congress—to the extent that your staff can provide the exact way in which this happened legislatively through committee, through subcommittee, however, through conference committee, I would be very grateful if you could provide it for the record.

Let me ask you this question. Do you believe that these unwarranted bonuses could have been prevented and prior bonuses clawed back if our Government established through a civil lawsuit or through administrative enforcement actions or criminal prosecution that the bonuses were prompted by accounting fraud? Could we open it up?

Mr. BAROFSKY. I'm trying to go back to my days as a prosecutor just a year ago of forfeiture and issues. There certainly are circumstances, if these payments were resulting from fraud, that there could be opportunities for forfeiture or restitution.

Ms. KAPTUR. All right.

Mr. BAROFSKY. I'm trying to think of the specific circumstances. But it certainly is possible.

Ms. KAPTUR. All right. That is an important statement for the record, because I think justice has to be won through the courts to the extent that we can, and they can't be on the sidelines of this, and parties to this suit should be thinking about that because the American people don't support this. Yet, this is going on and it has been made the law of the land. I think most Members of Congress, if you surveyed them, don't even realize that provision was in the recovery bill that was passed earlier this year.

It takes a lot of power to insert a provision like that literally puts the firewall up against us going after those bonuses.

Mr. BAROFSKY. And, to be clear, as the wheels keep turning, I think what we would probably need to show is an individual employee who participated in a type of fraud that resulted and included into the bonus payment. It may be more difficult to claw

back under a fraud theory someone who is a participant to the contract and fulfilled their obligations under the contract and received a payment. That person may be more difficult to recover. But if one of the recipients of the bonuses was involved in a fraud that helped lead to those, I think there would be legal remedy.

Chairman TOWNS. The gentlewoman's time has expired.

Ms. KAPTUR. Could I ask the gentleman to provide one piece of information for the record?

Chairman TOWNS. The problem is we are having a vote, and I am afraid that some of the Members might not have an opportunity to—that is the problem.

Congressman Welch.

Mr. WELCH. Thank you. I will be brief.

Thank you very much for your good work. I just want to make a brief statement.

Mr. Chairman, I think all of us are deeply troubled by AIG's unwillingness to live up to its clear obligation to return millions in bonuses that are totally unwarranted. Those should be returned to the American taxpayer. The Special Inspector General's report lays bare the troubling extent to which AIG continues to take advantage of the U.S. Government and the U.S. taxpayer. They acted in good faith last fall when the company's looming collapse posed a systemic risk to the entire U.S. economy, but the folks in AIG's Financial Products division who helped push our economy off a cliff don't deserve a dime in bonuses that are financed by the American taxpayer.

I continue to urge to Department of Treasury and the Federal Reserve to work together to recoup this money and ensure that AIG honors its commitments and that we honor our obligation to the U.S. taxpayers.

Thank you, Mr. Chairman. I yield back.

Chairman TOWNS. Thank you very much. I thank the gentleman for his statement.

I now yield to Congressman Murphy from Connecticut.

Mr. MURPHY. Thank you very much, Mr. Chairman.

I want to get back to the issue of retention for a moment, but before I do, in followup to Representative Kaptur's questions, the language regarding the contractual obligations of bonuses in legislation inserted in the Senate, just to be clear, that language was in the context of an amendment that limited the awarding of bonuses to companies that receive TARP and Federal rescue funds.

Mr. BAROFSKY. Yes. I mean, the ARRA restrictions, which significantly increased the executive compensation restrictions on TARP recipients, in the original version of the statute were much milder, to put it mildly. But this is all part of an amendment that included far greater restrictions which ultimately created the pay czar and the bonus restrictions that ultimately had been incorporated into EESA. That is correct.

Mr. MURPHY. In the context of the amendment offered by Senator Dodd in the Senate that was not part of the House version initially?

Mr. BAROFSKY. Yes. Senator Dodd's amendment was related to the entire executive compensation structure, was all authored by Senator Dodd. If I didn't make that clear, I perhaps should have.

That was his proposal to put into EESA through ARRA the enhanced executive compensation restrictions, and part of that was this provision. That is correct.

Mr. MURPHY. I want to come back to this issue of bonuses offered to retain employees, because it is a key part of your report and part of what you feel was missed in the discussions between Treasury and AIG was the lack of real solid questioning as to some of the declarations made by AIG.

One of the things you say in your report to start with is that the resignations at AIGFP have been, I think you used the word particularly acute over the course of this time period. Because this is such an important piece of the justification, I'm wondering if you can drill down a little bit on that and what leads you to the supposition that resignations have been particularly acute at AIGFP.

Mr. BAROFSKY. Basically the numbers. I don't have the specific numbers right in front of me, but AIG has reported that there has been a large number of resignations. The reasons for them could be multi-fold. I would hate to speculate. Certainly it has been reported to us that all of the attention that occurred in March—and there have been anecdotal stories of people going to AIGFP executives' houses. There is bus tours that stop at their houses. Obviously that creates a lot of pressure. Also, the business is one of winding down, and it is not the—and because of the very poor financial performance of the entity, that, too, could contribute to why people would leave.

Mr. MURPHY. How do we going forward try to get at this issue to make sure that it doesn't happen again? You have, I think correctly, laid out all sorts of reasons that people may leave, many having nothing to do with pay or compensation packages, and lots of reasons that people would stay, having nothing to do with pay and compensation packages, given the existing market. As we try to chart a course forward here, how do you suggest that Treasury or this Congress evaluate these claims that AIG or any other company may make that they must pay $1 million, $5 million, $10 million in bonus money in order to keep an employee, given all of those competing factors? What is your suggestion as to how we evaluate this going forward?

Mr. BAROFSKY. I think the key to any type of policy or procedure that addresses your question must be that it be formalized and be transparent, because I think where the biggest problems occur is when the types of dealings or transactions or dealings or advice are given behind the curtain. That creates the cynicism and anger that we have seen relating to this bailout and that pervades a lot of the TARP.

So I think what the actual policies and procedures are, that is a more difficult question. That is something for Treasury as the policymaker to determine and for this Body, but the structure I think is key.

Mr. MURPHY. I guess we need your help on that, though, because, you know, transparency is wonderful, but if all they are saying is a restatement of their claim that they must pay $10 million in bonuses in order to keep this employee, having that claim be transparent doesn't really help us much. It is hard for me to understand, as I think it is for many on this committee and in this Con-

gress to understand, why these bonuses were merited, given the fact that there weren't a lot of job opportunities out there for the very people that were responsible for the collapse of that company.

So I would just ask you going forward to help us try to chart those standards, help us come up with recommendations for Treasury so that we are not just reliant on the transparency piece, that we actually have some standards in place to guarantee that this is not just a claim of retention; that there is actually merit behind that claim.

I thank the chairman for the time.

Chairman TOWNS. Thank you very much. I thank the gentleman from Connecticut.

The gentleman from Illinois, Mr. Schock.

Mr. SCHOCK. Thank you, Mr. Chairman.

I would like to yield my 5 minutes to my distinguished ranking member, Mr. Issa.

Mr. ISSA. I thank the chairman.

I am sorry it seems like all my folks are being real shy today, but perhaps it is just my day to be tough on you. I am going to try and bring a close to this hearing with a tough question.

Mr. BAROFSKY. Sure.

Mr. ISSA. Your testimony previously and now is that then New York Fed Chairman Geithner didn't know about bonuses while he was New York Fed chairman, even though it was his responsibility to oversee that failed AIG and, of course, the funds that went to them; is not that correct?

Mr. BAROFSKY. We haven't seen any indication that he knew.

Mr. ISSA. OK. So we don't know if he knew, but it was his job to know, and so far he said he has testified he didn't know.

Mr. BAROFSKY. He said he didn't know and we haven't seen any indication to contradict that.

Mr. ISSA. OK. So according to his testimony he failed to know when it was his job to know.

Mr. BAROFSKY. Yes.

Mr. ISSA. And as Treasury Secretary he failed to stop, even though he had at least a couple of days notice, he failed to stop these bonuses and has said he just couldn't, right?

Mr. BAROFSKY. That is correct.

Mr. ISSA. So he failed to know when he should have known. He failed to stop when this committee on a bipartisan basis says he should have at least halted it for a review and not simply paid it, and now he is failing to give you transparency, you have testified, right?

Mr. BAROFSKY. That is correct.

Mr. ISSA. So we have a Secretary of the Treasury who failed to know what he should have known, failed to do what he should have done, and has failed to give us transparency. That is really what this testimony today is all about and, in fact, on a bipartisan basis we are hearing that, one, we are not getting transparency and, two, even if we get transparency, if we can't trust the judgment and decisions of the Treasury, then, in fact, we are not going to get the outcome the American people expect us to get and we are going to continue to have non-essential people paid huge bonuses in many cases that are unnecessary with taxpayers' dollars

or dollars that could be returned to taxpayers. That is correct, is not it?

Mr. BAROFSKY. There is a lot in your statement, a lot of which I agree with.

Mr. ISSA. OK. We won't ask for the minute part you may not agree with. So I guess this committee is dealing with a Treasury who is not providing transparency to the IG who has called for it and, in fact, this is a gentleman who was confirmed by the Senate, nominated by the President to be part of the most transparent—I repeat, the most transparent—administration in history. I'm sure you have heard that claim by the administration, right.

Mr. BAROFSKY. And much more importantly than being transparent to us, it is the transparency to the American people, the taxpayers who are the investors in this program. They have been good as far as giving us the documents and information that we have requested, but as far as bringing the necessary transparency to the program, I couldn't agree with you more.

Mr. ISSA. So, Mr. Chairman, when we have said that we wanted to go everywhere that the trail leads and to all people, I would say today—and I am not calling on you to do this, but I am suggesting that you and I work on a bipartisan basis to bring Secretary Geithner here to, in fact, review thoroughly what appears to be a pattern of not knowing, not stopping, and now not providing the transparency that the President has tasked him to provide.

I think that the IG has been—I don't want to say timid, but he has certainly been respectful as he has delivered this message. But if the summary of that message that we have all heard is correct, then I believe that it is now time for us to bring Secretary Geithner here to find out if, in fact, he will make a change in direction of the large ship of State, the Treasury Department, to make them provide the transparency the President tasked him to do.

I told you I would be tough. You are still standing, so it couldn't have been that tough. I want to thank you, though, for your testimony here today. I want to thank you for your respectful candor in delivering what is not what we like to hear. We don't like to hear that the administration doesn't have it right yet, and I think both sides of the aisle have worked with you to point that out. I thank you for this.

I would, in closing, ask if you can look through your schedule and, I'm assuming we won't do another hearing this soon, but I know you are releasing additional information next week. If your schedule allows, I think we would like to try to arrange for a less formal, maybe a 1-hour with Members, so that we could get briefed and have a quick discussion so that we understand what you are releasing next week, if you can see if that is available.

Mr. BAROFSKY. Any time. We will always be available for that, of course.

Mr. ISSA. Thank you. And I would like to thank Mr. Schock for yielding time, and I'm sure he would yield the balance to the chairman.

Chairman TOWNS. Without objection, we would love to arrange a joint briefing. Of course, I hope that we can do that. Not a hearing, but a briefing of all the Members.

Let me just close on this note by saying thank you very much, Mr. Barofsky, for your being here. We really appreciate the work that you are doing.

A year ago with major Wall Street firms either bankrupt or teetering on the edge, House Speaker Nancy Pelosi famously said the party is now over. For AIG, that was true. Only massive taxpayer bailout has kept AIG alive. Yet, despite the fact that mismanagement and poor business decisions brought the company down, AIG's executives still insist on extraordinary compensation. At AIG the party might be over, but the music hasn't stopped playing and the musicians keep hanging around.

One of the things we have learned today is that apparently AIG's executives still believe that millions of dollars in bonuses or retention payments or whatever you want to call them should be paid to them without regard to the company's performance. In other words, they don't want to look at performance; they want to just sort of say this is the way we do it, we've been doing it for years, and we are going to continue to do it. In other words, not much has changed since last spring.

Now the Special Master Ken Feinberg is reviewing AIG's latest proposal for nearly $200 million in bonuses. The Wall Street Journal today says he is having trouble convincing AIG to reduce those payments. He has his hands full. We will hear the record from him 2 weeks from now at our second hearing on executive compensation.

Finally, I want to thank you, Mr. Barofsky, who I think is doing a find job in looking into these important issues. I think it is particularly important for Congress to have the facts in hand on these important issues before we act on financial regulatory reform. I thank you, Mr. Barofsky, in terms of making this significant contribution in this regard.

I want to thank again the Members for attending on both sides of the aisle this very, very important hearing.

Finally, please let the record demonstrate my submission of a binder with documents relating to this hearing. Of course, without objection, I submit this binder into the committee records.

[The information referred to follows:]

Briefing Book

October 14th, 2009 Hearing on
"AIG Bonuses: Audit of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP)"

Chairman Edolphus Towns

Committee on Oversight & Government Reform
U.S. House of Representatives

EXTENT OF FEDERAL AGENCIES' OVERSIGHT OF AIG COMPENSATION VARIED, AND IMPORTANT CHALLENGES REMAIN

SIGTARP-10-002
OCTOBER 14, 2009

SIGTARP

Office of the Special Inspector General for the Troubled Asset Relief Program

.nmary of Report: SIGTARP-10-002

Why SIGTARP Did This Study

The unfolding U.S. financial crisis in fall 2008 resulted in large-scale Federal assistance to many U.S. financial institutions, such as the American International Group, Inc. ("AIG"). Much of this assistance came from the Treasury Department's Troubled Asset Relief Program ("TARP"), with significant assistance also from the Federal Reserve Bank of New York ("FRBNY"). The FRBNY provided the initial Federal assistance to AIG in the form of an $85 billion secured line of credit in September 2008, but it did not impose specific restrictions on executive compensation in connection with its funding. In contrast, Department of the Treasury ("Treasury") officials placed executive compensation restrictions on AIG personnel as it made an initial investment of $40 billion in AIG in November 2008 under authority of the 2008 Emergency Economic Stabilization Act ("EESA"). Considerable Congressional and public outcry resulted from AIG making $168 million in retention award payments to a large group of its employees in March 2009. Questions existed regarding AIG's compliance executive compensation restrictions and the ..nt to which Federal officials had advance knowledge of the payments. This report addresses:

- What was 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?
- To what extent were AIGFP retention payments governed by executive compensation restrictions or pre-existing contractual obligations?
- What are the outstanding AIG compensation issues requiring resolution, and what Federal Government actions are needed to address these issues?

What SIGTARP Recommends

SIGTARP recommends that: Treasury and FRBNY officials work collaboratively on future compensation decisions affecting both institutions' ability to be repaid by AIG for their federal assistance. SIGTARP also makes recommendations for improving Treasury oversight of institutions in which Treasury makes a substantial ownership investment. (See F.. of report for specific details.)

..commenting on a draft of this report, Federal Reserve Board and Treasury officials stated that they concurred with SIGTARP's recommendations.

October 14, 2009

EXTENT OF FEDERAL AGENCIES' OVERSIGHT OF AIG COMPENSATION VARIED, AND IMPORTANT CHALLENGES REMAIN

What SIGTARP Found

When FRBNY officials began examining AIG's executive compensation structure in the fall of 2008, they found a staggeringly complex, decentralized system consisting of hundreds of separate compensation and bonus plans. Over time, they identified 620 AIG bonus programs totaling approximately $455 million for 51,500 employees, 13 retention plans allocating about $1 billion to almost 5,200 personnel, and deferred compensation of approximately $311 million for about 5,400 employees. In early October 2008, FRBNY officials learned that these programs were about to expend $1 billion in retention, bonus, and deferred compensation payments. The magnitude of retention awards to AIGFP was also first discussed with a FRBNY official in early October 2008, and others soon afterwards. During this time, FRBNY officials began focusing on compensation issues, especially after learning that AIG's corporate management had limited oversight of compensation programs across the company. Treasury officials also focused on executive compensation provisions while structuring assistance to AIG in November 2008, but available information indicates that their monitoring of AIG compensation was often limited to receiving periodic information largely provided by FRBNY officials. Although broadly aware of the existence of contractually required retention and bonus payments in November 2008, there is little to indicate that Treasury officials took steps to assess the totality of AIG's compensation. Instead, they focused on identifying an expanded group of executives who would be subject to executive compensation restrictions. Senior Treasury officials did not become aware of details of the AIGFP retention payments until late February 2009. Currently, both FRBNY and Treasury officials are involved in monitoring AIG compensation and changes to those compensation programs, although not necessarily in concert.

Based on available information, the March 2009 AIGFP retention payments were consistent with the law in place at the time the payments were made and AIG's contractual obligations to the Government. These payments were not prohibited under EESA and the American Recovery and Reinvestment Act ("ARRA") and were subsequently excluded from the executive compensation regulations announced in the Federal Register in June 2009. Further, the retention awards were not affected by executive compensation restrictions that were placed on 57 AIG executives as part of the TARP assistance agreement. Several legal opinions concluded that the retention awards were contractually binding payments. Nevertheless, the public outcry over the announced retention payments and well-publicized threats to individual executives, prompted AIG executives to ask AIGFP to return a portion of the awards voluntarily. Collection has been incomplete due to certain employees leaving AIG and reported concerns of employees who remain at AIG regarding the status of future payments under the AIGFP retention plan.

Employee retention may be affected by AIG's structuring of future compensation, which will be informed by the Treasury-appointed Special Master to review pay decisions under its revised guidelines. Balancing the size of future payments, many of which are considered contractually required, against the need to offer incentives to attract and retain key employees is a challenge. Retention efforts are reportedly heightened in AIGFP, because the Special Master has informally advised AIG not to pay the full $198 million of the pending promised retention payments. Meanwhile, FRBNY officials have a great deal of experience in unraveling AIG's compensation structures, and have offered their help; the Special Master reportedly has recently initiated contact with them following SIGTARP's recommendation that he do so.

OFFICE OF THE SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM
1801 L STREET NW
WASHINGTON, D.C. 20220

October 14, 2009

MEMORANDUM FOR: The Honorable Timothy F. Geithner, Secretary of the Treasury
The Honorable Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System
Mr. William C. Dudley, President, Federal Reserve Bank of New York

SUBJECT: Extent of Federal Agencies' Oversight of AIG Compensation Varied, and Important Challenges Remain (SIGTARP-10-002)

We are providing this audit report for your information and use. It discusses the Federal Reserve and Treasury Department oversight of American International Group, Inc. compliance with executive compensation restrictions that were imposed as a condition to receiving financial assistance under the Troubled Asset Relief Program. The Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") initiated this audit due to significant congressional interest, highlighted by written requests of Senator Charles E. Grassley and Representative Elijah Cummings who had concerns about retention awards paid to certain AIG employees in March 2009. SIGTARP conducted this audit as Project 0005 under the authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general of the Inspector General Act of 1978, as amended.

We considered the written comments from the Federal Reserve Board, Federal Reserve Bank of New York, and Treasury; the comments are addressed in the management comments and audit response section of the report. Their full responses are included in Appendices G and H.

We appreciate the courtesies extended to the SIGTARP staff. For additional information on this report, please contact Mr. Barry W. Holman (Barry.Holman@do.treas.gov / 202-622-4633) or Jim Shafer (James.Shafer@do.treas.gov / 202-927-9334).

Neil M. Barofsky
Special Inspector General
for the Troubled Asset Relief Program

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EXTENT OF FEDERAL AGENCIES' OVERSIGHT OF AIG COMPENSATION VARIED, AND IMPORTANT CHALLENGES REMAIN

SIGTARP REPORT 10-002 October 14, 2009

Introduction

Between the spring and early fall of 2008, the United States witnessed an escalating crisis in the financial markets. Some institutions found themselves so exposed that they were threatened with failure—and some failed—because they were unable to raise needed capital as the value of their portfolios declined. By September 2008, the ramifications of the financial crisis included:

- the failure of financial institutions, such as Lehman Brothers, that had played critical roles in the financial markets
- increased losses of individual savings
- diminished corporate investments
- further tightening of credit that would exacerbate the emerging global economic slowdown

As this crisis unfolded, agencies such as the Federal Reserve and the Department of the Treasury ("Treasury") took numerous actions to stabilize financial markets and financial institutions. As the situation worsened, Congress enacted the Emergency Economic Stabilization Act of 2008 ("EESA").[1] This program provided authority for up to $700 billion in aid to financial institutions under the Troubled Asset Relief Program ("TARP"). Initial TARP investments injected equity capital into banking institutions, beginning in October 2008, under the Capital Purchase Program. The overall TARP program subsequently expanded to include many other initiatives.

Even before passage of EESA and the authorization of TARP, the financial crisis of 2008 had already taken its toll on American International Group, Inc. ("AIG") — a large, complex, insurance and financial services institution that had deteriorated rapidly and was unable to access the capital markets, causing it to potentially fail to meet billions of dollars in obligations. In particular, AIGFP, an AIG subsidiary, had incurred significant financial losses. In response to the likely systemic implications and the potential for significant adverse effects on the economy of a disorderly failure of AIG, and with the encouragement of Treasury, on September 16, the Federal Reserve Board authorized the Federal Reserve Bank of New York ("FRBNY") to lend up to $85 billion to assist AIG in meeting its obligations and to facilitate the orderly sale of some of its businesses. On October 8, the Federal Reserve announced an additional program under

[1] P.L. 110-343, October 3, 2008.

which it would lend up to an additional $38 billion to finance investment-grade, fixed-income securities held by AIG. This latter assistance was repaid in full by AIG and terminated on December 12, 2008. On November 10, 2008, the Federal Reserve announced the restructuring of the Government's financial support to AIG in order to facilitate its ability to complete its restructuring process.[2] Subsequently, in November 2008, Treasury purchased $40 billion of newly issued AIG preferred shares under TARP's Systemically Significant Failing Institutions ("SSFI") program. The $40 billion took some of the pressure off the initial Federal Reserve line of credit, allowing the Federal Reserve to reduce, from $85 billion to $60 billion, the total amount available under the credit facility. As part of this restructuring, AIG agreed to the imposition of various restrictions with respect to its payment of dividends, its repurchase of AIG stock, severance payments to senior officials, the payment of bonuses, lobbying, and expenses.

On March 2, 2009, the Federal Reserve announced authorization of up to $8.5 billion in loans secured by life insurance cash flows from designated blocks of policies established by domestic life insurance subsidiaries of AIG. Likewise, on April 17, 2009, Treasury established an equity capital facility, from which AIG will be able to access up to $29.8 billion in return for preferred shares in AIG. As part of the equity capital agreement, AIG also agreed to the imposition of various restrictions with respect to its payment of dividends, its repurchase of AIG stock, severance payments to senior officials, the payment of bonuses, lobbying, and expenses. On June 25, 2009, AIG and the FRBNY announced that they had entered into an agreement whereby AIG would reduce its debt to the FRBNY by $25 billion by contributing the equity of two subsidiaries, American International Assurance Company, Ltd. (AIA) and American Life Insurance Company (ALICO), to separate special purpose vehicles (SPVs) in exchange for preferred and common interests in the SPVs. The FRBNY will receive preferred interests in the AIA SPV of $16 billion and in the ALICO SPV of $9 billion.

In March 2009, the Congress and the public expressed significant concerns over reports of AIG making approximately $168 million in retention award payments to a large group of its employees at AIGFP. Questions quickly surfaced over such payments being made by a company receiving large-scale Government financial assistance, and in particular, payments to staff at AIGFP, the group whose financial losses largely had led to the need for federal assistance. Questions also arose concerning the extent to which Federal officials had advance knowledge of the payments and whether those payments complied with executive compensation restrictions that had been imposed on AIG as a condition of its assistance from Treasury.

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[2] As AIG continued to experience problems in the fall of 2008, and, to avoid a credit rating downgrade and to prevent an AIG bankruptcy, the Federal Reserve authorized FRBNY to lend up to $30 billion to a limited liability company formed as a Special Purpose Vehicle ("SPV") that bought assets from AIG's counterparties in exchange for terminating the credit default swap contacts. The SPV, called Maiden Lane III, LLC ("ML III") was funded with loans from the Federal Reserve and a relatively small equity investment from AIG. ML III initially borrowed $24.3 billion from FRBNY in the form of a senior loan, which was adjusted to include an additional $0.3 billion at the end of 2008. AIG also provided $5 billion in equity, for a total of $29.6 billion. These funds were used, in effect, to purchase CDOs at "par" or face value from AIG's counterparties. In connection with this purchase, each counterparty agreed to terminate its credit default swap contracts with AIGFP. No TARP funds were directly used in the ML III transaction. The ML III transaction will be addressed in an upcoming SIGTARP audit report dealing with counterparty payments.

Background

AIG is a global organization employing approximately 106,000 domestic and international employees and doing business in more than 130 countries as of June 30, 2009. AIG primarily offers a broad spectrum of insurance and asset management services, with employees working in these principal business lines:

- Financial Services
- Asset Management
- Life Insurance & Retirement Services
- General Insurance

The Financial Services business encompasses AIGFP, whose primary business is trading in derivatives of stocks, bonds, credit, and commodities as well as energy trading and trading in the foreign exchange markets. Derivatives are financial instruments that "derive" their value from something else (residential mortgage-backed securities, commercial mortgage-backed securities, *etc.*). AIG's financial woes were largely a result of AIGFP's position as underwriter of one type of derivative, credit default swaps,[3] which sustained substantial losses in 2008. AIGFP's credit default swap exposure on multi-sector collateralized debt obligations[4] alone accounted for approximately $19 billion of the almost $25 billion in losses AIG announced in the third quarter of 2008. These conditions led to the Federal Government providing AIG financial assistance in order to prevent a failure of the company and avoid potential market disruptions as the financial crisis facing the U.S. and world markets unfolded. The initial funding and subsequent infusions led to an approximately 80 percent interest in AIG being owned by the Federal Government.[5]

Federal Requirements for Executive Compensation

Important differences have existed between conditions placed on AIG by FRBNY and the Treasury Department as they relate to restrictions on executive compensation. FRBNY's credit

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[3] A CDS is a contract where the seller receives a series of payments from the buyer in return for agreeing to make a payment to the buyer when a particular credit event outlined in the contract occurs (for example if the credit rating on a particular bond or loan is downgraded or if it goes into default). It is commonly thought of as an insurance product where the seller is providing the buyer insurance against the failure of a bond. The buyer, however, does not need to own the asset covered by the contract, which means it can serve essentially as a "bet" against the underlying bond.

[4] A CDO is a financial instrument that entitles the purchaser to some portion of the cash flows from a portfolio of assets, which may include bonds, loans, mortgage-backed securities, or other CDOs.

[5] Treasury's June 17, 2009 report entitled "*FINANCIAL REGULATORY REFORM, A New Foundation Rebuilding Financial Supervision and Regulation*," notes that if a large interconnected bank holding company or other nonbank financial firm nears failure during a financial crisis, there are only two options: obtain emergency funding from the U.S. government as in the case of AIG, or file for bankruptcy. It states that neither of these options is acceptable for managing the resolution of the firm efficiently and effectively in a manner that limits the systemic risk with the least cost to the taxpayer. It thus recognizes the need for new tools and options for managing financial crises. It states that among the tools that should be made available to Treasury would be the ability to establish conservatorships or receiverships for failing firms. Then, in choosing among available tools, the report proposes that Treasury should consider the effectiveness of an action for mitigating potential adverse effects on the financial system or the economy, the action's cost to the taxpayers, and the action's potential for increasing moral hazard.

agreement established covenants with which AIG must comply, such as compliance with laws, use of proceeds, and minimum liquidity thresholds. None of the covenants directly restrict executive compensation, but FRBNY had flexible authority under its lending agreements with AIG that stipulated that FRBNY officials shall be "reasonably satisfied in all respects with the corporate governance of the Borrower." This lending condition grants monitoring authority to FRBNY officials over AIG's operational processes and internal controls.

In contrast, the Treasury Department imposed specific compensation conditions affecting senior executives employed by all TARP recipients generally, and AIG specifically in November 2008. Those conditions and others were guided by requirements explicitly stated or developed pursuant to authority granted to the Treasury under EESA. For TARP recipients under the initial capital injection program (known as the Capital Purchase Program), those requirements were generally related to structuring compensation programs to avoid undue risks that would threaten the value of financial institutions, to limiting tax deductibility of executive compensation, to limiting compensation for departing employees, and to provisions for recovering certain payments. See Appendix B for details concerning these requirements, including changes over time.

After Treasury determined that AIG would require Federal financial assistance above that previously provided by the Federal Reserve, Treasury, employing authorities available under EESA, imposed greater compensation restrictions than those imposed on financial institutions participating in the CPP. Accordingly, Treasury's agreement with AIG imposed the following executive compensation conditions that went beyond those placed on CPP participants:

- limits on severance payments, or "golden parachutes," to Senior Partners[6]
- restriction of the total bonus, retention payment, and severance payment to any Senior Partner with respect to 2009 to no more than 3.5 times base salary plus 2008 target annual bonus
- limits of Senior Executive Officers ("SEOs") and Senior Partners' 2008 and 2009 bonus pools to the average of 2006–2007 bonus pools paid (excluding quarterly and supplemental bonus)
- restrictions on payment of bonuses or future cash performance awards to SEOs and Senior Partners out of TARP funds
- restrictions on payments of electively deferred compensation out of TARP funds

The first four restrictions covered 57 employees, which was far greater than the number subject to the executive compensation restrictions under the Capital Purchase Program. The last restriction applied to all AIG employees.

[6] The executive personnel participating in AIG's Senior Partners Plan were identified as Senior Partners for purpose of the November 25, 2008, agreement.

Objectives

This report addresses the extent to which Federal officials were aware of the magnitude of AIG's compensation programs, including the March 2009 AIGFP retention payments, and whether those payments complied with executive compensation restrictions associated with TARP assistance. Specifically, the report addresses the following questions:

- What was the extent of knowledge and oversight by Federal Reserve and Treasury Department officials over AIG compensation programs and, specifically, AIG retention award payments to its Financial Products group personnel?
- To what extent were AIGFP retention payments governed by executive compensation restrictions or pre-existing contractual obligations?
- What are the outstanding AIG compensation issues requiring resolution, and what Federal Government actions are needed to address these issues?

For a discussion of the audit scope and methodology, as well as a summary of prior coverage, see Appendix A. For information on Treasury's restrictions on executive compensation and how they have changed over time, see Appendix B. For a timeline of FRBNY and Treasury officials' knowledge about key AIG compensation matters, see Appendix C. For an example of the award letter granting AIGFP employees the retention awards, see Appendix D. For a complete list of acronyms used in this report, see Appendix E. For the audit team members, see Appendix F. For copies of management comments from the Federal Reserve Board/FRBNY and Treasury, see Appendices G and H.

FRBNY Officials Had Early Involvement in AIG Compensation Decisions, Whereas Treasury Officials Had Far More Limited Involvement

This section provides insights regarding the knowledge of FRBNY and Treasury officials about AIG compensation issues in general and the AIGFP retention program and payments in particular. In the fall of 2008, AIG's compensation structure was being increasingly recognized, internally and externally, as being so decentralized as to make it difficult to get a complete overview of all programs and pending payments. Because of its ongoing contact with AIG, the Federal Reserve staff was in a better position than Treasury officials to appreciate quickly the challenges Federal entities would face in understanding AIG's compensation programs. That fall, after the Federal Reserve had begun providing financial assistance to AIG, but before the Treasury had begun providing such assistance, FRBNY officials began to raise concerns over compensation issues with AIG corporate officials. Both FRBNY and AIG corporate officials have struggled over time to fully understand and document the details of the varied compensation plans within AIG. Even so, detailed knowledge regarding those plans and future payments accrued slowly, based on available documentation provided to SIGTARP. Although FRBNY officials were a periodic source of some information to Treasury staff on AIG compensation issues, available information indicates that senior Treasury officials, over time, were not significantly engaged in the oversight of AIG and, as such, did not gain knowledge of the March 2009 AIGFP payments until shortly before their distribution. Since then, Treasury officials have become more engaged with AIG on compensation issues, along with FRBNY.

Decentralized Decision Making Limited AIG Corporate Management's Knowledge of Its Compensation Plans

AIG's approach to compensation has historically been extremely decentralized. According to officials at AIG, its corporate headquarters generally did not control or approve compensation packages of some of its business units, instead granting authority to those business units to develop and approve their own compensation programs and payment decisions. Moreover, the lack of a centralized management information system hampered collection of consolidated information on such plans.

According to AIG officials, their former long-time CEO, Maurice Greenberg, had managed AIG for more than 35 years during a time that the company had compensation plans weighted toward long-term incentives that were payable generally only at retirement. Key employees were required to remain with AIG until retirement to be vested in their stock-based awards. This practice was employed to deter employees from leaving the company and is commonly referred to as a "golden handcuff." The plans were designed to reward employee longevity. AIG's financial losses since late 2007, however, have reportedly erased most of the value of those potential awards.

By 2008, AIG officials reported that they were taking steps to update compensation plans based on then current industry practices and to address the effect of the financial losses on compensation programs. According to AIG management, they believed that past compensation plans were not meeting the needs of its employees, that financial losses were reducing the compensation available to employees at retirement, and that the combination of these were causing employee retention problems. Some of these plans, including those of AIGFP, were modified during 2007 and 2008 to provide incentives to retain employees whose deferred compensation had been significantly reduced by company financial losses. Those changes were especially significant when, according to AIG estimates, there were losses of at least $5 billion during each quarter between the fourth quarter of 2007 and the third quarter of 2008. AIG's quarterly losses culminated in a loss of approximately $62 billion during the fourth quarter of 2008. During this same time period, AIG officials estimate that AIG employees who held AIG stock lost more than $1 billion in share value. As of March 2009, AIGFP employees alone reportedly had lost around $790 million in future compensation tied to the company's financial performance. AIG officials stated that AIG's deteriorating financial performance created uncertainty about future compensation levels and job stability, so it used its compensation plans to provide incentives for employees to remain at AIG.

AIG stated that, as of March 2009, its approximately 630 compensation plans covering its 106,000 domestic and international employees[7] consisted of bonus payments and retention awards, plus there were a number of deferred compensation balances accrued by employees. The plans were designed for both employees of AIG's business units, or subsidiaries, as well as employees of AIG's corporate holding company.

- **Bonus payments.**[8] According to information developed by AIG officials, among the 620 corporate and business unit bonus programs, there were around 51,500 employees participating in 374 plans that allocated about $455 million in awards for service performed during 2008, which could be paid in increments by December 31, 2009.[9]
    - Bonus pool managed by AIG Corporate - According to information obtained by the compensation consulting practice of Ernst & Young, LLP, the consultant contracted by FRBNY, employees receiving bonuses through the corporate bonus pool received payments totaling approximately $122 million and ranging from approximately $25,000 to just more than $1 million. Data provided by AIG shows that about 98 percent of bonuses awarded to corporate employees were $100,000 or less. According to information provided by AIG

[7] The number of employees is based on data as of June 30, 2009.
[8] Bonus is generally defined as a stock or cash payment for meeting or exceeding performance expectations. However, the structure of such payments in AIG could vary by facts and circumstances present at individual business unit and location, nationally and internationally.
[9] The number of employees and amounts paid and payable under the bonus, retention, and deferred compensation plans are based on unaudited data received from AIG or unaudited data provided by AIG to Ernst & Young, LLP, as of March 20, 2009. The number of participants and amounts distributed under the bonus program do not include approximately 236 plans across AIG pursuant to which employees earn varying amounts based on sales and commissions on those sales or the nine plans governing payments required by local governments of the various countries within which AIG operates. Nor do these numbers reflect plans that pay amounts based on ownership interests on investments in certain products or real estate investments.

to Ernst & Young, LLP, approximately 96 percent of the corporate bonus pool was to be paid by June 1, 2009, with less than $5 million remaining to be paid by December 31, 2009.

- Bonus pools managed by business units - Of the approximately $330 million bonus pool managed by business units in 2008, Ernst & Young, LLP had not obtained complete details of the amounts remaining to be paid under the business unit bonus awards as of the date of SIGTARP's review, due to AIG's inability to collect the business unit data. However, AIG officials provided data on the average bonus scheduled to be awarded to employees in each of by the various business units. See Table 1 for details.

Table 1: Average 2008 Bonus Payments by AIG Business Unit (in dollars)

Business Unit	Average Award
Financial Services	$4,994
Domestic Life and Foreign Life Operations	$5,050
Foreign General Insurance Operations	$5,074
Property Casualty Group	$5,403
Retirement Services Operations	$11,889
Asset Management	$51,026

Source: AIG responses submitted for the record relating to the March 18, 2009, testimony of Edward Liddy before the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises.

- **Retention payments.**[10] AIG and FRBNY officials stated that there are 13 corporate and business unit retention plans as of March 20, 2009, that have allocated awards totaling a little more than $1 billion to almost 5,200 personnel that could be paid through 2010 or upon the sale of a business unit.
  - Corporate and business unit personnel, excluding AIGFP personnel - According to information provided to Ernst & Young, LLP, these retention awards total approximately $617 million for corporate employees and employees in business units other than AIGFP. The total awards divided across total award recipients averages approximately $130,000 and ranges from $500 to $4 million for corporate employees and employees in business units other than AIGFP. According to information provided to Ernst & Young, LLP, approximately 40 percent of retention awards due to all corporate and personnel in business units other than AIGFP were paid or to be paid before June 1, 2009, with approximately $363 million due on or after June 1, 2009 or upon the sale of a particular AIG business.

[10] Retention payments are generally defined as payments for remaining employed until an established date. However, this definition does not necessarily apply to all of AIG's retention programs, of which at least one plan provided payments in the event an employee was subject to an involuntary reduction in force.

- AIGFP personnel – According to information provided by Ernst & Young, LLP, AIGFP retention awards total approximately $475 million and would be distributed over a period of two years. AIGFP retention awards were reportedly not designed to reward employees solely based on performance, and the awards were not necessarily designed to increase with an employee's level of responsibility. Rather, the awards were designed to retain all AIGFP employees who would wind down the complex trades and/or continue AIGFP's general operations. Approximately half of the total retention awards were distributed to around 400 employees in two installments: nearly $69 million in retention awards in December 2008 and approximately $168 million in March 2009. According to AIG officials, individual awards paid in March 2009 ranged from $700 for one File Administrator to more than $4 million for one Executive Vice President, with total awards divided across total award recipients averaging just over $400,000. Within that range, AIG's data indicates that award amounts varied greatly. For example, $7,700 was awarded to one Kitchen Assistant, $59,500 to one Assistant Vice president, $87,500 for one Senior Administrative Assistant, $100,000 to one Vice President, and $980,000 to one Managing Director. Approximately 62 percent of AIGFP employees received retention awards greater than $100,000, according to data provided by AIG. The retention awards paid in March 2009 range from as little as 1 percent of a recipient's base salary to as great as 36 times base salary. Awards paid in March 2009 averaged 2.5 times total base salary. Distribution of the remaining $198 million is expected in March 2010, although the exact total would decrease if there is further loss of employees.

- **Deferred compensation.**[11] According to AIG, there was a total of approximately $275 million in deferred compensation payments distributed from 5,200 participant accounts[12] between January 2009 and September 2009 to AIG employees actively employed with AIG as of December 31, 2008. The deferred compensation balances were established outside of the approximately 630 compensation programs, the balances had grown over the years, and were historically not made until retirement or resignation. According to AIG officials, the $275 million in payments were made prior to these employees retiring or resigning given the substantial losses in their account balances that occurred due to AIG's financial losses. Additional losses to these amounts would likely have occurred should AIG have gone into bankruptcy, and early payments would avoid that risk. According to senior AIG officials, because the balances represented compensation already earned, the deferred compensation payments do not represent discretionary or performance-based awards. According to an AIG official, employees who were retired as of December 31, 2008 will continue to receive a distribution from their accounts based on the terms agreed-upon at their retirement.

AIG's Chief Human Resource Officer stated that many business units reportedly had authority to approve compensation plans for most staff on their own. Those plans may or may not have been reported to corporate headquarters. That same AIG official also stated some units had their own

[11] Deferred compensation is generally defined as a voluntary or involuntary deferral of pay to be distributed at a later date than when earned.

[12] According to an AIG official, the number of participant accounts does not represent the number of employees with a deferred compensation account, as an employee could have multiple deferred compensation accounts.

Compensation Committees to approve their compensation programs. Per information from AIG officials, AIG's corporate-level Compensation and Management Resources Committee approved corporate compensation programs as well as the compensation decisions for about 20 highly compensated executive officers, called "purview employees."

AIG Corporate officials told us that they have been unable to obtain a full understanding of their compensation plans because AIG does not have an integrated information system to show such data. According to AIG officials, approximately 60 different payroll systems housed data for the various plans and there was no integrated system to provide corporate management centralized compensation information to facilitate oversight. Also, the business units are subject to various compensation laws governing AIG's business in more than 130 countries and jurisdictions. AIG officials told us that certain foreign governments impose additional compensation laws with which AIG is required to comply, further adding to the complexity of the various compensation plans. This autonomy, the lack of a requirement to obtain corporate headquarters' approval, disparate compensation information systems, and various compensation regulations hindered the AIG corporate headquarters from obtaining an aggregate knowledge of compensation decisions.

AIG officials stated that after the March 2009 AIGFP retention payments were made, the corporate headquarters implemented a policy that all compensation plans would be reviewed by the Corporate Compensation and Management Resources Committee. However, at the time we completed our field work, AIG and Federal officials told us that they were still working to obtain a complete understanding of the many compensation plans implemented by AIG business units.

FRBNY Officials Developed Early Interest in AIG Compensation Issues and Provided Periodic Information to Treasury

Within fifteen days of signing its September 22, 2008, credit agreement with AIG, a team of FRBNY officers, including Senior Vice Presidents, Vice Presidents, and supervision staff, moved on-site at AIG to assess the magnitude of the company's funding and liquidity needs, to understand its financial condition, and to assess broader risk management issues at the company. According to FRBNY officials, the team's primary focus was on stabilizing the company and addressing imminent risk issues. On September 19, 2008, FRBNY officials engaged Ernst & Young, LLP as a consultant to assist in analyzing these risk issues. In the course of its work, FRBNY officials began obtaining information on the magnitude of pending corporate retention payments and severance awards. Further questions were triggered shortly thereafter when these FRBNY officials learned about AIG's plans to pay more than $1 billion in retention awards, bonuses, and deferred compensation across its corporate unit and various business units. The $1 billion included three separate retention plans, bonuses for employees working for businesses that eventually would be sold, deferred compensation balances such as the ones created under a 15-year-old deferred compensation plan, and compensation for certain senior executives to be paid between September 2008 and June 2009. By mid-fall 2008, FRBNY received documentation highlighting limited information about additional AIG plans, including at least $600 million in impending deferred compensation and bonus pools to AIGFP employees, but

available documentation indicates no further details on the timing of those payments were disclosed by AIG at that time.

An October 10, 2008, letter from an FRBNY Senior Vice President to AIG's Vice President of Global Compensation and Benefits expressed concerns about AIG's proposed payments, including the additional strain these compensation expenses would have on AIG's already tight liquidity position, emphasized by AIG's recent need for Federal financial assistance. In addition, FRBNY senior officials questioned the number of employees potentially receiving these payments, the incentives relative to base salary, and the period over which severance would be paid. For example, their concerns included the severance benefits for one executive departing in 2008 whose benefits would continue for a two-year term. In October 2008, FRBNY broadened the engagement scope of Ernst & Young, LLP to compensation issues, and with its assistance, spent the next several months influencing changes to future compensation decisions, ultimately resulting in restructuring of the 2008 bonus for Senior Partners. The restructuring made a portion of the bonus distribution contingent on making sufficient progress in reorganizing the company and repaying Federal financial assistance, as well as decreasing the 2008 bonus pool 30 percent below 2007 levels. FRBNY officials' influence also led to increased oversight of compensation decisions by AIG's Compensation and Management Resources Committee.

Knowledge Regarding the Magnitude of AIGFP Retention Plan Details Unfolded Slowly

Although the FRBNY on-site team had frequent interactions with AIG officials, details of the magnitude of AIGFP retention awards evolved over a period of several months according to FRBNY officials. At the end of September 2008, AIG briefed a FRBNY Senior Vice President about the structure of the AIGFP retention plan. A FRBNY Vice President received a similar briefing a few days later on October 1, 2008, including details about the total payments. A broader group of FRBNY officials leading the on-site team, including a Senior Vice President and Vice President, recall that they were not informed about the magnitude of AIGFP retention payments until November 11, 2008. Available information indicates Treasury's Counselor to the General Counsel's Office and an Attorney Advisor did not know about the March 2009 proposed payments until the end of February 2009. Treasury's Office of Financial Stability Chief Investment Officer and a Risk Manager also became aware of the retention payment details around this time based on available information received by SIGTARP. See below for a more complete discussion regarding the extent of Treasury's advance knowledge of the retention payments; also see Appendix C for additional information and timelines associated with FRBNY's and Treasury's knowledge of overall AIG compensation matters.

FRBNY officials, including a Senior Vice President and a Vice President who were leading the on-site team, identified early-on that derivative transactions executed by AIGFP traders were a source of risk to AIG's financial health. FRBNY staff believed, however, that those same traders were needed to manage and, in some cases, negotiate to end the complex deals. Thus, early discussions on compensation and retention structures for AIGFP employees began between AIG and FRBNY officials. On September 29, 2008, AIG executives met with FRBNY officials to explain AIGFP compensation and retention plans, including the formal descriptions and guidelines for the AIGFP Deferred Compensation, AIGFP Special Incentive, and AIGFP

Employee Retention Plans. The AIGFP 2008 Employee Retention Plan was created in December 2007 to provide incentives for employees to stay at AIGFP in light of the impact that accounting losses on the derivative transactions would have on employee compensation tied to AIGFP's financial performance. FRBNY officials wanted to determine if the AIGFP Employee Retention Plan was structured in a way that motivated traders to delay selling assets, which would create an accounting loss, in order to avoid having those losses impact their incentive compensation. According to a FRBNY Vice President, a telephone call between an AIG senior official and an FRBNY Vice President on October 1, 2008, reportedly minimized FRBNY officials' concerns after AIG reported that the retention plan excluded, or in some cases limited, the impact certain accounting losses would have on the bonus pool, thus diminishing the incentive of traders to make decisions not in the best interests of AIGFP simply to avoid a reduction in their retention awards.

As stated before, the AIGFP retention awards were not necessarily designed as a typical bonus, based on performance. Rather, as described by AIG, they were designed to retain all of the employees in the unit that would wind down the complex trades and/or the general operations of AIGFP. For example, awards went to employees who were not essential to winding down the trades, such as $7,700 to a Kitchen Assistant, $700 to a File Administrator, and $7,000 to a Mailroom Assistant. During the same meeting, AIG officials verbally disclosed the retention amounts of approximately $319 million for 2008 and $333 million for 2009. Each of these award pools, according to AIG, would be distributed by March 15, 2009 and March 15, 2010, respectively, over a two-year period to AIGFP employees. Of these amounts, approximately $100 million each year would be tied to AIGFP's financial performance and deferred to future periods, with employees expected to receive a net award amount of more than $200 million for each of the two award years. FRBNY officials indicate the award balances were not highlighted as an area of concern at that time, because FRBNY officials were focused on identifying and understanding other risks that could impact AIG's ability to repay the financial assistance provided by FRBNY. Further, while FRBNY officials expressed concern to AIG about the plans being overly broad, it is unclear whether FRBNY officials knew that the recipients of the payments would include non-essential AIGFP support employees who could presumably be replaced easily, such as a Kitchen Assistant and a Mailroom Assistant.

Although there were ongoing discussions between AIG and FRBNY officials between October 1, 2008 and November 11, 2008, available documentation does not indicate additional discussion or disclosure of AIGFP retention award amounts until November 11, 2008. Earlier, AIG officials told FRBNY officials on October 24, 2008, that 30% of the AIGFP retention awards would be accelerated from March 2009 to December 2008 in a broader document summarizing retention and incentive programs across AIG. No dollar amounts for the AIGFP retention awards, however, were described in this October 24, 2008, summary. Subsequently, on November 11, 2008, FRBNY and Ernst & Young, LLP, officials were present during a meeting of AIG's Compensation and Management Resources Committee where they reportedly heard for the first time a discussion of the AIGFP retention programs that included specific amounts to be distributed under the AIGFP Employee Retention Plan.

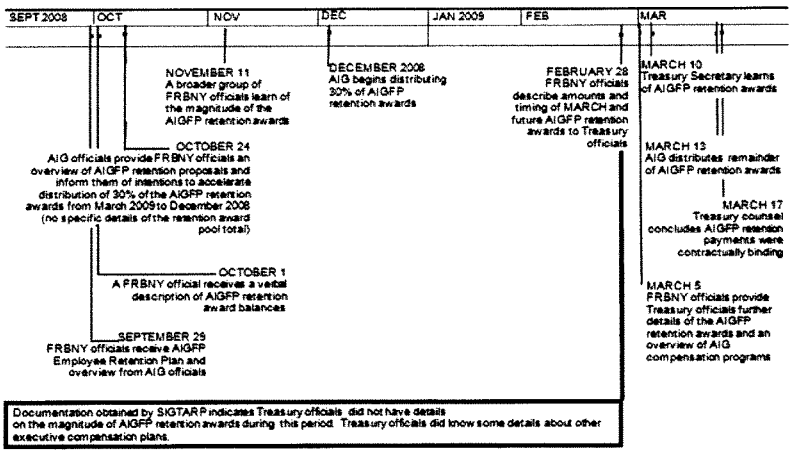
After spending several months studying AIG compensation, Ernst & Young, LLP was able to provide to the FRBNY Vice President leading their on-site team a summary of AIG

compensation programs they had learned about through March 5, 2009, as well as the balances and general timing of distribution of the AIGFP retention awards based on information provided by AIG to Ernst & Young, LLP. On February 28, 2009, FRBNY officials e-mailed Treasury's internal counsel the amounts and timing of the AIGFP retention awards, noting that the issue had "garnered press and Congressional attention" and warning that "it will not be easy for Treasury and the Fed to defend." The e-mail also promised more detailed information, which was later e-mailed to Treasury internal counsel on March 5, 2009. Despite the strong language of the e-mail, a Treasury official told SIGTARP that the e-mail did not raise any flags in Treasury.

Treasury Officials Became More Fully Aware of AIGFP Retention Payments Shortly Before Their Distribution in March 2009

While generally aware of the existence of retention awards, available information indicates that Treasury officials were not aware of the magnitude and timing of the March 2009 AIGFP retention awards until February 28, 2009. Further, available information indicates that their broader knowledge and oversight of AIG compensation plans was far less than that of FRBNY officials and was reliant on what FRBNY officials shared with them. Figure 3 shows a timeline regarding when both FRBNY and Treasury officials became aware of details surrounding the AIGFP retention awards.

Figure 3: Timeline of FRBNY and Treasury Officials' Knowledge of AIGFP Retention Awards



Source: SIGTARP analysis of AIG, FRBNY, and Treasury correspondence.

Treasury officials were present for a time at AIG as early as September 2008 along with FRBNY officials and interacted with FRBNY officials and AIG executives at that time, but Treasury's

involvement subsequently became more sporadic. Subsequent turnover of Treasury personnel left a temporary gap in Treasury oversight. Treasury officials became involved in AIG again in late October 2008, this time working on structuring terms of Treasury's $40 billion November 2008 TARP assistance to AIG. Treasury officials began discussions with AIG, via the outside counsel representing both Treasury and FRBNY, concerning the number of executives who would be subject to executive compensation restrictions.

Due to the extraordinary nature of the Government's investment in AIG, Treasury officials decided to substantially increase the number of AIG executives subject to EESA executive compensation restrictions beyond the five that would be covered under CPP, and their attention was quickly focused on identifying these individuals. A final decision was made to place the restrictions on approximately 70 executives.[13] Of that pool, 57 executives actually signed the November 2008 agreement on compensation restrictions; the others had left the company. However, available information indicates the decision on the number of executives was made with Treasury neither directly coordinating with FRBNY officials nor initiating requests for compensation data that FRBNY officials had gathered. Available documentation and discussions with available Treasury officials indicate that their primary efforts during this time focused on developing the executive compensation conditions and identifying the number of executives subject to those conditions, without an independent, broader assessment of compensation practices and obligations that would have identified a larger number of highly paid employees.

Available information also indicates that between the fall of 2008 and late February 2009, Treasury provided little direct oversight and, as a result, had limited knowledge of AIG compensation plans as a whole. For example, Treasury officials, including the Counselor to the General Counsel, became aware of at least $600 million in **bonus** and **deferred compensation** for AIGFP employees on October 26, 2008, which did not include any amounts intended for AIGFP retention awards. According to AIG Senior Vice President, Human Resources, the deferred compensation was reportedly never actually distributed to AIGFP employees because they were tied to AIGFP financial performance, which declined to such an extent by the fall of 2008 to eliminate the payments completely. Treasury officials, including the Counselor to the General Counsel received other details of severance packages for 48 AIG senior executives on November 7, 2008, as part of determining the compensation conditions to place on AIG executives. Treasury officials also reportedly had very limited staff time devoted to AIG compensation issues during that time. As a result, available information indicates the Counselor to Treasury's General Counsel and Attorney Advisor did not become aware of the timing and magnitude of the AIGFP retention payments that would be paid out on March 13, 2009, until late February 2009.

While senior FRBNY officials were aware of these payments during Secretary Geithner's term as President of the FRBNY, there is no indication in documentation received by SIGTARP or in discussions with FRBNY and Treasury officials regarding to what extent, if any, that Secretary Geithner was aware of the balances and timing of distribution of the AIGFP retention awards before March 10, 2009. While available information indicates Treasury officials became aware of these payments on February 28, 2009, there is no indication they informed Secretary Geithner

[13] The 70 executives represented the five senior executive officers as well as 65 other senior executives who participated in AIG's Senior Partner compensation plan.

until March 10, 2009. Once informed, Secretary Geithner reportedly contacted former AIG CEO Edward Liddy regarding AIG's compensation plans and his concerns with the magnitude of the pending AIGFP retention awards. Since that time, and leading up to the appointment of its Special Master for compensation, Treasury has become more involved with AIG compensation decisions. In March 2009, Treasury established an equity capital facility, from which AIG would be able to access up to $29.8 billion in return for preferred shares in AIG. While the deal, which was not signed until April 17, 2009, required AIG to repay $165 million over a period of five years in an effort to recoup the AIGFP retention awards, no new executive compensation restrictions were placed on AIG and future AIGFP retention award payments went unaddressed. The deal required AIG to comply with new executive compensation regulations that were later issued in June 2009. Shortly after the March retention award distributions, AIG officials began deferring approval of compensation decisions for individuals receiving greater than $250,000 to Treasury officials, with Treasury rendering a "no objection" decision for cases requiring "acute and immediate" attention.

The March 2009 Retention Payments Were Subject to Pre-existing Contractual Obligations and Not Executive Compensation Restrictions

This section presents information on the extent to which AIGFP retention payments were governed by Federal executive compensation restrictions or pre-existing contractual obligations. Based on available information, the AIGFP retention payments were consistent with the law and AIG's contractual obligations to the Government. They were not prohibited under EESA, the American Recovery and Reinvestment Act of 2009 (ARRA), or the post-ARRA legislative changes restricting executive compensation payments. Also, these payments were not governed by executive compensation restrictions that were placed on AIG executives as part of the TARP assistance agreement. Several legal opinions concluded that the payments were contractually required. While there was no effort initially to negotiate reductions to the payments, AIG executives asked Financial Products employees to voluntarily return a portion of the payments after public outcry over the compensation. Although AIG received a commitment from some employees to repay a portion of the retention awards, collection has been incomplete due to certain employees leaving AIG and reported concerns of employees who remain at AIG regarding the status of future payments under the AIGFP retention plan.

AIGFP Retention Payments Were Not Governed by Executive Compensation Restrictions

The March 2009 retention payments are not governed by executive compensation conditions outlined under EESA, Treasury guidelines, or ARRA. First, the March 2009 payments were retention awards based on 2008 plans, which are outside the scope of executive compensation restrictions imposed by Treasury. Second, the plans were exempted under ARRA, which explicitly stated that it did not apply to agreements in place prior to February 11, 2009. Moreover, Treasury's June 2009 interim final rules similarly state that payments accrued or made before June 15, 2009, based on a written employment agreement, are not subject to its executive compensation restrictions. The AIGFP Employee Retention Plan was offered in writing to employees during the first quarter of 2008, and all of AIG's 13 retention plans were offered to employees before February 11, 2009.

Executive compensation conditions placed on AIG as part of Treasury's November 2008 agreement applied to 57 AIG executives. SIGTARP examined the listing of the approximately 400 AIGFP personnel receiving the March 2009 retention payments and found that the recipients did not include any of the 57 persons covered under the TARP agreement restrictions. Moreover, the AIGFP retention pay recipients were not designated as Senior Executive Officers or Senior Partners, nor were any of them the five most highly compensated officers or participants in AIG's Senior Partners plan—categories of employees covered under Treasury guidelines applicable to AIG at the time the payments were made.

Legal Opinions Support Conclusions That the March 2009 Retention Payments Were Contractually Binding

AIGFP employees signed award letters from AIG accepting the terms of the AIGFP 2008 Employee Retention plan. See Appendix D for an example of the award letter. Several government and private parties reviewed the enforceability of the March 2009 retention payments, determining that they were legally binding. First, on March 16, 2009, one of AIG's outside counsels, Paul Hastings, Janofsky, & Walker, LLP, determined that the payments were contractually required and furnished this opinion to AIG and FRBNY general counsel. Second, according to Treasury, in early March 2009, Treasury officials asked another outside counselor, Davis, Polk & Wardwell, who serves as counsel to both Treasury and FRBNY regarding the AIG transactions, to discuss measures that could be taken to prevent the payments from being made. Although they did not provide any written opinion, the outside counsel reportedly communicated to Treasury officials that the retention awards appeared on their face to be contractually binding. Third, shortly after the AIGFP retention payments were distributed to employees, the Treasury Secretary asked the Department of Justice to investigate whether there was a legal basis to recoup the retention awards. The Department of Justice, on March 27, 2009, concluded that there was a low likelihood that alternatives to paying the bonuses would have much legal merit.[14]

While efforts could have been undertaken to achieve pay reductions through negotiations, AIG senior officials told SIGTARP they did not believe that was an option at the time given the contractual obligations and the need to retain those employees. Following the public outcry over the payments made in March 2009 and subsequent congressional legislative efforts to heavily tax the payments, however, AIG officials noted that options for negotiations became more viable.

Efforts Are Underway To Recoup a Portion of the March 2009 Retention Payments

Following the March 2009 AIGFP payments, subsequent congressional hearings, public outcry over the retention payments, and extensive media coverage, along with well-publicized threats to individual employees once details of payments were made public, AIG executives asked certain AIGFP personnel to return voluntarily a portion of the awards. AIG executives stated that they asked personnel who received AIGFP retention awards greater than $100,000 to return 50 percent of the award received. According to AIG officials, as of August 31, 2009, there had been pledges to repay approximately $45 million before taxes and actual repayments of a little more than $19 million before taxes had been made. These same officials state that additional progress to recoup the full amount pledged is subject, in part, to reaching agreement on the extent to which the second portion of the retention awards will be paid, as promised, in March 2010. Although a senior AIG official states future awards totaling approximately $198 million[15] are

[14] The Treasury Inspector General is conducting a separate analysis of the legal grounds for AIG bonus payments and the potential for recouping such payments.

[15] AIGFP retention awards totaled approximately $198 million as of August 31, 2009. The total that will be paid is subject to any changes in the terms of the retention agreements, as well as the number of employees present at the time of distribution.

supposed to be paid in March 2010 as part of the contractual AIGFP retention agreements, AIG officials indicated that they are working to propose new compensation arrangements to AIGFP employees in light of the negative fallout surrounding the March payments. Discussions between AIG and the Special Master regarding the terms of new compensation agreements are ongoing. AIG officials state that changes to the terms of the previously agreed-upon retention awards have created significant compensation uncertainty within AIGFP. As discussed more fully below, this is just one of the outstanding challenges AIG faces in structuring future compensation decisions that retain employees and comply with executive compensation regulations.

AIG's Continuing Employee Retention and Compensation Issues

This section discusses key AIG compensation issues that may affect employee retention and future decisions by the Special Master. AIG faces difficult challenges in balancing the size and timing of future compensation payments, some of which are considered by corporate and government officials to be contractually binding, while also complying with new restrictions on compensation. According to AIG and FRBNY officials, the loss of key employees in AIGFP and other business units could damage AIG's ability to retain customers and sell some of its companies, which are essential factors in repaying the Federal Reserve and Treasury. Recognizing a linkage of past pay decisions to future pay decisions, AIG reportedly has been in discussions with the Office of the Special Master concerning $198 million in future retention payments due to AIGFP employees. The complexity of AIG compensation issues are such that they are likely to require considerable attention of AIG management and Federal officials for some time to come. FRBNY officials, who have had far more detailed experience in examining AIG compensation issues than Treasury officials, are reportedly willing to share knowledge gained regarding AIG's compensation programs with the Special Master in understanding AIG compensation structures and retention challenges. The Office of the Special Master reportedly has recently initiated contact with FRBNY officials following SIGTARP's recommendation that he do so.

AIG Cites Unresolved Compensation Challenges To Retain and Recruit Key Employees

Although new TARP executive compensation regulations issued on June 15, 2009, will bring some certainty to compensation at AIG, the company reportedly has already lost many employees. According to AIG officials, these regulations do not resolve the need to structure compensation to retain and recruit key talent or to maintain a competitive compensation program relative to peer firms, which are not subject to the new regulations. AIG officials state AIG businesses not associated with AIGFP retention payments or financial losses generated by AIGFP credit default swaps have suffered employee turnover because of lost business volume and the negative stigma now associated with the AIG moniker. As a result of the compensation uncertainty, AIGFP and other business units reportedly have suffered hundreds of resignations, which AIG and FRBNY management believe potentially impact the company's ability to operate effectively, and ultimately, to repay Federal assistance.

AIG documentation indicates that dozens of Directors and Officers have resigned across the Commercial Insurance, Worldwide Life Insurance, Investments, and Financial Products businesses. According to senior AIG officials, the requirement to comply with the compensation regulations is another challenge they face relative to their competitors. AIG officials stated that their competitors are successfully recruiting AIG employees, potentially putting those peer firms not subject to the compensation regulations at a competitive advantage in attracting talent. AIG

officials have expressed the view that these resignations are affecting the AIG enterprise at large, but losses are reported to be particularly acute within AIGFP. Losing AIGFP employees is seen by AIG leadership as a significant risk. Because of their institutional knowledge, these employees are considered by AIG as key to finishing the unwinding of the complex derivatives book of business, estimated to be about $1.3 trillion in notional amount as of June 30, 2009. AIG officials emphasized that effectively retaining and recruiting quality staff throughout their organization directly relates to AIG's ability to repay the Federal Reserve and Treasury Department for the Government's investments in AIG.

Special Master's Decisions May Address Some of AIG's Compensation Challenges, but AIG Management Must Still Make Difficult Decisions

The appointment of the Special Master as part of the June 15, 2009, interim final compensation regulations and his subsequent determinations will clarify some decisions on AIG's compensation, but AIG management will still have to make difficult decisions on compensation issues that are outside of the regulations' scope. The Special Master will review the proposed compensation structures, including payments made pursuant to those structures, for the senior executive officers and the 20 next most highly-compensated, as well as the proposed compensation structure for the next 75 most highly-compensated employees. In addition, the Office of the Special Master stated the Special Master has authority to issue an advisory opinion with respect to payments outside of his scope if formally requested in writing by a TARP recipient. The Office of the Special Master states that under the interim final regulations, though, the Special Master is expressly permitted to consider certain prior payments in the course of decisions related to prospective compensation structures.

As noted earlier, according to AIG officials, resolution of the prior pay decisions are clearly linked to future pay decisions. Therefore, upon the Special Master's appointment, AIG began discussions with him with respect to the remaining AIGFP employee retention payments as well as other base pay issues. Although the final outcome of the Special Master's review and approval of these payments is not known, there are ongoing discussions between AIG and the Special Master regarding the amount of the remaining retention payments that will be distributed. Although the Office of the Special Master indicates AIG has not formally requested in writing an advisory determination for the remaining AIGFP retention payments, Treasury's Special Master has informed AIG management that the total of $198 million should be reduced. The Office of the Special Master has not indicated by how much this amount is to be reduced. Further, the Office of the Special Master stated that the Special Master has indicated that full repayment of $45 million in pledged amounts will be required by those individuals subject to Special Master review. According to AIG management, collecting repayments for the total $45 million will be difficult because some of the more than 400 employees originally receiving retention awards and who said they would repay are no longer with the company.

In a letter reportedly sent on July 20, 2009, to the seven firms receiving exceptional TARP assistance, the Office of the Special Master requested a voluminous amount of compensation data with respect to the proposed compensation structures and payments for the senior executive

officers and 20 most highly compensated employees of each recipient. For AIG to gain approval for its proposed compensation packages that fall within the new regulations, the Special Master will review whether AIG proposals are consistent with pay at competitor institutions and that they align with appropriate performance metrics, among other factors. According to the Office of the Special Master, information on the compensation packages of the senior executive officers and 20 most highly-compensated executives[16] was due to the Special Master by August 14, 2009. As of August 31, 2009, AIG received notification from Treasury that their application was considered substantially complete, thus triggering the beginning of the Special Master's sixty-day review. AIG also has to submit information to the Special Master on the compensation structures for the next 75 most highly compensated employees, which is due within 120 days of the issuance of interim final regulations.

FRBNY also has a significant stake in the compensation decisions made by the Special Master. It has developed an extensive body of knowledge and analysis about AIG's compensation programs, retention problems, and overall governance as part of its due diligence performed since signing the credit agreement with AIG in September 2008. FRBNY officials are currently monitoring AIG management's efforts to modify and develop future compensation packages that would require the Special Master's approval. FRBNY officials told us they are willing to work with the Special Master, and the Special Master reportedly has recently initiated contact with them based upon SIGTARP's recommendation.

[16] This would generally include the 5 Senior Executive Officers and 20 other most highly compensated employees.

Conclusions and Recommendations

Conclusions

When FRBNY officials began examining AIG's executive compensation structure after making substantial loans to AIG in the fall of 2008, they found a complex, decentralized system consisting of more than 630 separate compensation and bonus plans covering more than 50,000 employees and involving expected payments of more than $1.75 billion. FRBNY officials quickly began examining the extent of AIG's compensation obligations: FRBNY engaged a compensation consultant on September 19, 2008 and made specific inquiry to AIG management on October 10, 2008. The magnitude of retention awards due to employees of AIGFP—the AIG entity most responsible for AIG's financial problems—was first discussed with a FRBNY official in early October 2008, and a broader group of FRBNY officials learned of the award balances in November 2008. Although they learned of the size of the impending payments and their timing, among other things, it is unclear whether FRBNY officials knew that thousands of dollars in payments would go to non-essential AIGFP support employees, such as the kitchen and mailroom assistants.

In contrast to FRBNY, there is nothing to indicate that Treasury Department officials took any independent steps to assess broadly the amount or scope of AIG's compensation obligations. Treasury officials were engaged in executive compensation-related discussions with AIG in October and November 2008 to formulate the executive compensation restrictions that would be imposed upon AIG senior management in connection with the $40 billion TARP investment in AIG in November 2008. However, Treasury made no broader assessment of AIG's compensation practices and essentially relied upon what it was told by FRBNY. Moreover, we saw little indication that the knowledge being developed by FRBNY about AIG's compensation obligations was being passed along to Treasury in any systematic way: although Treasury officials had some general knowledge of AIGFP bonus and deferred compensation payment obligations as early as October 2008, there is no indication that senior Treasury officials were aware of the details of the March 2009 AIGFP payments until February 28, 2009.

In sum, Treasury did not conduct direct oversight of AIG's executive compensation prior to March 19, 2009, but chose instead essentially to defer to FRBNY. This, coupled with Treasury's subsequent limited communications with FRBNY with respect to that issue, has meant that Treasury invested $40 billion of taxpayer funds in AIG, designed AIG's contractual executive compensation restrictions, and helped manage the Government's majority stake in AIG for several months, all without having any detailed information about the scope of AIG's very substantial, and very controversial, executive compensation obligations. Treasury's failure to discover the scope and scale of AIG's executive compensation obligations, in particular at AIGFP, potentially resulted in a missed opportunity to avoid the explosively controversial events and created considerable public and Congressional concern over the retention payments. At the same time, Treasury's recent report with recommendations for reform to reduce the risk of future financial crises and to strengthen the ability of regulators to address any future crises that may occur seemingly recognizes the need for an improved framework for decision-making and additional options to manage crises such as those confronting AIG with the least cost to the taxpayer.

While SIGTARP saw no indication that Secretary Geithner had personal knowledge of the AIGFP bonuses until March 10, 2009, three days before they were paid, this too suggests a failure of communication. In light of the political sensitivities associated with the bailout of AIG, both as President of FRBNY and subsequently as Secretary of Treasury, it was necessary that Secretary Geithner be informed by his staff, in a timely manner, of such sensitive and significant information so that he could have sufficient time to explore possible solutions. For example, shortly after the payments were made, Treasury announced a commitment to provide an additional $30 billion in support to AIG that may have provided an opportunity to compel the renegotiation of the AIGFP retention payments. His lack of knowledge until the eve of the payment of the bonuses represents a failing at both FRBNY and Treasury to identify adequately the significance of an issue that had been identified as one that would "not easy for the Fed and Treasury to defend" and to inform their leadership.

From a legal perspective, the payments made to AIGFP were not inconsistent with the executive compensation restrictions in AIG's agreement with Treasury or with the statutory restrictions contained in ARRA. The contractual restrictions, for example, applied only to AIG's top approximately 57 executives, none of whom were recipients of the AIGFP retention payments. The restrictions in ARRA, meanwhile, expressly do not apply to plans in place prior to February 11, 2009.

With respect to the ongoing review of executive compensation at AIG, the Special Master indicated that he wants future AIGFP retention payments to be reduced, and though not binding, this may risk further employee turnover and a smaller recovery of voluntary repayments of the 2009 AIGFP retention awards. Because FRBNY employees are advising AIG on future compensation packages and have knowledge about AIG employee retention concerns, such information, if considered by the Special Master, could potentially provide an additional dimension to his evaluations and decisions regarding AIG's prior and future pay decisions. Without this coordination, FRBNY officials may advise AIG officials on changes to AIG compensation plans that will be rejected by the Special Master. We do not believe that this is in the best interest of the Government or AIG. It should be noted that, based on SIGTARP's audit work and after receipt of a draft report that contains this recommendation, the Office of the Special Master has agreed to and reportedly has initiated contact with FRBNY officials.

Looking forward, legitimate concerns exist over large bonus and retention payments to corporate employees of organizations that are now supported by large-scale financial assistance from the Federal Government, particularly at firms such as AIG, which, but for the Government's extraordinary intervention, would be in bankruptcy. At the same time, the uncertainty of future compensation levels poses a challenge for AIG in retaining personnel that will assist in winding down certain businesses, spinning off strong businesses for initial public offerings, and maintaining operations at any portion of the company that remains.

Recommendations

In light of FRBNY's ongoing involvement in monitoring and advising AIG on compensation issues, SIGTARP recommends that the Secretary of the Treasury direct the Special Master to work with FRBNY officials in understanding AIG compensation programs and retention

challenges before developing future compensation decisions that may affect both institutions' ability to get repaid by AIG for Federal assistance provided.

SIGTARP also recommends that Treasury establish policies to guide any similar future decisions to take a substantial ownership position in financial institutions that would require an advance review so that Treasury can be reasonably aware of the obligations and challenges facing such institutions. This includes not only those obligations or challenges of a financial sort that could negatively impact taxpayers' economic returns, but also obligations or challenges that implicate public policy issues (such as the obligation to pay large bonuses to the very entities that caused the financial problems in the first instance, as in the case of AIG) that could negatively impact the credibility of the TARP and Treasury itself.

SIGTARP further recommends that Treasury also establish policies to guide decision making in determining whether it is appropriate to defer to another agency when making TARP programming decisions where more than one Federal agency is involved. In making those oversight determinations, Treasury should bear in mind that its role under EESA, as the primary manager of TARP, carries with it certain obligations to protect taxpayer interests, to promote transparency and to foster accountability to the American people and to Congress, and as has been plainly demonstrated in this report, other agencies, operating with different missions and under different legal and regulatory frameworks, may not have the same priorities. Moreover, to the extent that Treasury chooses to rely on another agency to provide oversight over TARP-related activities, SIGTARP recommends that Treasury establish controls to ensure that effective communication takes place so that Treasury can carry out its own oversight role.

Management Comments and Audit Response

SIGTARP received official written responses to this report from both the Federal Reserve Board and Treasury's Office of Financial Stability. Technical and informal comments from these agencies were also incorporated as appropriate.

While SIGTARP's recommendations are directed at corrective actions needed by Treasury, the Federal Reserve Board stated that it stands ready to work with the Treasury Department's Special Master to implement our first recommendation of working with and taking advantage of the knowledge gained by the Federal Reserve regarding AIG compensation programs. In fact, Federal Reserve officials verbally clarified that conversations in this regard began approximately in the past two weeks following SIGTARP's recommendation. See Appendix G for the full response.

Treasury agreed with all three of SIGTARP's recommendations and has acknowledged that they are already working with the Federal Reserve in implementing the first recommendation. See Appendix H for the full response.

Appendix A — Scope and Methodology

We performed the audit under 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. The report addresses the following objectives:

- What was the extent of knowledge and control by Federal Reserve and Treasury Department officials over AIG compensation programs, and specifically, AIG retention award payments to its Financial Products Group personnel?
- To what extent were AIGFP retention payments governed by executive compensation restrictions or contractual obligations?
- What are the outstanding AIG compensation issues requiring resolution, and what Federal Government actions are needed to address these issues?

We performed work at AIG corporate headquarters in New York City, the Federal Reserve Bank of New York office in New York City, the Office of Financial Stability, Department of Treasury headquarters, and Federal Reserve Board headquarters, in Washington, DC. The scope covered Federal oversight of AIG executive compensation from September 2008 through June 2009. This performance audit was performed in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We completed our review between March 2009 and September 2009. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To assess the extent to which Federal Reserve and Treasury officials were aware of and exerted control over AIG's compensation plans, we reviewed relevant supporting documentation and e-mail correspondence among officials at Treasury, the Federal Reserve Board, FRBNY, AIG, and other entities, including outside law firms, regarding executive compensation. We also interviewed officials of those entities. Key documentation included the FRBNY's September 2008 credit agreement with AIG and Treasury's November 2008 and March 2009 TARP agreements with AIG. We also obtained and reviewed studies performed by contractors regarding the scope of compensation plans at AIG.

To assess the extent to which the March 2009 retention payments were governed by executive compensation restrictions, we reviewed the following:

- Emergency Economic Stabilization Act of 2008
- 31 CFR Part 30 for Capital Purchase Program participants
- Notice 2008 — Programs for Systemically Significant Failing Institutions
- November 25, 2008, agreement between Treasury and AIG
- February 2009 comments on executive compensation from the Obama Administration

- American Recovery and Reinvestment Act of 2009
- interim final executive compensation regulations of June 15, 2009

In addition, we reviewed the 2008 AIGFP Employee Retention Plan and management's communication of the plan to AIGFP employees. SIGTARP compared the names of the 57 AIG personnel subject to the November 2008 TARP agreement's executive compensation restrictions to employees who received awards under the AIGFP Employee Retention Plan. We also reviewed legal opinions rendered by AIG's outside counsel and the Department of Justice on whether the March 2009 retention awards were contractually binding. We obtained an oral summary of the verbal opinion rendered by Treasury's outside counsel.

To assess what Federal Government actions are needed to address outstanding AIG compensation issues, we interviewed AIG executives and Treasury officials. Moreover, we reviewed the interim final executive compensation regulations, documentation on AIG employee turnover, and documentation of individual compensation decisions deferred by AIG to Treasury.

Use of Computer-processed Data

To perform this audit, we used unaudited data provided by AIG on the amounts awarded under various incentive programs and on the employees receiving AIGFP 2008 Employee Retention Plan awards. The extent to which we captured the universe of incentive programs and the AIGFP 2008 Employee Retention Plan award recipients is subject to the completeness and accuracy of AIG's systems.

Internal Controls

As part of the review of Federal oversight of AIG executive compensation restrictions, we obtained and assessed information on AIG's governance of its compensation decisions, which is one component of the control environment. We also evaluated the Federal Reserve and Treasury internal control initiatives that were in place to oversee AIG executive compensation programs and decisions.

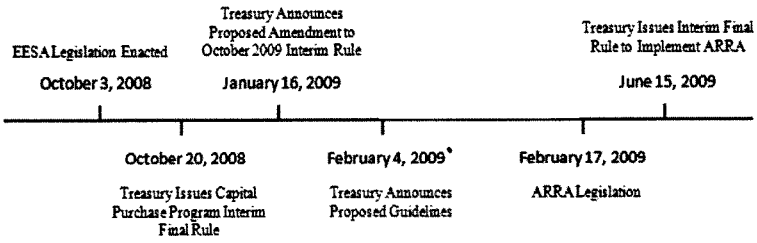
Prior Coverage

GAO, Report No. 09-490T, "*Federal Financial Assistance, Preliminary Observations on Assistance Provided to AIG,*" March 2009.

Appendix B — Treasury Restrictions on Executive Compensation

From the outset of TARP, all financial institutions directly participating in TARP and under an ongoing obligation to Treasury were expected to abide by the requirements for executive compensation set forth in EESA and applicable Treasury regulations and guidance. Since EESA was enacted, additional regulations, amendments, and notices on executive compensation have been issued. Figure 1 illustrates the changes in executive compensation restrictions set forth by Congress and Treasury over time.

Figure 1: Timeline for TARP Executive Compensation Limitations



Source: SIGTARP Analysis of TARP Executive Compensation Guidance

Section 111 of EESA, as originally enacted, required that all financial institutions that sell troubled assets to the Treasury under TARP abide by certain rules on executive compensation intended to avoid unnecessary and excessive risks, to provide for recovery of bonus and incentive payments based on criteria later proven to be materially inaccurate, and to impose restrictions on excessive departure pay (known as golden parachutes) to senior executive officers. On October 20, 2008, Treasury issued an interim final rule implementing the EESA restrictions on executive compensation. This interim final rule established the original standards for executive compensation for institutions participating in the Capital Purchase Program ("CPP"). The primary provisions are described below:

- **Excessive risk:** Incentive compensation for senior executive officers was required not to encourage unnecessary and excessive risks that threaten the value of the financial institution. The financial institution's compensation committee, or a committee acting in a similar capacity, was required to review the incentive compensation arrangements with its senior risk officers within 90 days of Treasury's purchase of preferred shares under the CPP.

- **Tax deductibility:** The institution could not deduct more than $500,000 of executive compensation for each senior executive officer based on limitations set forth under Section 162(m)(5) of the Internal Revenue Code.
- **Clawback:** SEO bonus and incentive compensation was required to be subject to a clawback, i.e., the recovery of any bonus or incentive compensation paid to a senior executive officer if statements of earnings, gains, or other criteria are later proven to be materially inaccurate.
- **Golden parachute:** Golden parachute payments were prohibited for senior executive officers. A golden parachute is defined as "any payment in the nature of compensation to (or for the benefit of) a senior executive officer made on account of an applicable severance from employment to the extent the aggregate present value of such payment equals or exceeds an amount equal to three times the senior executive officer's base amount."

These restrictions covered the institution's SEOs, defined as the Chief Executive Officer, Chief Financial Officer, and the three most highly-compensated executive officers. The restrictions were to apply for as long as Treasury held an equity or debt position in the institution.

On January 16, 2009, Treasury announced proposed amendments to its October 2008 interim final rule to include requirements for reporting and recordkeeping with respect to the executive compensation standards for CPP recipients. The January announcement stated that these regulations would be effective on the date they were published in the *Federal Register*. However, because of the transition of administrations and the resulting hold on all new regulatory actions, these amendments were never published in the *Federal Register*; therefore, they were never put into force.

Additional uncertainties about executive compensation restrictions flowed from proposed guidance announced on February 4, 2009, and differing requirements enacted later that month. On February 4, 2009, Treasury proposed restrictions that, among other things, generally sought to limit the future annual compensation of senior executives of TARP recipients to $500,000, in addition to grants of long-term restricted stock and long-term incentive awards (or in the case of TARP recipients that did not receive exceptional assistance, to have this limit waived through a shareholder vote on compensation and to increase the number of senior officers covered by the clawback and golden parachute provisions). Treasury also proposed that the guidelines would not apply retroactively to existing investments or to previously announced programs, but would apply to newly announced programs. Before the February 2009 guidance could be fully implemented, however, the American Recovery and Reinvestment Act ("ARRA") was signed into law on February 17, 2009. ARRA amended EESA requirements related to executive compensation, including these provisions:

- specifying what constitutes a golden parachute payment and the executives subject to a prohibition on such payments
- adding additional specificity to employees subject to clawback provisions
- limiting incentive compensation to one-third of selected employees' total compensation (The number of employees affected depends on the amount of TARP funding received.)

- specifying categories of employees who would be subject to incentive compensation restrictions, depending on the amount of TARP assistance received by the institution
- requiring institutions receiving TARP assistance to provide for a non-binding shareholder vote on executive compensation packages, the so-called, "Say on Pay" requirement

ARRA Required Treasury To Issue Implementing Regulations

On June 10, 2009, Treasury announced its latest interim final rule to implement the executive compensation requirements outlined in ARRA. The interim final rule was to be effective on June 15, 2009, the date published in the *Federal Register*, and will be finalized after consideration of comments received during a 60-day comment period. According to Treasury officials, the latest Interim Final Rule attempts to harmonize requirements in ARRA and prior guidance from Treasury and to make the following changes to previous interim rules or proposed guidance:

- The annual compensation limit of $500,000 proposed by Treasury in February 2009 was not retained.
- Bonus payments to senior executive officers[17] and to a specified number of the most highly compensated employees of TARP recipients were limited to one-third of total compensation.[18]
- The golden parachute prohibition will now extend beyond SEOs to include the next five most highly compensated individuals, and the definition of a golden parachute includes any and all payments made at the time of departure or change in control for services not performed.
- The clawback requirement applies to the SEOs and the next 20 most highly compensated individuals.

Although the above provisions generally apply to all TARP programs, the interim final rule established separate requirements for institutions receiving exceptional assistance under the Targeted Investment Program ("TIP"), Systemically Significant Failing Institutions Program ("SSFI"), and the Automotive Industry Financing Program ("AIFP"), as noted below.[19] The rule also created an Office of the Special Master for TARP Executive Compensation within Treasury. For the TARP recipients receiving exceptional assistance,[20] the Special Master will review compensation payments and structures for the SEOs and the next 20 most highly compensated

[17] A "named executive officer" of a TARP recipient is defined under Federal securities law to generally include the principal executive officer ("PEO"), principal financial officer ("PFO"), and the next three most highly compensated employees.

[18] The rule defines "most highly compensated" employees by reference to total annual compensation as calculated under federal securities regulations, in order to most accurately capture the amounts earned by these executives each year. The number of most highly compensated employees covered by the limit depends on the amount of financial assistance the company has received.

[19] The restrictions do not apply to those institutions that have repaid their TARP funds while Treasury still holds warrants to purchase the common stock of those institutions.

[20] The seven companies are American International Group, Bank of America, Citigroup, General Motors, General Motors Acceptance Corporation, Chrysler Financial, and Chrysler.

employees at each institution. In addition, he will be reviewing compensation structures for executive officers and the next 75 most highly compensated employees of TARP recipients receiving exceptional assistance. According to Treasury, this is to ensure that compensation is structured to protect taxpayer interests and to promote long-term shareholder value.

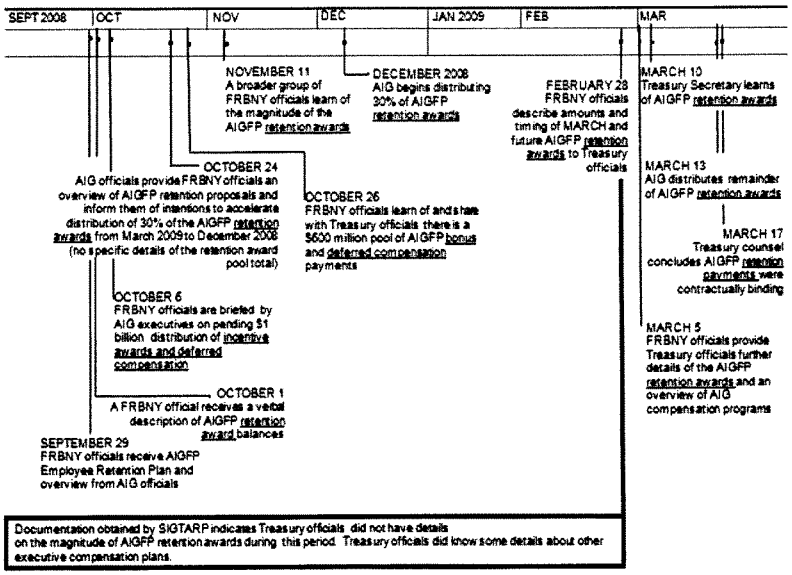
Furthermore, the Special Master is granted a "look-back" authority to review, for all TARP recipients, certain payments between the closing date of the contract with the TARP recipient and February 17, 2009 (the date of ARRA's enactment). The reviews will cover all bonuses, retention awards, and other compensation paid to the 5 SEOs and the next 20 most highly paid employees. This look back assessment will be conducted to determine whether any such payments were inconsistent with the purposes of TARP or were otherwise contrary to the public interest. The Special Master may then seek to negotiate for appropriate reimbursements.

The Special Master is also authorized to provide advisory opinions regarding the application of the interim final rule to particular payments and compensation plans. These opinions may be issued at the request of the participating TARP recipient or by the Special Master at his own initiative.

Appendix C — Timeline of FRBNY and Treasury Officials' Knowledge of Key AIG Compensation Matters

At the end of September 2008, AIG first briefed FRBNY officials about the structure of the AIGFP retention plan, including details about the total payments provided to one FRBNY official a few days later. Shortly thereafter, FRBNY officials became aware of $1 billion in pending compensation and incentive payments, and they expressed concerns to AIG executives. It was not until November 11, 2009, however, that a broader group of FRBNY officials recall being informed about the magnitude of AIGFP payments. Treasury officials received periodic updates on AIG compensation, primarily from FRBNY officials, but did not know about the March 2009 AIGFP retention payments until the end of February 2009. Figure 2 shows a timeline of when FRBNY and Treasury officials became aware of details surrounding AIG compensation.

Figure 2: Timeline of FRBNY and Treasury Officials' Knowledge of Key AIG Compensation Matters



Source: SIGTARP analysis of AIG, FRBNY, and Treasury correspondence.

Appendix D — AIGFP Employee Retention Award Letter

SCHEDULE 1

Confirmation and Acknowledgement

Name of Covered Person: _____
Member of Senior Management Team: _____ Yes or No _____

Compensation Year	Previous Guarantee	Buy-Out Amount	Guaranteed Retention Award
2008			
2009			

I acknowledge that I have received, read and understood the AIG Financial Products Corp. 2008 Employee Retention Plan (the "Employee Retention Plan") and that my participation in the Employee Retention Plan, including any payment of a Guaranteed Retention Award to me under the Employee Retention Plan, will be subject to the terms of the Employee Retention Plan, which provide in part that payment of Guaranteed Retention Awards (i) is subject to continued employment to the extent provided pursuant to Section 3.04, and (ii) is subject, if I participate in the Deferred Compensation Plan (as defined in the Employee Retention Plan), to deferral and, to the extent deferred, shall become an unsecured subordinated liability of AIG Financial Products Corp. to me and my Beneficiaries.

I further acknowledge that my right to receive any Guaranteed Retention Award under the Employee Retention Plan is separate from and independent of any Notional Bonus Amount I might receive for 2008 or 2009, as that term is defined in the Deferred Compensation Plan, and that, to the extent the portion of any Guaranteed Retention Award or any additional Notional Bonus Amount is subject to deferral as a Stock-Indexed Deferral, I waive any claim that such deferred amount would be subject to, or payable to me pursuant to, the Deferred Compensation Plan without reference to the terms of the Employee Retention Plan.

In the event that I should die prior to receipt of all Guaranteed Retention Awards to which I am entitled under the Employee Retention Plan, I hereby direct that, pursuant to Section 2.01(c) of the Employee Retention Plan, all amounts due to me under the Employee Retention Plan be distributed as follows:

Proportion	Name of Beneficiary(ies)
_____	_____
_____	_____
_____	_____

_____ _____
Signature of Covered Person Date

SIGTARP | Office of the Special Inspector General for the Troubled Asset Relief Program

Appendix E — Acronyms

Acronym	Definition
AIGFP	American International Group, Inc., Financial Products Corp.
ARRA	American Recovery and Reinvestment Act of 2009
EESA	Emergency Economic Stabilization Act
FRBNY	Federal Reserve Bank of New York
SEOs	Senior Executive Officers
SIGTARP	Special Inspector General for the Troubled Asset Relief Program
SSFI	Systemically Significant Failing Institutions
TARP	Troubled Asset Relief Program

Appendix F — Audit Team Members

This report was prepared and the review was conducted under the direction of Barry Holman, Audit Director, Office of the Special Inspector General for the Troubled Asset Relief Program.

The staff members who conducted the audit and contributed to the report include:

Alisa Davis

Trevor Rudolph

James Shafer

Kamruz Zaman

Appendix G — Management Comments from the Federal Reserve Board and the Federal Reserve Bank of New York

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

SCOTT G. ALVAREZ
GENERAL COUNSEL

October 9, 2009

Mr. Neil Barofsky
Special Inspector General
for the Troubled Asset Relief Program
1801 L Street, NW
Washington, DC 20220

Dear Mr. Barofsky:

Thank you for the opportunity to comment on your draft audit report dated September 30, 2009, and titled *Extent of Federal Agencies' Oversight of AIG Compensation Varied, and Important Challenge Remain*.

The draft report focuses on one aspect of federal regulators' involvement with American International Group, Inc. ("AIG") since September 16, 2008: the monitoring and oversight of AIG's retention payment and bonus policies and practices. We concur with the report's conclusions that the Federal Reserve Bank of New York ("FRBNY") had early involvement in monitoring AIG compensation decisions; that the March 2009 retention payments were subject to pre-existing contractual obligations; and that AIG continues to face employee retention and compensation issues.

Although none of the recommendations are directed toward the Federal Reserve or FRBNY, the first recommendation does address the interaction between the Special Master for TARP Executive Compensation and the FRBNY. In accordance with that recommendation, we stand ready to share our knowledge of AIG compensation practices with the Special Master and, in fact, have been doing so. It is important to note, however, that the Special Master has complete responsibility and statutory authority over decisions under the Treasury's interim final regulation regarding compensation payments and programs. As a creditor, the Federal Reserve's authority over AIG compensation programs is limited and does not include responsibility for, nor expertise in applying, the standards that govern the Special Master's decisions.

Sincerely,

Scott G. Alvarez

Appendix H — Management Comments from Treasury

ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 9, 2009

Neil M. Barofsky
Special Inspector General
Office of the Special Inspector General for the Troubled Asset Relief Program
1500 Pennsylvania Ave., NW, Suite 1064
Washington, D.C. 20220

RE: SIGTARP Official Draft Report

Dear Mr. Barofsky:

Thank you for giving the Department of the Treasury (Treasury) the opportunity to review and comment on your official draft audit report regarding federal agencies' oversight of AIG compensation. We welcome your comments and suggestions as Treasury continues to strengthen oversight of financial institutions participating in programs established under the Emergency Economic Stabilization Act.

Treasury concurs with your three recommendations contained in the audit report, and has taken specific actions, or will be taking actions, to implement your recommendations. We have provided below an overall summary response for each recommendation, and will provide a supplemental response letter at a later date describing actions we are taking to insure that your particular concerns are addressed.

SIGTARP Recommendation: ***The Treasury Secretary should direct the Special Master to work with Federal Reserve Bank of New York officials in understanding AIG compensation programs and retention challenges before developing future compensation decisions that may affect both institutions' ability to receive repayment of Federal assistance from AIG.***

The Office of the Special Master has spoken to Federal Reserve Board and Federal Reserve Bank of New York (FRBNY) officials on numerous occasions in recent weeks to take advantage of FRBNY's knowledge of AIG's compensation programs and retention challenges.

SIGTARP Recommendation: ***Treasury should establish policies to guide any similar future decisions to take a substantial ownership position in financial institutions that would require an advance review so that Treasury can be reasonably aware of the obligations and challenges facing such institutions.***

Treasury has no present intention of taking a substantial percentage ownership position in any additional financial institution. Nevertheless, Treasury intends to develop policies and protocols that can be used, subject to applicable time constraints, in evaluating potential TARP investments in institutions requiring exceptional assistance.

Additionally, the current Administration has proposed legislation to create a new regulatory regime that will allow for better monitoring, mitigation and responses to risks in the financial system. The proposed regime would include "resolution authority" for large and interconnected financial firms during extraordinary times, and would require strict governance and control procedures over these firms.

SIGTARP Recommendation: ***Treasury should establish policies to guide decision making in determining whether it is appropriate to defer to another agency when making TARP programming decisions where more than one Federal agency is involved. To the extent that Treasury chooses to rely on another agency to provide oversight over TARP related activities, Treasury should establish controls to ensure that effective communication takes place so that Treasury can carry out its own oversight role.***

Treasury agrees with the importance of effective communication when various Federal agencies have a role in executing TARP programs, and Treasury has developed a framework and plan for internal control over TARP.

Treasury maintains broad oversight of all TARP programs. Treasury has coordinated with other Federal agencies when executing certain programs in order to leverage platforms that are currently in place at these agencies. For example, Treasury has worked extensively with the FRBNY to develop appropriate controls and oversight mechanisms for the Term Asset-Backed Securities Loan Facility. Treasury will continue to work closely with other federal agencies that are involved in TARP programs to ensure that Treasury can carry out its oversight role.

We share your commitment to oversight for all TARP's programs, and communication with all Federal agencies that are part of the coordinated effort to stabilize our financial system. Thank you for your continuing efforts to help us improve our programs.

Sincerely,

Herbert M. Allison, Jr
Assistant Secretary for Financial Stability

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, 6th Floor
Washington, D.C. 20220

Press Inquiries

If you have inquiries, please contact our Press Office:

Kristine Belisle
Director of Communications
Kris.Belisle@do.treas.gov
202-927-8940

Legislative Affairs

For Congressional inquiries, please contact our Legislative Affairs Office:

Lori Hayman
Legislative Affairs
Lori.Hayman@do.treas.gov
202-927-8941

Obtaining Copies of Testimony and Reports

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

STATE OF NEW YORK
OFFICE OF THE ATTORNEY GENERAL
120 BROADWAY
NEW YORK, NY 10271

ANDREW M. CUOMO
Attorney General

(212) 416-8050

March 17, 2009

Honorable Barney Frank
Chairman, House Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Re: AIG 2008 Retention Bonuses

Dear Chairman Frank:

I am writing to provide you and your Committee with information regarding an ongoing investigation my Office has been conducting of executive compensation at American International Group ("AIG"). I hope this information will be useful to the Committee at its hearing on AIG tomorrow.

We learned over the weekend that AIG had, last Friday, distributed more than $160 million in retention payments to members of its Financial Products Subsidiary, the unit of AIG that was principally responsible for the firm's meltdown. Last October, AIG agreed to my Office's demand that no payments be made out of its $600 million Financial Products deferred compensation pool. While this was a positive step, we were dismayed to learn after the fact that AIG had made multi-million dollar payments out of its separate Financial Products retention plan on Friday.

AIG now claims that it had no choice but to pay these sums because of the unalterable terms of the plan. However, had the federal government not bailed out AIG with billions in taxpayer funds, the firm likely would have gone bankrupt, and surely no payments would have been made out of the plan. My Office has reviewed the legal opinion that AIG obtained from its own counsel, and it is not at all clear that these lawyers even considered the argument that it is only by the grace of American taxpayers that members of Financial Products even have jobs, let alone a pool of retention bonus money. I hope the Committee will take up this issue at its hearing tomorrow.

Furthermore, we know that AIG was able to bargain with its Financial Products employees since these employees have agreed to take salaries of $1 for 2009 in exchange for receiving their retention bonus packages. The fact that AIG engaged in this negotiation flies in

the face of AIG's assertion that it had no choice but to make these lavish multi-million dollar bonus payments. It appears that AIG had far more leverage than they now claim.

AIG also claims that retention of individuals at Financial Products was vital to unwinding the subsidiary's business. However, to date, AIG has been unwilling to disclose the names of those who received these retention payments making it impossible to test their claim. Moreover, as detailed below, numerous individuals who received large "retention" bonuses are no longer at the firm. Until we obtain the names of these individuals, it is impossible to determine when and why they left the firm and how it is that they received these payments.

If AIG were confident in its claim that those who received these large bonuses were so vital to the orderly unwinding of the unit, one would expect them to freely provide the names and positions of those who got these bonuses. My Office will continue to seek an explanation for why each one of these individuals was so crucial to keep aboard that they were paid handsomely despite the unit's disastrous performance.

As you may know, my Office yesterday subpoenaed AIG for the names of those who received these bonuses, and we plan to do everything necessary to enforce compliance. American taxpayers deserve to know where their money is going, and AIG's intransigence and desire to obscure who received these payments should not be tolerated. Already my Office has determined that some of these bonuses were staggering in size. For example:

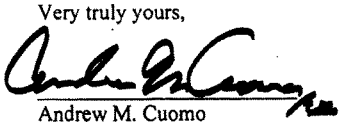
- The top recipient received more than $6.4 million;
- The top seven bonus recipients received more than $4 million each;
- The top ten bonus recipients received a combined $42 million;
- 22 individuals received bonuses of $2 million or more, and combined they received more than $72 million;
- 73 individuals received bonuses of $1 million or more; and
- Eleven of the individuals who received "retention" bonuses of $1 million or more are no longer working at AIG, including one who received $4.6 million;

Again, these payments were all made to individuals in the subsidiary whose performance led to crushing losses and the near failure of AIG. Thus, last week, AIG made more than 73 millionaires in the unit which lost so much money that it brought the firm to its knees, forcing a taxpayer bailout. Something is deeply wrong with this outcome. I hope the Committee will address it head on.

We have also now obtained the contracts under which AIG decided to make these payments. The contracts shockingly contain a provision that required most individuals' bonuses to be 100% of their 2007 bonuses. Thus, in the Spring of last year, AIG chose to lock in bonuses for 2008 at 2007 levels despite obvious signs that 2008 performance would be disastrous in comparison to the year before. My Office has thus begun to closely examine the circumstances under which the plan was created.

I look forward to continuing to cooperate with the Committee in any way possible to ensure that taxpayer funds are not misspent on unjustified bonuses or otherwise misused.

Very truly yours,



Andrew M. Cuomo
Attorney General of the
State of New York

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

March 17, 2009

The Honorable Nancy Pelosi
Speaker of the U.S. House of Representatives
Washington, DC 20515

Dear Madame Speaker:

I know that there is considerable outrage in the House of Representatives, as there is throughout the country, about the bonuses awarded to employees of AIG Financial Products division at a time when the company is reliant on significant taxpayer dollars. The President shares that outrage, and so do I.

I am writing to outline the steps taken by the Department of the Treasury to date, to update you on the actions we are taking to recoup the retention payments just made, and to deal with future payments of executive compensation by AIG.

I registered my strong objections to Mr. Edward Liddy, the CEO of AIG, last week when I was first informed by my staff about the pending payment obligations.

Mr. Liddy told me that a tranche of $165 million in retention bonuses were contractually committed and payable by March 15 to employees within the financial products division - the very division most culpable for the rapid deterioration of AIG. Mr. Liddy, who took the reins of the firm after the bonuses were negotiated in April of 2008, said AIG's lawyers had concluded that the contracts were legally binding. I asked for a written explanation and legal analysis to support that claim, including the legal liabilities that would arise if the contracts were breached, and turned it over to Treasury's own lawyers to review.

Our lawyers agreed, in consultation with outside counsel, that it would be legally difficult to prevent these contractually-mandated payments. Even the new executive compensation restrictions recently passed in the American Recovery and Reinvestment Act (ARRA) allow for the payment of contracts signed before the act went into effect.

I demanded of Mr. Liddy that he scrap or cut hundreds of millions of dollars in additional payments due this year and beyond. He has committed to do this on terms that are consistent with the executive compensation provisions of ARRA, the administration's executive compensation guidelines, and the interests of the American taxpayers.

As you know, the President has asked me to fully review all additional measures at my disposal to recoup these bonuses and to recover funds on behalf of taxpayers.

We are presently working with the Department of Justice to determine what avenues are available by which we can recoup the retention awards that have been paid. The executive compensation provisions of the ARRA provide that the Secretary of the Treasury "shall review compensation paid to the senior executive officers and the next 20 mostly highly-compensated employees of each entity receiving TARP assistance before the date of enactment of the ARRA, to determine whether any such payments were inconsistent with the purposes of this section or the TARP or were otherwise contrary to the public interest." If such a determination is made, the Secretary "shall seek to negotiate with the TARP recipient and the subject employee[s] for appropriate reimbursements to the Federal Government." Our review will determine whether we can recoup these bonuses under the authority granted by ARRA or by other means.

We also want to insure that taxpayers are compensated for any monies we cannot recover.

Therefore, as part of our provision of recently announced taxpayer funds, we will impose on AIG a contractual commitment to pay the Treasury from the operations of the company the amount of the retention awards just paid. In addition, we will deduct from the $30 billion in assistance an amount equal to the amount of those payments.

Going forward, future AIG bonuses will be subject to the strict executive compensation provisions enacted by Congress in the ARRA. We are currently developing the regulations to implement those provisions, which will apply broadly to AIG and other companies receiving assistance from Treasury. These actions, consistent with the ARRA and other executive compensation guidelines under consideration by the Administration, are being taken to protect taxpayer funds and align long-term compensation with the interests of taxpayers.

But in working to resolve the AIG bonus problem, we should not lose focus on the larger issue it raises.

This situation dramatically underscores the need to adopt, as a critical part of financial regulatory reform, an expanded "resolution authority" for the government to better deal with situations like this. Such a resolution authority should include a comprehensive and broad set of regulatory tools that would enable the government to deal with financial institutions, like AIG, whose failure would pose substantial risks to our financial system, but to do it in a way that will protect the interests of taxpayers and innocent counterparties. Without this expanded authority, the government has been forced to take extreme measures to prevent the catastrophic collapse of AIG and allow the time necessary for its orderly wind down.

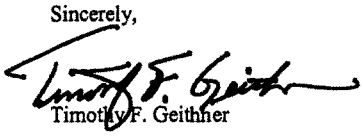
We will continue our aggressive efforts to resolve the future status of AIG in a manner that will reduce the systemic risks to our financial system while minimizing the loss to taxpayers. And we will explore any and all responsible ways to accelerate this wind down process.

I know that much of the public ire has fallen on Mr. Liddy, which is understandable, since it is his name on the door. But it also is unjustified. Mr. Liddy was put in place as the CEO of AIG last year at the request of the U.S. government to help rehabilitate the company and repay

taxpayer funds. He inherited a difficult situation, including these AIGFP retention contracts, which were entered prior to his or the government's involvement in AIG. As long as he is there, we will work with him on measures to wind down AIG in an orderly way and protect the American taxpayer.

Most important for the long-term health of the credit markets that are a key to the economy, I look forward to working with Congress to modernize our financial regulatory system in way that protects the American taxpayer, meets the challenges of a dynamic global market and reduces the chance that we will face a financial crisis of this magnitude in the future.

Sincerely,



Timothy F. Geithner

Chairman TOWNS. Without objection, the committee stands adjourned. Thank you.

[Whereupon, at 12:27 p.m., the committee was adjourned.]

[The prepared statements of Hon. Anh "Joseph" Cao and Hon. Geral E. Connolly follow:]

COMMITTEE ON HOMELAND SECURITY
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SUBCOMMITTEE ON WATER RESOURCES AND ENVIRONMENT

Congress of the United States
House of Representatives
Washington, DC 20515-1802

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Opening Statement

Rep. Anh "Joseph" Cao

Committee on Oversight and Government Reform

Hearing on

AIG Bonuses: Audit of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP)

Wednesday, October 14, 2009

Thank you, Mr. Chairman, and Ranking Member Issa, for the opportunity and honor to serve on this important Committee. I enjoyed sitting down with each of you yesterday to discuss our shared priorities. I also enjoyed the time I spent with Minority staff yesterday and am very impressed and encouraged by the remarkable wealth of knowledge and experience we have on this team.

Hurricane Katrina may be more than four years past us, but we are still recovering. Eighty percent of our buildings and forty percent of our housing stock were damaged in some way.

Many of the critical institutions like Charity Hospital and, basically, the entire health care infrastructure in the hardest-hit area of New Orleans East (where I live), have never reopened. Many of our basic services like hospitals, police, fire and rescue, libraries, and schools were wiped away and have not been repaired or rebuilt. In many cases this inactivity is due to protracted disputes with FEMA.

We are on our way to recovery, and that never could have happened without the generosity of the American people. But, if the American people had any idea of the inefficiencies at the federal level assisting with recovery – FEMA, Homeland Security, HUD, Medicare and Medicaid, SBA, and the list goes on – they would be concerned.

For this reason, my assignment to this Committee was a good day for my constituents in Orleans and Jefferson Parishes because I will have another platform, from which to fight waste and fraud in the federal government – especially that which is impeding the recovery of my hometown.

I also look forward to working on key issues including ensuring the unique needs of devastated areas in the Gulf Coast region are adequately addressed in the 2010 Census and exploring key national security issues, including US relations with my homeland of Vietnam.

Again, Mr. Chairman and Ranking Member Issa, I look forward to working with you and serving on this important committee and thank you for welcoming me today.

Statement of Congressman Gerald E. Connolly

Committee on Oversight and Government Reform

AIG Bonuses: Audit of the Special Inspector General for the Troubled Asset Relief Program

October 14th, 2009

Thank you, Chairman Towns for holding this series of hearings on AIG and the Troubled Asset Relief Program (TARP). I would hope that we can learn one important lesson from today's hearing: If the federal government is going to provide financial assistance to systemically important firms, which may be justified in extremely rare circumstances, then that assistance cannot come in the form of a blank check, but must have conditions imposed to protect the interest of taxpayers.

Several months ago this Committee held a hearing with AIG CEO Edward Liddy, during the furor over AIG bonuses. The Special Inspector General for TARP (SIGTARP) has found that AIG was contractually bound to award these bonuses. Based on this finding, it would seem clear that Bush Administration officials should have imposed conditions on the provisions of financial assistance to AIG when granting three rounds of assistance, totaling $162 billion, in 2008. Unfortunately, the Treasury and the Federal Reserve invested this money without addressing executive compensation. According to SIGTARP, "...there is nothing to indicate that Treasury Department officials took any independent steps to assess broadly the amount or scope of AIG's compensation practices." Since such practices have substantial bearing on our ability to recoup taxpayers' investments, analysis of compensation must precede any financial sector intervention, such as the rescue of AIG, in the future.

The Federal Reserve of New York claims that these 'retention' bonuses are necessary to keep key personnel on staff at AIG to minimize its losses now. It is a little hard to understand the logic of spending tens of millions of dollars to retain the very people who bankrupted this company, particularly for members of AIG Financial Products, which created disproportionately large losses relative to other segments of the company.

I would hope that we could begin to establish some consensus about standards for executive compensation that would accompany any taxpayer assistance of private firms. These standards should be based on the simple premise that it is illogical and counterproductive to reward bad behavior. Granting bonuses to individuals who bankrupted a previously successful insurance company is not helpful. I would hope that this hearing can help avoid repeating the mistakes committed by the Treasury and Federal Reserve in the waning days of the Bush Administration, and provide taxpayers greater protection in the future. We could make substantial progress in this direction simply by adhering to the SIGTARP's second recommendation, to "establish policies to guide any future decisions to take a substantial ownership position in financial institutions ...so that Treasury can be reasonably aware of the obligations and challenges facing such institutions." In short, we should look before we leap.

Questions for Neil Barofsky:

Q: According to your report, employees in AIG's Security Lending and Financial Products divisions received disproportionately large bonuses relative to employees in other divisions of AIG. Would you agree, then, that bonuses do not seem to have been granted to reward good employee performance, in general?

Q: In your report, you note that the Federal Reserve of New York saw some value in bonuses as a tool to maintain AIG's workforce to wind down the company. Do you understand the logic of paying an average of a $51,000 bonus to keep people on board who just bankrupted the largest insurance company in America?

Q: Based on the Federal Reserve's failure to restrict bonuses and the Treasury Department's apparent lack of awareness about this issue, it seems that we have a long way to go to prevent this problem from recurring. Can you elaborate on the second recommendation in your report, which suggests establishing "policies to guide future decisions to take a substantial ownership position in financial institutions…so that Treasury can be reasonably aware of the obligations and challenges facing such institutions," specifically with respect to bonuses?

○