DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 5, 2013

The Honorable Christy L. Romero
Special Inspector General
for the Troubled Asset Relief Program
1801 L Street, NW
Fourth Floor
Washington, D.C. 20036

Re: Status Update on Recommendations in the SIGTARP Quarterly Report

Dear Ms. Romero:

This letter responds to your request to describe the actions taken by the Department of the Treasury in response to the outstanding recommendations to the Office of the Special Master for TARP Executive Compensation (OSM) for companies receiving exceptional assistance under the Troubled Asset Relief Program (TARP) since the Special Inspector General for the Troubled Asset Relief Program's (SIGTARP) Quarterly Report to Congress, dated April 24, 2013. Enclosed please find an update on SIGTARP's recommendations to OSM. We look forward to continuing to work together.

Sincerely,

Patricia Geoghegan

Patricia Geoghegan
Acting Special Master
for TARP Executive Compensation

Enclosure

The U.S. Department of the Treasury
Office of the Special Master for TARP Executive Compensation
Status Update on SIGTARP's Outstanding Recommendations

July 5, 2013

The Department of the Treasury (Treasury) welcomes the recommendations on the Troubled Asset Relief Program (TARP) from the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP). This update serves as a status report on Treasury's response to SIGTARP's open recommendations to the Office of the Special Master for TARP Executive Compensation (OSM) for companies receiving exceptional assistance under TARP.

Treasury has given careful consideration to all SIGTARP recommendations. Treasury's policies and procedures currently address many of the issues you have raised, and in many cases Treasury has taken specific actions to implement your recommendations. When we determined that a recommendation would not help carry out Treasury's statutory duties under the Emergency Economic Stabilization Act, we developed alternative methods to address SIGTARP's underlying concerns and explained those methods in our summary responses to SIGTARP and to Congress.

As I explained in four previous letters to you, including as recently as April 4, 2013, OSM considers the first two recommendations from your 2012 audit of OSM's determinations implemented and closed. For your third recommendation from that audit, please see below. SIGTARP also made four new recommendations in its audit report of OSM's 2013 determinations. For our responses to those recommendations, please see below.

<u>Specific Recommendations from SIGTARP's Reports</u>

Recommendation: The Office of the Special Master should develop more robust policies, procedures, or guidelines to help ensure that its pay determination process and its decisions are evenhanded. These measures will improve transparency and help the Office of the Special Master consistently apply the Interim Final Rule principles of "appropriate allocation," "performance-based compensation," and "comparable structures and payments."

> Treasury agrees that it is important to have policies and procedures in place. OSM followed consistent policies, procedures, and guidelines for its top 25 determination letters and accompanying fact sheets for each of 2009, 2010, 2011, 2012, and 2013. Treasury also believes in the importance of open and transparent information and has always made its determination letters, and those policies, procedures, and guidelines, publicly available at www.financialstability.gov. Additionally, OSM recently compiled the policies, procedures, and guidelines, previously described in the 2009, 2010, 2011, 2012, and 2013 determination letters, in the OSM Policy and OSM Top 25 Determination Letters Procedure (both effective as of June 30, 2013). Thus, OSM considers this recommendation implemented.

Recommendation: Each year, Treasury should reevaluate total compensation for those employees at TARP exceptional assistance companies remaining in the Top 25 from the prior year, including determining whether to reduce total compensation.

OSM believes its existing procedures achieve SIGTARP's recommended objectives. For example, OSM reevaluates total compensation each year and its due diligence process is designed to alert it to any developments that suggest compensation should be reduced. Additionally, OSM has followed consistent procedures, as described in the 2009, 2010, 2011, 2012, and 2013 determination letters. OSM recently compiled these procedures in the OSM Top 25 Determination Letters Procedure (effective as of June 30, 2013). Finally, it is important to note that not only does OSM reevaluate total compensation each year to determine whether compensation should be reduced, but the companies themselves have from time to time asked OSM to reduce the total compensation of particular executives. Thus, OSM considers this recommendation implemented.

Recommendation: To ensure that Treasury effectively applies guidelines aimed at curbing excessive pay and reducing risk taking, Treasury should develop policies, procedures, and criteria for approving pay in excess of Treasury guidelines.

Treasury agrees that it is important to have policies and procedures in place. OSM has followed consistent policies, procedures, and guidelines in its top 25 determination letters and accompanying fact sheets for each of 2009, 2010, 2011, 2012, and 2013. Treasury also believes in the importance of open and transparent information. OSM has always made its determination letters, and those policies, procedures, and guidelines, publicly available at www.financialstability.gov. Additionally, OSM recently compiled these policies, procedures, and guidelines, previously described in the 2009, 2010, 2011, 2012, and 2013 determination letters, in the OSM Policy and OSM Top 25 Determination Letters Procedure (both effective as of June 30, 2013). OSM considers this recommendation implemented.

At the same time, we disagree with SIGTARP's description of some of OSM's guidelines. It is important to keep in mind that the Interim Final Rule on TARP Standards for Compensation and Corporate Governance (IFR)[1] requires OSM to strike a balance between limiting compensation and approving pay packages consistent with comparable positions at comparable companies. In implementing the IFR, OSM established a number of guidelines that were the foundation of the initial determinations in 2009 and 2010, and which we continue to follow today. These guidelines include the following:

- Pay generally should not exceed the levels paid for similar positions at similar companies.
- Most pay packages should be primarily stock-based. In this way, compensation is tied to the long-term performance of the company and executives are not just focused on short-term results or encouraged to take excessive risks.
- Cut cash compensation.
- Incentives are contingent on the achievement of pre-established performance goals.

[1] The IFR, technical corrections to the IFR, FAQs, and all determination letters are available on the Treasury website at www.financialstability.gov (click on "Executive Compensation").

- Limit executive perks.

As OSM has stated previously, these are guidelines rather than rigid formulas.

For example, in implementing the guideline that pay generally should not exceed the levels paid for similar positions at similar companies, OSM targets a benchmark percentile, and OSM's goal is to achieve an average total compensation for the top 25 around that benchmark. Thus, it is inaccurate for SIGTARP to characterize individual pay packages above the average as exceeding the guideline. While some individual pay packages will be above, and some below, the average, the guideline is satisfied if the average is at the target percentile. In fact, for 2013, GM's average total compensation for the top 25 was below the 50th percentile of similar positions at similar companies and Ally Financial, which has historically been higher due to its unique circumstances, was nevertheless on average mid-way between the 50th and the 75th percentiles. (In 2012, the year for which this recommendation was made, the average 2012 total direct compensation for the top 25 at AIG, GM, and Ally Financial was respectively at the 48th percentile, 50th percentile, and mid-way between the 50th and 75th percentiles for similar positions at similar companies.)

Recommendation: Treasury should independently analyze whether good cause exists to award a Top 25 employee a pay raise or a cash salary over $500,000. To ensure that the Office of the Special Master has sufficient time to conduct this analysis, Treasury should allow OSM to work on setting Top 25 pay prior to OSM's receiving the company pay proposals, which starts the 60-day timeline.

OSM believes its existing procedures are rigorous and address SIGTARP's concerns. As outlined in the OSM Top 25 Determination Letters Procedure, for each determination letter cycle, OSM prepares a chart substantiating its independent analysis for approving (in whole or in part) or denying a company request for cash salary in excess of $500,000 or a pay raise. Additionally, throughout the year, OSM analyzes each company's public securities law filings; consults with Treasury officials responsible for managing Treasury's investments in the companies; reviews published reports about the companies and their top personnel; and analyzes the companies' established performance goals for their executives. In addition, each company's CEO and CFO certify their pay proposals under penalties of perjury. OSM considers this recommendation implemented.

Recommendation: To be consistent with Treasury's Interim Final Rule that the portion of performance-based compensation compared to total compensation should be greater for positions that exercise higher levels of responsibility, Treasury should return to using long-term restricted stock for employees, particularly senior employees such as CEOs.

While long-term restricted stock continues to be a central element in most compensation packages approved by OSM, there are circumstances that OSM believes warrant exception—typically (1) where the executive is very senior and may retire in the next few years; or (2) where, due to particular circumstances, the executive's position may disappear in the near future (e.g., the planned disposition of a subsidiary or other corporate changes).

In those limited circumstances, approving pay packages without long-term restricted stock is reasonable and consistent with the IFR. This is because the IFR requires the executive to forfeit the long-term restricted stock if the executive does not continue to provide services for an additional two years after the date of the award—regardless of the reason. So, for executives who may retire, or whose future is uncertain due to corporate changes, any long-term restricted stock awarded to them would have no value and thus would not serve the IFR principle of designing compensation so as to retain talented employees. While OSM has approved a number of pay packages without long-term restricted stock in 2009 and each subsequent year, OSM nevertheless has also succeeded in increasing the percentage of pay packages that include long-term restricted stock to 87 percent of the total number of pay packages approved in 2013. This is an increase from 73 percent of the total number of pay packages approved in 2012 and 2011, and 67 percent of the total number of pay packages approved in 2010 and 2009.

Thus, to the extent this recommendation is that no executive subject to OSM's jurisdiction should receive any exception to OSM's general practice of including long-term restricted stock as a component of total compensation, OSM declines to accept SIGTARP's recommendation. To the extent this recommendation is that OSM should generally include long-term restricted stock as a component of total compensation for the executives subject to OSM review, OSM agrees and considers this recommendation implemented.