

KENNETH FEINBERG SPEECH

KF: I want to thank Lemma for that introduction, he did mention one very important fact, my book, my book about the 9/11 fund, *What is Life Worth?*, now you may have trouble finding that book these days at Barnes and Noble or Borders, don't worry, my supply of my book is virtually inexhaustible. And if anybody needs a copy, just let me know. Very pleased to be here. When I accepted this invitation months ago, I didn't quite realize the timing of this event today relative to my recommendations. I'm really here more than anything else, as a tribute to Robert Smith. I've known Bob Smith for many, many years.

His leadership at Maryland, the School of Business, is just one, one example of what he means and what he has done, his impact on this entire greater Washington community, in the nation. And when I was approached and asked if I would speak at this important event, sponsored by the Robert Smith School of Business, it took be about five seconds to accept because of the high esteem that I and everybody holds Bob Smith in. I'm also here because Nell Minnow is in the crowd and Nell has done as much as anybody in trying to raise the consciousness of everybody around the country for a long time, laboring in the vineyard, on the subject of executive compensation and... I'm pleased to share... this day with her.

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Now if there are any questions when I'm all through and I leave, get a hold of the deputy special master, Camille Byrose (ph.) who's sitting right here and knows this subject cold. And she's been involved from day one as one of my right arms in terms of the design and administration of what we're trying to do. Now in the next 20 minutes, let me just summarize what's going on here with the subject of executive comp. Congress passed a law and the law has been implemented by Treasury regulations and I am acting, pursuant to that law and those regulations. And the law is very, very clear. The law says that the special master shall determine individual executive compensation for the top 25 officials in each of seven companies, AIG, Bank of American, Citi Group, Chrysler, GMAC, GM and Chrysler Financial, that's it.

That is the limit of my jurisdiction when it comes to the mandatory requirement of doing what I did... two weeks ago, setting compensation for those individuals. The law also says that I shall, must design compensation structures for those seven companies concerning officials 26 to 100, 26 to 100. I don't, I don't determine their individual compensation package like I did with the top 25, instead I will be submitting, later this month or early in December,

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compensation structures, principles, to guide those seven companies in setting compensation, that's the second function.

The third function I have not yet implemented and I may not because it's discretionary. I have at least the right, in my discretion, for good cause shown, to attempt to claw back, recoup compensation previously distributed among hundreds of top companies, not just these seven, who once upon a time were involved in the top program. And I have the right to after compensation. But I think, and I've said this over and over again publically, I think that that exercise of discretion should be very, very narrow, should be very limited and should be limited to egregious cases which will be determined in the near future.

Now that is the program. Now there are a couple of arguments that are raised all the time at the foundation of what I'm doing. And these arguments you all know them, we have a very sophisticated crowd here, we all know what those arguments are and they go something like this. Argument number one, it's none of the government's business, the government should not be getting involved in setting executive compensation in the private sector. Now I don't hear that argument much anymore, and the reason I

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don't hear it is first, Congress has spoken, you can make that argument but I have a law that I have to interpret and, and implement.

So that gripe is with Congress, not with me, I'm acting pursuant to law. But that argument has also been undercut in recent months, but the argument made rather bi-partisan argument. Look, that might be a good principle in theory, but at least as to these seven companies, the taxpayers and the government own the companies. So in so far as executive compensation is being set for these limited number of people, we are acting as surrogates for the taxpayer as creditors. And what I hear mostly these days is as long as you limit your mandatory jurisdiction to these seven owned companies, as creditors on behalf of the people of the United States, that sits okay.

Then you hear the camel, you know, the slippery slope, and this is only the first round. I've tried to make it clear over and over again, that this is not, as far as I, I'm, my view, this is not the first round, my authority should not be expanded, it should become more pervasive, it should be limited to these seven companies. And right now I see no indication of anything else, I think that it is limited to these seven companies and only as long as these seven

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companies haven't repaid TARP. If they repay TARP, they get out from under the statutory jurisdiction which guides my, my actions. Now, as to this first function, setting compensation, why 25 people? It's in the statute.

That's where Congress drew the line, mandatory jurisdiction over the 25 individuals in each of the seven companies. Now, when we announced our decision a few weeks ago, what were the guiding principles that underlay the decision that we reached? And I suggest to you that much more important than the dollars for each of these individuals, is I think the underlying rationale that is now public in my report... that has already been issued, it's available on the website, the Treasury website. Much more important than how much Joe should get or Mary should get, is I think the underlying rationale for the compensation. And what is that rationale?

One, let's try and eliminate as much as we can, guaranteed anything, when it comes to compensation. Other than guarantee base cash salaries, let's try and do away, as best we can, with retention guarantees, with bonus guarantees, with commission guarantees, with periodic draw guarantees, guarantees, guarantees. And unless... and let's try and tie compensation overall to prospective

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performance. Now that's easier said than done. It's easier said than done because first, what do we do with long-standing practices in these companies, of guarantees, particularly guarantees entered into before the law was passed that have the sanctity of contract.

And what do we do in 2009 or 2010 when a company says, well, we're ready to sit with you, but don't forget, in 2007, we entered into long-term contracts with some employees that guarantee... excessive or extensive, cash payments in 2009 and 2010, it's a problem. And the law says what I should do in such a case is decide first, is the contract valid? Well I'm not prepared to upset or invalidate long-standing contracts entered into between employers and employees, I don't think it's a good idea. And if the both the employer and the employee and their lawyers say the contract's valid, it's probably valid.

Then the law says, in such a case, I can try and renegotiate the contract. Well we have been as, as Camille will tell you, we have been very, very successful in renegotiating these old contracts for a lot reasons. But when you sit down with the company and you say, look, you're entitled to this money for your employees, but why not roll that money over into prospective, performance

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based salarization? Almost in every case, cooperative companies among these seven, agreed to do that. Finally the law says, well what if a company won't agree to roll that cash over prospectively? The laws says I can take, in enforcing that contract, I can take that cash or that consideration into effect, into consideration in determining prospective cash, prospective compensation.

So if somebody's going to get a million dollars from a 2007 contract, I can take that into account in reducing her compensation in 2009 or 2010. That's what the law says, so what we tried to do, eliminate guarantees, sharply reduce the amount of cash salary guaranteed every two weeks a check. Come up with this idea of including as salary, stock which under the law must vest immediately but is not redeemable for up to four years, a third after two years, a third after three years and a third after four years. Somehow trying to tie compensation to longer term performance on the part of key employees.

And finally at the back end, a healthy amount of restricted stock which only vest after three years, you got to stay in the company for three years at least and even then, that million or two million dollars or more worth of restricted stock, is preconditioned on the company's ability to repay

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the taxpayer, which is really the goal, repaying the taxpayer. So that's how the program, basically that's the formula that we implemented for 2009. Now there's... the people in this room, would you do it a different way, maybe. Is my way the only way, absolutely not. I balanced the law and the regulations. Now it's not easy to balance these... the law and regulations.

If you look at some of the benchmark guiding principles in the law, here are some, I'll tell you how difficult this can be. One, special master make sure when you set salary, that you take into account, when you set compensation, take into account the need to keep these companies competitive, retain key people, and keep them active in the marketplace so they'll thrive and repay the taxpayer. Good, fair, I like that principle. Second, but make sure that the compensation's performance-based, quite apart from the competition. I mean, make sure that you, as much as you can, you tie overall compensation prospectively to performance and remember principle number three, make sure that your compensation determinations do not promote excessive risk.

I don't know what excessive risk is, I mean, I've, I've studied it and, and I think people in this room, there

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would probably a healthy divergency of view as to what constitutes not risk, but excessive risk, it's part of the statute and the regulations that guide us. Also try and provide compensation packages that promote loyalty to the company so that people will stay and help the company thrive. I mean when you read these prescriptions, it's hard to disagree with any particular prescription, then you decide now we've got to actually and here's why there's such a great interest in this you see. Now, let's translate the generic prescription to how much bucks this guy's going to get and how it's going to be structured.

Well no one's done that, except the Office of the Special Master. There's a lot of prescriptions, a lot of generic discussion about principle. Try taking the principles and calculating the actual dollars that constitute a total compensation package. That's the challenge, you see, that's where the balancing is and trying to figure this out. Now what did we do in coming up with the dollars? Well, first we, we received very constructive data submissions from the seven companies, they all gave us their submissions, all this data, you know they all have their consultants and... in a wheelbarrow it comes in. All this data about how our competition is the job classification.

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This guy is number... you know, you may think he's just a, a vice president for human resources, but really he's a CEO at heart and therefore his calculation or her calculation should be at this classification, never mind what it says, you're looking at the wrong data because you got to get the right apples and apples or it's, it's skewed. And you get that. So we got all that data and we, we evaluated it and we have about 12 people on the staff of the office, fabulous people, fabulous. Treasury... people, permanent government employees at Treasury, the best public servants you will ever find. A couple of lawyers of course, what would be an office be with a few lawyers? And... we sort of massaged the data and look at it and... and drawn some conclusions.

Then we get our own data, independent data, and we have a couple world class experts from, you know, academia, from the business schools, excellent, just helping us try and figure this out. And from that we, in a very principled way I would suggest, came up with compensation packages for these individuals. And I am surprised at the extent to which these packages have been fairly well received, for what they are designed to accomplish. And, and I think that's very, very important. I think that the report that

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we issued is rather credible and has been received as totally apolitical, there's been no political interference here at all, the White House has played no role in our decisions.

The Secretary of the Treasury has, has given us the resources and said, Ken, you'll do it, you'll do it right and, and it's worked fine. It's very controversial, but it's... it's worked fairly well. Now the next challenge in the next month or six weeks is to come up with compensation structures for these companies, not for the top 25, but for employees 26 to 100. Now we're not constrained as much by the statute, we have more flexibility, but still, coming up with structures that are designed to keep in place sort of second level, compensation wise, second level people at 26 to 100, that's a new challenge for us, cause those people, by definition, will likely get, receive less compensation. And when you have less compensation, how much can you spread compensation and, and work with these individuals?

Well, we'll, we'll once again work with these companies to try and come up with... some sort of consensual program. Now I must say, this title, pay czar, very, very unfortunate. First of all, my grandmother in Lithuania would be confused beyond belief. But aside from that,

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very, very, unfortunate because it sounds as if a pay czar through some sort of imperial decree is saying this is it, that's not at all what we have done. We have in a very cooperative manner, engaged the seven companies, in ongoing months of discussion, what will work, tell us? We want to know from your perspective, what will work. We may adopt it, we may not, but we want to know if we do this, how will you react?

What will be the impact on your company if we do this?

And, and it's work, I mean I must say, there have been some intense discussions over at Treasury, but overall, I have the highest regard for these companies. They are laboring under very difficult circumstances... there is a... a world view of their... ability to function and what is proper and what is effective and what is due them. And there's often a tension between Main Street and Wall Street on perception. Overall we've tried, it hasn't been easy, but again I think at the end of the day... people may have done it differently, but I think at the end of the day, there is a grudging acceptance that, that what we have done is principled. It is corroborative. It walks the line of the statute and the regulations which are often at odds.

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And I think it will, it will prove to be... workable. Now... the next question I've always asked this, I'll anticipate it, well, for these seven companies, you've done this. Will it have an impact beyond the seven companies? Will there be some voluntary adoption of the structure, of the principles you rely upon? Will Wall Street, on its own, follow suit and pickup on some of these principles and perhaps on some of the calculations? I do not know. I do not know, I hope so, I hope so. I think that we've done is worthy to be emulated by others in the private sector, not by government interference, but by the private sector seeing that some of this is worthwhile, I don't know.

We're working closely, at least I wouldn't say day-to-day, but hand in glove, the Federal Reserve has come out with some general... executive comp rules. The SEC we've met with, they are working on furthering transparency and coming up with some other regulatory principles. Sheila Beard at the FDIC, we've been over to see her, in terms of what she might be doing. So we're trying, in our own way, to move forward in providing some sort of limitation or consideration in how executive compensation is set and how dollars are determined. So that's sort of the picture. We will finish 26 60 100, the structures, we're working on that right now.

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And then in January, we're back to 2010, the top 25. We found that in 2009, by the time we issued our determination, don't for the law was passed in... later in the year, the special master's office after the regulations, didn't get up and running until May or June. We found that by the time we began our work with one to 25, some people had left, there was, there was just a slot that was empty, hadn't been filled. I think we filled, out of 175 total possibilities, there were enough company... departures that we only actually set compensation for around 135, the rest were, no one was filling those slots. On January 1 of 2010, we'll have 25 for each of the seven and we'll, we'll have more to work with then.

And we hope to get our, our 2010 compensation decisions rendered in the first quarter so that they'll have more of an impact than they did in the latter two months of 2009. So that's sort of the picture and I want to close by just telling you that although all of you may think that this is a very, very important conference and I certainly do. And... I'm glad to be here in honoring Bob Smith. Everybody doesn't agree that this conference is so important, the other day, I was talking to my daughter on the telephone.

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And I said to her, Leslie, do you believe in your wildest dreams, in your wildest dreams, did you ever think that your father would be addressing the Robert Smith Business School at the Reagan Center? And she said to me, dad, in my wildest dreams I don't think about Robert Smith or the Reagan Trade Center. Questions? [APPLAUSE] We've got about 15 minutes and Lemma you promised me that there's a lot of good questions.

Lemma: Yeah, yeah I think I'm going to depart from the protocol and I'd like those who wish to ask questions to line up here because we don't have, we have very little, little amount of time. Please introduce yourself.

Q: I'm Glen Gargen (ph.), thank you for coming first off. Within, let's take an example of any one company, what kind of leeway do you have from one to 25... once you come up with an agreement with the company, you mentioned that several times, do you have leeway with the individuals? The reason I ask, I read one article where this poor guy was one through 25, but he spent you know next year's bonus on this, so he's cash poor but the other guy may not be. What kind of latitude do you have with that?

KF: We have great latitude. After we collected all the data, do not underestimate the importance of anecdotal information offered by the company concerning certain

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individuals, claim to be either critical or, or dispensable or... about to leave or new slot, new title. We have, we had a great deal of discretion in taking into account individual merit, individual position and we tried to do that as best we could with guidance from the company itself.

Q: I, I'm Tim Burn with *The Washington Business Journal*. I'm just wondering if you, do you have a ballpark figure for the total haircut that, that the 25 people at the seven companies got?

KF: Yes.

Q: What they were earning last year and what they're going to be earning after you're done with them?

KF: Yes. This has been public, it's in the report. On average, the 20, the 175 slots or the 135 people, got approximately 90 percent less cash than they did in 2008, a corroboration of my view that guaranteed cash should be slashed substantially. And overall compensation was reduced on average by 50 percent, reflecting... our view that total cash... total compensation was too high, on average, at all of these seven companies.

Q: Do you think it'll be, that it'll be the same when, when you go back to it in January?

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KF: I have no idea what, what we'll do in January. We haven't even yet received the submissions from the companies as to what they expect.

Lemma: Okay, I'm going to read off a question for you. How will or can the fundamental structures of these pay package be adopted by other firms... not under federal regulation? Who are the key players to make this adoption?

KF: Well, Nell's the key player. I mean Nell, Nell will answer that question. I mean you're... that, that is a very difficult issue. In other words, how do we go from what is mandated by law... to be adopted voluntarily in the private sector? Now there are two answers to that, that I hear all the time, not news. One, there will be a ready wiliness on the part of some companies to pickup on this. They will just... view it as just sound, good management. Now that may be naïve to think that that will be pervasive, but there will be some hopefully that will do that.

Second, do not underestimate what the regulators may do here, the Federal Reserve has some prescriptions out, the SEC is getting invo, is involved in this. The FDIC has a role to play here, so... the extent to which the regulators pickup on this. Third, I'm watching with great interest in the Congress, corporate governance legislation. I mean, how much of what we're doing is sort of the tail wagging

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the dog? How much of this really goes to the basic question of corporate governance reform and the, the new, the changed role of shareholders, independent compensation committees, independent compensation consultants, if there is such a thing, I haven't found one.

How much of this is really the subject of Congressional interest in the broader question of corporate governance which is really not part of my mandate and that remains to be seen as well. So in all of these areas, private adoption, regulatory involvement, Congressional involvement, I mean from all of these different aspects, maybe, maybe we will see some change beyond the limited seven companies that I'm involved with.

Lemma: I'm going to read out another question for you. Some of your focus is to reduce guarantees and substitute performance-based compensation. How does this relate to the Federal Reserve's call to reduce comp, the compensation incentives to take on risk? That seems opposite of the special master's role.

KF: Well, the question is whether or not the Federal Reserve's recommendations are at cross purposes with mine. I've heard arguments that they're at cross purposes, I've heard arguments that if you really read carefully what is being said, they are not at cross purposes. We felt that with

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these seven companies, we're, there is the added issue of the taxpayer as creditor. Trying to get the money back, we felt that, that under those circumstances we should adopt the program that we've adopted. Whether or not our program should govern beyond the seven in terms of some of the performance-based metrics, where banks are healthier, where the taxpayer is not a creditor, where you have the luxury of maybe more flexibility, I'm not prepared to say.

I'll standby what we did as to these seven. I believe that much of what we did is useful beyond the seven, but that remains to be seen in terms of what the Federal Reserve will do with banking institutions and what others may do in the, in the other private sector industries.

Lemma: Okay, another question. There is a very fascinating Supreme Court hearing on this Hirsh and Jones case which you know. So the question is, to what extent will this ruling set precedence and influence long-term reform? How might it affect your efforts of influence?

KF: I have no idea what the Supreme Court's going to do. I read yesterday in *The Post* for the first time, that this case is being argued in the Supreme Court which I think even the article acknowledged, in yesterday's *Post*, only had tangential likely impact on the subject of executive comp. It's an rather narrowly drawn, legal, constitutional

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issue involving mutual funds, fees from mutual funds. Reading the article, it sounded to me like it didn't have all that much to and that the Supreme Court would not likely reach out and make more of it than it had to do in issuing a narrowing ruling, a narrower ruling.

But I have no idea and it remains to be seen what the Supreme Court will do with that case.

Lemma: Okay, one more. You have done a good job of balancing...

KF: That's what you say.

Lemma: ... very difficult interests. Do you believe there is risk that your determinations could result in a talent drain at one or more of the seven companies and that the shareholder derivative suit could actually result?

KF: Yes, of course there's a risk. This whole function of what we're trying to do under the law is, it's a risk. We've tried to minimize the risk of a talent drain. There is nothing more important in our... mandate than making sure these companies thrive so that the taxpayer gets their money back, that's... I'm asked all the time, what is the most important role, your, your most important priority? Is it to change the structure of how people get paid? Is it vindictive? Is it... the primary role of what we are

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doing is to see to it that these seven companies payback the taxpayer. That's what we're really trying to do.

And we've tried in every way we can, by looking at the data, by examining competitive market forces, by reading the statute, by interpreting the regulations. We've tried, as best we can, to minimize the likelihood that that risk will... become paramount. We think we've done that. We think the companies, hopefully, will thrive. I don't think executive compensation decisions that we are making will be the determining factor as to whether these companies survive or not, but I think what we've done is to take into account that very real risk and try to make it most likely that that risk is just that, a minor risk, and not a real factor, and I think we've done that effectively in this program.

Lemma: There's one... basic finance question that apply to all of your roles as special master. In conducting present value analyses, did you use a nominal or effective rates?

KF: That's an excellent question and Camille will be back to the questioner, at some point with an answer to that question. That's a very good question and... if we know who the questioner is at some point, we'll try and get a response.

Lemma: Okay, any other questions?

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KF: Any others? I just want to close, I want to thank you all... this tribute to, to a great business school at Maryland, a great man, Robert Smith and... I'm honored to be here and to help participate in some small way in what is obviously a very worthwhile day here at the Reagan Center and I thank you all very much. [APPLAUSE]

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