The U.S. pay czar will cut in half the average compensation for 175 employees at firms receiving large sums of government aid, with the vast majority of salaries coming in under $500,000, according to people familiar with the government’s plans.

As expected, the biggest cut will be to salaries, which will drop by 90% on average. Kenneth Feinberg, the Treasury Department’s special master for compensation, also intends to demand a host of corporate governance changes at those firms.

Mr. Feinberg’s ruling, expected in coming days, will provide fodder for the long-running debate about whether the Obama administration is being overly tough or overly lenient on Wall Street. An executive at one of the seven companies under Mr. Feinberg’s authority said the terms came as a shock, especially because they changed so suddenly. The compensation restrictions “were clearly much worse than what had been anticipated.”

The largest single compensation package will be less than $10 million and is destined for a Bank of America Corp. employee, according to people familiar with the matter. That’s much less than Wall Street’s standard payouts for star employees.

Yet some executives will still walk away with large paychecks. And some big salary cuts might skew overall numbers. Outgoing Bank of America Chief Executive Ken Lewis will receive no salary for 2009. Already, Citigroup Inc. is telling employees the net impact of Mr. Feinberg’s rulings will be minimal because the cut salary will be shifted from cash to longer-term stock grants, said people familiar with the matter.

The Obama administration gave Mr. Feinberg the job of more closely tying compensation to long-term performance, something the White House believes will help prevent employees from taking unnecessary risks for short-term gains. The administration believes skewed compensation incentives were one cause of the financial crisis.

In addition to setting dollar amounts for the top 175 employees at the seven companies, Mr. Feinberg is also charged with setting compensation structures for an additional 525 people at the firms.

Some of the toughest pay restrictions will come at the financial-products unit of American International Group Inc., which has been blamed for the firm’s near-collapse. No employee within that unit will receive compensation of more than $200,000, people familiar with the matter said.

The companies under Mr. Feinberg’s authority are AIG, Bank of America, Citigroup, General Motors Co., GMAC Inc., Chrysler Group LLC and Chrysler Financial.

Mr. Feinberg will also de-
mand a series of corporate governance changes at the firms, including splitting the chairman and CEO positions, requiring boards of directors to create "risk" committees and eliminate staggered board elections, which critics charge inhibit change.

The point of biggest debate will be the cutting of cash salaries, which are expected to hold below $500,000. Instead, employees will receive what has become known as "salary stock"—long-term stock grants in lieu of cash that can't be touched for at least four years. Employees could receive a lot of these grants in the next two months because Mr. Feinberg wants them issued in 2009.

Included in Mr. Feinberg's order are incentives for these companies to return the government's cash. Employees might get earlier access to their long-term stock grants if their companies pay back their bailout funds.

Companies under the pay czar's purview gave sharply differing reactions to the latest news. At Bank of America, executives worried about how the changes will be received by the global banking and markets group, run by Thomas Montag and home to a number of highly paid investment bankers, executives say. Mr. Montag is among those expected to have his pay slashed, even though his total compensation may still appear large by non-Wall Street standards.

The bank has lured a number of new recruits to this group in recent months, in some cases with multiyear guarantees.

At Citigroup, which is 34%-owned by the U.S. government, officials say the review isn't causing the upheaval some feared.

After weeks of negotiations, which led Citigroup to sell its energy trading unit to dispense with the salary of a star trader, Citigroup executives are comfortable the pay czar won't rebuke the company for its compensation practices.

Citigroup agreed to rebrand the contracts of a handful of traders and senior investment bankers, according to people familiar with the matter. But several Citigroup officials briefed on the company's dialogue with Mr. Feinberg's office said salaries and total compensation of the company's highest-paid employees aren't expected to shrink dramatically.

Partly as a result, some Citi group officials on Wednesday dismissed as political posturing reports that Mr. Feinberg intended to slash pay packages by 50% or more. One executive described it as "a bit of a hoax."

Mr. Feinberg's four-month effort to corral pay is one of the most visible ways the government has become intertwined with the private sector since the crisis began.

"There's definitely never been anything like this where a government sets pay for a company that's publicly traded," said J.W. Verret, a corporate law expert at George Mason University School of Law.

Espen Eckbo, director of the Center for Corporate Governance at Dartmouth College's Tuck School of Business, said the changes to corporate governance could be even more significant.

"'s, Charles Schumer (D. N.Y.) plans to press for legislation extending Mr. Feinberg's governance changes to all publicly traded companies.

Treasury officials decided to create a so-called pay czar after the furore over AIG paying bonuses in March. Edward Liddy, who was then CEO of AIG, told Treasury Secretary Timothy Geithner the company wouldn't make any payments without the Treasury Department's sign-off.

For several weeks, Mr. Geithner himself was making decisions such as whether a certain employee could collect a pension payment.

"It was definitely not a good use of his time," recalls one government official.

Since bringing Mr. Feinberg to the Treasury Department, the Obama administration has largely stayed out of his business, preferring instead to let him make the controversial calls unlikely to please many people.

Mr. Feinberg has met with Mr. Geithner just twice and hasn't spoken with White House officials at all.

The hands-off approach is part of a move by the administration to avoid making the hard decisions confronting Mr. Feinberg and to stave off criticism for what he ultimately decides. That hasn't stopped Mr. Feinberg from invoking the potential for political backlash, including from the White House, in negotiations, company officials say.

—David Enrich and Joann S. Lublin contributed to this article.