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Forcing humility on JPMorgan's Dimon misses the point

By Jeff Davis

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Somehow JPMorgan Chase & Co. has become a media punching bag, a byproduct of $6 billion of losses from the London Whale, though JPMorgan still posted record net income and EPS in 2012 of $21.3 billion and $5.20. Earnings this year could approach $25 billion. CEO Jamie Dimon's brashness in matters such as jumping the gun in announcing a buyback in 2012 before the Fed released the results of its capital plan review and joking that he was wealthier than a meek sell-side analyst has not helped his cause.

Goldman Sachs Group Inc. most recently held the media/Washington punching bag scepter for the sin of making too much money, taking an offsetting position in a subprime CDO that was constructed for a client and hiring people who refer to clients as Muppets and themselves as "Fabulous Fab." Goldman followed Bank of America Corp., which was the deserving recipient of scorn for making the worst corporate acquisition in U.S. history when it acquired Countrywide two months before its likely bankruptcy. Citigroup Inc. overlapped with Bank of America because it was massively undercapitalized, if not insolvent, prior to receiving $45 billion of TARP.

JPMorgan's May 21 shareholder vote regarding whether the roles of CEO and chairman should be split has taken on a tone of immense importance in the media that I think is not justified. Jamie Dimon's ego apparently does not like the proposition, given his suggestion that he might resign if he loses the chairmanship. Keep in mind that none of us were at the meeting where he said that to hear the context of the comment. He could have been laughing. I am not a corporate governance expert, but I have always thought the CEO and chairman roles should be split, though in no way would a split have precluded the London losses. Checks and balances have been embedded in institutions created by men since the dawn of time. Even when extraordinary events in the Roman Republic allowed for the appointment of a dictator to deal with a threat such as Hannibal's invasion during the Second Punic War, it was a temporary event prior to Julius Caesar.

Jamie Dimon ascended to the CEO position earlier than expected at year-end 2005 following the merger of Bank One and JPMorgan in 2004 that he helped engineer. William Harrison had been the CEO and chairman of the legacy JPMorgan and the new JPMorgan following the merger with Bank One. Dimon subsequently obtained the chairmanship at year-end 2006 when Harrison announced his retirement as chairman and director in late 2005. The arrangement is not unusual among banks whereby the outgoing CEO becomes nonexecutive chairman for several years as the new CEO consolidates his/her power. Usually, the outgoing CEO groomed the new CEO over a period of years as a key lieutenant who runs business units and gets lots of face time with the board and investors. In a sense, the transition is a continuation of a long-running partnership with the senior partner gradually exiting via the chairmanship and then retiring from the board.

Dimon's experience at JPMorgan differed. Some have suggested Dimon or his supporters on the board helped speed up the transition by pushing for a faster exit by Harrison. I think a lot of investors at the time were pushing for Dimon to take over given his reputation as an outspoken achiever from New York in contrast to the more reserved North Carolinian.

Every company has its unique board dynamics that are tied to the institution's history, board personalities and industry conditions. The shareholder vote to amend the bylaws to require the separation of the CEO and chairman roles will be what it will be. My assumption is that Jamie Dimon will retain both titles. The board in a May 10 proxy filing reaffirmed its support for Dimon and for not splitting the roles. Whether institutional investors care about the board's recommendation remains to be seen. Some are still upset over the Whale issue, which clipped earnings and tangible book value by roughly $1.00 per share, in addition to causing the shares to underperform during the second quarter of 2012. Those who bought the shares last July may have a more nuanced view as discussed here.

Even if Dimon loses the chairman role, it should not be lost on anyone that his team masterfully navigated the worst financial crisis since the Great Depression. JPMorgan shareholders suffered no earnings and tangible book value dilution from having to recapitalize, unlike those at Bank of America and Citigroup. JPMorgan was the antithesis, having acquired Washington Mutual and Bear Stearns for bargain purchase prices, though contingent liabilities attached to Bear Stearns have pushed the effective price higher.

What I think is missing from the JPMorgan debate is the composition of the boards. Many U.S. banks need more board members with industry experience. The same may be true of companies in other industries, but banks manage the financial plumbing of the U.S. economy and are levered by over 10x when measured solely on tangible common equity. Also, most banks are majority funded with government insured deposits, though the banks pay the premiums. I think the FDIC proves my point in that one of the key issues cited repeatedly in bank failures is inadequate board supervision.

This is not a call for more regulation, but it seems more industry experience at the board level will lead to more informed oversight of lending and other strategic decisions. For example, I think every bank board should have at least two ex-bankers. Ideally, both would have been lenders; one of whom never worked at the subject bank. Sometimes, maybe oftentimes, the board does not have the professional and institutional knowledge to adequately evaluate lending decisions. The presence of directors who are real estate developers or come from industries that the bank has significant exposure to provides an important perspective; however, investors and operators have different perspectives than lenders.

For larger institutions such as JPMorgan, Goldman and even Wells Fargo & Co., the board also should include one or more capital markets professionals who have been intimately involved in trading operations — ideally credit. Investment bankers do not fit this profile, as was seen at some institutions during the financial crisis when deal-makers who ran companies did not fully grasp markets and how fragile the funding of levered balance sheets would prove to be.

And I have often wondered how traditional commercial bankers who ran Wachovia Corp. ever bought Golden West Financial Corp. at the top of the housing market, a company whose core asset consisted of Option ARMs. I once asked an ex-Wachovia credit executive about this and he told me that executive management kept the general bank's credit staff in the dark about the deal until it was too late. The risk was that they would veto a deal that would put Wachovia in the California market. Presumably no one on the board knew enough about Option ARMs to raise the right questions. I doubt it would have mattered if Ken Thompson did not hold both the CEO and chairman roles.

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