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FCIC memo of staff interview with Robert A.G. Monks

Robert A.G. Monks

Thomas H. Stanton

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MEMORANDUM FOR THE RECORD – MFR

EVENT: Interview with Robert A.G. Monks
TYPE OF EVENT: Interview regarding corporate governance
DATE OF EVENT: April 12, 2010
TEAM LEADER(s): Thomas H. Stanton
LOCATION: via telephone
PARTICIPANTS/ NON-FCIC: Robert A.G. Monks
PARTICIPANTS/FCIC: Thomas H. Stanton
MFR PREPARED BY: Thomas H. Stanton

DATE OF MFR:

SUMMARY OF INTERVIEW & SHORT BIO OF INTERVIEWEE :

This is a paraphrasing of the interview dialogue and is not a transcript and should not be quoted except where clearly indicated as such.

This interview follows up on a letter sent to the FCIC Chair dated February 16, 2010.

Mr. Monks began the conversation by talking about the recent series of hearings on subprime mortgages and the GSEs. He thought that the public hearing section with Robert Rubin (Citigroup – day 2) had been important and reflected a good level of engagement. By contrast the dialogue with Dan Mudd (GSEs – day 3) simply reflected differing positions between the witness and the commission. It was more like a Harvard seminar, clear but with no sense of closure. Mudd had his substantial compensation and felt entitled to it.

Mr. Monks' point was that a journalist could have gotten the same results, including the two points of view. The Commission's task should be to provide information that a journalist cannot get. Mudd was evasive and unwilling to go as far (in engagement) as Rubin did. The Commission needs a cross-examiner. There must be some derived wisdom from the process.

More generally, Mr. Monks asks: what is the Commission's overall concept? Do we plan to come back and ask more pointed questions? Mr. Monks is disappointed.

The conversation then turned to governance.

The failure is that there is an absence of accountability. This is seen in the pay that people pay themselves, whatever they want. It isn't an arm's-length bargain. The CEO picks directors who dominate

the proxy machinery. It is an autocratic system. Here, Mr. Monks references the example of Fannie Mae CEO Franklin Raines who declined to approve a compensation consultant who would analyze Mr. Raines' compensation. (See Mr. Monk's book, *Corpocracy*, Wiley & Sons, 2008, pp. 93-95; the example is taken from the OFHEO Special Examination Report on Fannie Mae).

The absence of accountability is why we had such a range of financial horrors. For example, there is a mantra that institutions should hold more capital. But look: how much capital did Citi, Morgan, Freddie buy back? That created enormous risk. He has a major paper, in the Corporate Library 2006, called "CFRA Fueling EPS Through Share Repurchases: Who Benefits?"

So how do we get accountability back into balance? Virtually all of the recommendations on governance are naïve. For example, there is no such thing as an "independent director."

Therefore, Mr. Monks says that the owners must come into the process. Government cannot enforce all accountability provisions. Therefore there must be something within the corporation. Government then can oversee this. In the Commission's hearings, one sees a failure of government enforcement. But too much was expected of government. Therefore there must be a self-governing system for government to monitor.

Question: didn't CEOs and Chairmen like Cayne, Fuld, or Prince, lose a fortune when their stock became worthless? Response: they took home huge amounts before the stock became valueless. They could speculate with other investors' money even if they lost on their stock at the end.

The form of the organization makes a difference. He asked Lloyd Blankfein of Goldman; if Goldman had remained a partnership it wouldn't have leveraged itself 33:1.

Mr. Monks is a former ERISA program Administrator (US Department of Labor). He believes (and has written extensively) that holders of stock such as ERISA plans, PBGC, should exercise fiduciary responsibility vis-à-vis the owners of their plans. In response to a question about the governance efforts by CalPERS: It was better than nothing. But (because they came from the left) they could be trivialized and had a credibility problem.

The conversation then turned to risk management and governance. There is no legitimate science of risk management, no orthodoxy. He sold his company, ISF, which provides proxy services to a company known as Risk Metrics, and knows this area.

Compensation should be structured so that there is a payout five years after a person leaves the company, with the payout contingent on results. In response to a question whether it would be better to have a five-year payout generally, not tied to the departure date: no. He means a payout only after leaving the company.

He returns to the theme of involved owners. Henry Kravis (of KKR) represents an involved owner. He doesn't tolerate huge compensation. And seeks results. In response to a question about Goldman and the actions of the Goldman Chief Risk Officer: Goldman had a partnership culture even now with public

shareholders. Mr. Viniar (the CRO) was expected to act like an owner. See Lloyd Blankfein's speech to the Council of Institutional Investors.

It is always a matter of leadership. For example, Mellon Bank's Frank Cahouet created an owner culture.

Formerly managers thought of themselves as creators of value; then the culture shifted to the imperial CEO, with stars like Jack Welch.

He believes that outside owners, including ERISA, '40 Act funds (i.e, mutual funds) and bank trust funds, which together amount to 40 percent of total ownership. Owners must have skin in the game. There is no answer other than involved owners. Otherwise it's like having a loose cannon on deck.

Large corporations are fundamentally inefficient. We must have respect for the new. Big companies become less efficient. His book traces much of the change to the 1975 deregulation of the NYSE.

Another problem: the language of discourse was taken over by economists. We should look at the concept of the fiduciary responsibility of a trust. In response to a question about trusts in PLS, trustees in that context have a conflict of interest (especially with the financial firm that sponsors the trust).

We should make good use of the Corporate Library. Also he will share readings with us. We should feel free to call him at any time.