FREE FLOAT RESEARCH

BANK CRISIS 2023

THE BANK CRISIS ISN'T LIQUIDITY, IT'S PEOPLE

It's possible the difference between megabank JPMorgan and broken bank First Republic is two people. That's all that separates a failed bank from arguably the largest, most stable bank in the US. And neither of those people is Jamie Dimon.

As of March 2023, there were 168 large US publicly traded banks. Nearly 2,800 people sat on the boards of those banks - they are, in essence, the US banking system. Of those, a staggeringly low 102 are risk experts. Just under 4% of the stewards of the banking system have a background in anything resembling bank risk.

Those risk experts sit on the boards of… 66 of the 168 banks. Put another way: less than half (39%) of the US banking system uses a risk expert in their oversight.

RISK EXPERTS ONLY MATTER WHEN THEY HAVE POWER

We already know that at SVB, the executives were, in fact, alerted to the duration risk they were taking but were worried about affecting the share price. They ignored the risk. Signature Bank had two executives on the bank's risk committee - of the three risk committee members. The "risk committee" was effectively an executive committee. Now, First Republic, who had roughly 70% of deposits uninsured, took exactly the same risk with exactly the same profile - no risk experts, with a twist - rather than stacking the committee with executives, they stacked it with people who arguably have no business overseeing risk at all. They included a professor in organizational psychology, the head of a resale apparel company, and an affordable healthcare foundation CEO. How much influence do you think these people had in the direction of First Republic's risk management?

Influence is “earned” in a myriad of complicated (and infinitely human) ways, ways that Board Sabermetrics aims to quantify. There have been more than 250,000 directors globally at the 9,000 publicly traded companies on the MSCI ACWI IMI in the last five years. Those directors, conservatively, have over 2 million discrete connections with one another, often decades of experiences, long tenures, various expertises, and structural nuances unique to every board or team on which they sit.

PRE-POST-MORTEM

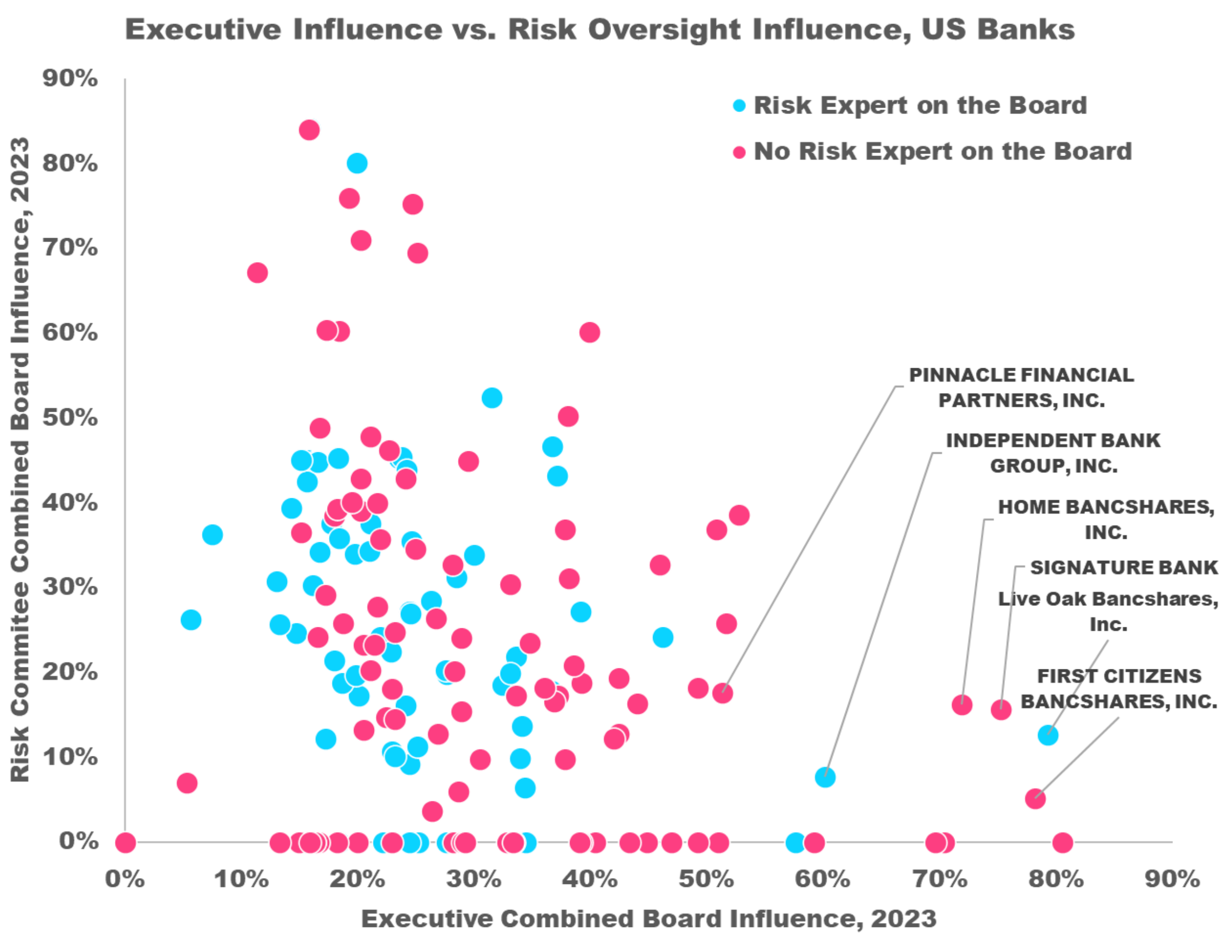
It doesn’t take that much data to find that a bank’s risk committee probably could use a risk expert, much less First Republic’s professor, apparel, and healthcare experts. What Board Sabermetrics do tell us, however, is that the risk committee members had a staggeringly low 12% of the board influence, compared to 42% of the board influence owned by executives and insiders. The result is an information asymmetry mismatch - the board *needs* the executives to make the decisions as much as the executives *own* the boardroom. Only at the failed Signature Bank was the mismatch even worse - executives controlled 75% of the board influence, including almost the entire risk committee itself.

In fact, on average, risk committee command just 28% of board influence across all the largest 168 US publicly traded banks. If that number seems high, it’s because fully 35% of risk committee members *are actually executives or former executives of the banks*. Non-executive risk committee influence stands at less than a quarter, and forget risk experts - where they DO exists, they average just 9% of board influence. Those committees are overweighted women, as well - just 21% of board members are women while 28% of risk committees are women - and our metrics show that women almost uniformly have less influence than body count.

WHO’S NEXT?

First Republic isn’t actually even the worst - there are banks in the US (40 of them) that either lack risk committees entirely or fold them into existing committees on top of other board duties. Only 8 of those have risk experts on the board at all - Silvergate, another failed bank, falls in this category. Overall, fully 54 of the largest 168 banks have executive influence greater both risk expert and risk committee influence and executives control more than a third of the board total decision making power. In maybe the greatest irony, among those is First Citizens Bank who announced their purchase of SVB assets. First Citizens has been tagged with no dedicated risk experts, 78% of the board influence is executives, and two of those executives sit on the risk committee. The remaining members are two retired PwC partners and a mechanical contractor CEO.

According to our data, no one is worse than First Foundation Bank for executive influence, however. The bank has no risk committee, no risk experts, and 81% of the influence is executives. It is a publicly-traded private company - fake public - and worse, the largest shareholder (Fidelity and BlackRock) uniformly voted FOR every director. They weren't alone - 95% of investors voted FOR First Foundation Bank's directors. 97% voted for First Citizens. Even 92% voted for First Republic. The average FOR vote for the 54 banks with outsized executive influence and limited risk influence: 93%.



NOW WHAT?

Bank-meme stock runs may be the future we can't stop, especially when it's a 1-percenter uninsured deposit panic. However, we CAN stop the rubber stamping of directors and change the "who" in "who's watching the hen house". Take JPMorgan, the now owner of First Republic bank - the 2 people that separate JPMorgan and First Republic are risk experts Tim Flynn and Linda Bammann (Bammann chairs the risk committee). The risk committee at JPMorgan has 20% of the board influence, all independent non-executives, and risk experts make up 17% of the board influence while the executives - Dimon alone - have just 28% of the influence. While Jamie Dimon may rule the board, at a minimum he has effective and powerful advisors.

While it may not be possible to say definitively "having a risk expert with influence is the difference between surviving or dying" for US banks, it certainly can't *hurt* if you're a shareholder wondering WHO should be managing the financial system.

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