Corporate Governance of Banks

Empirical Findings, Theory and Questions in Law and Economics

Klaus J. Hopt, Lecture, Tel Aviv, 31 October 2017

Abstract

The corporate governance of financial institutions is very special as compared to the general corporate governance of corporations. This is shown by empirical research and has resulted in a mass of national and financial legislation, supervisory practice, principles and recommendations. This should lead to a genuine theory of corporate governance of financial institutions that takes into account the interests of the creditors besides or even before those of the shareholders. An appropriate term for this would be creditor (debtholder, depositor) governance. This carries considerable consequences for research as well as for possible reforms that are still to be analyzed and developed. Problem areas include transparency, the composition of the bank board and independent directors, risk management, duties and liability of the bank directors, and enforcement and control by the state and private actors.

Survey

I. Introductory Remarks

1. Old and new bank regulation questions
2. Corporate governance and bank governance

II. “Bank Governance is Special”: The Theory of Corporate Governance in Banks and Other Financial Institutions

1. Unique Aspects of Banks and Financial Institutions
2. Variance Among Legal and Policy Analyses
3. The Road to Creditor Governance for Banks
4. Consequences for Research and Reform

III. The Research and Reform Agenda for the Corporate Governance of Banks: Some Examples

1. Corporate Governance and Transparency

2. Composition of the Board, Independent Directors
3. Risk Management, Organization, Compensation
4. Duties and Liability, Both Civil and Criminal
5. Public and Private Enforcement

Summary and Conclusions

The corporate governance of financial institutions is very special as compared to the general corporate governance of non-financial corporations. This has been shown by empirical research and has led to a mass of national and international financial legislation, supervisory practice, principles and recommendations. This should lead to a genuine theory of corporate governance of financial institutions that takes into account the interests of creditors besides or even before those of the shareholders. An appropriate term for this would be creditor (debtholder, depositor) governance.

The consequences for research and a reform agenda are manifold, here only some examples can be given. 1) Transparency is significantly more important in financial institutions than in other companies, particularly since it simultaneously serves a supervisory function. 2) On management and boards, there is a discussion on the appropriate composition, possibly by adding representatives of the creditors or the state bank supervisors. The independence of members is less important than expertise and experience, with the exception of auditing and risk committees. 3) Risk management and compliance play central roles, and a special importance is assumed by the topic of compensation and the avoidance of misplaced incentives. Unlike in general corporate law, not only management and board members, but also key function holders are incorporated into the corporate governance scheme and regulation of financial institutions. 4) The directors of financial institutions face stricter duties in terms of organizational structure and conduct, though the business judgment rule must be retained. Raising the standards leads to more civil and criminal liability, yet criminal liability must be reserved to grave offenses. 5) As always enforcement is key. For banks it is the state supervisory authority, and not just the creditors and stakeholders themselves, who must take responsibility for enforcement and ongoing control. This includes an energetic application of the fit-and-proper standard.