



Governance and banks

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Bank governance and the economy

- We care about bank governance in particular because of the peculiar role of banks in the economy: Bank governance and systemic risk
- But, one can have excellent governance and healthy banks and bank induced systemic events:
 - Spanish banks and the gigantic real estate bubble
 - They have yet to receive an euro of public capital.
 - S&Ls (“Cajas”) is another story; more below.
 - Competitive governance
 - The role of securitization



Governance and financial innovation

- Governance and risk management.
- Board are the first principal in a pyramid of principal agent problems.
- Leverage makes banks incredibly sensitive to “governance mistakes”
- One cannot think of governance independently of financial innovations:
 - Change in nature of principal agent problems.
 - Derivatives allow risk taking with little capital
 - Knowledge at the top (the board) and at the bottom (the trader)



Governance and supervision

- Governance and the role of the supervisor
- It is precisely because:
 - Of the special role of banks
 - Degree of obsolescence of corporate governance structure due to financial innovation:
 - Securitization
 - Off-balance sheet
 - Competition among financial intermediaries that prudential supervision is essential.
- Governance and competition
- Example: Spanish banks and the Bank of Spain



The “cajas”: Bad governance? - 1

- The “cajas” (the Spanish S&Ls) are where the problem of the Spanish financial system is:
- Why?
 - “FDIC” insured
 - Evident implicit political guarantee by local governments
 - Ability to attract good management?
 - Some evidence that they were the lead in particularly bad (syndicated) loans but not overwhelming.
 - Profit maximization not an objective: Cajasur, intervened by the Bank of Spain last weekend, “owned” by the catholic church and run by a priest.
 - No market mechanism of discipline



The “cajas”: Bad governance? - 2

- The political connection: Is it always bad?
 - Neither formal governance institutions (how the board is appointed) nor real ones (political connections in the board) correlate with portfolio composition or performance (Cuñat and Garicano, 2010):
 - The Basque “cajas” are the ones that have more political boards and yet they are the better run!
- It’s the chairman not the board: Loan composition and performance is worse
 - If the chairman was previously a political appointee.
 - If the chairman does not have an MBA or Ph.D.
 - If the chairman has no banking experience