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Symposium on Executive Compensation Keynote Address

*Kenneth R. Feinberg**

I want to thank Richard Nagareda¹ for inviting me to Vanderbilt; he's an old friend. I am very honored to return to Vanderbilt. I taught a course at Vanderbilt, and I loved teaching here. I loved going to the Country Music Hall of Fame and learning more about Patsy Cline and Johnny Cash. Really, it was great. I've already received an invitation from Dean Jim Bradford² to come back to the business school and the law school and to participate in an interdisciplinary look at executive compensation. I hope to return.

But when I saw that the Vanderbilt Law Review was hosting a symposium on executive compensation—an academic look at executive compensation—I just couldn't resist carving out a few minutes to come spend some time with the experts, learning where they're coming from on this important issue. I'm not accustomed to an academic look at executive compensation. I'm used to dealing with the practical,

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1. Richard Nagareda was the David Daniels Allen Distinguished Chair in Law and the Director of the Cecil D. Branstetter Litigation and Dispute Resolution Program at Vanderbilt University Law School. He passed away on October 8, 2010.

2. James W. (Jim) Bradford is dean of the Vanderbilt Owen Graduate School of Management; he also serves as the Ralph Owen Professor for the Practice of Management.

substantive, and political problems associated with executive compensation.

Today, I'd like to make a few preliminary points about executive compensation and the limits of my role as the Special Master for TARP Executive Compensation. The title Special Master is an interesting one. But, although I am the Special Master for TARP Executive Compensation, it's important to understand my very limited role in approving executive compensation packages.

I am responsible for issuing compensation determinations pursuant to a federal law,³ and that federal law says that the Special Master, under the authority delegated by the Secretary of the Treasury, shall make compensation determinations, but only as to seven companies that received the most financial help from the taxpayer under TARP: (1) Bank of America, (2) Citigroup, (3) AIG, (4) GM, (5) GMAC, (6) Chrysler, and (7) Chrysler Financial.⁴ In 2009, I had seven companies where I made compensation decisions, but pursuant to that statute, Bank of America and Citigroup completely repaid their financial obligation to the taxpayer, and thus I no longer have any authority over their compensation decisions.⁵ They are out. They are no longer subject to my determinations. They repaid the taxpayer.⁶ They raced to do it. Fine. That's always been the primary objective. Get the taxpayer's money back. So in 2010, I have only five companies where I am authorized to make compensation determinations.

But, it's also important that you understand the limits of my authority even as to those five companies. First, for each of these five companies, I am required to calculate compensation packages for the

3. As part of legislation establishing the Troubled Asset Relief Program ("TARP"), Congress authorized the Secretary of the Treasury to "require each TARP recipient to meet appropriate standards for executive compensation." 12 U.S.C. § 5221 (2010). The Secretary of the Treasury promulgated regulations to effectuate that statutory provision. See 31 C.F.R. § 30.

4. 31 C.F.R. § 30.1 ("The term 'exceptional financial assistance' means any financial assistance provided under the Programs for Systemically Significant Failing Institutions, the Targeted Investment Program, the Automotive Industry Financing Program, and any new program designated by the Secretary as providing exceptional financial assistance."); 31 C.F.R. § 30.16(a)(3).

5. OFFICE OF THE SPECIAL MASTER FOR TARP EXECUTIVE COMPENSATION, FINAL REPORT OF SPECIAL MASTER KENNETH R. FEINBERG 4 (2010), available at <http://www.financialstability.gov/docs/Final%20Report%20of%20Kenneth%20Feinberg%20-%20FINAL.PDF> [hereinafter FINAL REPORT].

6. Press Release, U.S. Dep't of the Treasury, Taxpayers Receive \$10.5 Billion in Proceeds Today from Final Sale of Treasury Department Citigroup Common Stock (Dec. 10, 2010), http://www.financialstability.gov/latest/pr_12102010.html (noting that Treasury not only recouped its initial \$45 billion investment in Citigroup, but also made a total profit of at least \$12 billion); Press Release, U.S. Dep't of the Treasury, Treasury Receives \$45 Billion Payment from Bank of America (Dec. 9, 2009), http://www.financialstability.gov/latest/pr_12092009c.html.

company's top twenty-five earners.⁷ Twenty-five, that's all. Second, the statute says that I shall design compensation structures, but only for employees twenty-six to one hundred in those five companies.⁸ One hundred people in each company. Thus, my mandatory jurisdiction is quite limited by federal law.

Now, the third statutory delegation that I have is purely advisory. I *may*—not shall—seek to claw back or recover compensation that was paid to any corporate official in any of the 400 plus companies that received TARP assistance.⁹ I have publicly stated I may do that as to those companies where there are egregious examples of excess compensation.¹⁰ We shall see. But that's it. That's my total role.

Now, with such a limited role, why is there such interest at Vanderbilt and everywhere else in what I am doing? I believe there are two main reasons why the interest in my role is out of proportion to my limited jurisdiction and authority. First, the United States is in a time of great economic uncertainty. Every day you read the newspapers, and you see an uncertain picture of the economic future of this country. With that level of uncertainty, a high unemployment rate, and with job security so problematic, it fuels anger and frustration on Main Street as to what is happening on Wall Street.

The second reason is very interesting. I am the only government official that I know of that has authority to calculate individual compensation for individual employees. It's one thing for the Federal Reserve, the SEC, the FDIC, and the G-20 to fashion prescriptions about compensation, but it's something quite different when you take the prescriptions, sit down with an adding machine, and tell the American people that, as to these companies, these officers are going to get these actual dollars. There is a great deal of interest in how you translate prescriptions into actual dollars and what that means to the American people. So for those reasons, I think that the interest in what I'm doing is out of proportion to the impact I can have on excessive pay practices.

7. 31 C.F.R. § 30.16(a)(3)(i).

8. 31 C.F.R. § 30.16(a)(3)(ii).

9. 31 C.F.R. § 30.16(a)(2).

10. See Steve Eder, *U.S. Pay Czar Says He Can "Claw Back" Exec Compensation*, REUTERS, Aug 17, 2009, <http://www.reuters.com/article/idUSTRE57G0E820090817> (quoting Kenneth Feinberg, "I can claw back, but we haven't focused on that at all"); Mary Thompson, *Pay Czar Will Seek Stricter Clawbacks From TARP Firms*, CNBC, July 20, 2010, <http://www.cnbc.com/id/38333143> (announcing Feinberg's plans to ask several firms to voluntarily strengthen their clawback provisions).

Now, how do I go about deciding what Joe Jones or Mary Smith ought to make at these companies? Well, that's an interesting assignment. Much of it is judgment, but it's judgment grounded in certain cabinized principles. I look to the statute and the regulations. What do they say about a blueprint to follow when calculating pay? Congress laid out certain specific prescriptions or principles that I am required to consider in fashioning pay. What are some of these principles in the statute?

First, the statute says that the Special Master shall consider compensation that will promote the competitiveness of the companies so that they will thrive financially and repay the taxpayers.¹¹ This is the companies' favorite principle. That's their bellwether. "Mr. Feinberg, this person is irreplaceable." "Irreplaceable!" The companies argue that you have to pay X dollars because the person must stay so that the company will thrive and repay the taxpayer. I'm dubious. But it is a factor I'm asked to consider, and it's in the statute.

Second, the statute says that the Special Master shall make compensation determinations in a manner that will encourage officers to avoid excessive risk.¹² What does that mean, "excessive risk"? Not risk, but "excessive risk." I have developed an answer to that question which has stood me in excellent stead: "I know it when I see it." And there are examples where I've said, "That person, based on that compensation, must be engaged in excessive risk-taking that undercuts the stability of the company."¹³

Third, the statute says that compensation shall be long term.¹⁴ No options. Options are prohibited by statute.¹⁵ That makes my job easier. But the statute says that the Special Master shall promote long-term loyalty to the company with the use of long-term compensation packages.¹⁶ That means stock. Those are just some of the statutory provisions that I shall consider in determining compensation.

Now, then what do I do? First, I ask the companies for data. "Companies, I want to see your comparative employment data for the top one hundred people in your organizations." "What do you think these people ought to be paid relative to the competition?" And the

11. 12 U.S.C. § 5221(b)(3)(A); 31 C.F.R. § 30.16(b)(1)(ii).

12. 12 U.S.C. § 5221(b)(3)(A); 31 C.F.R. § 30.16(b)(1)(i).

13. See FINAL REPORT, *supra* note 5 (rejecting proposed compensation plans for two employees at Citigroup subsidiary Phibro, LLC, because they would reward excessive risk-taking and temporary increases in value).

14. 12 U.S.C. § 5221(b)(3)(D); 31 C.F.R. § 30.16(b)(1)(i), (iii).

15. 12 U.S.C. § 5221(b)(3)(D).

16. *Id.*; 31 C.F.R. § 30.16(b)(1)(ii)-(iii).

companies send me wheelbarrows of data about employment. “Our CFO is requesting \$1.4 million in salary, and here is the data showing that other CFOs get \$1.4 million in salary. Here’s our comparative data, prepared for us by Mercer, McKinsey & Company, and Ernst & Young.” And in it comes, all sorts of data. Then, I’m invited by the regulations to hire independent compensation consultants to help me.¹⁷ Well, what I’ve learned in this job is that there are no independent compensation consultants. They are all conflicted. They all work for the very companies that I’m regulating. I can’t use them. Where do I go next? Academia. That’s where I find truly independent compensation consultants. So I retain some independent consultants: Lucian Bebchuk at Harvard Law School,¹⁸ whom Dean Bradford probably knows, and Kevin Murphy at the University of Southern California Marshall School Of Business.¹⁹ I bring them in and say, “Help my team massage and appreciate the data.”

Now here’s what happens with the data. “Mr. Special Master, here is our data, and the CFO should get \$1.4 million.” Well, our independent data says that a CFO should get \$990,000, not \$1.4 million. “No, wait a minute. You don’t understand what our CFO does anecdotally. The reason there’s a difference in the data is because our CFO is much more than a CFO. She puts the books in the library; she drives the limo. She does much more than the CFO reflected in your data. It’s apples and oranges. You’ve got to look at apples and apples.” So, I engage in a dialogue with the companies that I regulate. That’s why this title that the media promotes, the “Pay Czar,” is very unfortunate. The title Pay Czar makes it sound like I am issuing imperial edicts about pay. I’m not doing that. I’m engaging the companies in a dialogue, trying to come up with consensual packages of pay that are acceptable to everybody. Now you know the secret. First, there’s a statute, then there’s regulations, then there’s the company data, then there’s my own data, then there’s my own

17. See FINAL REPORT, *supra* note 5 (noting that the Office consulted with executive compensation scholars Lucian Bebchuk and Kevin J. Murphy).

18. Lucian Bebchuk is the William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance and Director of the Program on Corporate Governance at Harvard Law School. Bebchuk is also a Research Associate at the National Bureau of Economic Research and an Inaugural Fellow of the European Corporate Governance Network. *Lucian Ayre Bebchuk*, HARVARD LAW SCH., <http://www.law.harvard.edu/faculty/bebchuk/bio.shtml> (last visited Feb. 25, 2011).

19. Kevin J. Murphy is the Kenneth L. Trefftz Chair in Finance in the department of finance and business economics at the USC Marshall School of Business, professor of business and law in the USC Law School, and professor of economics in the USC Economics Department. *Kevin Murphy*, USC MARSHALL SCH. OF BUS., <http://www.marshall.usc.edu/faculty/directory/kjmurphy> (last visited Feb. 25, 2011).

consultants, then there's negotiation, and that equals packages. That's exactly the formula that we use to come up with the pay packages for the top twenty-five earners at the five companies that are subject to my jurisdiction.

Now, what are the principles that govern in establishing these pay packages? Forget the dollars for a minute. What have I concluded is the best blueprint to guarantee appropriate compensation that is consistent with the statute and will promote stability in the marketplace? When you apply the formula that I've laid out, here are principles that in 2010 should govern compensation.

First, you should receive a low cash-based salary: under \$500,000.²⁰ Cash under \$500,000 unless, for good cause shown, it should be more.²¹

Second, you should receive no other guaranteed salary.²² Your only guaranteed salary is your cash-based salary and that ought to be relatively modest. No retention contracts. No guaranteed bonuses. The word guaranteed is out of the equation.

Third, the rest of your salary will be in the form of stock, but salarized stock that will vest immediately.²³ That's the Dodd Amendment. I can't delay the vesting date for the top twenty-five earners, I can for employees twenty-six to one hundred, but I can't for employees one to twenty-five. So the rest of your compensation will be in salarized stock, which will vest immediately. But, consistent with the statute, it cannot be redeemed except one third after two years, one third after three years, and one third after four years.²⁴ You must retain the stock. Now, if you leave the company, you can take the stock with you; it vests immediately. But you can't redeem it. So, in this way, your compensation is very much tied to the overall value of the company because your stock might be worth two dollars today and in four years might be worth thirty dollars. That's what this whole program is about: tying your compensation to the overall performance and value of the company for which you work.

20. FINAL REPORT, *supra* note 5, at 9; *see also* 31 C.F.R. § 30.16(a)(3)(ii) (stating that annual compensation, excluding long-term stock options, that does not exceed \$500,000 is presumptively within the statute's safe harbor and no prior approval is required from the Special Master).

21. FINAL REPORT, *supra* note 5, at 9.

22. *Id.*; *see also* 31 C.F.R. § 30.16(b)(1)(iv) (dictating that a significant portion of executive compensation be tied to performance over a specified period, i.e., not guaranteed).

23. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, (2010) (specifying that any amount paid as a bonus must not exceed fifty percent of executive's compensation), *available at* <http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf>.

24. 12 U.S.C. § 5221(b)(3)(D)(i).

Next, we will give you, after no less than three years of continued service to the company, additional TARP stock.²⁵ But that stock will only vest at least three years out from date of grant.²⁶ And, importantly, the stock must be held two more years after it vests;²⁷ so, you're now at least five years out. And, this additional TARP stock can only be redeemed if and when the company repays the taxpayer.²⁸ So that chunk of stock is contingent on the taxpayer being repaid.

Finally, no perks over \$25,000 per individual without prior clearance from the Office of the Special Master.²⁹ No private jets, no country club dues, no golf club outings. Up to \$25,000, do what you want. Beyond \$25,000, it must be approved by the Treasury.³⁰

Now that's the basic structure. Now you know what my role is, you know what I rely on, you know how I get there, and you know what types of compensation packages I approve. So what's the magic? There is no magic. Except, at the end of the day, it's still subjective. There are 150 people in this room today, and I'll bet you I could give all of you a package from the company and say, "You choose. You calculate the compensation," and I'm quite certain we'd come up with 150 different bottom lines, and this is a sophisticated group. That's the subjective part of all this.

Before I conclude, I would like to address a few policy issues. First, "Mr. Feinberg, I must say you've given me a very good explanation of what you do and how you do it, but I want you to know it's none of the government's business setting private pay. It's a mistake. In a free market economy, the government has no role to play in setting compensation. You are micromanaging the private sector, and it's not a good idea. It's against the philosophy of this country, and it's a mistake." I would have thought I would have heard that argument a great deal, but that argument has completely

25. *See id.* (dictating that long-term restricted stock may be granted at TARP stock); FINANCIAL STABILITY BOARD, PRINCIPLES FOR SOUND COMPENSATION PRACTICES: IMPLEMENTATION STANDARDS 3 (2009) (suggesting that substantial portions of compensation be deferred at least three years).

26. *See* Press Release, U.S. Dep't of the Treasury, The Special Master for TARP Executive Compensation Issues First Rulings (Oct. 22, 2009), available at <http://www.treasury.gov/press-center/press-releases/Pages/tg329.aspx> (noting that receiving incentive stock is predicated on three years of service as executive).

27. *See id.* ("Unlike the pay practices of the past, which allowed executives to sell stock in their companies immediately . . . stock received as salary may only be sold in one-third installments that will not begin until 2011, unless the taxpayer is repaid earlier.")

28. 12 U.S.C. § 5221(b)(3)(D)(i)(I).

29. 31 C.F.R. § 30.11(b).

30. *See id.* (stating that TARP recipients must provide Treasury with narrative description of amount and nature of benefits, the recipient, and justification for offering these benefits within 120 days of completion of fiscal year any part of which is a TARP period).

disappeared. Republicans don't make that argument; Democrats don't; conservatives don't; liberals don't. Why? Why don't I hear that argument more often in my work?

The philosophic argument that allowing the government to set private pay is a bad idea is trumped by the fact that (1) my role is extremely limited, and (2) the taxpayers own these companies. So, what I hear often is, "Mr. Feinberg, go right ahead. We own these companies. We bailed them out. They survived because of us. And therefore, as long as you're not expanding your jurisdiction, we have no problem with what you are doing." The American people are creditors of these companies and as such have every right to set compensation, just like private creditors. "Now, don't expand your jurisdiction to other companies, but if you're limited to these seven (now five) we don't care." In fact, most of Wall Street tells me, "Ken, they only have themselves to blame." So, there really hasn't been much of an argument about the bigger issue of the government's role in the private marketplace because here the government is a surrogate for the taxpayers, who are these companies' creditors.

And, I constantly remind everybody that the Secretary of the Treasury, Secretary Geithner, who's been very supportive of what I'm doing, and the President have both said repeatedly, "We are not looking to micromanage these companies. We hope that they will repay TARP and be out from the Treasury's thumb. And, frankly, we have no intention of expanding the authority of the Special Master." That basically blunts any political criticism. That's why, although the job is very challenging, for the most part, I've received a fair amount of bipartisan support. Senator Shelby of Alabama, for example, has been quite supportive of what I'm doing. "Ken, as long as your role is limited to these companies, I support you. I didn't like the whole idea of the bailout, but it's done. Do your job on behalf of the citizens of Alabama."

Now, how long under the law does the Special Master regulate pay for this limited number of people? Answer: as long as their companies owe the taxpayer money.³¹ Some would say, if that's the case, my great-grandchildren will be Special Masters. We'll see. All of the companies, to their credit, have a plan to repay the taxpayer. We shall see. The crystal ball is murky. It depends in large part on the state of the economy.

Before I conclude, I'd like to make a few other logistical or mechanical points about my role. Who does the job? Well, we have a staff of twelve people at the Treasury. We have a tremendous

31. 12 U.S.C. § 5221(b)(1)(A).

advantage over the companies because they are no match for the Treasury's dedicated public servants. They do this for a living. They really are the experts when it comes to executive compensation. It makes my job a lot easier.

So, in 2009 we issued our compensation determinations.³² First, we did one to twenty-five. Then we prepared compensation structures, for twenty-six to one hundred. Now it's February 2010, and I'm sure one to twenty-five should be issued in the next two weeks. Twenty-six to one hundred should be issued in the next thirty days. Done. Then we'll focus on claw back and whether we should recover money.

The final problem that I would like to mention is the frustration that you feel doing this job when you are compelled by law, by the Constitution, to honor old contracts that were entered into before the TARP law was implemented. That's a real problem. "Mr. Feinberg, you're setting my compensation, but what about the contract that I entered into in 2007 that entitles me to \$2 million to join the company?" Well, the law says I have two options. First, renegotiate the contract.³³ I've been successful doing that: "Why don't you take the \$2 million that you're owed, and we'll agree to roll it over into prospective salarized stock? Be a patriot." Most people have been willing to do that. Not all, but most. And second, for those businessmen who say, "No, I want my money, and I'm entitled to it." I say, "Okay, under the statute, you're entitled to it."³⁴ Take it. But I do know that the statute allows me in 2010 to take it into account in determining prospective compensation what you've received through a retention contract.³⁵ So if you received \$500,000 or \$2 million, I can take that into account in determining your compensation in 2010."

32. See U.S. Dep't of the Treasury, *supra* note 26 (setting forth compensation determinations for the top twenty-five paid employees); Press Release, U.S. Dep't of the Treasury, The Special Master for TARP Executive Compensation Rules on Compensation Structures for Certain Executive Officers and Most Highly Compensated Employees 26–100 (Dec. 11, 2009), available at <http://www.treasury.gov/press-center/press-releases/Pages/2009121111464313585.aspx> (setting forth compensation determinations for employees 26–100).

33. 12 U.S.C. § 5221(f)(2).

34. See *id.* § 5221(b)(3)(D)(iii) ("The prohibition required under clause (i) shall not be construed to prohibit any bonus payment required to be paid pursuant to a written employment contract executed on or before February 11, 2009, as such valid employment contracts are determined by the Secretary or the designee of the Secretary."); 31 C.F.R. § 30.10(2) (stating that the general prohibition does not extend to payments under previously executed, legally binding contracts).

35. See 12 U.S.C. § 5221(f) (stating that prior payments to executives may be reviewed); 31 C.F.R. § 30.16(2) (setting forth the ability of the Special Master to take account of prior payments to executives).

So there's the overall program. I wanted Vanderbilt to hear about this. I think it's an important, unique piece of legislation, and this is an important conference.

Thank you.