BETTER MARKETS

FACT SHEET

Bank Directors Must Be Held Accountable

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Banks—including the biggest banks in the country headquartered on Wall Street—have repeated failures of the most basic risk controls, routinely break the law, and too often collapse into bankruptcy, resulting in massive losses and taxpayer bailouts. Yet, the executives and members of the Board of Directors who are responsible for hiring and overseeing the management of those banks virtually never face any accountability. Not only is that wrong, but it almost certainly results in more and greater failures because of the moral hazard it creates: after all, what incentive is there to do a better job if there's zero accountability or consequences for doing even a really bad job?

The failure of Silicon Valley Bank in March of 2023 is only the latest, most egregious example. As that bank was crashing into bankruptcy and being bailed out, its CEO was landing at his multimillion-dollar waterfront home in Hawaii. At the same time, the FDIC was literally pumping more than $20 billion into the bank to prevent its collapse, stop a destabilizing run, and prevent contagion to the rest of the banking system while the CEO was sunning himself on the beach and sipping tropical drinks. It's not clear what the directors of SVB were doing at that time, but it would seem pretty clear based on the publicly known fact that they were not properly discharging their duties to ensure the bank had competent management, was properly run, and that its risks were appropriately managed. The FDIC has since sued 17 former executives and directors of the bank for gross negligence and breaches of fiduciary duty, but it is unclear how or if the defendants will actually be held accountable.

In many areas of life, we recognize the importance of having informed, responsible people in charge, especially in complex and consequential situations. In a hospital, for example, the board of directors is trusted to hire the best doctors and ensure that professional standards of care are achieved to provide the best care for patients, who are often facing life-or-death situations.
Boards of directors for the largest banks in the country are no different. Main Street Americans should be able to expect bank boards of directors to be qualified, competent, and free from conflicts of interest because these boards have the ultimate responsibility for maintaining the health and safety of banks and protecting the life savings of Main Street Americans and small businesses.

In 2023, the Federal Deposit Insurance Corporation ("FDIC") proposed enforceable corporate governance standards. These would rightly hold the largest banks in our country accountable for meeting basic, minimum standards for operating safely and fairly. Better Markets strongly

supported these standards because they will directly support and protect consumers and small businesses as well as banks, the economy, and the entire financial system.

Unfortunately, an entire year has now passed since the public comment deadline and the proposed standards remain in limbo. To make matters worse, the FDIC's Acting Chairman Travis Hill opposed and voted against the standards when they were originally proposed and, more recently, said that a withdrawal of the proposal is among his first priorities as Acting FDIC Chairman.

Continuing to delay, or worse impede, the finalization and implementation of strong corporate governance standards is a dangerous and irresponsible action. Countless banking and economic experts from the U.S. and around the world recognize the critical importance of strong corporate governance. Moreover, there are numerous examples of inadequate corporate governance during both the 2008 Financial Crisis and the 2023 Regional Banking Crisis that directly resulted in costly, devastating bank failures and financial losses. Simply put, the FDIC must take action to implement enforceable corporate governance standards to protect Main Street Americans and the financial system by promoting accountability among those who are responsible for the operations at the banks, which includes senior management and boards of directors.

Common Sense Standards for Corporate Governance

What Is the FDIC Proposing for Directors?

The Proposal states that the board of directors "has the ultimate responsibility for the safe and sound operation of the institution, overseeing management, and fulfilling its fiduciary duties" To that end, the Proposal contains the following guidelines:

- **Board Composition** – direction on board member characteristics, backgrounds, and skills. The guidelines also state that the board should include a majority of outside, independent directors.

- **Duties of the Board** – direction on setting an appropriate tone and corporate culture that promotes responsible and ethical behavior; approving the strategic plan and policies; establishing a code of ethics; providing active oversight of management; exercising independent judgment; selecting and appointing qualified executive officers; providing ongoing training to directors; conducting an annual effectiveness self-assessment; and establishing and implementing compensation and performance management programs.

- **Committees of the Board** – direction on the establishment of an organizational structure that keeps board members informed and provides an adequate framework to oversee the bank. This structure should include an audit committee, a compensation committee, a trust committee (for covered firms that have trust powers), a risk committee, and any other committees that the board thinks are needed to perform its

duties.

Furthermore, the guidelines require ***a comprehensive and independent risk management function and effective programs for internal controls, risk management, and audit***. This includes:

- **Risk Management Program and Standards,**
- **Risk Profile and Risk Appetite Statement,**
- **Communication Processes,**
- **Processes Governing Risk Limit Breaches, and**
- **Processes Governing Identification of and Response to Violations of Law.**

Enforceable Guidelines are Vital

One of the key strengths of the FDIC's Proposal is the fact that it is enforceable, meaning that it isn't merely a set of suggestions of things that banks should do. It is legally enforceable and will hold banks accountable to minimum standards that are necessary to protect Main Street Americans' money and maintain stability in the financial system.

The Proposed Standards Would Only Apply to the Largest Banks
The Proposal would only affect FDIC-supervised institutions with total consolidated assets of $10 billion or more, or ***just 57 of the 3,012 banks that the FDIC supervises***. In other words, the remaining 2,955 banks that have less than $10 billion in total assets would not be subject to the new guidelines.

Opponents of the Proposal, including Acting Chairman Travis Hill, have said that the guidelines will be too stringent, set expectations too high, and ultimately discourage individuals from wanting to serve on boards of directors at all. However, Better Markets has consistently emphasized that necessary and appropriate rules should never be weakened for such reasons. Moreover, the potential costs or difficulty of finding individuals with appropriate skills to be effective board members are well worth the benefit of strong corporate governance.

Well-known Banking Crises, Contagion, Crashes, and Failures Resulted Directly from Inadequate Corporate Governance

2008 Financial Crisis

Numerous studies have concluded that poor corporate governance was to blame for the 2008 financial crisis. For example, the Group of Thirty ("G30") highlighted the devastating impact that ineffective corporate governance had on banks around the world in 2008 and beyond:

> In the wake of the crisis, financial institution (FI) governance was too often revealed as a set of arrangements that approved risky strategies (which often produced unprecedented short-term profits and remuneration), was ***blind to the looming dangers*** on the balance sheet and in the global economy, and therefore ***failed to safeguard the FI, its customers and shareholders, and society at large***. ***Management teams, boards of directors, regulators and supervisors, and shareholders all failed, in their respective roles, to prudently govern and oversee.***

The Organization for Economic Co-operation and Development ("OECD") also showed that the 2008 Crisis was rooted in inadequate corporate governance:

> ***When they were put to a test, corporate governance routines did not serve their purpose to safeguard against excessive risk taking in a number of financial services companies.*** A number of weaknesses have been apparent. The risk management systems have failed in many cases due to corporate governance procedures rather than the inadequacy of computer models alone: information about exposures in a number of cases did not reach the board and even senior levels of management, while risk management was often activity- rather than enterprise-based. These are board responsibilities. In other cases, boards had approved strategy but then did not establish suitable metrics to monitor its implementation.

Of course, it doesn't take a banking expert to recognize that individuals who take on the responsibility of being on a large bank's board of directors must have fluency with banking and finance to meaningfully contribute appropriately to the board's business.

Elevating people to bank boards for other reasons—such as fame, social status, or wealth—is a recipe for disaster. Evidence from some of the largest banks in 2008 shows the devastating consequences that can result from board members who do not have banking expertise:

> ***[M]ore than two-thirds of the occupants of those board seats [at the eight largest banks in 2008] had no significant recent experience in the banking business. Fewer than half had any financial services industry experience at all.***
>
> Moreover, many of the directors without a financial background happened to sit on highly technical board committees. At Lehman, for example, Roger Berlind, a theatre impresario and private investor . . . [was] on both the board's audit committee and the finance and risk committee. At Citi, John Deutch, a former head of the CIA who [was] a physical chemistry professor at the Massachusetts Institute of Technology, [sat] on the audit and risk management committee. Similarly, Tommy Franks, the retired top US Army general, [was] on the audit committee of Bank of America.

Citigroup

During the lead-up to the 2008 Crisis, Charles Prince was both Chief Executive Officer ("CEO") and Chairman of the Board of Citigroup. Despite Prince's reassurance that he and the board would set the appropriate tone at the top, establish safety nets, and correct mistakes, the effects of the bank missing massive mortgage-related risks, both on and off the balance sheet, that ultimately led to the loss of billions of dollars and served as a catalyst for the 2008 Crisis that cost millions of Americans their livelihoods. The blindness to risks that were building rendered the board superfluous at best:

> In September 2007, with Wall Street confronting a crisis caused by too many souring mortgages, Citigroup executives gathered in a wood-paneled library to assess their own well-being.
>
> There, Citigroup's chief executive, Charles O. Prince III, learned ***for the first time*** that the bank owned about $43 billion in mortgage-related assets. He asked Thomas G. Maheras, who oversaw trading at the bank, whether everything was O.K. . . .
>
> For months, Mr. Maheras's reassurances to others at Citigroup had quieted internal concerns about the bank's vulnerabilities. But this time, a risk-management team was dispatched to more rigorously examine Citigroup's huge mortgage-related holdings. They were too late, however: within several weeks, Citigroup would announce ***billions of dollars in losses***.

Morgan Stanley

Another example is at Morgan Stanley, where John Mack was CEO and Chairman of the Board from 2005 through 2009. Morgan Stanley had cumulative losses in its subprime mortgage portfolio of nearly $10 billion in the fourth quarter of 2007. Despite these enormous losses, Mr. Mack kept his job, took home an $800,000 paycheck, and deflected responsibility:

> Mr. Mack ***blamed the firm's inadequate risk-monitoring procedures*** and said the firm's risk managers would now report to the chief financial officer, which is the practice at Goldman Sachs. Previously the risk managers had reported to Zoe Cruz, the co-president overseeing trading, who was ousted by Mr. Mack last month, a further indication that ***the firm's big bets lacked objective risk oversight***. . . .
>
> By all accounts, Mr. Mack still ha[d] the support of his board. . . ***Mr. Mack, has ties to the firm's glory days in the 1970s and 1980s and with his ability to charm, he is still liked within the firm.***

Silicon Valley Bank

The [Federal Reserve Board's postmortem report on Silicon Valley Bank] ("SVB") and its holding company Silicon Valley Bank Financial Group ("SVBFG") points directly to failed corporate governance:

> ***SVBFG's rapid failure can be linked directly to its governance*** . . . ***The full board of directors did not receive adequate information from management about risks at SVBFG and did not hold management accountable.*** For example, information updates that management sent the board did not appropriately highlight SVBFG's liquidity issues until November 2022 despite deteriorating conditions. Moreover, the board put short-run profits above effective risk management and often treated resolution of supervisory issues as a compliance exercise rather than a critical risk-management issue. Compensation packages of senior management through 2022 were tied to short-term earnings and equity returns and did not include risk metrics. As such, managers had a financial incentive to focus on short-term profit over sound risk management.

Signature Bank

Similarly, the FDIC's report on Signature Bank of New York ("SBNY") states:

> ***SBNY management did not prioritize good corporate governance practices***, did not always heed FDIC examiner concerns, and was not always responsive or timely in addressing FDIC supervisory recommendations (SRs). SBNY funded its rapid growth through an overreliance on uninsured deposits without implementing fundamental liquidity risk management practices and controls. Additionally, SBNY failed to understand the risk of its association with and reliance on crypto industry deposits or its vulnerability to contagion from crypto industry turmoil that occurred in late 2022 and into 2023. ***Although fallout from the liquidation of Silvergate and the failure of SVB was unprecedented and unfolded rapidly, SBNY's poor governance and inadequate risk management practices put the bank in a position where it could not effectively manage its liquidity in a time of stress, making it unable to meet very large withdrawal requests.***

Necessary Next Steps

Better Markets strongly supports the Proposal and urges the FDIC to implement the changes as soon as practicable. As the FDIC details, poor corporate governance and insufficient risk management practices were key drivers that led to the 2008 Financial Crisis and the 2023 Regional Banking Crisis. Better Markets also showed how the Federal Reserve's 2021 guidance on Boards of Directors' oversight sent an unmistakable message to supervisors to back off both management and board members. This is directly related to seriously weakening and undermining the supervision of banks like SVB and undoubtedly enabled the mismanagement and risk-taking at

SVB that eventually led to its failure.

Not only do bank failures negatively result in losses to the FDIC's Deposit Insurance Fund and the failed institutions' depositors, customers, and employees, but they also harm and impose significant costs on the American public, taxpayers, the financial system, and the economy as a whole.

Banks, particularly the largest banks, must be held accountable for implementing strong corporate governance and risk management to protect all stakeholders and the financial system.

Better Banks | Better Businesses
Better Jobs | Better Economic Growth
Better Lives | Better Communities

Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

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