What’s a Bailed-Out Banker Really Worth?

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By Steven Brill
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Last August, as midnight approached on a Friday, two Treasury Department staff members sat in a cramped basement office in the Treasury Building next to the White House and watched as their e-mail in-boxes filled up. The aides worked for Kenneth Feinberg, the government’s special master for executive compensation, and they were awaiting submissions from companies that had received (and not yet paid back) billions in what federal regulations call “exceptional assistance” from the government’s Troubled Asset Relief Program, or TARP. The government had the authority to set compensation levels at those seven TARP recipients, and this was the companies’ opportunity to plead for salaries and bonuses for each of its top 25 executives. Chrysler Financial and General Motors submitted their proposals — about 2,000-plus pages each — a few days before. Now, like college kids crashing a term paper, the other five — A.I.G., Bank of America, Chrysler, Citigroup and General Motors Acceptance Corporation — were frantically trying to get their pitches into Treasury’s digital in-box by the Aug. 14 deadline.

Feinberg, a 64-year-old lawyer with an often-booming voice and pronounced Boston accent, has said jokingly that he loves “jobs that seem so hard that they have a low bar for success.” This one, for which he is not accepting a salary, fits the bill. In proposals from the TARP Seven and in confrontations that followed the August deadline, Feinberg would hear arguments that Main Street America would find incredible. Citigroup and Bank of America, for example, concluded that everyone in their executive suites was above average when compared with peers at other giant banks that didn’t need a bailout. Or there was A.I.G.’s behind-closed-doors argument against Feinberg’s directive to pay its top people in large part with A.I.G. stock. The company’s reasoning? That the stock — trading briskly at the time at around $40 on the New York Stock Exchange — was actually worthless. Yet Feinberg would be pushed by staff at Treasury and officials of the Federal Reserve Bank to accept that argument and others in order to keep the captains of these broken companies from quitting.

Feinberg’s other constituency — the rest of America, as represented by members of Congress — wasn’t so eager to placate the executives. Barney Frank, the Massachusetts Democrat who is the chairman of the House Financial Services Committee and whose views on this flash-point issue reflected a broad sentiment, told me recently that his attitude was, and is: “Let ’em quit. Who needs them? How can we reward the same people who screwed up in the first place?” Indeed, if to many on Wall Street the spectacle of their best and brightest reduced to submitting payroll permission slips to government bureaucrats was a dangerous exercise in populist pandering, to almost everyone else it was an overdue reckoning.

When Feinberg announced his pay packages in late October, he found a way to give something to everyone. The public enjoyed a measure of revenge: Feinberg’s ultimate rulings looked hard-nosed when compared with what the executives used to make. Yet the leaders of these failed companies still ended up winning big paydays — an average of $6.5 million to each Bank of America executive and $6.2 million to those at Citigroup. Meantime, the Obama administration
looked tough on fat-cat compensation, even as it quietly cajoled Feinberg to ease up on some of the restrictions he wanted to impose.

Feinberg’s power was limited from the start and is now fading as quickly as it rose up last spring amid the furor over huge bonuses given to bailed-out executives. While other companies receiving smaller or different kinds of bailouts were subject to general compensation restrictions (like a ban on lavish severance payments or guaranteed bonuses), Feinberg’s authority to set specific pay packages applied only to the seven companies that got the most TARP money. Today, two of those firms — Bank of America and Citigroup — have made arrangements to pay the government back, so that they will no longer be under Feinberg’s thumb. Still, Feinberg’s stint as paymaster is important for two reasons. As someone with no ax to grind, Feinberg produced a credible template for broader compensation reform — reforms that corporate boards could adopt on their own. But the fact that it required such elaborate staging just to rein in a portion of the payouts at companies temporarily controlled by the government also illustrates just how difficult systemic reform will be.

THE BABE RUTH STANDARD

How people are paid at the top in a free-market system has always been a contentious issue, especially in bad times. Babe Ruth’s most famous quip was not about baseball but about salaries. When asked in 1930 if it was right that he should be making more money than President Hoover, he replied, “I had a better year than he did.”

It’s an issue that people come at from different angles. There’s the equity approach: Is it “fair” that executives at big companies should make 275 times (today’s approximate ratio) what their average employees make? Setting high tax rates for what are regarded as excessive earnings is a popular fairness remedy, as we’ve seen lately with a proposal for a surtax on bonuses that was recently passed in England and another being pushed in France. (It is likely to surface in Washington this winter too.)

On the other side, there is the free-market view: Whatever consenting adults agree to is fine. If the Babe had hit no home runs and the Yankees still wanted to pay him $80,000 a year (President Hoover made $75,000), that would have been between the Yankees and its slumping slugger.

Then there is the middle-ground idea that the free market should be regulated — not for the larger purposes of social fairness, but to ensure that shareholders, especially public shareholders, are well served or at least well informed. This could mean that shareholders would be able to make their boards set clear standards tied to an executive’s performance, as measured, for example, by the company’s share price or its profit. Or it could mean that the government sets rules, requiring, for example, that top executives’ compensation be disclosed to shareholders (as is now the case, though clarity and completeness are often lacking), or mandating an annual vote by shareholders on top executives’ compensation packages — which is included in a reform bill recently passed by the House of Representatives, though it would be only a nonbinding, “advisory” ballot meant to embarrass boards into doing the right thing.
Whatever the approach, even defining fair compensation is harder than it looks, as is implementing reforms that don’t have unintended consequences. When governments intervene to impose taxes or put limits on bonuses, for example, companies tend to increase salaries or introduce new perks. When the issue is left to the companies’ boards, endless questions peck away at the seemingly simple idea of paying executives based on performance. If pay is based on what an executive’s peers at other companies get, how is a peer group defined? Why penalize and demoralize talented employees if the firm’s stock or profits are down because the economy as a whole collapsed, or because the company incurred a short-term loss while making a sensible long-term investment? Besides, as a general matter isn’t it just plain silly to worry about spending a few extra million to keep the leaders at the top happy when they’re making decisions with billions at stake?

Questions like these add up to infinite reasons — or excuses — for why standards, whether set by boards or regulators, haven’t had much effect. Over the last 50 years, the ratio of top pay to average pay at public companies has multiplied roughly 11 times (24:1 to 275:1). That’s more pay in one workday for the chief executive than his average employee makes in a year. Academic journals, compensation-consultant white papers and even corporate proxy statements (typically in the section introducing wildly extravagant pay plans) are filled with the apple-pie watchwords of prudent compensation: “transparency,” “independence” (of board compensation committees), “long-term” and, of course, “performance.” Turning these principles into specifics, as Feinberg had to do, rarely happens.

Warren Buffett, the famed investor and chief executive of Berkshire Hathaway, offered this view of the problem — and his own impotence in solving it — in his 2006 letter to shareholders:

“Too often, executive compensation in the U.S. is ridiculously out of line with performance. . . . . A mediocre-or-worse C.E.O. — aided by his handpicked V.P. of human relations and a consultant from the ever-accommodating firm of Ratchet, Ratchet and Bingo — all too often receives gobs of money from an ill-designed compensation arrangement. . . . . The drill is simple: Three or so directors — not chosen by chance — are bombarded for a few hours before a board meeting with pay statistics that perpetually ratchet upward. Additionally, the committee is told about new perks that other managers are receiving. In this manner, outlandish ‘goodies’ are showered upon C.E.O.’s simply because of a corporate version of the argument we all used when children: ‘But, Mom, all the other kids have one.’ ”

Indeed, what has happened with executive compensation — and what that blizzard of paper that Feinberg would review is so emblematic of — is that a culture of entitlement has apparently become the norm. It’s not a matter of how much anyone in particular makes, and certainly not a question of an innovator like a Steve Jobs hitting the jackpot. The problem is that so many now seem automatically to receive so much (the chief executives in the Fortune 500 averaged $11 million in 2008) despite average or poor performance — or, in the case of the TARP companies, performance that was so colossally bad that it almost brought down the financial system.

That a government regulator now had the power to decide the paychecks at seven companies that failed so conspicuously would seem to offer a laboratory for concocting real reform. But Feinberg’s work instead became an experiment demonstrating just how entrenched and insulated
Wall Street’s pay culture has become. The thousands of pages of electronic templates and supporting documents submitted to Feinberg by the TARP Seven may have provided the aura of a bureaucratic regulatory exercise, but what began that summer night turned out to be anything but a by-the-numbers process. It became a kind of proxy war between Wall Street and Main Street.

BUSINESSMAN OR AVENGER?

Following the Sept. 11 terrorist attacks, Feinberg took a job that put him in a similar squeeze: Attorney General John Ashcroft named him to run a government fund intended to compensate those injured in the attacks and the families of those killed. (He did that job pro bono; Feinberg earns his living as the senior partner of his law firm, Feinberg Rozen.) In an exercise similar to his TARP work, Feinberg had to decide how much a person was worth. In the case of the 9/11 families, he based the figure on the projected future earnings of the person who had been killed. He ended up persuading 98 percent of the 3,000 victims’ families — even those of janitors offered a tenth of what families of killed stockbrokers got — to stay out of court and instead apply to his fund. And, while dispensing $7 billion in awards, he also got the support of an instinctively anti-plaintiff Republican administration.

Feinberg sees the parallels in his new assignment, but he keeps it in perspective. “9/11 was horrific,” he told me this fall. “This is just about money for executives.” We were sitting in his law firm’s Washington office across Pennsylvania Avenue from the Treasury Department. It is festooned with mementos from his service as chief of staff to Senator Edward Kennedy, with whom he maintained a strong, lifelong friendship. After he left Kennedy’s office, he began a law practice that blossomed into a specialty mediating cases where the stakes and emotions were high. On a coffee table is a framed, handwritten note that suggests that he is either miraculously successful at playing both sides, or that he has a special skill for getting people to let him find middle ground: “Ken: You served our nation with such class,” scribbled President George W. Bush.

Kenneth Feinberg’s mediating is a lifelong skill, according to his younger brother, David, who works in the Feinberg law firm. “Ken had this role that he always assumed when we were growing up of organizing a game of pickup stickball or basketball, and then being the one who chose the sides,” David Feinberg says. “Even when he was 9 or 10, he had this ability to make decisions that everyone accepted. . . . Everyone always thought he divided the teams into fair sides. He saw that as his assignment.”

Feinberg says that when he met with Treasury Secretary Timothy F. Geithner to discuss his new assignment, the secretary did not talk about avenging popular anger over executive pay abuses but instead stressed “the need to keep the seven companies in business so that the taxpayers could eventually get their money back.” But, Feinberg says, Geithner also “expressed the hope that . . . I could build in some new substantive criteria for compensation, such as prospective performance” as well as “low cash-based salaries . . . so that my work would have an impact well beyond the seven companies.” How could he do both? Political common sense might dictate that the last executives who should get excessive pay were executives at companies the government now partly owned, but business common sense seemed to dictate that because the government
owned them, these were the last companies the government should want to undercut with unilateral pay disarmament. And of course, the overwhelming political impulse across the country, as expressed by the legislators who wrote the law Feinberg was now supposed to enforce, was that Feinberg should ignore the companies’ doomsday scenarios of the talent fleeing because this was the “talent” that got the country into this mess in the first place.

Feinberg tackled the dilemma by deploying a doomsday scenario of his own to win over the TARP Seven: “I told them it wasn’t Citi or Bank of America or the others against me, it was Citi and me or B. of A. and me, against them” — “them” being the public.

“What I tried to make them understand,” he explained, “was that if I didn’t do something, the public would revolt, and Barney [Frank] would surely do something much more drastic that would endanger them and the whole system.” He underscored his point by recalling that soon after lavish bonus payments to A.I.G. executives were revealed in March 2009, the House passed legislation putting a 90 percent tax on any TARP-company bonuses.

Feinberg sat down with the TARP companies, one by one, well before the Aug. 14 deadline for submitting their compensation requests and laid out a series of guidelines that were his blueprint for injecting accountability, fairness and long-term thinking into executive compensation. The first principle was that there would be no guaranteed bonuses, and performance bonuses would have to be tied to metrics that combined both individual performance and the long-term performance of the company. He also ruled out perks worth more than $25,000 and deferred compensation plans (pseudo-retirement plans for executives that defer taxes and mask current payouts).

For base cash salaries, Feinberg suggested a sum that, on Wall Street, is considered piddling — typically no more than $500,000 a year. He also said there would be no cash bonuses. But he tempered that with a compromise: The firms could provide additional annual salary compensation if paid in company stock — stock that the executive would receive every payday but could not sell immediately.

This last provision came to be called “salarized stock.” It sounds like jargon only an M.B.A. could love, but it became a key element of the negotiations and a clever way for Feinberg and the bailed-out companies to work around a law passed in the early weeks of the Obama administration. Back in February, Senator Christopher Dodd, the Connecticut Democrat who is the chairman of the Senate Banking Committee, inserted what is now called the Dodd amendment into the President’s economic stimulus bill. A provision in that amendment limited any bonus compensation to 50 percent of the executive’s salary. This clause seems logical but has the potential to backfire. Rather than limit compensation or encourage pay-for-performance, it could encourage Wall Street executives to pay themselves higher, risk-free salaries so that their bonuses could then be higher.

Because Feinberg’s salarized stock would be dispensed every payday, it could therefore be considered salary under the Dodd amendment. But because executives would be prohibited from selling the stock right away, Feinberg was putting a long-term performance measure — the fluctuating value of the stock — into the equation. Thus, someone who in 2008 might have
earned a total of $3 million in cash and a cash bonus might now be offered $500,000 in cash salary and $2 million in salarized stock. The value of the stock would be calculated at its price when paid, but it could not be sold for two to four years. (The first third could be sold on the second anniversary of when it was earned, and each of the next two thirds a year and two years after that.) That would be a big cut in current, spendable cash, but much less of one when the stock’s value was considered; and it might turn out not to be a cut at all if the stock’s value increased (something that seems possible at some of the TARP Seven companies, especially Citigroup).

Feinberg laid out his proposals, but he also told the TARP Seven that he’d be open to their suggestions for fulfilling his mandate. This was a key part of his choreography. The 30 pages of regulations he was operating under used the empty word “appropriate” 32 times. This was an invitation to the TARP Seven to do their part of the dance, or as A.I.G.’s vice chairman, Anastasia Kelly, puts it, to follow “our board’s instructions to request what was needed.” What was needed would be articulated by people who see the issue in the following way, as expressed by one earnest Wall Street lawyer who worked on one of the proposals: “We really believe these industries provide real value to America — in jobs created, in raising capital, in making the system work,” he says. “If people in these industries — which are a main American export — see that Congress can jerk them around whenever they want, they’re going to stop going into these businesses, just the way people have stopped becoming doctors.”

The stage was set. These Aug. 14 proposals could shoot high, and Feinberg could cut them down, a lot, and look tough, while still giving these executives the millions that they said they could not live without.

WHERE EVERYONE IS ABOVE AVERAGE

And they did shoot high. To take a near-comic example, the firms did not present a single executive as meriting a pay grade below the 50th percentile of their supposed peer group, according to two people in Feinberg’s office. In fact, all 136 of the executives (the 25 top earners for each of the seven companies, less 39 who left during the year) were depicted as well above average, typically in the 75th percentile or higher. And the peer groups they were supposed to be in were often inflated; for example, someone running a unit might be portrayed as a chief executive because, the argument went, he ran a really big unit.

Beyond that, the proposals ran roughshod over the basic guidelines Feinberg had set. Bank of America’s pitch included salaries that far exceeded Feinberg’s stricture that cash be limited in most cases to about $500,000, and added huge amounts of salarized stock on top of that, so that the bank’s total compensation proposals were typically more than $10 million and ran to as much as $21 million. (J. Steele Alphin, Bank of America’s chief administrative officer, declined to comment on the bank’s submissions to Feinberg.)

Citigroup also proposed salaries in cash and stock far higher than instructed, and it ignored the guideline that salarized stock would have to be held for two to four years. It proposed that a third of it could be sold immediately. (Citigroup’s spokeswoman, Shannon Bell, said the bank did not want to comment on anything having to do with the Feinberg process.) Most of the other
companies proposed shorter holding periods, too. ("A lot of our folks have second and third homes and alimony payments and other obligations that require substantial current cash," said one banker, who insisted on anonymity because he did not want to attract any attention to his firm.) The two car companies also stretched or ignored some guidelines, but what was most jarring was the evidence that these manufacturers and Wall Street now exist in different universes: the stock awards proposed by G.M. and Chrysler were as low as $11,000 in G.M.’s case and $56,000 for Chrysler.

The TARP Seven deployed squadrons of blue-chip lawyers and compensation consultants to file their proposals. A.I.G. alone spent $3 million on two compensation consultants and two Wall Street law firms, according to A.I.G.’s vice chairman Kelly. (Of course, most of that money ultimately came from taxpayers, who now own 80 percent of A.I.G.) Not only did the high-priced talent hired by the seven companies typically ignore one or more of Feinberg’s basic guidelines, but many also failed to answer questions and complete various templates. A.I.G. tried to make up for its failings by tossing in an additional 167-page PowerPoint presentation, which was drafted by one consulting firm as part of its $500,000 fee, according to Kelly, to “provide a full picture.”

So why didn’t Feinberg — dubbed the all-powerful Wall Street pay czar in the press — send A.I.G.’s submission back as “noncompliant,” the way any bureaucrat would have? Better yet, why not project a new-sheriff-in-town image the way special prosecutors and others Washington czars typically do by leaking his smackdown to the press? “Sure, it bothered me,” says Feinberg, whose small, temporary staff works in one basement office. “But rather than get angry, we demanded, quietly, and received seven or eight supplemental submissions from them. The goal is to get it done.”

Once he got all his data, Feinberg could have simply pored over it and rendered his rulings, czarlike. Once again, he chose to be a mediator rather than an avenger. Armed with binders for each of the 136 employees whose pay was at issue, he and two or three aides began a series of discussions with representatives of the TARP Seven to hammer out deals.

“He’d tell us where he was coming out on an issue or on a person, and we’d push back a bit, and he’d push back,” recalls one lawyer for one company (who, like the other lawyers representing the TARP Seven who were interviewed, requested anonymity because he did not have his client’s permission to discuss the work). According to eight people who participated in these discussions, there was a rhythm to Feinberg’s method. His initial response to any question or comment, no matter how caustic, was typically that it was “perceptive” or “thoughtful.” (It’s a trick Feinberg uses on reporters and congressmen at hearings too.) And he would invariably sympathize with their complaints about his rules. But after a while a tougher side would emerge. He’d warn that they “just didn’t get it” — that to the rest of the world they were “living on another planet.”

THE BONUS ETHOS

To that “rest of the world,” the farthest-off planet was called A.I.G. Popular disgust with executives who took millions while their companies were being bailed out boiled over last
March, when it was revealed that A.I.G. had just paid $168 million in bonuses, including 73 payouts of $1 million or more, to employees in its Financial Products subsidiary. That’s the division whose wild trafficking in risky derivative products sank A.I.G. and, according to the Treasury Department and the Federal Reserve Bank of New York, could have crashed the global economy had the company not received some $180 billion in bailouts.

“I have never seen the public angrier about anything than when the stuff about the A.I.G. bonuses came out,” Barney Frank, who has been an elected official for 36 years, says. “I think the country snapped. . . . This was not like Vietnam or Iraq, where there was a split. Everyone was united on this.”

While it’s understandable that the A.I.G. bonuses fueled that firestorm, there’s an argument that they were not as outrageous as they seemed, and that they were not even bonuses. I’m going to let a friend — a longtime A.I.G. employee who received one of the multimillion dollar payouts — make the case. It’s worth considering if only to understand the distance between Wall Street and Main Street.

My friend (who did not want his name used because, he says, “being associated with A.I.G. is not safe for my family”) is a mild-mannered math whiz who worked at a unit of A.I.G. Financial Products that, he says, had nothing to do with the small London-based credit-default-swaps group that sank the company. Over the last half-decade, he made millions every year from a bonus pool composed of the profits supposedly made by Financial Products. But he had to leave roughly half of his bonuses in the pool for five years so that the payouts could be adjusted for any subsequent gains or losses from Financial Products’ trades. (That’s an extreme version of what’s called a “claw back,” another reform that Feinberg’s guidelines would require.) When the credit-default-swaps unit went bust, he personally lost tens of millions in that pool. (Which would also mean that he took home tens of millions over those five years.)

He says his salary barely changed once he reached a senior level at A.I.G. Financial Products, but that it didn’t matter after a while, because “by the end it was a tiny portion of my earnings” — meaning his bonus, which grew to millions a year, represented most of his pay.

In early 2008, he and his colleagues were offered “retention contracts,” he says, because it was becoming clear that “one business within our firm had issues that could kill the entire bonus pool. . . . They needed us to stay, because we were still making them lots of money, and we had the kind of business we could take to any competitor or, if they wanted, that we could wind down profitably.” Thus, the retention agreement, which was actually a contract, not literally a bonus payment, guaranteed that in 2008 and 2009 he would make 75 percent of what he had made in 2007 regardless of the amount of the bonus pool for those years, and that he would be paid those bonuses in March 2009 and 2010 (for work done in 2008 and 2009).

“Why should I simply walk away from a contract?” he now argues. “I earned that money, and I had nothing to do with all of the bad things that happened at A.I.G.”

By getting a guarantee of 75 percent of his take from a 2007 bonus pool that was drastically inflated because it included what we now know to be nonexistent profits attributed to the
London-based credit-default swaps, he’d no doubt be getting more than he actually “earned.” But he did keep his part of the bargain, and every lawyer who has looked at these contracts agrees that they are enforceable. Still, last March he and most of his colleagues orally pledged to return the bonuses after Attorney General Andrew Cuomo of New York threatened to name them and after, in the case of some whose names had already been revealed, they were scared by camera crews camping on their front lawns and even a bus full of angry citizens riding by their homes. All but two have since reneged on those pledges, saying they were made under duress.

“The people who make these companies go work really hard,” adds one of my friend’s former colleagues. “They think: I’m making lots of money to support my family, but I’m not with my family. I can’t go to the soccer games or the dance recitals. Stop paying them well, and they’ll leave.”

Senator Dodd has a sharp retort when I asked him about that warning: “Oh, that’s very patriotic. What do I tell a guy who worked in an auto dealership in Bridgeport — who can now go to all of his kid’s soccer games, because he’s lost his job and his health insurance and his 401(k)?”

That Dodd led the attacks on A.I.G. when what came to be called the retention bonuses were revealed infuriates my A.I.G. friend. He says that his boss asked everyone at A.I.G. Financial Products “to contribute the maximum to Dodd, because he was so important in Washington in terms of regulating the products we sell.” My friend went on to say: “Before he attacked us, Dodd was in our office” — in Wilton, Conn. — “giving a speech telling us how great we were. And our checks were in envelopes stacked up right there.”

Federal Election Commission filings show 31 maximum $2,100 contributions to Dodd during the last quarter of 2006 from employees of A.I.G. Financial Products. My friend’s former boss, A.I.G. Financial Products’ head, Joseph Cassano, who is listed as giving $2,100, did not return calls to his home, nor did his lawyer return calls seeking comment.

Asked about the event, and about checks stacked on a table, Dodd said: “Yes, it happened. I remember having a fund-raiser there. . . . I can’t finance my own campaigns. I have to raise money,” he added. “But what does this guy think? That if they give me money I have to do what they want me to do? That tells you something about them.”

A.I.G.’S STOCK: REAL OR PHANTOM?

Feinberg consulted regularly with Deputy Treasury Secretary Neal Wolin and others at Treasury, Wolin says, though he met with Geithner only three times. “We pushed back with him on some issues,” Wolin recalls, referring to Treasury’s desire to make sure that the companies would be able keep talented employees — and eventually repay the government. Wolin says that he, not Feinberg, communicated with the White House, providing Rahm Emanuel, the chief of staff, and the economic adviser Larry Summers with what Wolin calls an occasional “heads up on scheduling, nothing about substantive decisions. . . . The secretary basically gave this job to Ken.”
At the negotiating table, Feinberg certainly didn’t stress that independence, let alone make it clear that whatever pressure he was getting from the administration was to go easier on the companies. “Feinberg has told everyone that he got no pressure from anyone, but that’s not what he told us,” says a TARP Seven lawyer who participated in the negotiations. “I’d make a case for one of my guys getting x, and he’d say: ‘You’re being too reasonable. The people who I have to worry about are not reasonable. They’re worried about politics and the fallout. . . . They think you should get zero.’ And he’d point to the White House, and then he’d point up to Capitol Hill. . . . He tried to make it seem like his job was to be the mediator between zero and getting us what we wanted.”

On the surface, Feinberg seems to have met them more than halfway. His overall awards were, on average, about 60 percent of what the TARP Seven requested in total compensation. Yet, according to Jeffrey Sonnenfeld, associate dean at Yale School of Management, the structure of the packages “was a radical departure from perverse executive compensation as we know it,” making them worth far less in present value than what the TARP Seven requested. Sonnenfeld cites not only Feinberg’s crisp rules that do away with camouflaged payment, like perks and deferred compensation, but also the way so much of the compensation — the salarized stock, which was typically more than 80 percent of these packages — is delayed and depends on long-term results.

When it came to A.I.G., however, Feinberg’s push for long-term accountability was met with what Feinberg calls “intense pressure” from officials at the Treasury Department and from the Federal Reserve Bank of New York, which had provided most of the A.I.G. bailout, to make accommodations for the firms whose perceived extravagance had created his job in the first place. First, there were those cash retention bonuses, which 8 of the 12 A.I.G. executives now under Feinberg’s purview received in 2009. Feinberg pushed to have the executives return the money and replace it with salarized stock. They all refused, even those who had pledged to give the bonuses back altogether. Among those who insisted on keeping the cash was David Herzog, A.I.G.’s chief financial officer, whose bonus was $1.5 million. He and the others told Feinberg, through A.I.G.’s vice chairman Anastasia Kelly, that if they didn’t get to keep that bonus, plus get additional bonuses for work in 2009, they would leave, which would grievously imperil the company. No one at A.I.G. seemed to be embarrassed to argue that the chief financial officer of Wall Street’s Titanic was irreplaceable. (Herzog declined to be interviewed.)

Second, and more important, those top executives at A.I.G. who hadn’t received the retention bonuses refused to accept the salarized stock as part of their pay packages. They wanted all cash. A.I.G.’s Kelly told Feinberg that their position was that A.I.G.’s stock — which was trading in the late summer and fall at around $40 — was, in a word that Feinberg says he remembers vividly, “worthless.” Kelly explained A.I.G.’s position this way: “We wanted compensation for people at A.I.G. that they would see value in.”

Feinberg dug in, insisting that every executive at every other company was going to get the majority of his or her annual salary paid in the company’s stock, and that these stocks, too, were hardly safe bets. In fact, that was the point of paying them with the stock — to get them to share risk with the company’s owners.
Officials at Treasury weighed in on A.I.G.’s side, according to Feinberg. Herbert M. Allison, the assistant secretary for financial stability, and the official to whom Feinberg reported day to day, confirms pressing Feinberg to consider, he recalls, “the fact that we were dealing with a highly volatile stock that seemed to the employees to have a less than reliable value.”

The regulations establishing his office say that Feinberg can be removed by Treasury Secretary Geithner at any time for any reason. Of course, his removal for being too lenient was unlikely. And Feinberg takes pride in not being a spoilsport. He often talks about how he, a Ted Kennedy man, was able to pay the 9/11 victims well (and even help survivors who were asserting rights as the gay partners of victims) without getting into a fight with John Ashcroft. Besides, as he constantly reminded himself and his staff, his job was to find that middle ground between compensation reform and, as the regulations put it, paying enough “to retain and recruit talented employees . . . so that the company will ultimately be able to repay its TARP obligations.”

Feinberg says Allison’s office told him to consult officials at the Federal Reserve Bank of New York. Those at the Fed were even more insistent that Feinberg make exceptions for A.I.G., according to Feinberg and to a senior official at the New York Fed who refused to be named because of a policy that no official can speak on the record about these matters.

The New York Fed is a Wall Street institution whose officials, perhaps more than any others on the public payroll, inhabit the world of Wall Street bankers and lawyers. (For example, the law firm advising Citigroup and General Motors in the Feinberg negotiations — Davis Polk & Wardwell — is also counseling the New York Fed on TARP matters related to A.I.G., at rates of $305 to $1,055 per hour, according to the retainer agreement.) In a little-noticed section of a report he issued in October, Neil Barofsky, the Treasury Department’s TARP inspector general, wrote that the New York Fed actually worked with A.I.G. after its 2008 bailout to set up another generous bonus arrangement for other A.I.G. executives. (Geithner was president of the New York Fed at the time, but he has said he did not become aware of the details of the A.I.G. bonus plans until March 2009, by which time he was at Treasury.) That Fed-blessed bonus plan nearly mirrored the 75-percent guarantee of 2007 bonuses that ignited the firestorm over compensation in the first place.

As the standoff over the A.I.G. stock continued, a New York Fed official told Feinberg that the Fed had done its own analysis of the stock and concluded that with all the bailout debt and other obligations, the common stock was, indeed, worthless, according to Feinberg and one person at Treasury who worked on the matter but was not authorized to speak. (Asked if they had done this analysis, Jack Gutt, a New York Fed spokesman, said that Fed officials would “not speak on the record about that or anything to do with these issues.”)

Finally, a compromise was suggested that Feinberg agreed to: The A.I.G. executives would get a form of “phantom” salarized stock that would reflect the value of only four A.I.G. operating units that made money and had not been part of the company’s downfall — according to a formula to be worked out by the Fed and A.I.G. Moreover, the phantom stock would not reflect the $180 billion dollars in loans and purchases of preferred stock that the taxpayers had extended and that had to be paid back, nor any losses at other A.I.G. units. This seemed a reasonable way to create, in Kelly’s words, a stock that her people would see value in. But it does present the paradox of
the top executives of a company, including its chief financial officer, declaring behind closed
doors that its real stock is worthless to its employees — with the Treasury Department and
Federal Reserve Bank agreeing — even as the rest of the world is buying and selling it for $40 or
$50. (As of last week the stock was trading at about $29, a decline largely attributed in the
business press to the growing realization that A.I.G.’s overall equity value was, indeed, unlikely
ever to exceed its debt to the government.)

Thus, the A.I.G. executives who hadn’t received the cash retention bonuses got cash salaries of
$450,000 and between $3 million and $4 million in this phantom salarized stock. As for Herzog,
the chief financial officer, and the seven other A.I.G. executives who took the 2009 cash
retention bonuses and wouldn’t give them back, Feinberg pointedly gave them cash salaries
ranging from $100,000 to $450,000 and nothing else.

MANAGING EXPECTATIONS

Seen simply through a business lens, the Fed and Treasury people were arguably right to restrain
Feinberg. Why obsess over $20 million or $30 million in extra payouts at businesses that have
billions in other expenses and where the government had billions at risk? What if some of those
people really did leave? Even if replacing them would just cause a hiccup or two, the risk wasn’t
worth it.

But Feinberg did not see the issues involved in isolation from what Barney Frank calls
“maintaining the public’s confidence in our capacity to govern.” In fact, as Feinberg began
planning to release his decisions on Oct. 22, his principal fear, he told me, was that despite the
cuts in compensation he had made and despite his reliance on measurements of long-term
performance, giving out millions to each of these executives would generate a new wave of
public anger. So he approached the drafting of the decisions, which would be released publicly,
as more of a political challenge than a regulatory exercise, making sure that each decision first
recounted in detail what the company had initially requested and then outlined all the ways he
was ruling against them. There was no hint of the multiple discussions that took place after the
proposals were filed — after which most companies amended their demands and ultimately, if
grudgingly, came to terms with the decisions Feinberg was going to render. “Only mentioning
our original proposals and then knocking them down was really clever,” one bank negotiator
says.

Accompanying the rulings was a Treasury Department press release that led to headlines
heralding the czar’s crackdown. The release highlighted how much Feinberg had cut cash
salaries from the year before (more than 90 percent in the case of some of the companies, but
that was because the millions in salarized stock did not count as “cash”), as well as total
compensation (more than 50 percent in some cases). Of course, 2008 was the year the firms had
all gorged on bonuses and perks as if there had been no crash, so the bar for prudence was hardly
high.

Whatever the limits of the work Feinberg had done, the dance was so well staged that Feinberg’s
decisions conveyed a story line destined to play well on Main Street: masters of the universe
reduced to opening the czar’s envelope to find out how much, or little, was inside. Bank of
America — whose executives had been awarded an average of $6.5 million by Feinberg in total compensation — complained mildly to the press that there would now be a talent drain, but by early December the bank announced that its profits had bounced back so quickly that it was repaying its TARP loans. It would be out from under Feinberg’s thumb by early 2010. A.I.G.’s often-tempestuous C.E.O., Robert Benmosche (who joined the company only in late August), was quoted in The Wall Street Journal on Nov. 11 as having told his board that he was ready to quit because Feinberg was crippling his ability to keep talent. But Benmosche issued a statement later that day that he was not quitting. None of the other TARP Seven complained at all, although Citigroup began a frantic effort to pay back its TARP money, too.

On Capitol Hill, Representative Darrell Issa of California reflected the views of fellow Republicans. While complaining that “the idea that private enterprise should lead to all the reward one can earn is unfortunately not shared by every member of Congress,” he allowed that “given Feinberg’s mandate, it’s hard not to give him a high grade.” Across the aisle, the most rabid critics of Wall Street among the Democrats praised Feinberg, even as he was awarding millions to the bailed-out executives. And although Feinberg described the A.I.G. phantom-stock provision in his ruling, no one seemed to notice or care how he had accommodated the A.I.G. executives.

In December, as this article was being prepared, A.I.G. formally requested Feinberg’s permission to have the option “in appropriate cases” to go back to taking common stock instead of the phantom stock. At that point, A.I.G. officials knew that they were going to be quoted as having taken the position through the summer and fall that the A.I.G. stock didn’t have any value to its employees. Feinberg, of course, agreed to A.I.G.’s request, although it appears from Feinberg’s decision that A.I.G. did not commit to the shift back to the common stock.

By mid-December, Feinberg had finished his second exercise — setting pay structures and principles (but not specific amounts) for the 26th through 100th top earners at each of the TARP firms. As with the highest earners, he ruled that at least 50 percent of any compensation must be in stock that cannot be sold immediately, and that cash salaries should generally not be more than $500,000. He has again forbidden payments that create incentives for risk (like paying people for the simple dollar volume of derivatives they sell), while nixing perks over $25,000 and other extras.

Now he’s on to deciding specific pay packages for 2010 for the top 25 executives at the shrinking list of companies left under his control. A.I.G. is once again his toughest customer. Those who got the reviled cash retention bonuses last year are due — under those contracts — to get the same bonuses this March. Feinberg still can’t stop the payments, but he has been threatening to pay those executives practically nothing, as he did this year, if they take the bonuses instead of agreeing to roll them into stock.

“If he tries that a second year, these guys are just going to start to come in late and leave work early,” says one of the people representing A.I.G. in the Feinberg process. “They’ll quietly look for other jobs. And six months or nine months from now they’ll be gone. Why should they stay? They’re already millionaires. Do you think a hundred- or two-hundred-thousand-dollar salary means anything to them?”
Which brings us back to Main Street, where a hundred thousand dollars means a lot, and where the public’s fury is already building once again because big banks that are not beholden to Feinberg are cashing in as never before. Frank says he thinks the A.I.G. executives are not irreplaceable and are probably bluffing about leaving anyway. “Let’s see how many are really gone in six months,” he says. Certainly, the bluff is not alien to the Wall Street deal culture.

“My philosophical lodestone,” Frank concludes, “is Henny Youngman. When someone asked him, ‘How’s your wife,’ he said, ‘Compared to what?’ Ask me how Feinberg did, and I say, ‘Compared to what?’ He inherited a structure, and he did a good job with it.”

INCITING CORPORATE BOARDS

Will Feinberg’s work become a model for changing that structure? He has said he would like for that to happen, and the Federal Reserve Bank has announced that it will soon require all major banks to abide by structural guidelines intended to assure that executives are compensated based on performance and that they are not given incentives to take undue risk. European regulators have been talking tough, too. And Goldman Sachs has already mimicked the centerpiece of Feinberg’s new pay structure by dispensing all bonuses to its top people in stock that must be held for five years. That structure, rather than the actual amounts he awarded, could be Feinberg’s lasting contribution — but only if its influence spreads beyond the corporate boardrooms that have been temporarily in the public spotlight.

“The boards of these companies just don’t have an arm’s-length relationship with these executives,” says Lucian Bebchuk, a Harvard Law School expert on executive compensation who advised Feinberg. Board members are frequently executives or board members at other big corporations, Bebchuk explains, and therefore are likely to be steeped in the same entitlement culture. Indeed, they are lavishly paid, too; in 2008, A.I.G. board members earned an average of about $300,000 for their work in 2007, the year when apparently unsupervised trading in toxic financial products destroyed the company.

“No director wants to be the skunk at the garden party,” says Sonnenfeld, the Yale Management School associate dean. “And the headhunters, whose compensation, by the way, is based on how much executives make, won’t pick them for boards if they’re going to be dissenters.”

Prof. Jonathan Macey of Yale Law School, who has written widely about how government efforts to regulate pay have backfired, agrees that the boards are the only route to real change. “What I object to about the process Feinberg engaged in,” he says, “is the pretense that he can develop some superior system. . . . It’s not that people in charge don’t know how; it’s that they don’t want to.”

Feinberg made progress “threading the needle between competing interests,” as Wolin, the deputy Treasury secretary, puts it. However limited his special-master assignment, his willingness to dive into the details and then doggedly pursue a compromise, plus his political savvy in selling it, improved the pay structure at the seven companies and produced an important structural template for others. In paying more than $6 million on average to the top executives at Citigroup and Bank of America, he certainly wasn’t as tough as Main Street would have liked
him to be (or thought he was). Yet he was tough enough to get the two banks scurrying to pay back the TARP money in order to get out from under him.

But the larger issue isn’t whether we should admire Feinberg for finessing his way to a middle ground or jeer him for not throwing down the gauntlet. Rather, the clearest lesson that has emerged so far from his nine months of tortured choreography is that if it’s this hard to inject even a limited measure of common sense into the way executives are paid at companies that taxpayers partly own and control, broader change requires a boardroom upheaval.

Even if the government should not regulate executive pay directly in a free market, regulators could force the kind of transparency that would not only help shareholders control their boards but would also unleash some of what Frank calls “the power of embarrassment.” One idea would be to require that all public companies publish a chart each year showing the total annual income of its highest-paid executive and of a worker earning the median income, as well as the ratio between the two amounts. Perhaps boards might get some gumption once the press starts publishing tables comparing pay-gap ratios at hundreds of well-known companies.

As for more tangible reform, Warren Buffett has written that pension funds and other big institutional shareholders are the key, because they have the expertise and power, if they choose to use it, to influence the boards of the companies they own. Perhaps these powerful shareholders should give Feinberg another assignment. This time, the job would not be to find a compromise between satisfying the masses and mollifying executives at a few failed companies, but to coax the hundreds of boards that lack Buffett’s common sense or fortitude into different behavior. The big institutional investors could join together and ask Feinberg to adapt his TARP decisions into a set of more widely applicable rules and then demand that the boards in whose companies they have invested explain when they veer from those rules. They might even ask Feinberg to set up a service where he could issue advisory rulings for them. After all, a man who can persuade pickup stickball players, populist congressmen and, in most cases, corporate titans that he does a smart, fair job of playing it down the middle might be able to improve on a system that everyone except those cashing the checks seems to think is a mess.

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