

Compensation Controversies at AIG

American International Group (AIG), a behemoth insurance and financial services company, became infamous in early 2009 for the payment of \$165 million in retention bonuses to employees in its Financial Products unit, the business unit that brought AIG to its knees and necessitated the infusion of many billions of dollars in United States government bailout money, beginning in September 2008. Although the near collapse of AIG was influenced by “soured trades entered into by the company’s Financial Products division,” the operations of other AIG units, such as the financial gambles of its 2,000-employee Investments unit, crippled the company as well.¹

Rapidly mounting financial losses had been occurring in the Financial Products unit for some time. Consequently, AIG decided to unwind the business and shut it down. In early 2008, employees in the Financial Products unit were asked to remain with the company through the unit’s shutdown and, essentially, to work themselves out of a job.² To entice talented employees to stay and work through the shutdown, a contractual retention bonus plan was instituted.³ According to a report in *The Washington Post* newspaper, the Financial Products employees were repeatedly assured, subsequent to the plan’s implementation decision being made in March 2008, that AIG would honor these contractual obligations.⁴

The bonus plan was highly favorable to AIG’s Financial Products employees, and the bonuses were not linked to the employees’ performance. The unit’s employees were paid bonuses totaling \$423 million in 2007 despite a paper loss of \$11.5 billion on toxic real estate assets.⁵ *The 2008 bonus plan*, which was approved in March of that year by the board of AIG’s Financial Products unit as the unit’s losses were beginning to surface,⁶ was “designed to kick in without regard to paper losses.”⁷ For 2008, paper losses on the toxic real estate assets ballooned to \$28.6 billion, and total losses were more than \$40 billion.⁸

According to New York Attorney General Andrew Cuomo, who was threatening legal action against AIG, 73 Financial Products employees received \$1 million or more in bonus payments. The top recipient, identified by *The Wall Street Journal* as Douglas Poling, received more than \$6.4 million, whereas the next six top bonus recipients got more than \$4 million each. In addition,

another fifteen employees received \$2 million or more, and fifty-one other employees received \$1 million or more.⁹ “Of those people collecting more than \$1 million, eleven . . . had already left the company [by March 2009], Mr. Cuomo’s office said.”¹⁰

When the retention bonuses were paid in March 2009, the United States Congress, President Barack Obama’s administration, and the public were outraged. Under intense political pressure, AIG’s then-CEO Edward Liddy, who was working for only \$1 a year, asked the “bonus recipients to cough up half their pay, despite fearing that *resignations* would follow.”¹¹ In defense of the bonuses, however, Gerry Pasciucco, head of the Financial Products unit, observed that the “top bonus recipient, Douglas Poling, had successfully sold off several holdings in his area of responsibility, infrastructure and energy investments. He’s done an excellent job at the task of unwinding his book, of realizing value.”¹²

In the ensuing emotionally charged days, employees of the Financial Products unit pondered what to do. According to one account, “employees have huddled in small groups in conference rooms off the division’s main trading floor in Wilton, Conn., debating what to do. Some have expressed worries about retaliation. One employee said he had instructed his wife to call the police in the event his identity became known and a news truck appeared at his home. Others commiserated that their children have been verbally abused in school. Employees have passed around emails from colleagues who opposed returning the payments.”¹³

Some Financial Products employees decided to return their bonuses. Mr. Poling indicated he intended to return his bonus.¹⁴ “Fifteen of the top 20 recipients of the retention bonuses have agreed to give back a total of more than \$30 million in payments.”¹⁵

Others Financial Products employees opted to keep their bonuses, perhaps the most notable of whom was Jake DeSantis, a Financial Products unit executive who received an after-tax bonus of \$742,006.40. On March 25, 2009, in an Op-Ed contribution to the *New York Times*, DeSantis published an open letter to Edward Liddy, wherein he resigned his AIG position. DeSantis’s letter read in part:

"After 12 months of hard work dismantling the company—during which A.I.G. reassured us many times we would be rewarded in March 2009—we in the financial products unit have been betrayed by A.I.G. and are being unfairly persecuted by elected officials. In response to this, I will now leave the company. . . . I take this action after 11 years of dedicated, honorable service to A.I.G. I can no longer effectively perform my duties in this dysfunctional environment, nor am I being paid to do so. Like you, I was asked to work for an annual salary of \$1, and I agreed out of a sense of duty to the company and to the public officials who have come to its aid. Having now been let down by both, I can no longer justify spending 10, 12, 14 hours a day away from my family for the benefit of those who have let me down."¹⁶

Because the United States government bailed out AIG, along with numerous other financial institutions, through the Troubled Asset Relief Program (TARP), significant oversight of executive compensation was imposed on these recipient companies. Kenneth Feinberg has played a key role in addressing the controversy over the AIG retention bonuses. As the federal government's overseer of executive *compensation at AIG* and other major TARP recipients, Feinberg tried "to recover \$45 million paid to the most highly compensated executives, but AIG management. . . said reclaiming the entire amount would be difficult because many employees who originally received retention awards have left the company."¹⁷

In late October of 2009, Kenneth Feinberg, the federal government's pay czar, rejected much of the proposed pay package AIG put forth for "a group of highly paid employees—including five at the financial products unit whose problems helped nearly sink the firm—as inconsistent with the 'public interest'."¹⁸ Feinberg said base salary should not exceed \$500,000 annually; however, he did not rule out bonuses for financial products employees which were scheduled to be paid in 2010.¹⁹ Feinberg allowed AIG to "compensate executives with 'stock units' tied to the value of four of its insurance units—an outcome that executives at AIG had pushed for

in negotiations. The stock units . . . would be payable in three equal annual installments, starting two years after they were granted—in effect giving executives incentive to stay at the company and help it thrive."²⁰ "Feinberg rejected AIG's proposal that five high-paid officials at the financial-products unit get 'significant increases in cash base salary' and total 2009 compensation of \$13.2 million. He concluded that those employees should get only the cash salaries that were in effect at the end of 2008."²¹

Did Kenneth Feinberg's make appropriate decisions regarding executive compensation at AIG?

Discussion Questions

1. What types of work behaviors did AIG intend to encourage through its retention bonus plan?
2. Which needs seem to be important to the employees of AIG's Financial Products unit?
3. Using the model of the individual-organizational exchange relationship, explain the relationship that employees of AIG's Financial Products unit believed they had with the company. How was this exchange relationship violated?
4. Which motivation theory do you think has the most relevance for understanding the responses of the Financial Product employees to the implementation and unraveling of the retention bonus plan? Explain the reasoning behind your answer.
5. The amount of compensation earned by executives—as well as by professional athletes and famous actors/actresses and musicians—often spark emotionally-charged debate. Do you believe the \$1 million plus retention bonuses received by 73 employees of AIG's Financial Products was excessive? Why or why not?
6. Do you think that the various decisions made by Kenneth Feinberg with respect to executive compensation at AIG were justified? Explain the reasoning behind your answer.

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