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A Fair Deal for Taxpayer Investments

Public Directors Are Necessary to Restore Trust and Accountability at Companies Rescued by the U.S. Government

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Executive summary

During the financial markets crash of 2008, the Treasury Department and the Federal Reserve—of necessity—improvised dramatic and aggressive solutions to rescue the financial sector from imminent collapse. A welter of creative regulatory and monetary solutions provided massive amounts of government assistance to rescue private firms from probable failure. However, the benefits of government intervention have so far largely flowed one way only—from the taxpayers to the financial sector—and there has been a marked absence of accountability or transparency associated with these government-provided benefits.

Taxpayer bailouts have become a central policy tool since the onset of the current economic crisis—with approximately $12 trillion dollars to date deployed to support or rescue private companies in total.[2] The de facto policy of providing taxpayer support to struggling "systemically important" companies has produced an ill-defined terrain of shared governance between financial executives on the one hand and federal regulators who hold both the power of government and the power of ownership on the other.

This unusual mix of private and public power requires a more visible implementation of financial accountability to regain the trust of the American public. The American people must know that their interests as taxpayers are being safeguarded, and that as investors they can have confidence that federal intervention into the private markets is following a consistent, well-defined, and transparent process—one which follows well-established guidelines for ensuring accountability, rather than a series of ad hoc approaches. This paper argues that the best vehicle to accomplish this goal is the establishment of public directors[3]—positions of direct representation in the boardrooms of companies that have received significant amounts of government funds and which will provide federal agencies that are the new owners and regulators with a visible structure of accountability.

The prospects for a robust prudently guided financial sector have been substantially clouded by the fact that the both the corporate governance structure and the executive leadership of the financial sector remain largely unchanged—92 percent of the management and directors of the top 17 recipients of TARP funds are still in office. The Obama administration has outlined an ambitious and sweeping plan to reform the regulatory system governing financial institutions and markets. This regulatory reform is certainly indispensable, but perhaps insufficient. The recent market crashes exposed severe deficiencies in the fiduciary obligations and public-regarding culture of financial firms. In order to prevent

future crashes, we must not only seek to change how these firms are regulated, we must also seek to change the structures by which they are run. One major issue in this regard is the passivity, insularity, and narrow band of values represented by those who oversee these firms—the directors who make up the boards of the country's largest financial institutions.

A driving force of the 2008 market collapse was the imprudent risk taking by financial sector leaders. The CEO and board of directors of each company have the legal responsibility to make decisions that advance shareholder interest. In the period leading up to the crisis, the conventional wisdom among financial sector CEOs was that the high returns available from mortgage-backed securities, and the highly leveraged balance sheets and off-balance sheet transactions concentrated in exotic financial instruments were the way to maximize short-term profitability and thus advance shareholder interests. This industry-wide consensus proved to be fatally flawed.

Public directors will provide a corrective to the boards of the financial institutions that helped cause the crisis. Public directors can offer increased independence of thought and diverse perspectives among board members. Public directors should be chosen for a strong public service history, financial and corporate literacy, as well as independence from links to the financial sector. The primary aim of the public director appointments should be to diversify traditional board member profiles and to avoid replicating the disastrous pool of narrowly self-reinforcing financial sector conventional wisdom and experience that led to the crisis. As the economy heals, there are troubling signs that banks have not increased lending, and have instead resumed planning risky strategic acquisitions, and excessive compensation practices. Proportional representation by public directors can ensure that systemically-important firms that have any measure of government ownership do not relapse into the homogenous, CEO-dominated boards that were in place before the crisis.

Regulators should determine most of the details of the public directorships—after all, they have the most direct experience in trying to regulate private companies that have received public funds. But the decisions should be made with two critical principles in mind. First, the principle of proportionality should be applied to government investments in private firms. Public directors should be appointed to the boards of directors on a roughly proportional level to the amount of funding received by the rescued firm—and this should include not just purchases of company stock, but other investments and subsidies provided to help support the firm. For example, if a company receives government funding equivalent to 25 percent of its market capitalization, public directors should make up roughly 25 percent of that company's board.

Second, because public directors should represent taxpayer interests, they should have a history of public service, and they should be chosen to provide both intellectual diversity and diversity of perspective gained from individual experience.[4] They should also have experience and expertise from outside of the economic sector in which they serve. Diversity is necessary for good governance, as it breaks up the "groupthink" that too often

characterizes corporate boards, which are typically filled by allies of management.[5] And experiential diversity is also important for the appropriate representation of taxpayer interests. When other stakeholders—such as pension funds, unions, or hedge funds—invest major sums in corporations, they demand board representation, and their directors are picked to represent the interests and worldview of these stakeholders. Taxpayers should not be treated any differently.

Public directors against the current backdrop of bailouts

The Obama administration took control amid the worst economic and financial crisis to face our country since the Great Depression. They also inherited a regulatory response to this crisis, which was widely criticized as haphazard and poorly designed and executed. The massive amount of public funds directed to the financial sector and the auto industry to keep them from failing, the seeming lack of accountability in how these funds were distributed, and the politically tone-deaf oversight of this process created a breach of trust between taxpayers and the managers of these firms, as well as the government officials regulating the institutions.

The original $700-billion Troubled Asset Relief Program, or TARP, intended to rescue the failing financial system was proposed by then-Secretary of the Treasury Henry Paulson in a three-page document, which explicitly barred any oversight, transparency, or accountability over the administration of funds. This bill was met with heavy skepticism and strong public backlash, and failed to pass out of Congress on its first go around.[6]

The mistrust created around TARP was then exacerbated by Secretary Paulson's decision to abandon the plan to purchase troubled assets—the legislative intent for TARP—and use a loophole in the legislative language to instead use TARP funds to recapitalize a wide array of financial institutions. This sentiment was underscored by a report issued by the Congressional Oversight Panel for TARP, which concluded that the Treasury had paid substantially more than market value for the preferred equity investments they made in these financial institutions.[7][8] Concern over the use of TARP funds was also reinforced when TARP funds were later used to prop up Chrysler LLC and General Motors Corporation, an act that many believed was outside the program's legislative intent.

Public opposition to these bailouts was intensified by the apparent lack of any accountability from the firms that benefited so much from the public purse. The Treasury generally refused to take any voting rights in the companies which received TARP funding; as a result, it has been enormously complicated for the Treasury to steer these firms toward certain public policy goals—namely using these funds to shore up balance sheets and increase lending. Moreover, Treasury has attained a majority voting stake in some companies, but for these it has relied upon vaguely defined trustee appointments. Neither of these approaches has proven particularly effective or popular. Only recently has the Treasury decided to push for the appointment of directors representing its inter-

est—and this only in the case of Chrysler, and without explicitly stating the criteria for how these directors were chosen.

The enormous amounts of public money provided to private enterprises, and the perception that this money was doled out without any restrictions, accountability, transparency, or even orderly process, has created an enormous breach with the public.[9] The Obama administration, which took the reins after most of the TARP fund had already been allocated, has managed to appease some of the harshest critics of the bailouts, but it is still struggling with the issue of restoring the public's trust.[10] At the same time, the collapse of the financial sector in 2008 has compromised confidence in the stability of the entire global financial system.

The federal government cannot restore this trust by supplying vast amounts of capital alone. Purely financial metrics,[11] such as the stress tests conducted on the 19 largest U.S. financial institutions earlier this year, are important measures of the effectiveness of the Treasury Department and Federal Reserve Board interventions. But an equally important gauge is the long-term restoration of confidence, which has been eroded by the perception that certain favored institutions are receiving massive bailouts with no strings attached while taxpayers—who are also struggling through the effects of a depressed economy—pick up the bill. Restoring the trust and confidence of the public—taxpayers, consumers, and investors—is critical for maintaining the future stability of our market-based economy. Future confidence will require reining in the affinity for catastrophic short-term risks, as well as the excessive compensation practices that were so intertwined with blind risk-taking.[12]

One way to restore the public's confidence in the process of providing public funding to private companies is through the appointment of public directors to the boards of these firms. The Obama administration appears to have belatedly recognized this, as the recent appointment of Treasury-selected directors to the board of Chrysler shows.[13] These public directors would be installed as a new category of corporate agents,[14] representing taxpayers in the boardrooms of private firms to which the United States provided significant amounts of public investment funding. Most firms that meet this description are financial firms receiving TARP funds, but public directorships can be instated in any instance in which the United States invests a significant amount of funds in a private firm.

The basic premise underlying public directorships is that we live in an economy where certain firms have become "too important to fail"—so that the government will step in with guarantees, loans, and even the purchase of equity stakes, should these companies be on the verge of insolvency. This paper does not address the desirability of "too big to fail" firms, or whether and how we might consider dealing with this problem; instead, it simply acknowledges that this situation exists, and proposes a solution to the problems posed when taxpayer money is invested in these firms.

This proposal specifically attempts to address a structural problem with the process by which "systemically important" companies—also called "too big to fail" companies—have

received taxpayer support. Taxpayers are suffering from "bailout fatigue," and this is fundamentally connected to the lack of accountability tied to the investments made in their name. In the nine months since the Troubled Assets Relief Program was authorized on October 3, 2008, the president and Congress have repeatedly encountered public outrage over the way that TARP funds have apparently been used by their recipients, including for performance bonuses, excessive compensation,[15] corporate retreats, lavish offices, and other benefits at a number of companies receiving TARP funds.[16]

The appointment of public directors—directors chosen to represent the taxpayer interest on the boards of private companies that receive substantial public support—can contribute to transparency and accountability in the management of firms receiving massive amounts of federal funding, ensuring a seat at the table for taxpayer interests, and at the same time easing concerns about a slippery slope into nationalization. Public directors themselves will not solve all of the problems we have encountered with bailouts, but they will address some of the key concerns about accountability and process that have been so problematic in the government's response to the current economic crisis.

The public directors' value can truly be realized if they are installed following a consistent and well-articulated set of principles. This paper suggests two such principles: first, the principle of proportionality, meaning that public directors are appointed based on the proportion of public funds received; and second, the principle that public directors can only represent taxpayer interests if they represent the broad diversity of viewpoints held by taxpayers and have a history of public service. If these principles are consistently and transparently applied, future bailouts—which seem likely so long as we maintain systemically important private companies—will likely be better received by the public.

The blurred line between public and private actors in the economy

The current economic crisis took hold against a backdrop similar to what Japan faced in the early 1990s. Credit was cheap and abundant, which helped to inflate the value of investment assets such as stocks, bonds, and real estate to historically high valuation levels. These high asset values sparked a credit boom. As a result, Americans became heavily leveraged, as consumers and businesses alike assumed high levels of debt based on the high values of their assets such as homes, stocks, and bonds.

The first signs began to emerge in August 2007 that credit had been overextended and poorly underwritten, and that the larger economy would suffer greatly as a result, and policy makers scrambled to contain the economic damage, particularly in the financial markets. But as they began to formulate potential policy solutions, they encountered firms with such large balance sheets or such tremendous amounts of counterparty exposure that their failures seemed likely to have a catastrophic effect on the larger economy. Government leaders clearly believed that in an environment of financial panic they could not allow these "systemically important" institutions to fail.

When the problem of the collapsing market for mortgage-backed securities first emerged in the spring of 2007, Secretary Paulson announced that the Bush administration would not commit any taxpayer support to address the problem, and that the consequences of any failures would be borne completely by private actors. And he remained faithful to that promise—at least for a while. As the credit crisis again reared its ugly head in October 2007, this time in the form of deteriorating credit assets held in off-balance sheet vehicles by major financial institutions, Paulson announced the creation of the Master Liquidity Enhancement Conduit, a voluntary industry-developed solution designed to support these off-balance sheet entities. A week earlier, Paulson had unveiled a different purely private solution, negotiated with a number of leading banks and servicers, designed to address the other side of the mortgage problem—rising foreclosures—through loan modifications voluntarily performed by servicers. Both of these programs were based on the voluntary participation of the private sector, with no government role other than in appealing to the better natures of industry leaders. Both were consistent with the Bush administration's ideological approach. And both programs were abandoned relatively quickly, as it became clear that purely private measures were simply inadequate to address the enormous scale of problems in the credit markets.

Secretary Paulson finally abandoned the approach of purely private solutions as credit conditions continued to deteriorate. In a major shift from its previous position, the Bush administration formulated strong governmental interventions into the private markets, each more aggressive than the last, relying on the Fed's significant powers and independent control over its sizable balance sheet. At first, the Fed simply acted as an activist central bank, cutting rates aggressively to try to jumpstart liquidity in the markets. But as the credit markets continued to seize up, it began to intervene more decisively.

In response to severe distress in the short term credit markets in December 2007, the Fed announced the Term Auction Facility, which allowed banks to borrow for short-term periods at low rates by pledging distressed assets as collateral. This was the first of a number of major new lending facilities created by the Fed in response to increasingly illiquid credit markets, such as the Term Securities Lending Facility,[17] the Primary Dealer Credit Facility,[18] the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility,[19] the Temporary Guarantee Program for Money Market Funds,[20] the Commercial Paper Funding Facility,[21] and the Temporary Liquidity Guarantee Program.[22] All of these initiatives provided significant public support to private players in the financial markets through a combination of cheap lending and guarantees.

This welter of programs may have helped support the fragile financial markets, but they were insufficient to create true stability, at least in the minds of policy makers, who also set out on a course of providing public funds to rescue "systemically important" private enterprises facing insolvency. The first major "bailout" was that of Bear Stearns, which was saved in March 2008 by a Fed-engineered acquisition by JP Morgan, in which the Fed guaranteed $30 billion in toxic assets held by Bear. Bear appeared at first to be an isolated instance. But panic in the credit markets reached crisis levels by September 2008, and a number of other "systemically important" firms teetered on the edge of insolvency, including the housing government sponsored entities Fannie Mae and Freddie Mac,[23] [24] and the insurance firm American International Group, Inc. As AIG approached insolvency, federal regulators stepped in with an $85-billion lending facility,[25] for which the government received 79.9 percent of AIG's stock.

Perhaps just as importantly, the federal government did not rescue Lehman Brothers, which declared bankruptcy on September 15. Lehman was not generally considered "too big" to cause large systemic impacts, insofar as its balance sheet seemed of a manageable size. However, what most observers—including the Fed and Treasury—reportedly did not appreciate was how interconnected Lehman was,[26] particularly in the over-the-counter derivatives market. Lehman was reportedly the counterparty in some $400 billion dollars worth of derivatives deals after its collapse in September 2008.[27] Lehman's collapse was followed by a massive credit crunch and general market panic, as counterparties to Lehman sought to cover their exposure to Lehman, causing a run in the credit markets. The accelerating psychology of a severe market panic soon overwhelmed traditional regulatory tools. Conventional wisdom is that the market panic that followed the Lehman's

bankruptcy occurred because the company was "too interconnected to fail,"[28] and following this episode, policy makers appeared to shy away from letting any firm that appeared to have systemic significance fail.[29]

The financial panic following Lehman's insolvency led to a complete reversal of the purely private, "no bailout" approach initially articulated by the Bush administration. Bernanke and Paulson became so alarmed by the credit illiquidity they were facing that they proposed the $700-billion TARP fund, warning of catastrophic economic consequences if such a fund was not immediately appropriated.[30] Indeed, the idea of "systemically important" firms extended beyond the financial sector, as the Treasury intervened into the private markets to prevent the outright failures of the auto companies General Motors and Chrysler, acceding to arguments that the effect their failures would have on unemployment would be calamitous for an already-struggling economy.

In short, the emergence of "systemically important" private enterprises has created major dilemmas for U.S. policy makers, who previously acted under a consensus that the government would largely stay out of the affairs of private markets, particularly with respect to the process of insolvency.

It is true that some firms have straddled the gap between the private and public spheres in U.S. policy—most notably the housing finance entities Fannie Mae and Freddie Mac, which served a number of public purposes and were universally thought to enjoy an implied backing from the U.S. government. These government-sponsored entities typically serve some important public purpose, are highly regulated, and are thought to enjoy an implied guarantee that the government would step in to prevent their failures.

But the idea that the government would step in to prevent the failure of ordinary, private firms, which served no public policy goals and were unique only insofar as they were "systemically important," was unprecedented, and has blurred the traditional line between the public and private sectors in the U.S. economy. The traditional deference paid by U.S. policymakers to private enterprise may help to explain why the Treasury was so reluctant to take voting shares in exchange for its TARP capital investments. The rise of systemically important firms has forced the government to intervene where it previously refused to do so, a fact that is recognized in the Obama administration's white paper for financial regulatory reform.[31]

Ad hoc government solutions lack consistency and accountability

Because the United States has a deeply ingrained tradition of separate private markets and public regulatory spheres, policy makers have been reluctant to delve too deeply or aggressively into the private sector, and when they have done so, they have treaded softly. The government's response to the growing financial and economic crisis has consequently been haphazard and lacked any strong measures to ensure accountability when taxpayer money has been used to help private actors. As a result, stakeholders of all kinds—shareholders, taxpayers, management—have become confused and frequently upset about the lack of any accountability or any consistent "rules of the game."

New solutions were both unavoidable and indispensable as the federal government moved to stabilize private markets during this crisis. Yet there are risks from the improvised regulatory collaboration between government and corporate decision makers. The collaboration has operated within the narrow bounds of an unprecedented ad hoc public-private partnership. Two new risks are that on one hand, financial CEOs and their boards will see federal regulators as unaccountable bullies, intruding into a domain of private sector strategic decision-making. On the other hand, the public has begun to strongly object to behind-the-scenes negotiations in which hundreds of billions of dollars of taxpayer funds were delivered—with few or no strings attached—to the same CEOs whose poor judgment led to the crisis. Now, more than ever, transparency and accountability are mandatory for decisions that affect the lives of millions of Americans.

President Barack Obama pointed out this problem with the bailouts when he remarked: "This isn't just a matter of dollars and cents. It's about our fundamental values,… all across the country, there are people who work hard and meet their responsibilities every single day, without the benefit of government bailouts or multi-million dollar bonuses… And all they ask is that everyone, from Main Street to Wall Street to Washington, play by the same rules." John Bogle, a venerated money manager, makes a similar argument from inside the financial industry.[32]

The first problem is that, as discussed in the previous section, it has been—and continues to be—unclear which companies will be bailed out by the federal government, and under what circumstances. The federal government was initially adamant that there would be no public funds committed to rescuing any private institutions. It later became clear that this stance had been abandoned, and that there was an unstated policy that bailouts

would occur for financial institutions deemed "too big to fail." When Lehman Brothers, a financial institution that was generally not thought to be "too big to fail," became insolvent with apparently catastrophic results for the financial markets, it became clear that bailouts would not merely be limited to financial institutions which were "too big to fail", but also those which were "too systemically significant to fail". This initially gauzy concept was eventually formalized in the Obama administration's regulatory reform white paper in the form of "Tier 1 financial holding companies"—"firms whose failure could pose a threat to financial stability due to their combination of size, leverage, and interconnectedness."[33] Even so, the concept of a "Tier 1 FHC" is nebulous, with a number of undefined parameters that invite accusations of regulatory improvisation and favoritism. And of course the auto companies Chrysler and General Motors were not financial holding companies, and yet they received federal support from TARP.

A second source of confusion is that when the federal government has utilized a variety of different tools and approaches when it has decided to provide a bailout to a failing institution. The government has at times bailed out systemically important businesses by providing federal guarantees on toxic assets to facilitate their acquisition by other, healthier companies.[34] In other instances, regulators have provided below-market loans designed to allow private companies to continue operations while they seek an acceptable outcome, such as a partner or buyer.[35] The government has most recently chosen to recapitalize companies by purchasing equity shares, either in the form of common stock or, more typically, preferred shares with warrants.[36][37] And the federal government has established a number of programs designed to provide cheap liquidity and—arguably—easy profits to institutions in the struggling financial services industry.[38] For example, the Obama administration has attempted to put in place some semblance of a framework—most notably around the stress tests it conducted on the 19 largest financial institutions—to determine their capital needs.[39]

Third—and perhaps most relevant for this paper—Treasury has tried a mish-mash of different techniques to try to maintain some accountability from companies that have received public funds, as well as to get those companies to act in ways consistent with public purposes. According to the most recent report from the TARP Inspector General Neil Barofsky, none of these attempts have worked very well.[40] These approaches include: 1) a "money-whispering" model similar to that unsuccessfully used by the government of Japan in its "lost decade" of the 1990s, in which regulators use a combination of persuasion and threats to keep the interests of rescued companies in line with that of the government; 2) the use of informally and opaquely selected trustees who exert influence over the management and boards of directors of rescued companies in a non-transparent and undefined process; and 3) the installation of directors selected by the Treasury.

Money-whispering is my term for the newly improvised combination of informal administrative guidance, threats to remove directors and CEO's, bargaining and arm twisting, and forceful direction to private financial actors to comply with policy initiatives that often lacked explicit legal authority during last year's financial crisis. The opportunity for misdi-

rection and unfair advantage in this non-public process is very large.[41] The recent hearings on the Bank of America merger are a primary example of the problems that can emerge when government coercion is used to direct corporate decisions.[42][43]

If the acquiring firm failed to act in accordance with the Treasury's wishes, regulators allegedly used a combination of persuasion and threats, as was reportedly the case when Bank of America threatened to try to withdraw from its acquisition of Merrill Lynch.[44] When Treasury acted to prevent the insolvency of AIG, it took 79.9 percent of the voting shares and eventually installed trustees—in an informal process—to represent its interests.

AIG is now partly run with a trusteeship of three members from former government positions. Doug Foshee is chairman and chief executive officer of El Paso Corporation and chairs the board of directors of the Houston branch of the Federal Reserve Bank of Dallas. Jill Considine recently completed a six-year term as a member of the board of directors of the FRBNY and had retired as chairman of the Depository Trust & Clearing Corporation. Chester Feldberg retired as non-executive Chairman of Barclays Americas in 2008 and until he retired in 2000 was a 36-year employee of the FRBNY.[45]

The trustees receive $100,000 per year for their duties,[46] and they are supposed to act for the sole benefit of the Treasury department.[47] The trustees have the power to surrender the stock at any time, but they can only act in concert with a majority vote, not separately.[48] No one who has worked within one year at the Treasury department can serve on the AIG board, and the trustees themselves are not allowed to manage the company.[49] Their duty, according to the charter, is to maximize the value of the shared stock, and they are allowed to do this even by investing in other companies.[50] The trustees, however, are not personally liable to the taxpayer if they do not perform their duties correctly, and only the trust itself can be sued, not the individuals who run the trust.[51] These are the basic parameters for the AIG trust.

One of the problems with this system is that the trustees have other responsibilities, which means that AIG executives do a lot of the decision-making. Another problem with the trustees is that they neither directly nor indirectly oversee the company's management.[52] The company cannot sell the shares without their permission, and they help the company fix its corporate board, but they cannot step in and demand that the company take any particular action. It looks increasingly likely, however, that the trustees will soon replace most of the board, including CEO Edward Liddy.[53]

The trustees have formed a group of advisors that help give them and the company advice, but they ended up keeping most of the people from AIG and people that AIG recommended.[54] They have made it clear that they want AIG to be run well, but they have been vague about exactly what that means. The promises that the trustees make are good, but they are vague, and their statements seem to indicate that little has been accomplished so

far.[55] Staff support for public directors would enhance the possibility of effective participation because staff would be able to identify, acquire, and process the large volume of internal information that would are required to make informed judgments.

The bonus structure at AIG has received a lot of attention, so one would assume that the government is moving quickly to fix this particular problem. One article goes into detail about the bonuses that AIG was forced to give out to its financial services department. It also describes how the government was outraged by the bonuses and how the taxpayers now own 80 percent of the company. The government, however, was powerless to stop the bonuses from being delivered.[56] Another article describes how AIG did not ultimately lose much during the entire public outcry over the bonuses. AIG essentially hired the Sullivan and Cromwell law firm and wrote the contract with the government in a way that will probably keep the bonuses in executives' hands.[57] This shows that actual government control is needed to control how public money is spent.

One would assume that the federal AIG trustees would work quickly to address this problem. That would be a partially incorrect assumption. The trustees have moved to make the bonuses more merit-based and less "more risk, more money" based, but they have not forced the company to accept these recommendations.[58] In addition, the trustees have said that they want the market structure to control the bonuses that they give and to ensure that they give bonuses high enough to attract the best people to AIG.[59] Until the compensation culture is removed from Wall Street, one would assume that the same adverse motivations that the trustees want out of the bonus system are still in the market as a whole. This means that the goal of market control and attracting the best talent may run counter to the goal of limiting these bonuses as much as possible. These ideas to control bonuses proposed by AIG have some merit, but they need to be more specific and uncoupled from pure market incentives to have the desired effect.

Despite the widespread and deep concerns about the management and boards of directors' failures at these systemically important firms, Treasury has largely refrained from even suggesting that it might seek to change them. It is appropriate to be concerned about the political consequences of accusations of "nationalizing" the banks by taking a direct hand in management on a day-to-day basis. But, in the shadow of the fear over nationalization, the government has retreated behind a mysterious curtain of improvisation that includes new and largely unexplained hybrid corporate agents, such as trustees, as well as the apparent use of threats and arm-twisting.

Public directors would step in to address the emerging pattern of improvised administrative guidance that the Secretary of the Treasury, the Chairman of the Federal Reserve, and the Chair of the FDIC have been using to negotiate with bankers about regulatory terms and conditions. The public has lost confidence in the federal government, and this will not be reversed with vague, unofficial remedies such as off-the-record administrative guidance.

The use of trustees whose charter, scope of operation, and instructions for representation have only emerged slowly on the public record, also erodes public confidence; it diminishes transparency regarding how government power will be exercised inside the boardroom.

When the U. S. government provides significant public support to private enterprises, these investments present significant questions of representation. How will it manage the taxpayers' financial investment in the private sector? Will the power of ownership be executed through traditional corporate governance structures, such as corporate elections, board membership, and voting? What ability do the federal regulators have to direct the choices of a firm that has systemic importance? The conventional avenues of democratic representation flow through the three branches of government. When the Treasury Department holds shares with voting rights, the line between the avenues for public and private representation can become blurred.

Several problems that have emerged during the current crisis illustrate the negative consequences of blurred representation. Taxpayers are represented by elected officials in the legislative and executive branches. Accountability for elected representatives is the heart of all democratic ideals. Yet this issue of accountability posed a serious threat to the financial rescue, as taxpayers became understandably furious when the Treasury Department asked for $700 billion to rescue failing financial firms while ordinary citizens faced home foreclosure, dramatically reduced retirement and college savings, and the loss of home equity during the collapse. The first vote on the financial rescue failed, imperiling a fragile global financial system, until a series of compromises and arm-twisting allowed the Emergency Economic Stabilization Act to pass into law on the second try.

But the failure to impose accountability has led to its own problems. Taxpayers understand that it is their money being used to support these companies, so when the executives who lead these firms make decisions that are objectionable to the average American, there is understandably a public outcry. At the same time, corporate managers have a fiduciary duty to their shareholders, whose interests are often contrary to those of the taxpayer. The current situation is the worst of all worlds, because there is a total lack of certainty, and major stakeholders—shareholders, managers, and taxpayers—all believe that their interests are being un- or under-represented.

Establishing public directors consistent with American attitudes toward the public-private relationship

My proposal for public directors would enter the debate about nationalization by rejecting both comprehensive nationalization and the appointment of invisible U.S. Trustees for the most distressed institutions. Nationalization is either the compensated state ownership or management of formerly private enterprises, or government confiscation of private assets for public use. The former approach is not compatible with American traditions of regulated markets, and the latter may remind many economists of the much-criticized Japanese model.

The tradition of separating government regulation from government ownership is especially important in the financial sector. Rejecting nationalization should not lead, however, to complacency and indirect endorsement of the status quo of CEO primacy that produced the crisis and its attendant compensation scandals. The government has already essentially adopted virtual nationalization with the conversion from convertible preferred stocks to the common stock plan. Yet the conversion to common stock has not matched this move toward national ownership with the representation that taxpayers need and deserve.

Rejecting informal, behind-the-scenes relationships between corporate officers, Treasury-appointed trustees, and regulators does not mean that there is no appropriate vehicle for expressing the views of taxpayers as shareholders. Public directors are the appropriate vehicle for satisfying the American democratic values of representation, transparency, accountability, and prudent managerial innovation.

The Congressional Oversight Panel report for February 2009 noted that after only four months, significant questions had already emerged about the processes used to make and manage TARP investments. On one hand, financial CEOs and their boards see regulators as unaccountable bullies, intruding into a domain of private strategic decision-making with the coercive tools of government action. On the other hand, the public strongly objects to behind-the-scenes negotiations in which billions of taxpayer funds are delivered, with few strings attached, to the same CEOs whose poor judgment contributed to the crisis. The conflicting perceptions held by financiers and taxpayers can only be reconciled by directors who explicitly represent taxpayers as shareholders on the boards of any firm in which the United States owns a controlling interest.

The key will be to implement public directors in a way that ensures they fill the functions they are intended to serve as well as possible—providing transparency, accountability, and a fair deal to taxpayers. The federal regulators should determine most of the details since they are the ones who have the most direct experience in trying to manage private companies that have received public funds. But it will be critical for the federal government to follow at least two key principles while doing so: installing public directors in a manner proportional to the government's stake in the company, and seeking diversity of representation and commitment to public service among the directors.

Principles for implementing public directors

1. Install public directors based on the principle of proportionality.[60]

The principle of proportionality should be applied to government investments in private firms. Public directors should be appointed to the boards of directors on a roughly proportional level to the amount of funding received by the rescued firm, and this should include not just purchases of company stock, but other investments and subsidies provided to the firm to help support it.

For example, if a company receives government funding equivalent to 25 percent of its market capitalization, public directors should make up roughly 25 percent of that company's board. Given current laws, the implementation of this proposal may require legislation to provide federal authorities with the authority to bypass corporate bylaws and install public directors. This type of authority could be given to the proposed systemic risk regulator as a sort of "resolution-light" type power—an additional tool for the systemic risk regulator that could be used in lieu of declaring systemically important firms insolvent and taking them over, when circumstances dictated.

2. Choose directors based on their history of public service and the diversity of their life experiences.

Diversity is necessary for good governance. Public directors should represent taxpayer interests, they should have a history of public service, and they should be chosen to provide both intellectual diversity and diversity of perspective gained from individual experience. They should also have experience and expertise that is outside of the economic sector in which they serve.

Insularity has been—and continues to be—a major defect in the financial sector's decision-making structure. It is distressing to find that 92 percent of the directors who approved the dramatically flawed compensation policies and ineffectual risk management practices that led to global financial failure are still in place and have received $12 trillion of taxpayer support.[61] In return, these same boards have failed to increase lending,[62] and many have used the liquidity provided by the FDIC guarantees and the Treasury capital infusions to book eye-popping profits in the second quarter of 2009.[63]

A small circle of elite business leaders continue to cross-designate one another to serve on boards. This limited circle of corporate officers and directors has led to an unspoken agreement of reciprocal passivity. CEOs populate each others boards, and then all defer to one another. This leads to the accumulation of once-unthinkable strategic risk, fueled by the escalation of over-the-top pay and benefits that have horrified the general public in the current crisis.

Conclusion

The proposal to appoint public directors is designed to restore public trust by making government participation in management visible, transparent, and accountable. The United States has demanded sweeping management changes, liquidation, and radically restructured business plans for the auto companies, so why should it not demand a similar range of solutions from the banks? The public director as it is conceived here has the advantage of blending government participation with existing corporate structures. This blending takes place even as the introduction of corporate directors should bring needed intellectual and experiential diversity and change to corporate problem-solving in the crucial financial sector, where taxpayer subsidies are concentrated.

Capturing shareholder and depositor resources for the unchecked benefit of bank holding company management is not a new phenomenon. In 1906, the controller—now comptroller—of the currency delivered an angry Jeremiad to a meeting of bankers in Philadelphia: "There is no excuse for such robbery (corporate fraud and looting by CEOs) of a bank. It cannot happen where the directors are honest and doing their duty."[64] Those comments are as applicable to today's truly excessive bonuses, options backdating, and other elaborate perks, as they were during earlier banking crises.

Boards of directors should provide diverse experience, wise counsel, and moral counterweights to the management of corporations. Intellectual diversity becomes even more crucial during a crisis of confidence—such as we recently endured—in the leadership of both the public and private sector leaders of the financial crisis.

Public directors have the promise of bridging the hybrid public-private combination of government ownership and newly improvised government regulation. Public directors will not be a silver bullet insuring perfect accountability, but they offer the opportunity to begin changing in the corporate culture of board passivity, insularity, and intellectual homogeneity. The magnitude of the financial and economic crisis makes clear that this internal problem needs addressing. Public directors represent the most effective option for beginning to stimulate this necessary reversal.

Endnotes

1 I especially appreciated the insightful comments and editorial suggestions of David Min, Assoc. Director Financial Markets, Center for American Progress. William Bratton, Michael Diamond and Steven Salop of Georgetown University Law Center, and Robert L. Thompson of Vanderbilt Law School (visiting Georgetown) read & commented on early drafts. William F. Steinwedel, Sol. L. Kim, and Jennifer Locke Davitt provided invaluable research assistance.

2 This includes $9.0 trillion in investments, $1.7 trillion in insurance, and $1.4 trillion in lending. See "Adding Up the Government's Total Bailout Tab," *The New York Times*, February 4, 2009, available at http://www.nytimes.com/interactive/2009/02/04/business/20090205-bailout-totals-graphic.html. This is the lowest estimate of taxpayer money already spent. The Office of the Inspector General, however, stated that over $23.7 trillion dollars of taxpayer money is at risk in various bailout programs. Neil Barofsky, *Office of the Inspector General for the TARP Program Quarterly Report, July 21, 2009*, Congressional Report, July 21, 2009 available at http://www.sigtarp.gov/reports/congress/2009/July2009_Quarterly_Report_to_Congress.pdf.

3 Emma Coleman Jordan, Keynote address, January 27, 2009 Council of Institutional Investors Meeting. "The Causes and Consequences of Structural Amnesia in the Financial Sector", Mayflower Hotel, Washington, D.C. January. I urged the council to support a focused agenda for reform based first on creation of "public directors" as direct representatives of the taxpayers. The Council of Institutional Investors is the nation's largest group of shareholder activist organizations it includes for example, TIAA-CREF, and California Public Employees Retirement System, CALPERS. *See also*, excellent argument supporting public directors approach in Robert B. Reich, "We Need Public Directors on TARP Bank Boards," *Wall Street Journal*, April 25, 2009, p. A11.

4 Intellectual diversity and identity diversity are distinct concepts. An example of the difference can be found in the similar positions of African-American former Secretary of State Condolezza Rice and former Vice President Richard Cheney, a white male, on the issue of "enhanced interrogation techniques." *See*, Stanford Student confronts Rice on Torture, CBS, available at http://cbs11tv.com/national/condoleezza.rice.torture.2.998870.html; and *New York Times* Editorial, "Legalized Torture Reloaded," October 26, 2005, available at http://www.nytimes.com/2005/10/26/opinion/26wed2.html. Former Secretary of State Colin Powell—an African-American male—and Senator John McCain—a white male—have both supported legislation to comply with international treaties on torture. It is thus clear that diversity of life experience and/or personal identity does not automatically imply intellectual diversity, or vice versa.

5 Steven Ramirez, "Games CEOs Play and Interest Convergence Theory: Why Diversity Lags in America's Boardrooms and What to Do About It," 61 Washington and Lee Law Review 1583 (2004). This article discusses how the lack of diversity in corporate boardrooms leads to boards of directors picking people of similar backgrounds to their own to be CEOs of companies.

6 Only after heavy lobbying by President Bush and Secretary Paulson, and some major revisions to the substance of the legislation, including the creation of a Congressional Oversight Panel (COP) to oversee TARP and a TARP Inspector General's office, was the TARP fund created, via the Emergency Economic Stabilization Act of 2008, which narrowly passed both chambers of Congress.

7 Congressional Oversight Panel, February 6, 2009, February Oversight Report. Valuing Treasury's Acquisitions. The report concludes that "Treasury paid substantially more for the assets it purchased under the TARP than their then-current market value."

8 Ibid, p. 10. In its response to the Oversight Panel, Treasury identified two metrics: (1) the average credit default swap spread for the eight largest U.S. banks; and (2) the spread between the London Interbank Offered Rate, or LIBOR, and Overnight Index Swap rates, or OIS.

9 "Accountability. Willingness to hold management accountable and to prevent excessive risk-taking in the future; also, to build public trust that any taxpayer support is designed to protect the system by replacing – and, in cases of criminal conduct, prosecuting failed managers. Accountability for managers appears critical both in terms of public support and in terms of facilitating an accurate assessment of the financial status of sick financial institutions. See, Congressional Oversight Panel, TARP Oversight Report (April 7, 2009), p. 71.

10 It is worth noting that the Obama administration has initiated some highly criticized programs of its own, including the Term Asset-Backed Securities Lending Facility and the Public-Private Investment Program, both of which were heavily criticized as being giveaways to banks and hedge funds. Martin Crut Singer and Daniel Wagner, "Treasury Picks 9 Managers For Toxic Asset Program," *Associated Press*, July 8, 2009; Andy Kroll, "The Greatest Swindle Ever Sold," *Huffington Post*, May 26, 2009.; Bob Davis and John Hilsenrath, "Federal Intervention Pits Gets v. Gets-Nots," *Wall Street Journal*, June 15, 2009; Jeffrey Sachs, "The Geithner-Summers Plan is Even Worse Than We Thought," *The Huffington Post*, April 8, 2009.

11 The April Oversight Report groups a variety of metrics into "improving metrics," "worsening metrics" and "intermediate metrics." Improving metrics include the TED spread and the LIBOR-OIS spread while worsening metrics include corporate bond spreads and housing prices. Intermediate metrics include spreads on overnight commercial paper and credit card borrowing. Ibid, p. 29-35.

12 Lucian Bebchuk and Jesse Fried, *Pay without Performance: The unfulfilled Promise of Executive Compensation*, Chapter 5, 62-64 (2004).

13 Chrysler was "bailed out" through a series of loans made out of the TARP fund, as well as a federal guarantee on Chrysler warranties, which it used to continue operating while it sought new sources of capital. Chrysler eventually sold itself to Fiat under a managed bankruptcy process. David E. Sanger and others, "Bush Aids Detroit, But Hard Choices Wait for Obama," *New York Times*, December 19, 2008; Sheryl Gay Stolberg and Bill Vlasic, "U.S. Lays Down Terms for Auto Bailout," *New York Times*, March 30, 2009.

14 Emma Coleman Jordan, Keynote address, January 27, 2009. "The Causes and Consequences of Structural Amnesia in the Financial Sector", Council of Institutional Investors Meeting, Mayflower Hotel, Washington, D.C. January. I urged the Council to support a focused agenda for reform based first on creation of "public directors" as direct representatives of the taxpayers. The Council of Institutional Investors is the nation's largest group of shareholder activist organizations it includes for example, TIAA-CREF, and California Public Employees Retirement System, or CALPERS.

15 Lucian Bebchuk and Jesse Fried, *Pay without Performance: The unfulfilled Promise of Executive Compensation* (Cambridge: First Harvard University Press, 2004) Chapter 6-8 at 80-110.

16 It should be noted that TARP is not the only vehicle by which Treasury is dispensing massive amounts of taxpayer subsidies onto private businesses. In addition to TARP, there are a number of other Federal, Treasury, and FDIC programs that have effectively committed many trillions of dollars to providing support and subsidy to ailing financial institutions. See http://www.nytimes.com/interactive/2009/02/04/business/20090205-bailout-totals-graphic.html.

17 The TSLF provided short term liquidity to investment banks (which were historically not allowed to directly access Fed lending). Press Release, Board of Governors of the Federal Reserve System, Federal Reserve Actions Done At Meeting of G-10 Bankers (March 11, 2008).

18 The Primary Dealer Credit Facility, or PDCF, is an overnight loan facility that provides funding to primary dealers for a specified range of eligible collateral and is intended to foster the functioning of financial markets more generally. *Primary Dealer Credit Facility,* Board of Governors of the Federal Reserve System, available at http://www.federalreserve.gov/monetarypolicy/pdcf.htm.

19 The Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, or AMLF, extends loans to banking organizations to finance their purchases of high-quality asset-backed commercial paper from money market

mutual funds. Press Release, Board of Governors of the Federal Reserve System, Federal Reserve Announces Two Rules Related to AMLF (January 30, 2009).

20 The Temporary Guarantees Program for Money Market Funds insures shareholder assets in participating money market funds as of the close of business on September 19, 2008. In other words, if a money market fund that participates in the guarantee program subsequently fails to maintain a stable $1.00 NAV, the program will provide coverage to shareholders up to the amount they owned on the date the program was announced. This action is intended to enhance market confidence and alleviate investors' concerns about the ability of money market funds to absorb a loss. See FINRA Investors, "Treasury's Guarantee Program for Money Market Mutual Funds: What You Should Know," Press release, October 1, 2008.

21 The CPFF provides a liquidity backstop to U.S. issuers of commercial paper through a special purpose vehicle, or SPV, which will purchase three-month unsecured and asset-backed commercial paper directly from eligible issuers. The Federal Reserve will provide financing to the SPV under the CPFF and will be secured by all of the assets of the SPV and, in the case of commercial paper that is not asset-backed commercial paper, by the retention of up-front fees paid by the issuers or by other forms of security acceptable to the Federal Reserve in consultation with market participants. Press Release, Board of Governors of the Federal Reserve Board, Federal Reserve Board Announces Creation of Commercial Paper Funding Facility, October 7, 2008.

22 The FDIC has created the Temporary Liquidity Guarantee Program to strengthen confidence and encourage liquidity in the banking system by guaranteeing newly issued senior unsecured debt of banks, thrifts, and certain holding companies, and by providing full coverage of non-interest bearing deposit transaction accounts, regardless of dollar amount. "Temporary Liquidity Guarantee Program," FDIC, available at http://www.fdic.gov/regulations/resources/tlgp/index.html.

23 As government-sponsored entities, Fannie and Freddie were never purely private institutions, so the government's actions in supporting those entities—namely guaranteeing their obligations and placing them in conservatorship—are not directly relevant to the issue of public directors.

24 In addition to taking over the GSEs, the Fed also announced a number of measures designed to shore up confidence in the debt securities issued by the GSEs, which were widely held by international investors and generally thought to have the backing of the U.S. government. These measures included the authorization of Fed lending to the GSEs, the announcement by the Treasury that it would increase the GSEs' credit lines and purchase equity in them if needed, an emergency ban on short-selling GSE shares by the SEC, and the passage of substantial GSE reform by Congress. See: http://timeline.stlouisfed.org/index.cfm?p=timeline.

25 AIG subsequently received additional public funds in three separate actions by the federal government. Taxpayer funds to AIG now total nearly $200 billion in total. See: http://www.reuters.com/article/newsOne/idUSTRE52624P20090308.

26 Zachary Kouwe, "Paulson Counters His Critics," *The New York Times*, July 17, 2009; Frontline: Inside the Meltdown (PBS Television Broadcast: February 17, 2009). This article and this television program demonstrate how everyone—especially Treasury Secretary Henry Paulson—did not fully appreciate the systemic risk that Lehman Brothers failure would cause for the economy.

27 Liz Moyer, "Lehman Auction Leaves Cloudy Picture for Banks," *Forbes.com*, October 10, 2008, available at http://www.forbes.com/2008/10/10/lehman-bonds-banking-biz-wall-cx_lm_1010auction.html?feed=rss_news.

28 This view is the one that is most generally held in the public and in business circles. Lynnley Browning, "In A Fallout From Crisis, Rethinking Risk and Human Judgment," *New York Times*, November 20, 2008.; Testimony of Edward Liddy, CEO AIG, 111th Congress (2009). However, another view, that AIG and Fannie and Freddie Mac caused the credit crisis, has been argued by a few economists. John B. Taylor, "How the Government Created the Credit Crisis," *Wall Street Journal*, February 9, 2009.

29 Cait Murphy, *Barry Ritholz: The Real Cost of Life in Bailout Nation*, CBS Moneywatch, May 29, 2009. available at http://moneywatch.bnet.com/economic-news/article/the-real-price-of-life-in-bailout-nation/306729. In this interview, Barry Ritholz, the author of Bailout Nation, says that the government giving all of these companies bailouts leads to, as he says, "moral hazard run riot" in the business community.

30 Indeed, this bill was not initially passed, as populist outrage about the enormous bill to be picked up by taxpayers grew. Only after a second round of heavy lobbying and the inclusion of major taxpayer protections, such as the inclusion of an Inspector General and Congressional Oversight Panel for the TARP Fund, was the TARP bill passed into law. See Bill Moyers Journal, October 3, 2009, Interview with Professor Emma Coleman Jordan, Georgetown University Law Center. BILL MOYERS: "On Monday, the people rose up and Congress backed down, sending the bailout to defeat. But then the lobbyists rushed in with a Brinks truck of bribes, and this afternoon Secretary of the Treasury Henry Paulson got $700 billion dollars to save the system that his crowd on Wall Street had exploited to enrich themselves while plunging the country to the edge of catastrophe."

31 The administration's white paper refers to "firms whose failure could pose a threat to financial stability due to their combination of size, leverage, and interconnectedness" as "Tier 1 FHCs". See http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.

32 "We must work to establish a "fiduciary society," where manager/agents entrusted with managing other people's money are required—by federal statute—to place front and center the interests of the owners they are duty-bound to serve." John Bogle, Crisis of Epic Proportions, *The Wall Street Journal*, April 21, 2009. p. A19.

33 Ibid.

34 An example of this is the acquisition of Bear Stearns by JP Morgan Chase, in which the Federal Reserve guaranteed $29 billion of Bear assets to facilitate the deal. Andrew Ross Sorkin, "JP Morgan Pays $2 a Share for Bear Stearns," *The New York Times*, March 17, 2008.

35 The federal government oversaw the buying of Chysler by Fiat and a partnership between the UAW, investors and the government to buy GM. Sheryl Gay Stolberg and Bill Vlasic, "U.S. Lays Down Terms for Auto Bailout," *The New York Times*, March 30, 2009.

36 An example of this is AIG. Andrew Ross Sorkin and Mary Williams Walsh, "U.S. Provides More Aid to AIG," *The New York Times*, November 11, 2008. "AIG Credit Facility Trust Agreement," Federal Reserve Bank of New York, January 16, 2009, p. 14.

37 Edward V. Murphy and Baird Webel. "Proposal for Treasury to Buy Mortgage Related Assets to Address Financial Instability," CRS Report for Congress, September 22, 2008, available at http://fpc.state.gov/documents/organization/110286.pdf.

38 The government has at least 17 programs helping the credit markets of either individual companies or the credit system as a whole: the Capital Purchase Program, the Automotive Industry Financing Program, the Auto Supplier Support Program, the Auto Warranty Commitment Program, the Unlocking Credit for Small Business, the Systemically Significant Failing Institutions Program (this program is better known as another group of initials, AIG, the Targeted Investment Programs [better known as Citigroup and Bank of America], the Asset Guarantee Program, the Term Asset Backed Securities Loan Facility, the Public Private Investment Program, the Capital Investment Program, the Primary Dealer Credit Facility, the Asset-Backed Commercial Paper Money Market Liquidity Facility, the Temporary Guarantee of Program for Money Market Funds, Commercial Paper Funding Facility, and the Temporary Liquidity Guarantee Program. The total possible cost to the tax payer is in the tens of trillions of dollars. Neil Barofsky, *Office of the Inspector General for the TARP Program Quarterly Report, July 21, 2009*, Congressional Report, July 21, 2009 available at http://www.sigtarp.gov/reports/congress/2009/July2009_Quarterly_Report_to_Congress.pdf; Board of Governors of the Federal Reserve.

39 The "stress test" is an assessment of capital conducted by the Federal Reserve System and thrift supervisors to determine if the largest U.S. financial organizations have sufficient capital to provide against higher-than-expected losses. Timothy Geithner, How We Tested the Big Banks, *The New York Times*, May 7, 2009, pg. A33; Board of Governors of the Federal Reserve System, "The Supervisory Capital Assessment Program: Design and Implementation 1 (2009). For references, *see* FAQs—Supervisory Capital Assessment Program, available at http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20090225a1.pdf; "Grading the Banks' Stress Test," *New York Times*, May 6, 2009, available at http://roomfordebate.blogs.nytimes.com/2009/05/06/grading-the-banks-stress-test/?scp=2&sq=Taxpayer%20Representation%20on%20Bank%20Boards&st=cse.

40 Neil Barofsky, *Office of the Inspector General for the TARP Program Quarterly Report, July 21, 2009*, Congressional Report, July 21, 2009 available at http://www.sigtarp.gov/reports/congress/2009/July2009_Quarterly_Report_to_Congress.pdf.

41 Testimony of Henry M. Paulson, Former Treasury Secretary, before the House Committee on Oversight and Government Reform, 111th Congress, July 16, 2009, available at http://oversight.house.gov/documents/20090715180923.pdf.

42 Testimony of Kenneth D. Lewis Before the House Committee on Oversight and Government Reform Subcommittee on Domestic Policy, 111th Congress, June 11, 2009, available at http://groc.edgeboss.net/download/groc/transfer/testimony.of.mr.kenneth.d.lewis.pdf.

43 Testimony of Ben S. Bernanke, Chairman of Board of Governors of the Federal Reserve System Before the House Committee on Oversight and Government Reform, 111th Congress (June 25, 2009), available at http://oversight.house.gov/documents/20090624185603.pdf.

44 Testimony of Kenneth Lewis, CEO of Bank of America; Benjamin Bernanke, Chairman of the Federal Reserve; Paulson, former Secretary of the Treasury, before the House Committee of Government Oversight.

45 *Committee on Oversight and Government Reform U.S House of Representatives Hearing on the Collapse and Economic Rescue of AIG*, 111th Congress (May 13, 2009) (statement of The Trustees of the AIG Credit Facility Trust.)

46 "AIG Credit Facility Trust Agreement," Federal Reserve Ban k of New York, January 16, 2009, p. 14.

47 Ibid, p. 4.

48 Ibid, p 5.

49 Ibid, p 7.

50 Ibid, p 10.

51 Ibid, p 13.

52 Committee on Oversight and Government Reform, U.S. House of Representatives, Hearing on the Collapse and Economic Rescue of AIG.

53 Monica Langley and others "AIG Trustees Seeking New Board, New CEO," *The Wall Street Journal*, May 13, 2009, available at http://online.wsj.com/article_email/SB124215047119211479lMyQjAxMDI5NDEyMzExNTMwWj.html.

54 Committee on Oversight and Government Reform U.S. House of Representatives Hearing on the Collapse and Economic Rescue of AIG.

55 Federal Reserve Bank of New York, "AIG Credit Facility Trust Agreement," January 16, 2009. In this document, the trustees' role is defined and their potential control over management is described. However, the "hands-off" approach described in this agreement leaves much room for abuse.

56 Edmund L. Andrews and Peter Baker, "AIG Planning Huge Bonuses After $170 Million Bailout," *The New York Times*, March, 15, 2009, p. A1.

57 Steven M. Davidoff, "We Fought AIG and AIG Won," *The New York Times*, April 21, 2009, available at http://dealbook.blogs.nytimes.com/2009/04/21/we-fought-aig-and-aig-won.

58 Letter from Jill M. Considine, AIG Trustee, to Edward Liddy, CEO of AIG, May 7, 2009.

59 Statement of the Trustees of the AIG Credit Facility Trust before the House Committee on Oversight and Government Reform, Hearing on the Collapse and Economic Rescue of AIG, 111th Congress, May 13, 2009. In this testimony the trustees said, "The company should benchmark AIG's compensation levels against available market data of organizations of similar size and complexity with which AIG competes for talent. These data should be used as a guide in assessing the appropriateness of any compensation plan."

60 An important question that will arise in any instance in which the United States becomes a controlling shareholder is whether the United States will be subject to fiduciary duties to the corporation in which the controlling interest is held. In this discussion, the controlling interest arises when a shareholder holds a majority (50% +1) of voting shares. The right and opportunity to designate some directors may arise well before the dominant shareholder acquires the right to elect the entire board. The United States, as shareholder, can both represent the taxpayer interest, and avoid the political and economic quagmire of full nationalization by designating public directors, in proportion to their ownership interest.

It would be unwise to think that the United States is just like any other shareholder. The ownership interest arises because of a systemic crisis that is inversely related to the economic profitability of the "investment." Unlike ordinary shareholders looking for the highest return, the United States is concerned with the viability of the entire financial system, both in America and globally. This interest in systemic health may lead to actions that forebear the full spectrum of options to maximize the profitability of any individual firm.

61 John D. Stoll and Josh Mitchell, "Bloom: Boards in Charge," *The Wall Street Journal*, July 28, 2009; Deborah Solomon, "U.S. Pay Czar To Rework Contracts Deemed High," *Wall Street Journal*, July 27, 2009.

62 David Enrich and Dan Fitzpatrick, "Loans Shrink as Fear Lingers," *The Wall Street Journal*, July 27, 2009.

63 Mark Gongloff, "Banks Profit from US Guarantee," *The Wall Street Journal*, July 28, 2009.

64 "Ridgely Blames Boards for Bank Robberies," *The New York Times*, September 27, 1933.

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