

# Large Bank Governance Reform

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May 28, 2010

# Objectives

- Value maximization of the firm.
- Other objectives relating to other stakeholders?
  - The FDIC?
  - Borrowers?
  - The economy?
- These are aspects that bank regulation (capital regulation, liquidity regulation, etc.) can and should address, but management should stick to its knitting of maximizing firm value.
  - Focus is good
  - Value maximization leads to efficient resource use, assuming that distortions from safety nets, and externalities of insufficient capital can be addressed by regulation. Which they can.

# Problem

- Agency problem between manager and stockholders is key friction.
- Temptation in banks of value-destroying short-term risk taking under asymmetric information?
- Large banks are often fragmented, making agency problems more severe.
  - Takeovers are not feasible because of human resource intensity. Good employees will leave if there is a protracted control battle.
  - Private equity investors are also limited by commerce-banking restrictions and suitability rules.
  - Other institutional investors, as with all public firms are limited to small percentage holdings.
- See Bhagat and Bolton (2010) on crucial role of director ownership and corporate governance/performance.

# Solutions

- Remove ownership restrictions on institutional investors of all types, and encourage appointment of independent directors with large ownership stakes.
- Regulate pay to create long-term objectives. Restrictions can force long-term focus, albeit at a cost (more pay).
- Regulations that impose and reward market discipline in the debt market (CoCos) would work well to solve agency problem since the main concern – value-destroying risk taking – is something outside stockholders and debtholders can agree on, and concentrated debt holders would have incentive to monitor and punish it. (CoCos have other benefits, too.)
- Long-term equity-based pay, concentrated ownership, and CoCos reinforce each other, since CoCos punish equity holders via dilution effects of either conversion or preemptive offerings.