

BAILOUTS AND BONUSES ON WALL STREET

“They want Wall Street to pay...They think we’re overpaid assholes.”¹
Jamie Dimon, CEO JP Morgan Chase

The \$100-Million-Dollar Problem

Matt, a top level executive at Goldman Sachs, never figured that how he paid his employees would be one of his most pressing issues—not after having watched his entire industry turned on its head for the past two years and the world economy shaken to its core. But as of January 2010, all that was on Matt’s mind was how to deal with his own group of highly paid traders who had been promised generous compensation packages and had made Goldman Sachs between \$1.5 – \$3.0B in 2008 and 2009.

Matt knew the financial services industry was still stinging from a seemingly outrageous pay package bestowed upon an individual at Citigroup—a trader who became known as the \$100-Million-Dollar-Man. This commodities trader received a \$100 million bonus just a few months previous based on his contract with the company; he had earned Citigroup \$2 billion with bets against the oil market and contractually was owed the money. Citigroup, however, had received \$45 billion in taxpayer funds and, at the time of the bonus payments, had yet to pay back the funds to the US government. As word leaked out to the press, calls for pay reform reverberated throughout the industry.²

In the midst of a recession, this pay problem was industry-wide, and executives like Matt were dealing with the same issue: how big should employee paychecks be?³ Matt needed to make a decision about how to pay *his* employees and was not sure how to factor in the industry and economic public perceptions. His task was difficult. On one hand, Matt had to pay his eight employees a total of \$125M owed under contract, yet Goldman Sachs had received more than \$10B in taxpayer aid from a federal bailout. In addition, this particular trading group played an unusual role in the financial crisis due to its relationship with AIG Financial Products (FP) group—considered by many to be the epicenter of the crisis.

¹ Andrew Ross Sorkin, *Too Big to Fail* (New York: Viking Penguin, 2009), 335.

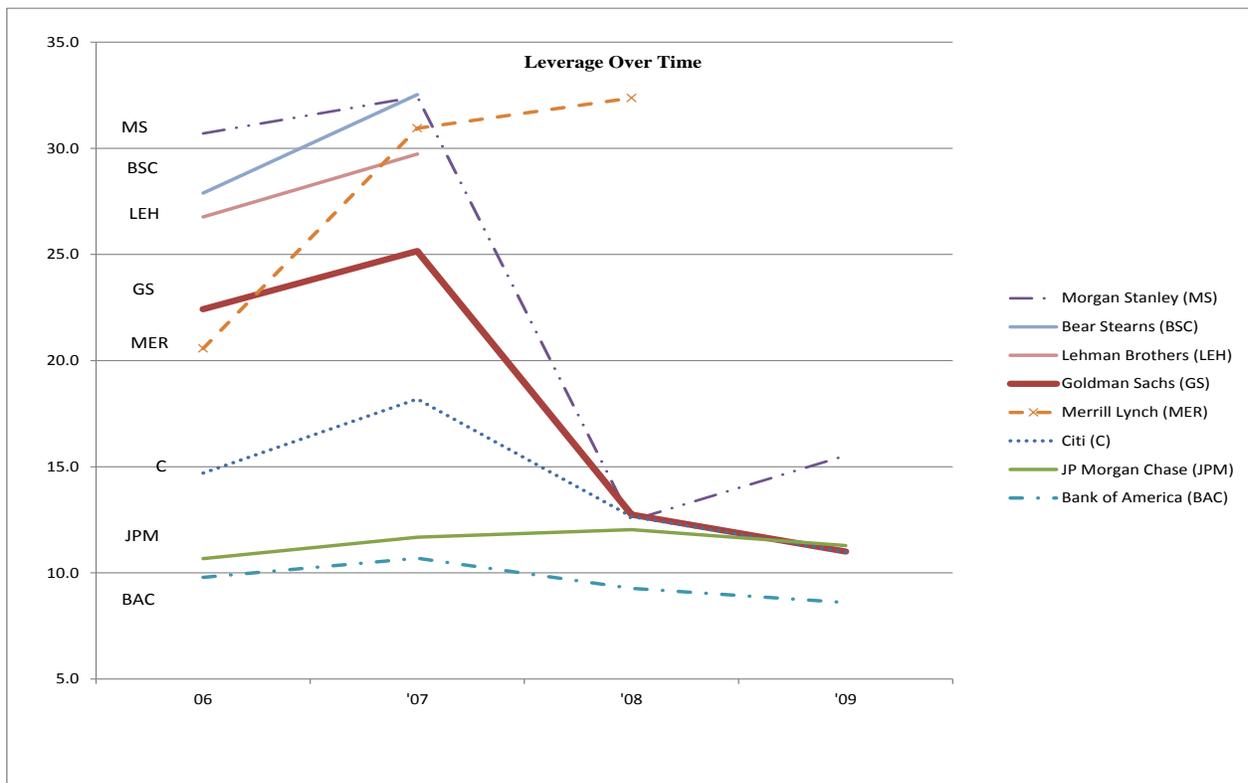
² David Segal, “\$100 Million Payday Poses Problem for Pay Czar,” *The New York Times*, 1 August 2009.

³ Louise Story and Eric Dash, “Banks Prepare for Big Bonuses, and Public Wrath,” *The New York Times*, 9 January 2010.

Financial Crisis

Compensation decisions within the financial industry had become a public debate in the wake of one of the worst financial crises to ravage Wall Street and send the rest of the global economy into a downward spiral. A combination of factors such as a lack of liquidity, overleveraged balance sheets, and a heavy reliance on financial instruments tied to the housing markets, also known as *mortgage-backed securities*, created a domino effect within the financial industry. When these mortgage-backed securities dropped in value due to the collapse of the housing bubble, the over-extended Wall Street firms could not absorb the loss in asset value and increase in short term liabilities. See **Figure 1** for leverage over time.

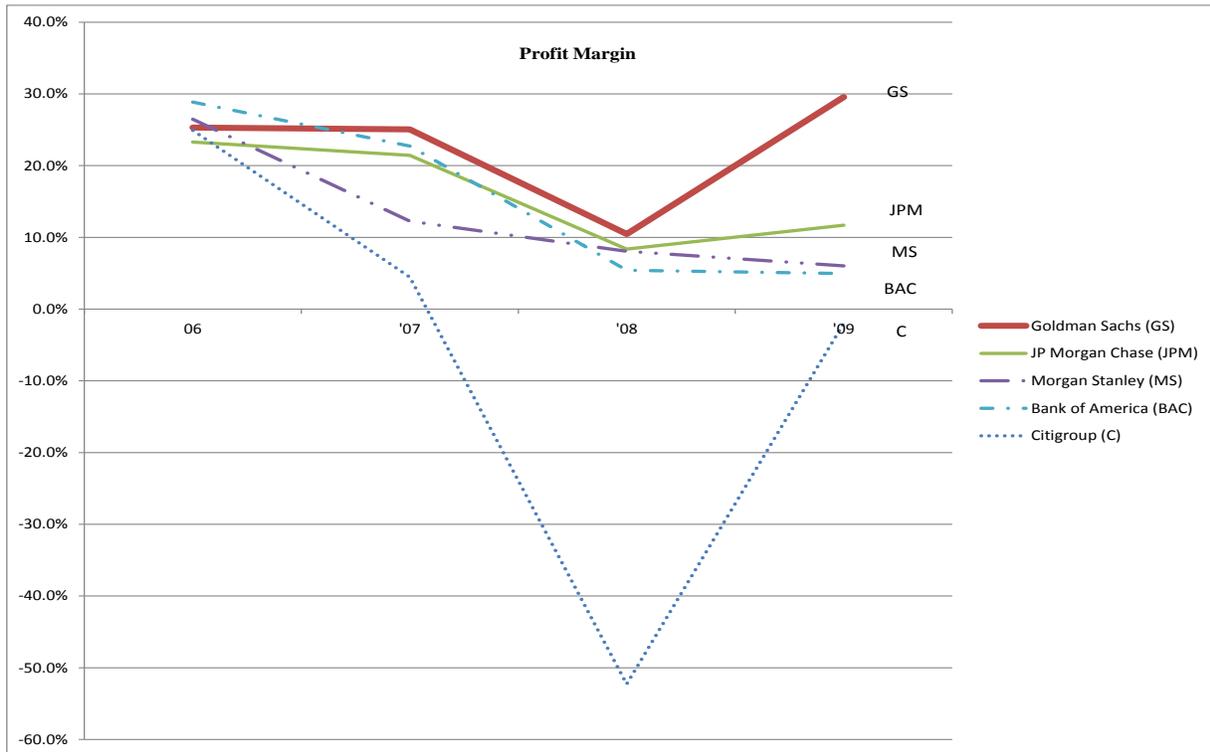
Figure 1. Leverage.



As banks took major write-downs of the assets on their books due to their huge stakes on the housing market, concerns spread over whether certain banks could remain solvent. The first domino to fall was that of investment bank Bear Stearns. Only a year after its stock was trading at \$133 per share, Bear Stearns was forced to sell to JP Morgan Chase in March 2008, at \$2 per share,⁴ due to a lack of investor confidence in Bear's ability to cover obligations it held with its trading partners. See **Figure 2** for profit margin.

⁴ Eventually was negotiated to \$10/share.

Figure 2. Profit margin.



Key to this transaction was that the federal government had stepped in to guarantee up to \$30 billion of Bear Stearns’ assets. This action set a precedent wherein the US government—in the form of the Federal Reserve, the Treasury Department, and eventually the US Congress—acted to bail out banks and securities firms. Some banks would survive with the help of the government, whereas others would collapse due to a lack of government assistance.⁵

One of the major players in the financial crisis was insurance giant American International Group (AIG).⁶ One of its products—the credit default swap (CDS)⁷—was an insurance contract (or bet) on the value of bonds based on subprime mortgages.⁸ It was sold by AIG’s FP group.⁹ The CDS market looked particularly attractive because the underlying bonds

⁵ Peter J. Solomon, “Another View: Unintended Consequences on Wall St.,” *The New York Times*, 19 November 2009.

⁶ David Segal, “\$100 Million Payday Poses Problem for Pay Czar,” *The New York Times*, 1 August 2009.

⁷ Some felt that the credit default swap not only insured against the underlying mortgage backed securities, but the CDS actually created and spread the subprime housing crisis by creating a demand for collateralized debt obligations, which, in turn, increased demand for the underlying subprime mortgages.

⁸ A CDO—collateralized debt obligation—is a pyramid structure with levels of debt with stair-step credit ratings and associated yields. Some levels are of higher quality with a lower risk of default. Other levels are of lower quality with higher risk of default. Problems arose when companies did not hedge their bets on CDOs sufficiently in the event that they lost value. Even those firms who did buy ‘insurance’ against the possibility of loss in CDO value – the purchase of credit default swaps (CDSs) – were in trouble. AIG and other issuers of CDSs did not put aside enough cash in the event that they needed to pay out on such ‘insurance’ claims.⁸

⁹ Adam Davidson, “How AIG Fell Apart,” *Reuters*, 18 September 2008.

historically did not go bankrupt. Companies such as AIG that sold CDSs were able to profit by selling the swaps and collecting premiums, with a low risk of pay out on claims.¹⁰ Problems arose when homeowners began defaulting on their subprime mortgages and all the bonds associated with mortgage-backed securities fell in value. AIG had sold CDSs that insured more than \$440B in bonds, yet AIG did not have the assets to back these risky swaps or insurance policies. AIG FP had taken on responsibility for \$20B in mortgage bonds through deals with Goldman Sachs' trading desk alone.¹¹ Customers, trading partners, and credit rating agencies lost faith in AIG's ability to cover its promises.¹² The federal government then stepped in to bailout AIG on September 17, 2008, by extending an emergency \$85 billion line of credit to the company.¹³

On October 3, 2008, Congress set aside over \$700B to invest in the US economy through the Troubled Asset Relief Program (TARP). CEOs from nine banks—JP Morgan Chase, Goldman Sachs, Bank of America, Merrill Lynch, Morgan Stanley, Citigroup, Wells Fargo, State Street, and Bank of New York Mellon—were called to a meeting on Monday, October 13, 2008, and told they each would be taking between \$10B and \$25B in government assistance in the form of TARP funds. This original TARP proposal was written on three pages with no requirements on capital, leverage, compensation, or profit-sharing for those receiving the money.¹⁴ All banks were expected to take money no matter how financially solvent they believed themselves to be. See **Appendix** for detailed breakdown of companies receiving TARP funds.

TARP had in effect stabilized the economy, but when Wall Street's 'bonus season' came around only four months later in the spring of 2009, AIG was ready to hand its employees a total of \$165M in bonuses, including those in its Financial Products division—the largest recipient of taxpayer money and the same division that sold the credit default swaps that every other financial institution relied upon to 'insure' its collateralized debt obligation (CDO). When the underlying assets—those subprime mortgages—first fell in value in 2008, AIG's trading in credit-default swaps began to cost the company billions of dollars. AIG offered its FP employees more than \$400 million in retention pay, with lump sums due in March 2009 and March 2010.¹⁵ See **Exhibit 1** for a timeline of financial activities.

When AIG's retention bonus plan became public in March 2009, President Obama vowed to "pursue every single legal avenue to block" the bonuses, and lawmakers backed a bill that would have taxed the payments to Financial Products' employees at 90%.¹⁶ The New York Attorney General threatened to publicize the recipients' names, thus prompting executives at AIG FP to hastily agree to return about \$45 million in bonuses by the end of 2009.¹⁷ Matt's

¹⁰ Adam Davidson, 18 September 2008.

¹¹ Michael Lewis, *The Big Short*, (New York: W.W. Norton and Company, 2010), 72.

¹² Adam Davidson, 18 September 2008.

¹³ Kirk Shinkle, "AIG: The Biggest Bailout," *US News and World Report*, 17 September 2008.

¹⁴ Stephen Castle and Katrin Bennhold, "European Bank President Joins Critics of Bonuses," *The New York Times*, 12 December 2009.

¹⁵ Brady Dennis, "AIG Plans to Pay \$100 Million in Another Round of Bonuses," *The Washington Post*, 3 February 2010.

¹⁶ Brady Dennis, "AIG Executives' Promises to Return Bonuses Have Gone Largely Unfulfilled," *The Washington Post*, 23 December 2009.

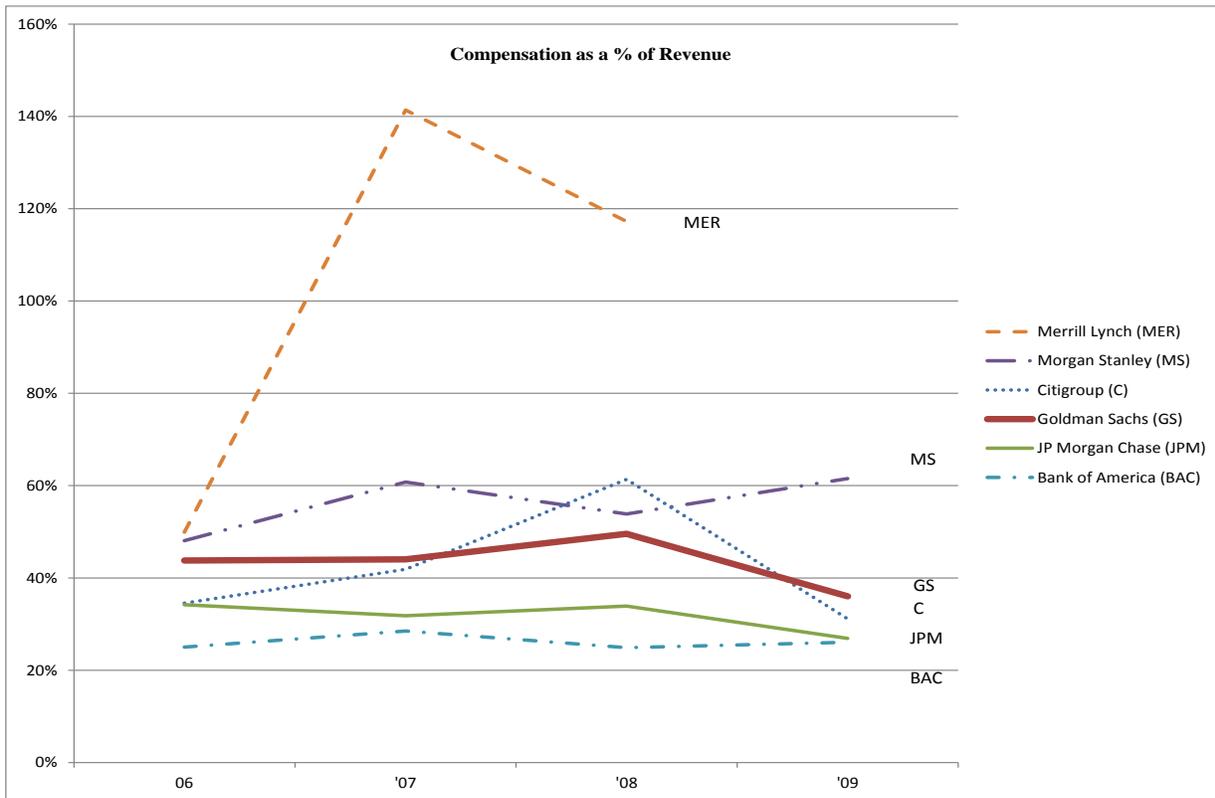
¹⁷ Brady Dennis, 23 December 2009.

decision to pay his employees was increasingly complicated by these two highly publicized scandals: the \$100-Million-Man at Citigroup and the AIG FP bonuses.

Compensation in Financial Services

Wall Street executives and employees have historically been awarded a mix of stock and cash bonuses as a percent of revenue. Prior to the financial crisis, however, bonuses had become cash heavy—compensation was not tied to the long-term performance of the companies, and executives were able to walk away from a company at any time. Since the financial crisis, companies began to shift the focus of their bonuses to stock with provisions to prevent executives from the option of quickly selling their shares.¹⁸ An emphasis on bonuses rather than salary was not new for Wall Street, where the bulk of bankers’ and traders’ pay was tied up in year-end performance bonuses. See **Figure 3** for Wall Street compensation history.

Figure 3. Compensation.



Government assistance to the financial industry opened the door to public scrutiny on pay practices that had gone unchallenged for decades. But both the role of the financial industry in the larger economy and the structure of financial organizations had changed. First, the financial industry became a larger part of the overall economy. From 1929 through 1988, financial

¹⁸ Louise Story, “Takeouts: College Football, Wall St. Pay, Listeners on Religion,” The Take Away (WNYC Radio), 9 November 2009.

industry profits averaged 1.2% of GDP. Starting in the 1990s, however, profits increased rapidly and peaked at 3.3% of GDP in 2005.¹⁹ In addition, the industry was more concentrated: the 10 largest financial institutions had 10% of financial assets in the United States in 1990, yet in 2009, the top 10 institutions owned over 60% of the US financial assets.²⁰

Finally, the structure of the organizations changed. Until the 1970s, many Wall Street firms were private partnerships, where the partners' capital supported the firms' operations, and compensation was a form of profit sharing. Profits from firm activities were divided at year-end among the partners of the firm as a percent of revenue. As such, compensation was a negotiation among partners and generally tracked the amount of ownership in the firm and the ability of a partner to add value to the firm.²¹ When many financial firms went public—including the companies at the center of the financial crisis—the compensation structure did not change. Executives were still paid as if they were in a partnership without the same risk profile. Some were concerned that the rewards were out of balance with the risk. According to Peter J. Solomon Company's founder and chairman, "If securities traders could lose their capital as well as their income, the public might be less upset about their gains."²²

Banks' Post-Crisis Activities

The landscape of Wall Street was completely changed, from the largest profits ever in the fall of 2007, to the lows in March of 2009. Lehman Brothers, Bear Stearns, and Merrill Lynch—all once staples of a thriving sector—were either liquidated or sold at depressed prices. The surviving players on Wall Street included Goldman Sachs, Morgan Stanley, Bank of America, JP Morgan Chase, and Citigroup. All received aid from the Troubled Asset Relief Program (TARP), and as of January 2010, only Citigroup had yet to repay its bailout funds.

These Wall Street survivors saw a revival in revenue and profitability in 2009. During the first nine months of 2009, five of the largest banks that had received federal aid—Citigroup, Bank of America, Goldman Sachs, JPMorgan Chase, and Morgan Stanley—together set aside \$90 billion for compensation. That figure included salaries, benefits, and bonuses, but at several companies, bonuses made up more than half of compensation.²³ While average bonuses for the industry were expected to be around half a million dollars for 2009, the amount was not evenly distributed throughout the companies. Bond and currency traders, as well as investment bankers, received a disproportionate amount of the bonuses.²⁴ Surprising to many, the traders making the most money were not at hedge funds but rather at the investment banks—firms who received

¹⁹ Floyd Norris, "To Rein In Pay, Rein In Wall St.," *The New York Times*, 29 October 2009.

²⁰ Floyd Norris, 29 October 2009.

²¹ Peter J. Solomon, "Another View: Unintended Consequences on Wall St.," *The New York Times*, 19 November 2009.

²² Peter J. Solomon, 19 November 2009.

²³ Louise Story and Eric Dash, 9 January 2010.

²⁴ Louise Story and Eric Dash, 9 January 2010.

TARP money and were not considered traditional places for trading activity.²⁵ See **Exhibit 2** for a breakdown of the financial results of each bank.

Public and Government Reactions to Bonuses

On May 20, 2009, President Obama signed the Fraud Enforcement and Recovery Act of 2009, creating the Financial Crisis Inquiry Commission (FCIC). The Commission was established to “examine the causes, domestic and global, of the current financial and economic crisis in the United States”²⁶ and report the findings to the President, to Congress, and to the American people. In addition, “Pay Czar” Ken Feinberg was named Special Master for TARP executive compensation for those firms that had not paid back TARP funds. Feinberg determined the compensation for the top 30 executives at those firms.

Even with additional controls, a tremendous amount of public backlash against Wall Street over the ‘bonus culture’ persisted. One school of thought was that bonuses themselves led to the meltdown of the global financial system. Because executive pay was tied to short-term success, excessive risks were taken in the form of CDOs and CDSs. According to this line of reasoning, the packages for executives were structured to encourage a get-rich-quick mentality and led to extremely risky behavior, which helped bring the financial markets crashing down and wipe out the profits of multiple companies.²⁷ Jean-Claude Trichet, president of the European Central Bank, noted that the “so-called bonus culture is one of the many factors that can drive the financial system in the wrong direction.” He added that it encouraged “self-referential speculation,” discouraged medium-term stability, and drove banking “away from being a service sector to being a self-serving sector.”²⁸

To add fodder to this argument, most compensation analysis did not take into account the executives who left the firms before the financial crisis.²⁹ For example, during the 11 years before the crisis, Merrill Lynch paid its three CEOs more than \$240 million in performance-based compensation.³⁰

In addition, the US Treasury required banks that had not paid back TARP funds to pay executives almost entirely in stock. For example, 19 executives at Citigroup could split \$113 million in stock for 2009.³¹ If Citigroup’s stock returned to levels just 24 months prior, however, the executives’ shares would be worth more than \$800 million.³² This trend toward stock compensation was not limited to those holding TARP money due to the heavy influence of the

²⁵ Cyrus Sanati, “Big Poker Bet Falls Short for Former Bear Executive,” *The New York Times*, 9 November 2009.

²⁶ Financial Crisis Inquiry Commission Web Site, <http://www.fcic.gov/about/>, (accessed April 2010).

²⁷ Steve Eder, “Goldman, Morgan Stanley Payouts Hog the Spotlight,” *Reuters*, 19 January 2010.

²⁸ Stephen Castle and Katrin Bennhold, “European Bank President Joins Critics of Bonuses,” *The New York Times*, 11 December 2009.

²⁹ Gretchen Morgenson, “Gimme Back Your Paycheck,” *The New York Times*, 22 February 2009.

³⁰ Gretchen Morgenson, 22 February 2009.

³¹ Dan Fitzpatrick, “BoFA’s Banker-Pay Pool: \$4 Billion,” *The Wall Street Journal*, 3 February 2010.

³² Dan Fitzpatrick 3 February 2010.

Pay Czar, who was charged with the task of rebuilding how employees were compensated on Wall Street.

The emphasis on stock also complicated matters. Bankers were predicted to make large gains on stock compensation due to the depressed stock prices at the time stocks were issued. For example, 2008 compensation was considered low at the time, yet increased in value when the entire financial system began to mend and banks' stock prices climbed.³³ As noted by Jesse M. Brill, chairman of the CompensationStandards.com trade publication, "People have to look at the sizable gains that have been made since stock and options were granted last year, and the fact is this was, in many ways, a windfall... This had nothing to do with people's performance. These were granted at market lows."³⁴ Matt's trading group at Goldman Sachs was profitable because it was trading through the market lows in 2008 and 2009.

Finally, some grew frustrated that not enough lending was taking place with the investment of TARP funds into financial institutions—firms were more interested in trading their own money rather than lending money to companies or individuals. Goldman Sachs and JP Morgan Chase were so highly profitable in proprietary trading and taking large risks "that weaker rivals were unable or unwilling to shoulder—a benefit of less competition after the failure of some investment firms last year."³⁵ Yet, the lack of lending to large and small businesses impacted business expansion and new company start-ups—steps which are integral for economic recovery.³⁶

The Financial Industry's Response

Financial institutions at the middle of the storm made their own arguments, defending their business and compensation practices.

Strong versus weak institutions

While some found the competitive advantage of Goldman Sachs and JP Morgan Chase distasteful, others saw it as a natural consolidation of power in an industry with tremendous upheaval. The collapse of competitors such as Lehman Brothers, Bear Stearns, and Merrill Lynch concentrated financial power in a few hands that were able to take stronger, more risky positions in the market place.³⁷ "They are able to charge more for all kinds of services because companies need banks and investment banks more now, and there are fewer strong ones to help them," said Douglas J. Elliott of the Brookings Institution.³⁸

³³ Louise Story, 7 November 2009.

³⁴ Louise Story, 7 November 2009.

³⁵ Graham Bowley, "Bailout Helps Fuel a New Era of Wall Street Wealth," *The New York Times*, 16 October 2009.

³⁶ Brady Dennis, 23 December 2009.

³⁷ Graham Bowley, 16 October 2009.

³⁸ Graham Bowley, 16 October 2009.

Conforming to standards

As stated by a Bank of America spokesperson, “We’re paying for results, and there were some areas of the company that had terrific results, and they will be compensated for that.”³⁹ In this manner, the financial institutions were conforming to the standards set out by the Pay Czar and Congress in structuring compensation payments to align with results. In fact, even the original \$100 Million-Dollar-Man within Citigroup could be seen as exemplifying the new pay structure espoused by the Pay Czar and lawmakers. James Forese, Citigroup’s co-head of global markets indicated that the \$100 Million-Dollar-Man’s pay-for-performance contract was one of which the Pay Czar would approve. “We’re confident in the value these types of profit-sharing arrangements bring to the company and its shareholders,” Mr. Forese wrote in a statement, “as they directly align compensation with performance.”⁴⁰ In Matt’s case, his trading group had made money for Goldman Sachs the past two years. Paying his people for their performance was in-line with industry standards.

Unintended consequences

In an op-ed in the *Washington Post*, staff writer Brady Dennis noted that sweeping indictments actually punished healthy banks—those that survived the crisis intact and were currently thriving—for the mismanagement by the failed banks. According to this argument, we may, in fact, tie the hands of the healthy banks when we need them to provide financial resources to consumers and businesses. Vilifying all bankers creates a climate where excessive regulations are more likely. Banks will act more conservatively and lend less, “thereby crimping expansion by small business and shutting down start-ups” leading to slower economic recovery.⁴¹

We’re getting better

As the CEO of Bank of America Merrill Lynch noted during congressional testimony in front of the FCIC, his institution had paid back all TARP funds plus dividends; his employees were working hard and deserved to be paid competitively.⁴² He was not alone, as banking executives reportedly thought they had made enough concessions to the growing anti-Wall-Street sentiment. Collectively, the banks—Goldman Sachs, Morgan Stanley, J.P. Morgan Chase, Citigroup, and Bank of America—announced lower than expected compensation totaling \$114 billion for 2009.⁴³ While this constituted a 4% increase over \$109 billion in 2008, this compensation was based on revenues that jumped 63% to produce combined profits of \$31 billion.⁴⁴ In addition, these banks performed as expected—paying back TARP funds with interest, changing pay practices, reducing the use of borrowed money, and clearing bad assets

³⁹ Louise Story and Eric Dash, 9 January 2010.

⁴⁰ David Segal, 1 August 2009.

⁴¹ Brady Dennis, 23 December 2009.

⁴² The Official Transcript of the Financial Crisis Inquiry Commission (FCIC), 13 January 2010, <http://fcic.gov/hearings/pdfs/2010-0113-Transcript.pdf> (accessed 4 April 2010).

⁴³ Tomoeh Murakami Tse, “Banks Stung By Criticism Over Pay Despite Recent Changes,” *The Washington Post*, 23 January 2010.

⁴⁴ Tomoeh Murakami Tse, 23 January 2010.

from their balance sheets.⁴⁵ As noted by John Mack, CEO of Morgan Stanley, “I think in the past...we’ve taken it too far...[However,] I think the structure of compensation has changed.”⁴⁶

Recent Events

“Throughout the country, the anger at bankers is palpable. This isn’t a narrow populist phenomenon; rather, it reflects widespread mistrust in the nation’s financial institutions. A ‘Bank Anger’ tour has percolated across the blogosphere. ‘I Hate Banks’ yields 70,000 Google Index results.”⁴⁷

While US Treasury Secretary Timothy Geithner was calling for an end to “an era of irresponsibly high bonuses,”⁴⁸ European Central Bank President Trichet suggested profitable banks use their cash to “strengthen their capital positions, rather than to distribute a large part of their profits or to pay out unwarranted levels of compensation or bonuses.”⁴⁹

As such, Europe was tackling the compensation issue differently by applying a large ‘windfall’ tax to executives’ bonuses. Such a tax was not unprecedented in the United States either. A windfall profits tax was used during wartime when certain industries benefited from an unusual macroeconomic shock. A similar tax was imposed on US oil producers when they profited from an increase in the price of oil due to an embargo.⁵⁰ Other regulations were also considered in the United States such as (1) forcing banks to hold more capital or (2) dividing the banks’ roles by risk: one side would contain conventional lending and relationship-oriented business and another side would hold more risky, transaction-oriented capital markets activities.⁵¹

In January 2010, Goldman Sachs CEO John Mack made the statement, “As long as unemployment in the US is in the 10% range... [then as a citizen] I’m angry when I see the compensation bankers are getting.”⁵² Unfortunately, unemployment was 10.2% and underemployment was at 17.5%.⁵³ Housing had not yet rebounded and a second wave of mortgages was expected to enter foreclosure.

In an effort to stem the growing sentiment against bankers in general, Goldman Sachs considered working with a philanthropy consultant to set up a charitable program, paying a special dividend to shareholders, reinvesting in its bonus pool, or paying the scheduled bonus

⁴⁵ Tomoeh Murakami Tse, 23 January 2010.

⁴⁶ Becky Quick, Interview with John Mack, “Davos 2010: Road to Recovery,” CNBC, 28 January 2010.

⁴⁷ Brady Dennis, 23 December 2009.

⁴⁸ Robert Schmidt, “Geithner Slams Bonuses, Says Banks Would Have Failed (Update2),” *Bloomberg*, Dec. 4, 2009.

⁴⁹ Stephen Castle and Katrin Bennhold, 11 December 2009.

⁵⁰ Peter J. Solomon, 19 November 2009.

⁵¹ Peter J. Solomon, 19 November 2009.

⁵² Becky Quick, Interview with John Mack, 28 January 2010.

⁵³ The Celebrity Café.com, 6 November 2009, <http://thecelebritycafe.com/features/35471.html>, (accessed April 2010).

payouts for 2009.⁵⁴ Two pension funds, however, sued Goldman Sachs over its 2009 compensation plan, which they charged “vastly overcompensated management and constituted corporate waste.”⁵⁵ In addition, a civil lawsuit was filed requesting that Goldman’s charitable contributions be the responsibility of the CEO and management team rather than Goldman Sachs’ shareholders.⁵⁶

The FCIC—charged with identifying the factors that led to the financial crisis and possible remedies to avoid a repeat—held a hearing on February 13, 2010, where the CEOs of JP Morgan Chase, Goldman Sachs, Morgan Stanley, and Bank of America Merrill Lynch were asked to testify. During the hearing, Phil Angelides, chairman of the FCIC, summarized the popular sentiment toward all bankers with a question for Goldman Sachs’ CEO Lloyd Blankfein:

“At your firm, you tripled your assets, almost, from about 403 billion to 1.1 trillion from 2003 to 2007. That’s an annual compounded growth rate of 29 percent when GDP was growing at 1 to 3 percent. Your leverage ratio, when measured against tangible equity, was 26 to 1. By some analysts’ measures, 32 to 1 against common—tangible common equity.

In the end of the day—and I’m going to press you on this—it seems to me that you survived with extraordinary government assistance. There was \$10 billion in TARP funds, \$13.9 billion as a counterparty via the AIG bailout.

By your own Form 10-K, you said that you issued \$28 billion in debt guaranteed by the FDIC, which you could not have done in the market but for that. You were given access to the Fed window and the ability to borrow at next to nothing. You became a bankholding company over the weekend. You had access to TALF. You benefited from a ban on short selling, which you initially opposed, which Mr. Mack had advocated. And you got relief—some relief from mark-to-market rules even though I understand you were assiduous about marking to market.

... do you really believe that your risk management in the big picture was sufficient to have allowed you to survive but for that government assistance which I laid out?”⁵⁷

Matt’s Dilemma

Given the hostile climate toward his industry, Matt knew something had to change. Talk of compensation reform had spread to the public forum. Even his favorite sports columnist had taken up the cause in the middle of dissecting the National Football League playoffs.⁵⁸ The fact

⁵⁴ Tomoeh Murakami Tse, 23 January 2010.

⁵⁵ Jonathan Stempel and Steve Eder, “Goldman Sachs Sued By Big Pension Fund Over Pay,” *Reuters*, 9 March 2010.

⁵⁶ Jonathan Stempel and Steve Eder, 9 March 2010.

⁵⁷ FCIC Chairman during congressional hearing, FCIC Transcript, 13 January 2010.

⁵⁸ Gregg Easterbrook, *Sonic Boom: Globalization at Mach Speed*, (New York: Random House: 2010).

that someone who studies and writes about the NFL was lamenting the disproportionate pay of any industry indicated to Matt that the \$100-Million-Problem had gotten out of control. There were congressional hearings and articles on the front page of the papers every day about compensation, unemployment, and the overall recession.

While change may be needed, should it affect Matt's company and his employees? Even the \$100-Million-Dollar-Man had made money for Citigroup—the kind of profits taxpayers would want to see in a company they partly owned—and had said that he would take his business to a competitor if Citigroup was unable to pay him the money.⁵⁹ What if Matt's star employees left?

Although his firm had paid back its share of the TARP, Matt wasn't sure that a single individual or even eight traders should be given a \$125 million bonus when unemployment numbers were over 10%. Any decision was going to need to go past the COO, CEO, and public relations department in a meeting tomorrow. Matt did not see any good options at the moment.

⁵⁹ David Segal 1 August 2009.

Exhibit 1 BAILOUTS AND BONUSES ON WALL STREET Financials Timeline

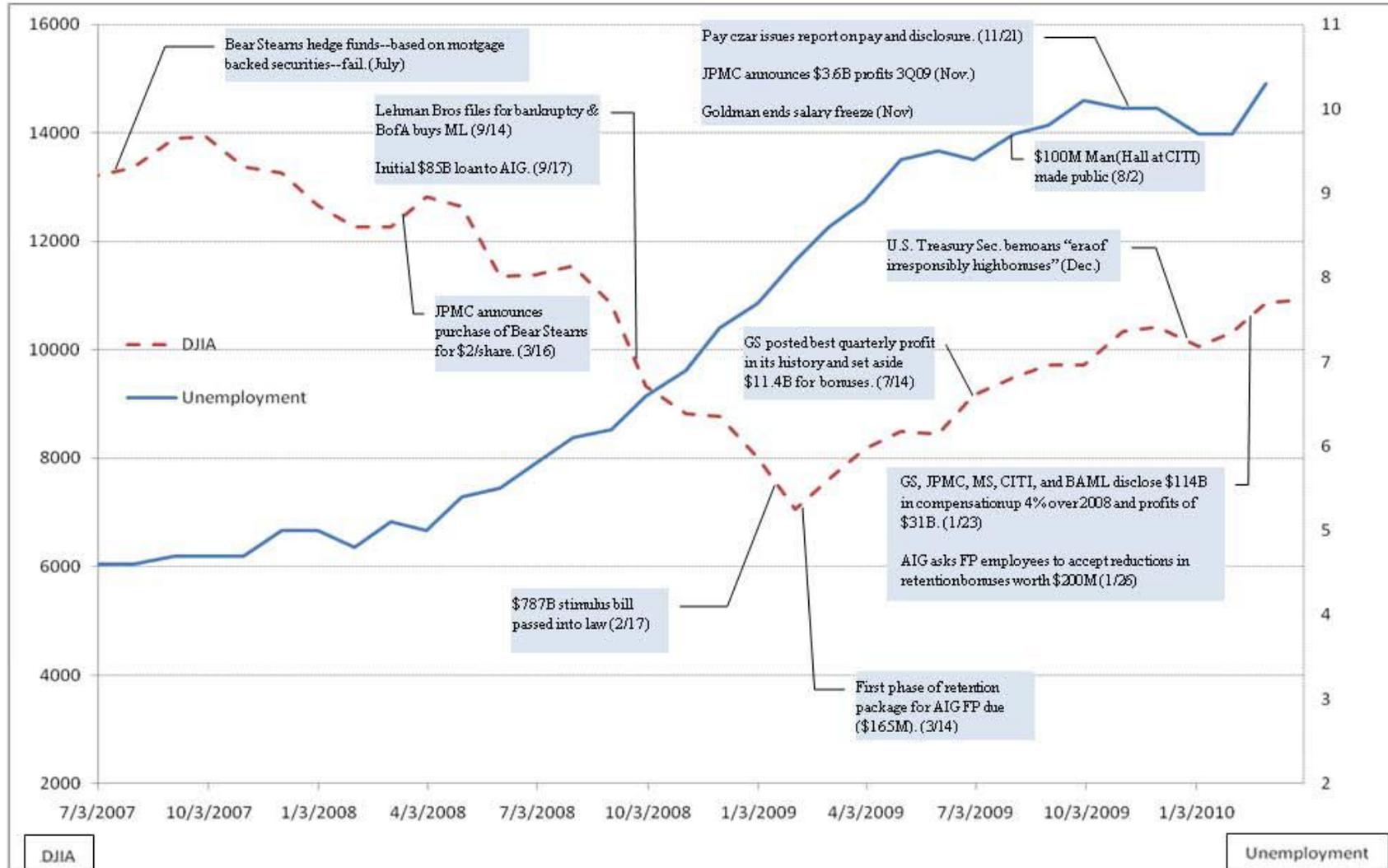


Exhibit 2
BAILOUTS AND BONUSES ON WALL STREET
 Financials Breakdown
 (all from banks' SEC Form 10-K)

	Citigroup				Goldman Sachs				JP Morgan Chase			
	'06	'07	'08	'09	'06	'07	'08	'09	'06	'07	'08	'09
Revenue	\$86	\$81	\$53	\$80	\$38	\$46	\$22	\$45	\$62	\$71	\$67	\$100
in billions												
Compensation	\$30	\$34	\$32	\$25	\$17	\$20	\$11	\$16	\$21	\$23	\$23	\$27
as % of rev	35%	42%	61%	31%	44%	44%	50%	36%	34%	32%	34%	27%
Income	\$22	\$4	(\$28)	(\$2)	\$10	\$12	\$2	\$13	\$14	\$15	\$6	\$12
as % of rev	24.9%	4.4%	-52.3%	-2.0%	25.3%	25.1%	10.5%	29.6%	23.3%	21.4%	8.4%	11.7%
Employees	327,000	374,000	322,800	265,300	264,67	30,522	30,067	32,500	174,360	180,667	224,961	222,316
Compensation/ee	\$91,131	\$90,642	\$100,372	\$94,233	\$623,418	\$661,818	\$362,524	\$498,462	\$121,588	\$125,646	\$100,906	\$120,999
Leverage (debt/equity)	14.7	18.2	12.6	11.0	22.4	25.2	12.7	11.0	10.7	11.7	12.0	11.3

	Morgan Stanley				Bank of America				Merrill Lynch			
	'06	'07	'08	'09	'06	'07	'08	'09	'06	'07	'08	'09
Revenue	\$28	\$27	\$22	\$23	\$73	\$66	\$74	\$121	\$34	\$11	\$13	n/a
in billions												
Compensation	\$14	\$16	\$12	\$14	\$18	\$19	\$18	\$32	\$17	\$16	\$15	n/a
as % of rev	48%	61%	54%	62%	25%	28%	25%	26%	50%	141%	117%	
Income	\$7	\$3	\$2	\$1	\$21	\$15	\$4	\$6	\$7	(\$9)	(\$28)	n/a
as % of rev	26.5%	12.3%	8.1%	6.0%	28.8%	22.7%	5.4%	5.0%	22.2%	-76.8%	-219.3%	
Employees	43,124	48,256	46,964	61,388	203,425	210,000	243,000	284,000	56,200	64,200	59,000	n/a
Compensation/ee	\$315,370	\$333,637	\$253,386	\$234,574	\$89,468	\$89,524	\$75,720	\$110,915	\$300,125	\$247,710	\$250,220	n/a
Leverage (debt/equity)	30.7	32.4	12.5	15.5	9.8	10.7	9.3	8.6	20.6	30.9	32.4	

APPENDIX Companies Receiving TARP Money

The following is a breakdown of the major players in Wall Street's financial crisis and bonus controversy.

AIG¹ [Received \$40B in TARP]. After AIG received over \$180 Billion² in taxpayer aid, it was virtually owned by the government, with taxpayers taking 85% share of the company. AIG's Financial Products division, at the heart of the financial crisis and the compensation controversy, was to receive \$168 million in March 2009, when a fury of public outcry resulted in Financial Products' current and former employees taking 10% to 20% less money than AIG had initially promised.³ As part of this renegotiated pay package, AIG employees were due \$100 million in March 2010. AIG and Pay Czar Ken Feinberg, however, sought to extract the \$26 million that Financial Products' employees had said they would return in 2009, but did not.⁴ Financial Products shrunk steadily during 2009, winding down the number of derivatives trades on its books to about 16,000 at the end of 2009, from 44,000 before the bailout. It closed offices in Hong Kong and Tokyo and reduced its staff to 237 employees from 428.⁵

Morgan Stanley⁶ [Received \$10B in TARP]. Morgan Stanley took a number of steps to secure its business after taking TARP funds. First, Morgan Stanley converted to a bank-holding company, providing it with access to funds from the Federal Reserve.⁷ This enabled it to use the Fed's capital and guarantees to buy higher yielding securities, as well as protect itself under the FDIC. In addition, Morgan Stanley reduced leverage from 33-to-1 in 2007, to 16-to-1 by 3Q09;⁸ raised \$14 billion in capital from private sources, including \$9 billion from Mitsubishi, as part of a broader strategic alliance;⁹ and diversified its revenue through the acquisition of Citigroup's Smith Barney wealth management division.¹⁰

¹ American International Group Corporation (AIG) with two divisions of business, the first is the insurance agency, which provides general and life insurance options. The second is the financial services division, which includes retirement savings and asset management.

² AIG was awarded \$40 Billion in TARP money, but has also received other capital infusions from the Government with its total equaling over \$180 Billion in tax payer aid.

³ Brady Dennis, "AIG plans to pay \$100 million."

⁴ Brady Dennis, "AIG plans to pay \$100 million."

⁵ Brady Dennis, "AIG plans to pay \$100 million."

⁶ Morgan Stanley was one of the two remaining investment banks left after the crisis. Although both Morgan Stanley and Goldman Sachs were converted to bank holding companies, they did not lend in the classic banking sense. Morgan Stanley was a financial services company whose principal activity was to provide products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals.

⁷ The Official Transcript of the Financial Crisis Inquiry Commission (FCIC), 13 January 2010, <http://fcic.gov/hearings/pdfs/2010-0113-Transcript.pdf> (accessed 4 April 2010).

⁸ FCIC Transcript.

⁹ FCIC Transcript.

¹⁰ FCIC Transcript.

While Morgan Stanley repaid its TARP funds, providing taxpayers a 20% annualized return,¹¹ James Gorman, who took over as CEO of Morgan Stanley in January 2010, recommended to his board that he receive no bonus in 2009, due to the “unprecedented environment in which we are operating and the government’s extraordinary financial support to our industry.”¹² The company, however, was criticized for paying out 62% of its 2009 revenue as compensation and benefits, though many of its internal divisions struggled. In comparison, rival Goldman Sachs, with record net income, had a compensation ratio of 36% of revenue.¹³ Morgan Stanley, however, revised its compensation structure to emphasize deferred cash with clawbacks¹⁴—up to three years if investments or trading positions produced subsequent losses¹⁵—as well as stock and salaries rather than bonuses.

Goldman Sachs¹⁶ [Received \$10B in TARP]. Goldman Sachs received \$10 billion in TARP funds. Similar to many in the industry, Goldman reduced its balance sheet by 25% while increasing the amount of cash on hand.¹⁷ Goldman’s total bonus pool in 2008 was \$4.82 billion but was worth \$7.8 billion by November 2009 because 50% was paid in stock.¹⁸ In December 2009, however, Goldman announced that the management committee would receive all of its discretionary compensation—non-salary compensation or bonus—in the form of shares at risk that could not be sold for five years. Further, these shares could be ‘recaptured’ or clawed-back if an employee did not effectively manage risk¹⁹ and shareholders had an advisory vote on the firm’s compensation at the shareholder meeting in 2010.²⁰ Goldman Sachs was expected to pay its employees an average of \$595,000 apiece for 2009, one of the most profitable years in its 141-year history.²¹

While Goldman repaid its \$10 billion bailout allotment of TARP funds, many pointed to additional taxpayer support in the form of ‘counterparty’ agreements with AIG. In receiving billions in bailout funds, AIG was able to fulfill its contractual obligations with

¹¹ FCIC Transcript.

¹² FCIC Transcript.

¹³ Aaron Lucchetti, “Morgan Stanley Compensation Ratio to Decline this Year,” *The Wall Street Journal*, 3 February 2010.

¹⁴ “Clawbacks” is a strategy being considered by many firms to make sure that the decisions made by executives will be for long term purposes and not for simply short term gain. Executives will be awarded bonuses based on performance, but if the decisions they make turn sour in the future the company holds the option to “clawback” the bonus money.

¹⁵ FCIC Transcript.

¹⁶ Goldman Sachs is one of two remaining investment banks since the financial crisis. Although it is now a bank holding company, it is still a global investment banking and securities firm specializing in investment banking, trading and principal investments, asset management, and securities services.

¹⁷ FCIC Transcript.

¹⁸ Louise Story, “Takeouts: College Football, Wall St. Pay, Listeners on Religion,” *The Take Away* (WNYC Radio), 9 November 2009.

¹⁹ FCIC Transcript.

²⁰ FCIC Transcript.

²¹ Louise Story and Eric Dash, “Banks Prepare for Big Bonuses, and Public Wrath,” *The New York Times*, 9 January 2010.

its counterparties; Goldman was a primary beneficiary of these fulfilled agreements and was paid \$12.9 billion through AIG.²²

Bank of America Merrill Lynch²³ [Received \$45B in TARP]. Bank of America received \$45B in TARP funds and in fall 2008, bought Merrill Lynch in a deal partially arranged by the Treasury.²⁴ Merrill Lynch was one of the largest CDO issuers on Wall Street and garnered lucrative fees by creating and selling CDOs. Merrill was heavily invested in the housing market and even acquired mortgage services companies including the largest subprime mortgage lender in late 2006 and continued to increase its position in mortgage-backed securities through the first seven months of 2007.²⁵ Merrill's losses as a result of the credit crisis—\$35.8 billion in 2007 and 2008—effectively offset 11 years of earnings.²⁶ Bonuses in 2006 and 2007 were triggered by the \$700M in fees generated by creating and trading the CDOs—despite not all of them being sold.²⁷

In response to the backlash and receipt of TARP funds, neither the current nor previous CEO, nor any of the top leaders of Bank of America Merrill Lynch, received a bonus for 2008, and bonuses were cut more than 80% for the executives just below the top leadership.²⁸ For 2009, however, Bank of America approved more than \$4 billion in pay for its investment bankers and traders, which equals an average of \$300,000 to \$500,000 per employee;²⁹ this represents about 19% of the roughly \$23 billion in revenue generated by investment-banking and capital-markets activities, and is close to what Bank of America paid during its peak compensation year of 2006, when the ratio of bonuses to total revenue was 27%.³⁰

Bank of America Merrill Lynch paid back the \$45 billion in TARP funds in addition to nearly \$3 billion in dividends and other payments.³¹

JP Morgan Chase³² [Received \$25B in TARP]. JP Morgan received \$25 billion in TARP funds, yet JP Morgan posted profits throughout 2008 and 2009 and was able to

²² Editorial, "Goldman's Non-Apology," *The New York Times*, 22 November 2009.

²³ Bank of America Merrill Lynch was formed in on September 15, 2008, when Bank of America bought Merrill Lynch for \$50 billion in an all-stock transaction. Bank of America accepts deposits and offers banking, investing, asset management, and other financial and risk-management products and services. The company has a mortgage lending subsidiary and an investment banking and securities brokerage subsidiary. Merrill Lynch is now a subsidiary of Bank of America and is a leader in wealth management services.

²⁴ Gretchen Morgenson, "Gimme Back Your Paycheck," *The New York Times*, 22 February 2009.

²⁵ Andrew Ross Sorkin, *Too Big to Fail* (New York: Viking Penguin, 2009), 335.

²⁶ Gretchen Morgenson, 22 February 2009.

²⁷ Andrew Ross Sorkin, 145.

²⁸ FCIC Transcript.

²⁹ Dan Fitzpatrick, "BofA's Banker-Pay Pool: \$4 Billion," *The Wall Street Journal*, 3 February 2010.

³⁰ Dan Fitzpatrick, 3 February 2010.

³¹ FCIC Transcript, Bank of America.

³² JP Morgan Chase is one of the largest and oldest financial services firms in the world, with operations in 60 countries, assets of \$2 trillion, the largest market capitalization, and the third largest deposit base in U.S. banking behind Wells Fargo and Bank of America. The firm was formed in 2000, when Chase Manhattan Corporation merged with J.P. Morgan & Co.

pay back its TARP funds on June 17, 2009. Workers in the investment bank of JP Morgan Chase collected an average of \$463,000 in bonuses for 2009.³³

JP Morgan Chase became an active acquirer during the financial crisis. The March 2008 purchase of Bear Stearns, with the guidance and assistance of the federal government was, perhaps, its most public activity at the height of the crisis. During the period when Bear Stearns' stock reached a height of \$162.78 per share in 2007,³⁴ CEO Jimmy Cayne received compensation totaling \$39.6 million.³⁵ Bear Stearns had become increasingly reliant upon mortgage-related properties leading to a massive mortgage-related write-down of \$854 million and the collapse of two large hedge funds created to invest in subprime mortgages in 2007.³⁶ J.P. Morgan Chase stepped in to buy the company with backing from the federal government for a final sale price of \$10/share.

Citigroup³⁷ [Received \$45B in TARP]. In total, Citigroup received \$45 billion in TARP funds because it was deemed 'too big to fail.' Citigroup's size—it manages nearly 200 million customer accounts across six continents in more than 100 countries³⁸—in addition to untenable balance sheet positions including CDOs³⁹ resulted in the federal government taking a strong ownership position through TARP funds. On December 23, 2009, Citigroup paid back a portion of the TARP funds (\$20 billion), yet the US treasury still owned 27% of Citigroup's common stock⁴⁰ and, therefore, Citigroup was still required to comply with the US government's standards for executive compensation. All compensation arrangements for the top 30 most highly compensated employees were subject to review by the Federal Reserve Board and other regulators.⁴¹ Vikram S. Pandit, Citigroup's CEO, stated he would take a salary of \$1 and would receive no bonuses until his troubled bank turned a profit. As of February 2009, he had not received any performance pay since taking over the top job at Citigroup in late 2007.⁴²

³³ Louise Story and Eric Dash, 9 January 2010.

³⁴ Russ Britt, "Gauging Plight of Bear Stearns' Staffs Investments: Stock's Swift Tumble Gave Brokerage Employees Little Time to React," MarketWatch, 18 March 2008.

³⁵ Bear Stearns Case Study, AFL-CIO Web Site, http://www.aflcio.org/corporatewatch/paywatch/retirementsecurity/case_bearstearns.cfm#_ftn5, (accessed April 2010).

³⁶ These two hedge funds based were invested in CDOs based on subprime mortgages. Their failure is considered by many to be the beginning of the financial crisis.

³⁷ Citi is one of the largest and most diversified financial services companies to act as one to deliver solutions to clients throughout the world.

³⁸ Citi Web Site, <http://www.citigroup.com/citi/business/brands.htm>, (accessed April 2010).

³⁹ Barbara Kiviat, "Five Questions (and Answers) About Citi's Bailout," *TIME*, 25 November 2008.

⁴⁰ Citigroup Inc. Annual Report Form 10-K, December 2009, http://www.sec.gov/Archives/edgar/data/831001/000120677410000406/citi_10k.htm, (accessed April 2010).

⁴¹ Citigroup Inc. Annual Report Form 10-K, December 2009.

⁴² Gretchen Morgenson, "After Huge Losses, a Move to Reclaim Executives' Pay," *The New York Times*, 21 February 2009.