Hearing Summary

HEARING ON EXECUTIVE COMPENSATION II: CEO PAY AND THE MORTGAGE CRISIS

Rep. Henry A. Waxman
Chairman, Committee on Oversight and Government Reform

The Committee on Oversight and Government Reform held a hearing titled, "Executive Compensation II: CEO Pay and the Mortgage Crisis" on Friday, March 7, 2008. The hearing examined the compensation and retirement packages granted to the CEOs of three corporations deeply involved in the current mortgage crisis. This was the Committee's second hearing on executive compensation practices. On December 5, 2007, the Committee examined the role of compensation consultants in determining CEO pay.

CEO Pay Continues to Rise Dramatically. Executive pay is increasing rapidly and dramatically. The CEOs of the 500 largest American companies received an average of $15 million each in 2006, a 38% raise from 2005. And the gap between CEOs and other workers is also increasing. In 1980, CEOs were paid 40 times the average worker. Today, they are paid 600 times more.

A Case Study. The mortgage crisis and credit crunch has proven devastating to both homeowners and our nation's economy. At the time of the hearing, over 7% of all mortgages were delinquent or in foreclosure, the highest rate ever recorded. As of June 2008, the number of home loans past due or in foreclosure has risen to 8.8%. Banks in the United States have written off billions in assets. Mortgage companies have gone under or are on the brink. Thousands of Americans have lost their jobs and their homes.

In order to examine this issue more closely, the Committee undertook a case study of three companies that gambled heavily on the mortgage market and lost: Countrywide Financial Corporation, Merrill Lynch, and Citigroup.

Countrywide lost $1.6 billion in 2007 and its stock lost 80% of its value. In 2007 Merrill Lynch lost $10 billion and its stock lost 45% of its value. Citigroup also lost $10 billion and its stock lost 48% of its value. By any measure, these were extraordinary losses and the CEOs of Merrill Lynch and Citigroup were forced to resign in light of these results. The CEO of Countrywide is also being forced out once Bank of America completes its acquisition of Countrywide.

As the Committee's investigation and hearing demonstrated, the pay received by these CEOs as they exited their respective companies was also extraordinary.

The Committee Investigation and Staff Memorandum. In preparation for the hearing, Committee staff received thousands of pages of documents from the three companies, including board minutes and internal company e-mails. Committee staff also reviewed hundreds of public Securities and Exchange Commission filings and consulted with leading experts in executive compensation.

Shortly before the hearing, the Committee released a staff memorandum [insert link here] examining the apparent breakdown between shareholder interests and the compensation and retirement benefits awarded to Angelo Mozilo of Countrywide, E. Stanley O'Neal of Merrill Lynch, and Charles Prince of Citigroup.

The staff memorandum demonstrated that the compensation of the CEOs and their shareholders' interests were not aligned. Despite steep declines in the performance and stock price of the three companies, Mr. Mozilo, Mr. O'Neal, and Mr. Prince were rewarded generously. In 2007, Mr. Mozilo received over $120 million in compensation and sales of Countrywide stock; Mr. O'Neal departed with a $161 million "retirement package" and Mr. Prince was awarded a $10 million bonus, $28 million in unvested stock and options, and $1.5 million in annual perquisites upon his departure from Citigroup.

The View from Main Street. At the hearing, Wharton School professor and real estate finance expert Susan M. Wachter explained how skewed compensation incentives led to the mortgage market meltdown and credit crunch. Dr. Wachter referred to the crisis as a "textbook demonstration of how misaligned incentives cause financial markets to fail."

The Committee also heard directly from state and local officials dealing with the impact of the crisis directly. Massachusetts Secretary of State William F. Galvin described the consequences of the bursting credit bubble and frozen credit markets on individual investors, small businesses, and local governments. Secretary Galvin also described his experiences investigating the sale of complex collateralized debt obligations to cities, towns, and other investors in Massachusetts. Secretary Galvin noted the link between the havoc created by these complex financial instruments and the Wall Street banks that created them.

Brenda Lawrence, Mayor of the City of Southfield, Michigan, discussed the problem of home foreclosure in her community and the spillover effect with regard to the city's budget, crime level and home values.

Corporate governance expert Nell Minow emphasized that Countrywide, Merrill Lynch and Citigroup all designed executive compensation programs with "all upside and no downside" that affected their CEOs' assessment of risk. As a result, the CEOs of these companies were "able to offload the risk onto the shareholders without much in the way of adverse consequences to himself." Ms. Minow also noted that it is not the CEO but members of the boards of directors that are ultimately responsible for determining the structure and level of executive compensation. The attention of regulators, lawmakers, and shareholders should therefore focus on members of the board.

The View from Wall Street. The Committee also heard from the CEOs and compensation committee chairs of Countrywide, Merrill Lynch, and Citigroup. These witnesses explained how their respective companies established the pay and departure packages received by Mr. Mozilo, Mr. O'Neal and Mr. Prince, and emphasized that the amounts received were, in fact, linked to performance.

Closing Observations. Chairman Waxman concluded the hearing by reiterating that the mortgage crisis is having enormous repercussions across the economy. Families are losing their homes and thousands are losing their jobs. Yet the CEOs who had a very direct role in creating the mortgage problem were granted enormous departure packages on their way out the door. This demonstrates that we do not have a system where there are real consequences for failure. Simply put, executives who preside over billions of dollars in losses should not be receiving millions in cash bonuses, stock and other perquisites. Without a better mechanism for holding corporate executives accountable, our economy will remain vulnerable to the kind of disruption now being experienced.

Additional information, including Chairman Waxman's statement, copies of testimony, and a transcript of the hearing, is available online at www.oversight.house.gov.