

THE LAW ON CORPORATE GOVERNANCE IN BANKS

IRIS H-Y CHIU

Consulting Editor
Michael McKee

With contributions from

Anna P Donovan, Rod Edmunds, Andreas Kokkinis, John Lowry,
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ELGAR FINANCIAL LAW AND PRACTICE

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THE LAW ON CORPORATE GOVERNANCE IN BANKS

ELGAR FINANCIAL LAW AND PRACTICE

Series Editor: Roger McCormick, *London School of Economics and Political Science, UK*

The Elgar Financial Law and Practice series is a library of works by leading practitioners and scholars covering discrete areas of law in the field of banking and finance. Titles in the series are both analytical and descriptive in approach, highlighting and unpicking the legal issues that are most critical and relevant to practice. Designed to be detailed, focused reference works, the books in this series offer an authoritative statement on the law and practice in key topics within the field, from Financial Collateral to Private Equity, from Secured Transactions to Financial Crime, and from Financial Derivatives and Hedge Funds to Bank Resolution and Bank Capital.

ABOUT THE AUTHORS

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Iris is a Reader in Law at University College London, and her research expertise lies in financial regulation and corporate governance. She has published extensively on corporate governance, as well as regulatory theories and governance in the financial sector, in over 20 peer-reviewed journals in the UK and US. She has published a number of books including *Regulatory Convergence in EU Securities Regulation* (Wolters Kluwer 2008) which deals with EU securities regulation and a systemic analysis of harmonisation in the law in books as well as the law in action; *The Foundations and Anatomy of Shareholder Activism* (Hart Publishing 2010) which deals with the legitimacy issues surrounding various forms of shareholder activism in the UK and EU; and *The Foundations and Future of Financial Regulation* (Routledge, 2014, co-authored with Mads Andenas). Her books have been well received (see positive reviews of the *Shareholder Activism* title, Katelouzou, *JCLS* 2012, and Masouros, *JBL* 2011). She is executive editor of the *European Business Law Review* and co-series editor of the *Palgrave Macmillan Corporate and Financial Law Series*. She was a Visiting Professor of Law at Singapore Management University (2014).

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Anna is a Lecturer at UCL Laws and an advisory board member of the Faculty's Centre for Ethics and Law. Anna's research expertise lies in corporate governance and regulation, with a specific focus on corporate compliance strategies and anti-corruption measures. Prior to UCL, Anna was a senior corporate solicitor in London, specialising in corporate restructuring and governance where she advised boards extensively on their corporate governance obligations. During her time in practice Anna was a principal

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John is Chair of Commercial Law at Hong Kong University, and Emeritus Professor of Commercial Law at UCL. He has taught law in the USA and practised in Canada specialising in corporate litigation. He has written widely in domestic and international journals on directors' fiduciary obligations, shareholder remedies and insurance law. He is co-author of a number of books including, *Limitation of Actions* (LLP, 1998); *Company Law* (OUP 2012); *Pettet's Company Law* (Pearson 2014); *Insurance Law: Doctrines and Principles* (Hart 2011); and *Insurance Law: Cases and Materials* (Hart 2004). He is also a contributing editor to *Gore-Browne on Companies* (Jordans) and *Annotated Companies Legislation* (OUP). He is a member of a number of editorial boards, including the *Journal of Business Law*, *Company Lawyer* and *International Corporate Rescue*. In 2001 he was a Visiting Fellow at the University of Connecticut and he was made an Honorary Fellow of Monash University in 2009. In 2010 he was elected Distinguished Global Jurist Visiting Professor at the Chinese University of Hong Kong.

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Marc is Reader in Corporate Law and Director of the Centre for Corporate and Commercial Law (3CL) in the Faculty of Law, University of Cambridge. He is also a Fellow of Murray Edwards College, Cambridge; an Honorary Reader in the Faculty of Laws, University College London; and Deputy Chief Examiner for Company Law on the University of London's external LLM programme. Marc has previously held teaching positions at University College London, the University of Bristol, and Seattle University. Marc's principal area of expertise is Anglo-American corporate law and governance. He has authored and co-authored a number of articles and papers in this field within leading international publications. In 2013 his book, *Corporate Governance in the Shadow of the State* (Hart Publishing 2013), was shortlisted for the SLS Peter Birks Prize for Outstanding Legal Scholarship. In 2012, Marc was awarded a Philip Leverhulme prize in recognition of outstanding research achievement to date. Marc is a commissioning editor of a new Palgrave-Macmillan text series on corporate and financial law, and in 2010 he was UK national reporter on corporate governance for the XVIIIth Congress of the International Academy of Comparative Law at Washington DC.

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Arad is currently a Reader in Corporate and Financial Law and Director, UCL Centre for Commercial Law. He acted as Vice Dean (Research) at UCL Faculty of Laws between 2009–12. He has been teaching at the Faculty since September 2003, and joined it full time in September 2006. He was formerly a Senior Arts Scholar (2001–03) and a Tutor at Pembroke College Oxford, where he taught law at six colleges at Oxford University between 2001–05. He has also been a Visiting Lecturer at Oxford University (2005) and more recently, a Visiting Professor of Law at Brooklyn Law School (Fall Term 2012), and a Visiting Professor of Law at NUS (2014). He is the recipient of numerous academic scholarships and awards and has written widely on shareholder remedies and directors' duties. Arad is the author of *Derivative Actions and Corporate Governance* (OUP 2007), the first book to provide a detailed and theoretical explanation of the law governing derivative actions. He is also an Academic Member of ECGI (European Corporate Governance Institute), a co-editor of *Pettet's Company Law*, sits on the editorial boards of the *International Corporate Rescue* and the *Journal of Corporate Ownership and Control*, and is a contributing author to *Annotated Companies Legislation* (OUP).

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Georgina is a Lecturer in Law at the University of Bristol Law School and her research expertise lies in takeover regulation and corporate governance. She has formerly held posts at University College London, Faculty of Laws, as a Postdoctoral Research Associate (2013–14) (and at Queen Mary University of London, School of Law, as a Teaching Fellow (2010–2012)). Georgina holds a PhD from Queen Mary University of London sponsored by a Full Scholarship (2009–12) award from QMUL School of Law. She has written on the prospective reform of the EU Takeover Directive and the changes to the UK City Code on Takeovers and Mergers following the reform

prompted by the Kraft–Cadbury deal in 2011. Georgina is a qualified Solicitor of England and Wales and an attorney-at-law in Greece. She has lectured on the LLM and LLB programmes at UCL, Centre for Commercial Law Studies, QMUL and BPP Law School respectively and has acted as a guest academic tutor at LSE Summer School. Her recent publications include: ‘A long-term vision for UK Firms? Reconsidering target director’s advisory role post the takeover of Cadbury’s plc’ (2014) 14(1) *Journal of Corporate Law Studies* 241 and ‘The revision of the EU Takeover Directive in light of the 2011 UK takeover law reform’ (2013) 10(1) *International and Comparative Company Law Journal* 21.

Edward Walker-Arnott

Edward is a Visiting Professor at UCL’s Faculty of Laws. He has been with Herbert Smith Freehills throughout his professional career and was senior partner between 1992–2000. He sat on the Departmental Committee (the Cork Committee) inquiring into insolvency law between 1977–82. The report resulted in the enactment of the Insolvency Act 1986. At the beginning of 1983, Edward was appointed one of the first three nominated members of the Council of Lloyd’s, sitting on the Council for six years. He chaired the Investigations Committee at Lloyd’s, which conducted the investigations of the many Lloyd’s scandals of the late 1970s and early 1980s and prosecuted the subsequent disciplinary proceedings. He is well known in the City having been involved in many high-profile cases including a number of celebrated take-over battles.

Edward has also served as Governor of the South Bank Centre between 1999–2009; he was on the Board of the Royal National Theatre from 2000–08 and served as Governor of the Wellcome Trust from 2000–10. Edward is currently a non-executive director of a private company with significant commercial and property interests in the UK and in Europe and of a biotech start-up company backed by both the Wellcome Trust and the Gates Foundation. He is a member of the Takeover Appeal Board and was made a QC (Hon) in 2013.

PREFACE: THE LAW OF THE CORPORATE GOVERNANCE OF BANKS AND FINANCIAL INSTITUTIONS

The corporate governance of banks and financial institutions came under the spotlight in the wake of the global financial crisis 2008–09, the subsequent conduct scandals such as the manipulation of the London Inter-Bank Offered Rate by several UK and international banks, and other miss-selling, corruption and financial crime scandals. Although misjudgements in risk and sub-optimal corporate behaviour are not uncommon in the corporate sector, the utility and systemic risk profiles of the banking sector, in particular, are important attributes that warrant public concern with any failings in the internal governance of banks that could culminate in excessive risk-taking or sub-optimal corporate behaviour.

In this volume, we address key themes in the internal governance of banks and financial institutions that we believe are of topical interest. The law and Corporate Governance Code discussed in this volume are stated as at March 2014. In Chapter 1, Andreas Kokkinis discusses the governance structure of most widely held banks and financial institutions, and the incentives that may result in excessive risk-taking. He reveals that conventional agency-based corporate governance frameworks may be unsuitable for banks and financial institutions as they arguably do not address the governance challenges in banks and financial institutions and may indeed entail counter-productive incentives exacerbating governance problems.

In Chapter 2, Edward Walker-Arnott discusses the importance of the board as collectively managing and making key decisions in banks and financial institutions, and argues that neither company law nor financial regulation address the issue of collective responsibility and how that can be boosted to improve board stewardship. This thought-provoking chapter takes stock of recent policy discussions and proposals for legislative reforms but critically asks if new law and new provisions in governance codes are really on the right track.

In Chapter 3, John Lowry and Rod Edmunds shift the focus from collective directorial responsibility by asking whether individual directorial responsibility for banks and financial institutions could be enhanced via the application of the directors' disqualification regime. They highlight that to date it has not been applied notwithstanding some clear political pronouncements (including those of UK's Business Secretary, Dr Vince Cable) that it should be harnessed to prevent certain named directors in the UK's failed banks (RBS and HBOS in particular) from holding directorships in the immediate future. As the chapter indicates, the reasons why disqualification proceedings have not been initiated is all the more intriguing in the

light of both the recent proposals for reforming the regime and also the introduction of the new offence of 'reckless misconduct in the management of a bank' contained in the Financial Services (Banking Reform) Act 2013.

Chapter 4 turns the attention to shareholders of banks and financial institutions and the excessive short-termism that prevails in the securities markets that characterise the nature of such shareholding. Short-termist shareholding entails behaviour such as preference for exit over voice and disengagement from monitoring, issues that have been flagged up in the Walker Report of 2009, relating to weaknesses in bank and financial institution corporate governance. Arad Reisberg critically discusses the development of short-termism as a prevalent notion in the UK securities markets and argues that although a slate of tax and corporate governance reforms (which are re-surfacing in recent reforms) may seek to change short-termist behaviour, answers to behavioural changes are far from easy and would take time to bed down.

Chapters 5–8 then address specific issues of internal governance in banks and financial institutions. In Chapter 5, Marc Moore discusses the legal and Corporate Governance Code framework for setting remuneration, and the specific controls provided in financial regulation to control excessive remuneration in the banking sector. This is an area that has seen many recent reforms at the UK and EU levels but it may be queried as to whether appropriate remuneration design can be micro-managed by legal frameworks and institutions.

Chapter 6 deals with the issue of risk management in banks and financial institutions, identified as a key problem in the global financial crisis of 2008–09. Iris Chiu discusses the failures of risk management culminating in excessive risk-taking by banks and financial institutions and how reforming the corporate governance frameworks at the highest management levels may address risk management sub-optimalties.

In Chapter 7, Iris Chiu addresses the issue of reliable and timely corporate reporting by banks and financial institutions and the role that such corporate reporting may play in incentivising market discipline. The weaknesses of corporate reporting frameworks are discussed and recent reforms are also critically examined to inquire into the objectives of corporate reporting and how that may serve as a mechanism to enhance internal governance of banks and financial institutions and external scrutiny by markets.

Chapter 8 deals with a particular issue of systems and controls in banks and financial institutions, that of instituting anti-bribery and corruption controls. Anna Donovan examines the interpretation and impact of the Bribery Act 2010 on the corporate sector and highlights particular challenges and issues faced by banks and financial institutions.

Finally, in Chapter 9 Georgina Tsagas addresses the efficacy of the UK/EU legal framework regulating the market for corporate control in the banking industry. With reference to a series of case studies, including the RBS takeover of ABN-AMRO prior to the global financial crisis, the chapter specifically examines whether the market for corporate control in the banking industry functions perversely, how this function affects and is affected by prudential concerns and whether the parties involved in an offer effectively discharge their roles respectively. The chapter highlights the consequences that may flow from a failed change in the corporate control of a bank and ultimately questions the shareholder primacy norm followed in the case of banks proposing regulatory reforms in the interests of prudence.

This volume takes on both academic and critical perspectives in some highly topical issues in the corporate governance of banks and financial institutions. Many of its insights are also drawn from and applicable to the general corporate sector. Not only does a financial crisis give rise to reforms pertaining to the financial sector, but the mood for critical scrutiny generally of the corporate sector also paves the way for more broad-based reform at the UK and EU levels. The contributions in this volume reflect this broader context and interest.

Iris H-Y Chiu

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Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, [2013] OJ L176/1	7.04
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