



# SIGTARP

OFFICE OF THE SPECIAL INSPECTOR GENERAL  
FOR THE TROUBLED ASSET RELIEF PROGRAM

ADVANCING ECONOMIC STABILITY THROUGH TRANSPARENCY, COORDINATED OVERSIGHT AND ROBUST ENFORCEMENT

## **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.

Special Inspector General for the Troubled Asset Relief Program



OFFICE OF THE SPECIAL INSPECTOR GENERAL  
FOR THE TROUBLED ASSET RELIEF PROGRAM  
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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](mailto:Barry.Holman@do.treas.gov) / 202-622-4633) or Jim Shafer ([James.Shafer@do.treas.gov](mailto: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

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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”).<sup>1</sup> 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

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<sup>1</sup> 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.<sup>2</sup> 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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<sup>2</sup> 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 contracts. 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,<sup>3</sup> which sustained substantial losses in 2008. AIGFP’s credit default swap exposure on multi-sector collateralized debt obligations<sup>4</sup> 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.<sup>5</sup>

## 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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<sup>3</sup> 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.

<sup>4</sup> 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.

<sup>5</sup> 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<sup>6</sup>
- 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.

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<sup>6</sup> 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**

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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<sup>7</sup> 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.**<sup>8</sup> 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.<sup>9</sup>
  - 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

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<sup>7</sup> The number of employees is based on data as of June 30, 2009.

<sup>8</sup> 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.

<sup>9</sup> 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.**<sup>10</sup> 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.

<sup>10</sup> 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.**<sup>11</sup> According to AIG, there was a total of approximately \$275 million in deferred compensation payments distributed from 5,200 participant accounts<sup>12</sup> 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

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

<sup>12</sup> 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

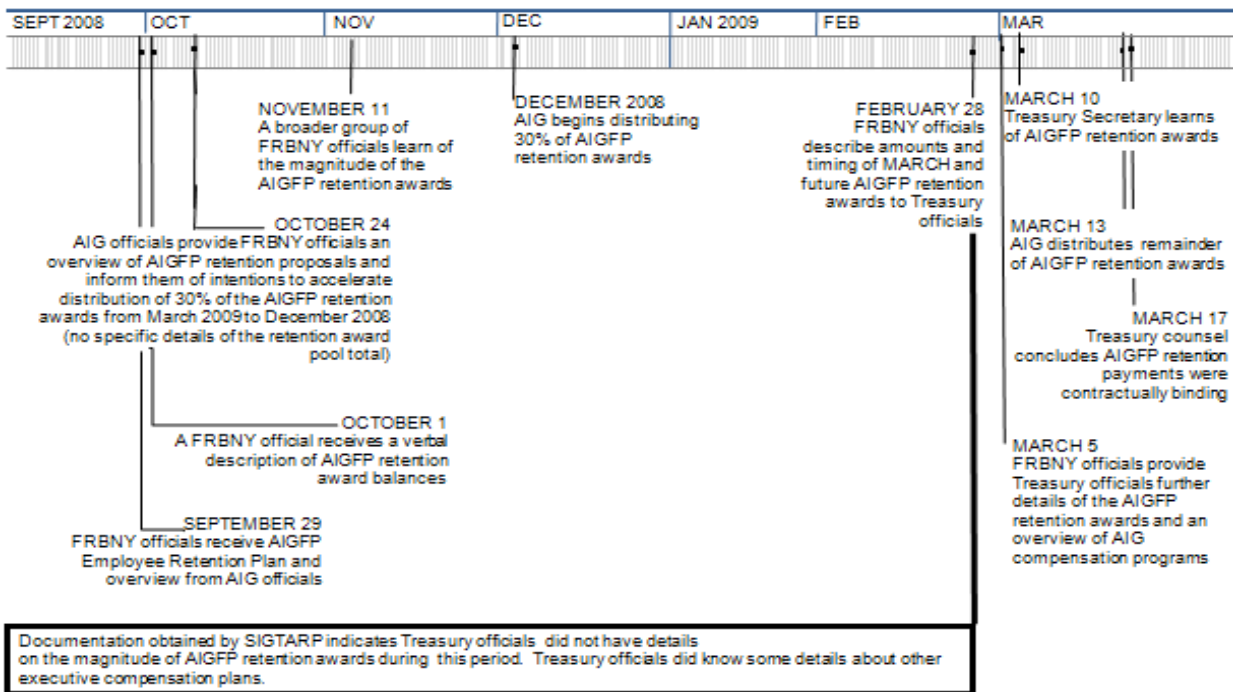


compensation programs they had learned about through March 5, 2009, as well as the balances and general timing of distribution of the AIGFP retention awards based on information provided by AIG to Ernst & Young, LLP. On February 28, 2009, FRBNY officials e-mailed Treasury’s internal counsel the amounts 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.<sup>13</sup> 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

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<sup>13</sup> 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**

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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.<sup>14</sup>

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<sup>15</sup> are

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<sup>14</sup> The Treasury Inspector General is conducting a separate analysis of the legal grounds for AIG bonus payments and the potential for recouping such payments.

<sup>15</sup> 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**

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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<sup>16</sup> 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.

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<sup>16</sup> This would generally include the 5 Senior Executive Officers and 20 other most highly compensated employees.

# Conclusions and Recommendations

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## 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

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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

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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.

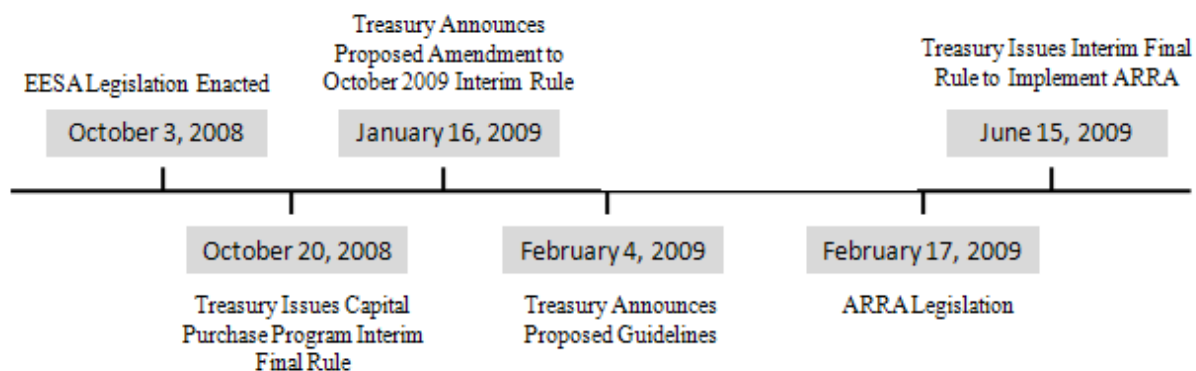
## Prior Coverage

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<sup>17</sup> and to a specified number of the most highly compensated employees of TARP recipients were limited to one-third of total compensation.<sup>18</sup>
- The golden parachute prohibition will now extend beyond CEOs 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 CEOs 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.<sup>19</sup> The rule also created an Office of the Special Master for TARP Executive Compensation within Treasury. For the TARP recipients receiving exceptional assistance,<sup>20</sup> the Special Master will review compensation payments and structures for the CEOs and the next 20 most highly compensated

<sup>17</sup> 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.

<sup>18</sup> 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.

<sup>19</sup> 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.

<sup>20</sup> 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.

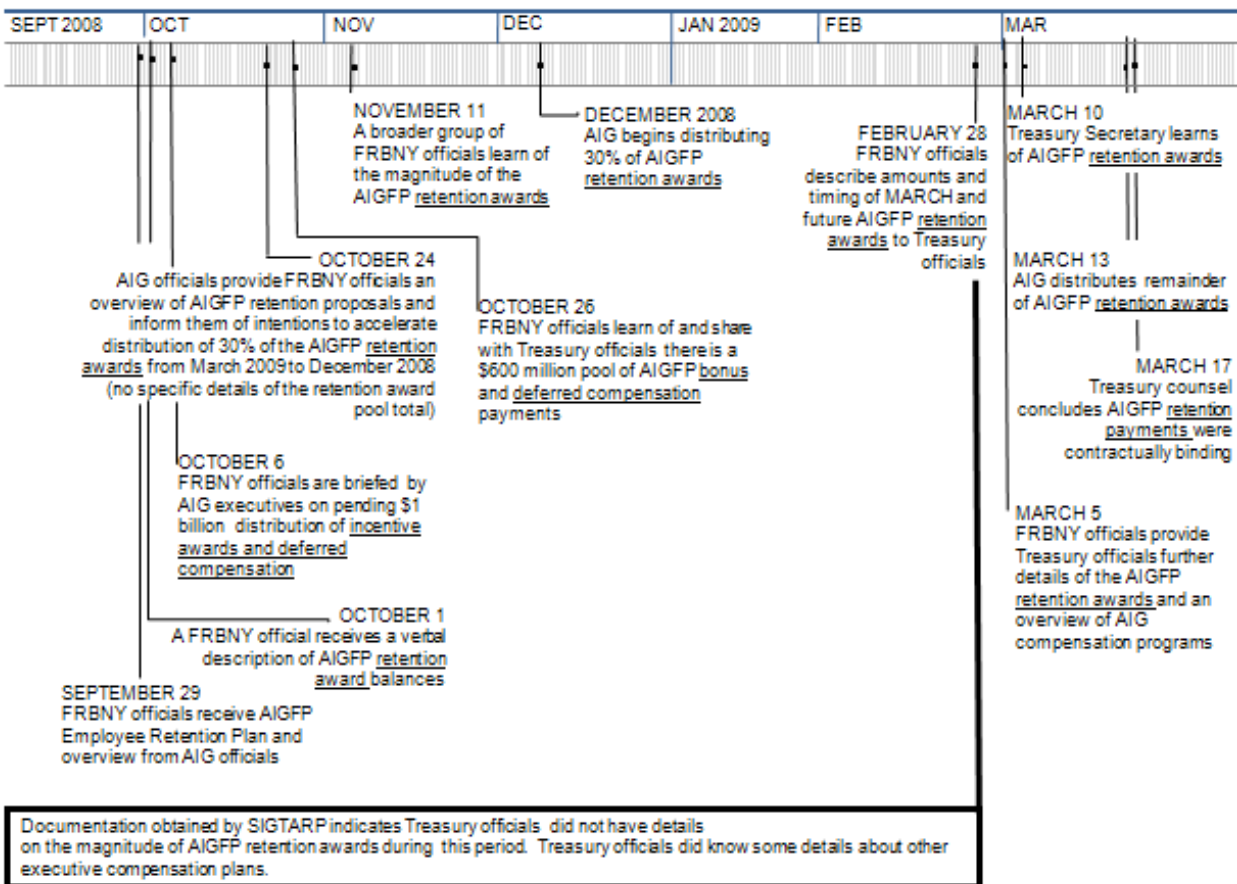
Furthermore, the Special Master is granted a “look-back” authority to review, for all TARP recipients, certain payments between the closing date of the contract with the TARP recipient and February 17, 2009 (the date of ARRA’s enactment). The reviews will cover all bonuses, retention awards, and other compensation paid to the 5 CEOs 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:

| <u>Proportion</u> | <u>Name of Beneficiary(ies)</u> |
|-------------------|---------------------------------|
| _____             | _____                           |
| _____             | _____                           |

\_\_\_\_\_  
 Signature of Covered Person

\_\_\_\_\_  
 Date

# Appendix E — Acronyms

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| <b>Acronym</b> | <b>Definition</b>   |
|----------------|---|
| 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

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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

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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,

A handwritten signature in blue ink, appearing to read "Scott G. Alvarez", with a large, stylized flourish at the end.



# Appendix H — Management Comments from Treasury

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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.

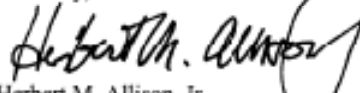
***SIGTARP Recommendation: Treasury should establish policies to guide decision making in determining whether it is appropriate to defer to another agency when making TARP programming decisions where more than one Federal agency is involved. To the extent that Treasury chooses to rely on another agency 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](http://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, 6<sup>th</sup> Floor  
Washington, D.C. 20220

## Press Inquiries

If you have inquiries, please contact our Press Office:

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Director of Communications  
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202-927-8940

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