Quack Corporate Governance, Round III? Bank Board Regulation Under the New European Capital Requirement Directive

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After a crisis, broad and sweeping reforms are enacted to restore trust. Following the 2007-2008 Great Financial Crisis, the European Union has engaged in an ambitious overhaul of banking regulation. One of its centerpieces, the 2013 Fourth Capital Requirements Directive (CRD IV), tackles, amongst other things, the perceived pre-crisis failings in the governance of banks. We focus on the provisions that are aimed at reshaping bank boards' composition, functioning, and their members' liabilities, and argue that they are unlikely to improve bank boards' effectiveness or prevent excessive risk-taking. We criticize some of them for mandating solutions, like board diversity and the separation of chairman and CEO, that may be good for some banks but are bad for others, in the absence of any convincing argument that their overall effect is positive. We also criticize enhanced board liability by showing that it may increase the risk of herd behavior and lead to more serious harm in the event of managerial mistakes. We also highlight that the push towards unfriendly boards will negatively

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affect board dynamics and make boards as dysfunctional as when the CEO dominates them. We further argue that limits on directorships and diversity requirements will worsen the shortage of bank directors, while requirements for induction and training and board evaluation exercises will more likely lead to tick-the-box exercises than under the current situation in which they are just best practices. We conclude that European policymakers and supervisors should avoid using a heavy hand, respectively, when issuing rules implementing CRD IV provisions with regard to bank boards and when enforcing them.

Introduction

After corporate scandals hit or, even worse, a full-blown financial crisis materializes, policymakers take measures to "restore trust" and prevent further scandals or crises from happening.[1] Whether the laws enacted in such circumstances bring about overdue changes to an inadequate legal framework or are rather the innocuous or even detrimental product of political posturing is debated.

In the wake of the Sarbanes-Oxley Act (SOX),[2] Roberta Romano has famously dubbed SOX corporate law reforms as "quack corporate governance."[3] She uses the term to epitomize the features of "[in]efficacious"[4] pieces of legislation, with no ground in the extensive body of empirical accounting and finance literature.[5] In her view, those reforms were the product of "recycled ideas advocated for quite some time by corporate governance entrepreneurs,"[6] which members of Congress enacted for the very purpose of "enact[ing] something, with the specific content of less concern and importance."[7] More recently, Stephen Bainbridge has revived the quackery epithet to chastise the corporate governance provisions contained in the Dodd-Frank Act.[8] He

1 *See, e.g.*, Stuart Banner, *What Causes New Securities Regulation — 300 Years of Evidence*, 75 Wash. U. L.Q. 849 (1997).

2 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 18 and 28 U.S.C. (2006)).

3 Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 Yale L.J. 1521 (2005).

4 *Id.* at 1523.

5 *Id.* at 1526.

6 *Id.* at 1523.

7 *Id.* at 1526.

8 Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 Minn. L. Rev. 1779 (2011).

argues that such provisions also display the typical features of post-crisis, do-something, take-whatever-is-ready, never-mind-the-consequences reforms.[9]

Unsurprisingly, the "quack corporate governance" qualification of SOX and Dodd-Frank corporate law provisions has undergone heavy criticism, lastly and most vigorously by John Coffee.[10] His view is that only post-crisis can reform-minded policymakers, led by political entrepreneurs, overcome the resistance of well-organized and highly effective business and financial services lobbies, which in normal times succeed in maintaining a lax, crisis-prone status quo.[11]

No matter which side one takes in the U.S. debate on the quackery of SOX and Dodd-Frank corporate governance reforms,[12] few would disagree that in a post-financial crisis environment there is the risk of lawmakers acting in haste. And, in their effort to restore trust (and withstand the burgeoning popular outrage), they may use a heavier hand than needed. On the other hand, in mastering a financial crisis regulators face enormous challenges. Exceptional circumstances may, at least short-term, justify unorthodox solutions.

As in the United States, European policymakers have taken a number of measures as a reaction to the financial crisis, some of which (admittedly not the core ones) address corporate governance issues. A number of new measures have tackled banks' and investment firms' governance,[13] reflecting the view, promoted by policymakers and supervisors, that banks' corporate governance, while not itself one of the crisis triggers, was nonetheless a "crucial underlying factor"[14] thereof.[15] These measures have come on top of

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9 *Id.* at 1795.

10 *See* John C. Coffee, *The Political Economy of Dodd-Frank: Why Financial Reform Tends to Be Frustrated and Systemic Risk Perpetuated*, 97 Cornell L. Rev. 1019 (2012); *see also* J. Robert Brown, Jr., *Criticizing the Critics: Sarbanes-Oxley and Quack Corporate Governance*, 90 Marq. L. Rev. 309 (2006); Robert A. Prentice & David B. Spence, *Sarbanes-Oxley as Quack Corporate Governance: How Wise Is the Received Wisdom?*, 95 Geo. L.J. 1843 (2007).

11 *See* Coffee, *supra* note 10, at 1020-22.

12 For a broad and insightful survey of the empirical literature on SOX's effects, see John C. Coates, IV & Suraj Srinivasan, *SOX After Ten Years: A Multidisciplinary Review* 2 (Eur. Corp. Governance Inst. Law Working Paper No. 234, 2014), *available at* http://ssrn.com/abstract=2343108.

13 While the measures we focus on throughout this Article apply both to banks and to investment firms (i.e., broker-dealers in U.S. jargon), in the following we usually refer to banks only for brevity's sake.

14 Eur. Banking Authority, EBA Guidelines on Internal Governance 3 (2011).

15 *See, e.g.*, OECD, Corporate Governance and the Financial Crisis: Key Findings and Main Messages 41 (2009) ("The financial crisis has also pointed in a

a number of corporate governance reforms adopted throughout the 2000s.[16]

With the most recent overhaul of European banking law known as the Fourth Capital Requirements Directive[17] (CRD IV) and, to a lesser degree, the related Capital Requirements Regulation,[18] the European Union has directly intervened in the composition and functioning of banks' boards.[19] It has done so with the purpose of ensuring that banks' boards become effective monitors of management and, more generally, effectively perform their steering role at the bank's top. Diversity requirements,[20] enhanced board members' duties and liabilities,[21] separation of chair and CEO,[22] limits on

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large number of cases to boards of financial companies that were ineffective and certainly not capable of objective, independent judgment."); Brian R. Cheffins, *The Corporate Governance Movement, Banks and the Financial Crisis*, 16 Theoretical Inquiries L. 1, 18 (2015) (observing that the persistence of imperial CEOs at U.S. banks plausibly "contributed to the onset of the financial crisis"). *But see also* Cheffins, *supra*, at 42-43 (clarifying that his study leaves "the intriguing question whether the financial crisis would have been as severe as it was if bank executives had not been given a corporate governance free pass in the mid-2000s . . . open"); Klaus J. Hopt, *Corporate Governance of Banks and Other Financial Institutions After the Financial Crisis*, 13 J. Corp. L. Stud. 219, 237-38 ("[T]he clear majority view is that the role of bank governance failures in the financial crisis was rather limited.").

16 *See* Commission Proposal for Modernising Company Law and Enhancing Corporate Governance in the European Union — A Plan to Move Forward, COM (2003) 284 final (May 21, 2003). These corporate governance reforms followed the bursting of the internet bubble and the 2002-2003 corporate scandals (chief among them, Enron and WorldCom in the United States, and Ahold and Parmalat in Europe).

17 Council Directive 2013/36 of the European Parliament and of the Council of 26 June 2013 on Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms, 2013 O.J. (L 176) 338 [hereinafter CRD IV].

18 Commission Regulation 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms, 2013 O.J. (L176) 1 [hereinafter CRR].

19 We note incidentally that it has done so going far beyond the recommendations of the banking regulators' coordination body at the international level. *Cf.* Basel Comm. on Banking Supervision, Principles for Enhancing Corporate Governance 7-15 (2010) (falling short of proposing the governance measures adopted by the CRD IV and the CRR).

20 CRD IV, arts. 91(10)-(11).

21 CRD IV, arts. 91(1), (8).

22 CRD IV, art. 88(1)(e).

directorships,[23] induction programs,[24] and (for larger banks only) self-evaluation exercises[25] are all instrumental to that purpose.

In the following, we focus on such rules and argue that they are meritless or even counterproductive for the governance of European banks.[26] We criticize some of them for mandating solutions, like board diversity and the separation of chairman and CEO, that may be good for some banks but are bad for others in the absence of any convincing argument that their overall effect is positive. We also criticize enhanced board liability by showing that it may increase the risk of herd behavior and lead to more serious harm in the event of managerial mistakes. We also highlight that the push towards unfriendly boards may negatively affect board dynamics and make boards as dysfunctional as when the CEO dominates them. We further argue that limits on directorships and diversity requirements will worsen the shortage of bank directors, while requirements for induction and training and board evaluation exercises will more likely lead to tick-the-box exercises than under the current situation in which they are just best practices.

While we do not cover each and every one of the provisions on bank boards in the CRD IV,[27] our scope is so wide-ranging as not to justify the criticism that we have cherry-picked provisions we do not like.[28] Those who like the quack corporate governance metaphor will find familiar traits in the provisions we discuss. Those who do not like the characterization of post-crisis reforms as quackery may in turn acknowledge that post-crisis lawmakers can easily err

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23 CRD IV, arts. 91(3)-(6).

24 CRD IV, art. 91(9).

25 CRD IV, art. 88(2).

26 Needless to say, our focus is exclusively on bank governance, which has its own special features. *See* Marco Becht, Patrick Bolton & Ailsa Röell, *Why Bank Governance Is Different*, 27 Oxford Rev. Econ. Pol'y 437, 444-57 (2011). We leave the question open as to whether the rules we criticize would make better sense in nonfinancial corporations, although we doubt, as a general matter, that that could be the case, if only because banks' special features may warrant more intrusive governance regulation rather than less.

27 Specifically, we do not cover rules requiring banks to set up a risk management committee at the board level. *See* CRD IV, art. 76(3). Neither do we take issue with the provisions outlining a bank management body's functions and the requirement (for larger banks) to set up a nomination committee. *See* CRD IV, art. 88. Finally, we leave rules on executive remuneration, CRD IV, arts. 92-96, for a future project.

28 *See* Prentice & Spence, *supra* note 10, at 1855 (criticizing Roberta Romano's critique of the Sarbanes-Oxley Act, Romano, *supra* note 3, along those lines).

on the side of doing too much, and, while rejecting the metaphor, possibly concur with us that the CRD IV board rules are unjustified on their merits.

We are willing to acknowledge that any reform is an easy target for criticism and that a negative judgment of the new rules is only justified if (1) the *status quo ante* can be shown to have been better than the new regulatory framework, *or* (2) an alternative solution is shown to be superior to the one criticized. Throughout this Article, our criticism rests upon the former argument, i.e., that the *status quo ante* (a world *without* the rules we criticize) was superior to the new setting.

Like previous articles criticizing quack corporate governance,[29] we tend to give weight to the new provisions' inconsistency with the available empirical evidence. To be sure, pre-crisis empirical analyses, or even those based on data gathered during the crisis, no matter how accurate and reliable they are, tell us little about the post-crisis world in which banks have been operating and policymakers have legislated.[30] Further, for policy measures that are unprecedented, previous empirical studies can only look at different market participants' freely chosen behavior (e.g., the separation of chair and CEO functions); they cannot tell us what the effects will be of *imposing* that specific behavior on all banks. Hence, it would be admittedly impossible to find compelling empirical evidence in favor of the new measures. However, despite the (perceived or real) limited value of finance and corporate governance empirical findings, we do cite amply from that literature, because such studies provide us with convincing intuitions as to why mandatory laws resulting in one-size-fits-all solutions may lead to suboptimal outcomes.

In Parts I and II we develop our criticism of the bank board measures listed above.[31] Part I deals with provisions aimed at eradicating CEO-dominated boards, i.e., diversity requirements and enhanced board members' duties and liabilities. Part II discusses provisions petrifying current trends in boardroom best practices (separation of chair and CEO, rules setting limits on directorships, and those requiring induction programs and self-evaluation exercises). Part III concludes that the CRD IV governance rules are unlikely to improve the functioning of bank boards. Policymakers appear to have deployed these

29 *See, e.g.*, Romano, *supra* note 3, at 1529-43.

30 The crisis itself has made the environment totally different from the pre-crisis world or the middle-of-the-crisis one: correlations (or absence thereof) that were to be found before the crisis might well be hard to replicate in its wake, because all market participants' behavior has changed in response to the game-changing events they have gone through.

31 We categorize them under two broad headings, not because each of the measures is exclusively characterized either way, but rather because of a predominance of one of the two features in explaining why we deem the measure to be misguided.

measures, together with the many others that have been taken during and after the crisis, to demonstrate their political commitment to do "whatever it takes" to restore trust in banks. We admit that this trust restoration effect may have been helpful in dealing with the crisis; in fact, we are not aware of any acceptable method to falsify that claim. In light of that possibility, instead of concluding that the various provisions we criticize should be repealed, we argue that implementing legislation should avoid further ratcheting up the new board rules' intensity and that banking supervisors should refrain from prioritizing enforcement of the new governance rules in their day-to-day supervisory activity.

I. Overcoming Friendly Boards

Like many corporate governance initiatives in the last three decades, the CRD IV seeks to eradicate the CEO-captured, "group-thinking" board and to replace it with an independent and critical "monitoring" board.[32] This goal is made explicit in article 88(2)(d) of the CRD IV, which sets as one of the nomination committee's tasks that of "ensur[ing] that the management body's decision making is not dominated by any one individual or small group of individuals in a manner that is detrimental to the interests of the institution as a whole." Similarly, bank boards' legislation was enacted on the premise that "lack of monitoring by management bodies of management decisions . . . [before the crisis was] partly due to the phenomenon of 'groupthink.'"[33]

The CRD IV aims at strengthening the monitoring role of the board mainly in two ways: first, by imposing composition requirements in the form of diversity mandates; second, by tightening board members' duties and liabilities. We discuss mandated diversity and tighter board duties separately, highlighting the drawbacks of each of these tools in the next two Sections. The final Section questions, in turn, the wisdom of the goal itself of these two measures, i.e., the idea that more independent and, by implication, more confrontational boards are unequivocally better for individual banks and generally for financial stability.

32 On monitoring as the main function of boards, see, for example, Melvin A. Eisenberg, The Structure of the Corporation 140-48 (1976). For a more recent account, see Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 39 Stan. L. Rev. 1465, 1472-99 (2007).

33 CRD IV, Recital 60.

A. Board Diversity

In its Preamble, the CRD IV explains that one of the causes of groupthink[34] is "lack of diversity" within the board.[35] Based on the assumption that more diverse boards will monitor management more effectively and therefore contribute to improved risk oversight and banks' resilience, the CRD IV imposes diversity as one of the criteria for board composition. In particular, banks and their nomination committees are required "to engage a broad set of qualities and competences when recruiting members to the management body and for that purpose to put in place a policy promoting diversity on the management body."[36]

Banks must publicly disclose their diversity policy as well as key diversity figures.[37] National banking regulators shall collect information on, and benchmark, diversity practices; the European Banking Authority (EBA) shall issue guidelines on the "notion of diversity to be taken into account for the selection" of board members.[38] Accordingly, under article 88(2)(a) of the CRD IV, the nomination committee shall, *inter alia*, "evaluate the balance of knowledge, skills, diversity and experience of the management body and prepare a description of the roles and capabilities for a particular appointment, and assess the time commitment expected." Furthermore, the nomination committee shall decide on a target for the representation of the underrepresented gender in the management body and prepare a policy on how to increase the number of the underrepresented gender in the management body in order to meet that target. The target, policy and its implementation shall be made public.

Diversity is itself a diverse concept, which includes social background, gender, age, race, nationality, and residency.[39] While the diversity requirement

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34 *See generally* Irving Janis, Victims of Groupthink (1972).

35 CRD IV, Recital 60.

36 CRD IV, art. 91(10); *see also id.* Recital 60 (stating that board composition should be "sufficiently diverse as regards age, gender, geographical provenance and educational and professional background to present a variety of views and experiences").

37 CRR, art. 435(2)(c).

38 CRD IV, art. 91(11), (12)(e).

39 These formal characteristics are understood as rough proxies for the board candidates' values. It is far from certain, however, that directors with a preset combination of gender, age, race and nationality have specific values while others with different characteristics have not. *See* Amir N. Licht, *State Intervention in Corporate Governance: National Interest and Board Composition*, 13 Theoretical Inquiries L. 597, 614-22 (2012).

in the CRD's text is about more than gender equality, gender equality is emphasized by the requirement to set a gender target as well as in the (non-binding) Preamble.[40] That is why we focus more on gender diversity in the following. Let us clarify at the outset that we do not argue against gender balance or diversity *per se*, but rather against a *legal requirement* (as opposed to a social norm and/or a mere best practice) for diversity *in bank boards*. We are willing to concede that lack of mandated diversity could preserve male dominance of boards. However, we do not discuss diversity as a broader social goal here, but rather look at it through the CRD IV prism and hence exclusively with its goal of enhancing banks' stability in mind.

Some empirical studies claim that board diversity is "universally good" for all firms;[41] but these results are challenged by studies concluding either that gender diversity does not affect firm performance[42] or finding gender diversity

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40 CRD IV, Recital 60.

41 *See, e.g.*, Zena Burgess & Phyllis Tharenou, *Women Board Directors: Characteristics of the Few*, 37 J. Bus. Ethics 39, 41 (2002); David A. Carter, Betty J. Simkins & W. Gary Simpson, *Corporate Governance, Board Diversity, and Firm Value*, 38 Fin. Rev. 33 (2003); Catherine Cassell, *The Business Case for Equal Opportunities: Implications for Women in Management*, 12 Women Mgmt. Rev. 11 (1999); Helen Kang, M. Cheng & Sid Gray, *Corporate Governance and Board Composition: Diversity and Independence of Australian Boards*, 15 Corp. Governance 194 (2007); Mijntje Lückerath-Rovers, *Women on Board and Firm Performance*, 17 J. Mgmt. Governance 491 (2011). Influential publications by nonprofit organizations and consultancy firms support the universal benefits thesis: for example, a study by Catalyst (a global nonprofit organization dedicated to expanding opportunities for women in the workplace) finds that on average firms with more diverse boards outperform firms with less female representation on the board level. *See* Catalyst, The Bottom Line: Connecting Corporate Performance and Gender Diversity (2004), *available at* http://www.catalyst.org/knowledge/bottom-line-connecting-corporate-performance-and-gender-diversity; *see also Women Matter*, McKinsey & Company, http://www.mckinsey.com/features/women_matter (last visited Nov. 21, 2014) (using an organizational success model and finding "that the companies where women are most strongly represented at board or top-management level are also the companies that perform best").

42 *See, e.g.*, Anita Du Rietz & Magnus Henrekson, *Testing the Female Underperformance Hypothesis*, 14 Small Bus. Econ. 1 (2000); Niclas L. Erhardt, James D. Werbel & Charles B. Shrader, *Board of Director Diversity and Firm Financial Performance*, 11 Corp. Governance 102 (2003); Claude Francoeur, Réal Labelle & Bernard Sinclair-Desgagne, *Gender Diversity in Corporate Governance and Top Management*, 81 J. Bus. Ethics 83 (2008).

to have negative effects.[43] Most empirical studies show diversity in one or more of its varieties to be beneficial for *some* firms,[44] taking into account that diversity is only one of many governance features. A general diversity requirement, and in particular its gender-oriented variety, could well misfire at individual firms, when coupled with other characteristics. Empirical evidence suggests that the following features are relevant: (1) whether the bank has otherwise strong or weak governance (those with strong governance suffer from more diversity within the board, those with bad governance benefit);[45] (2) whether the business environment surrounding the bank requires sudden adaptations to changes (in which case, board diversity has negative effects);[46] (3) the level of information asymmetry between insiders and outsiders (the lower it is, the more positive diversity's effects);[47] (4) the age of the firm, or the stage within the growth cycle in which it finds itself (the younger the firm and the earlier the stage, the more negative the effects of diversity);[48]

43 *See, e.g.*, Charles Shrader, Virginia B. Blackburn & Paul Iles, *Women in Management and Firm Financial Performance: An Exploratory Study*, 9 J. Managerial Issues 355 (1997); Øyvind Bøhren & R. Øystein Strøm, *Aligned, Informed and Decisive: Characteristics of Value-Creating Boards* 2 (Norwegian Sch. of Mgmt., Working Paper, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=966407.

44 See the literature survey in Commission Staff Working Document — Annexes to the Impact Assessment on Costs and Benefits of Improving the Gender Balance in the Boards of Companies Listed on Stock Exchanges, at 19-32, SWD 348 final (Nov. 14, 2012); *see also* Deborah L. Rhode & Amanda K. Packel, *Diversity on Corporate Boards: How Much Difference Does Difference Make?* (Rock Ctr. for Corporate Governance, Stanford Univ., Working Paper No. 86, 2010), *available at* http://ssrn.com/abstract=1685615 ("[T]he relationship between diversity and financial performance has not been convincingly established.").

45 *See* Renée B. Adams & Daniel Ferreira, *Women in the Boardroom and Their Impact on Governance and Performance*, 94 J. Fin. Econ. 291, 306-07 (2009) (showing that diversity has a positive effect on performance in firms with weak governance, while it may lead to over-monitoring and hence have negative performance effects in firms with strong governance).

46 *Cf.* Jerry Goodstein, Kanak Gautam & Warren Boeker, *The Effects of Board Size and Diversity on Strategic Change*, 15 Strategic Mgmt. J. 241 (1994) (arguing that board diversity restricts the ability of companies to adapt to changing business circumstances due to potentially conflicting conceptions of strategic change).

47 *See* Knut Nygaard, *Forced Board Changes: Evidence from Norway* (Norges Handelshøyskole Discussion Paper, 2011), *available at* http://EconPapers.repec.org/RePEc:hhs:nhheco:2011_005.

48 Joe McCahery, Erik. P.M. Vermeulen & Masato Hisatake, *The Present and Future of Corporate Governance: Re-Examining the Role of the Board of Directors*

and (5) the formal qualification of female top management when assigned to the board (women with top education having a positive impact on the firm).[49] If these empirical findings tell as something about banks as well, it is safe to agrue that the ability of diverse boards to influence banks' performance and risk-taking is highly contingent on the specific circumstances of each bank and of each market for bank directorships.[50] Whether the net effect of a diversity requirement will be positive is impossible to tell. If the ideal diversity quota is highly firm-specific, it is more likely that the board rather than a regulator knows whether diversity is beneficial, and which diversity quota if any is best for the firm.

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and Investor Relations in Listed Companies, 10 Eur. Company & Fin. L. Rev. 117, 139-40 (2013) (arguing that "the unique governance issues that result from including growth in the corporate governance discussion are part of a complex, three-dimensional continuum, wherein each of the dimensions (managerial control, long-term commitments and growth) are intertwined and constantly evolving," and concluding that strong-growth firms benefit from club-like board structures while mature businesses benefit from diverse boards); Jose M. Mendoza, Christoph Van der Elst & Erik P.M. Vermeulen, *Entrepreneurship and Innovation — The Hidden Costs of Corporate Governance in Europe*, 7 S.C. J. Int'l L. & Bus. 1, 23 (2010).

49 Nina Smith, Valdemar Smith & Mette Verner, *Do Women in Top Management Affect Firm Performance?: A Panel Study of 2500 Danish Firms*, 55 Int'l. J. Prod. Performance 560 (2006).

50 For this conclusion (again, in general and with no specific regard to banks), in addition to the literature cited *supra* notes 44-49, see Sabine Boerner, Hannah Keding & Hendrik Huttermann, *Gender Diversity und Organisationserfolg — Eine kritische Bestandsaufnahme* [*Gender Diversity and Organization Success — A Critical Survey*], 64 Schmalenbach's Zeitschrift für betriebswirtschaftliche Forschung [Schmalenbach's J. Econ. Res.] 37 (2012) (Ger.); David A. Carter, Frank D'Souza, Betty J. Simkins & W. Gary Simpson, *The Gender and Ethnic Diversity of US Boards and Board Committees and Firm Financial Performance*, 18 Corp. Governance 396 (2010) (finding — contrary to their earlier results mentioned in Carter, Simkins & Simpson, *supra* note 41 — "no effect, either positive or negative," and explaining the results with a contingency effect); Paul L. Davies & Klaus J. Hopt, *Boards in Europe — Accountability and Convergence*, 61 Am. J. Comp. L. 301, 326 (2013); Sean Dwyer, Orland C. Richard & Ken Chadwick, *Gender Diversity in Management and Firm Performance: The Influence of Growth Orientation and Organizational Culture*, 56 J. Bus. Res. 1009 (2003); Thomas Kochan et al., *The Effects of Diversity on Business Performance: Report of the Diversity Research Network*, 42 Hum. Resource Mgmt. 3, 5, 12 (2003) (highlighting a "mismatch between research results and diversity rhetoric").

Supporters of CRD IV diversity rules may counter that a higher presence of women on the board will ensure lower risk-taking across the board, and hence be instrumental to overall financial stability. Some (but not all) influential nonacademic publications stress this argument.[51] One explanation for the risk reduction thesis refers to groupthink in all-male boards: homogenous groups apply homogenous problem-solving strategies. The greater heterogeneity of boards with female representation reduces the likelihood of "groupthink" errors.[52] Another argument relies on the overconfidence hypothesis; overconfident male directors paired with more cautious female board members achieve balanced board decisions.[53]

Academic studies testing the risk-reduction argument yield inconclusive results. Some empirical studies do find a correlation between gender composition and risk. For example, Nick Wilson and Ali Altanlar show a negative correlation between female directors and insolvency risk, irrespective of size, sector and ownership.[54] Maurice Levi and others find that firms with female directors are less likely to make acquisitions and, if they do, pay lower bid premia. They conclude that less overconfident female directors overestimate merger gains less than men.[55] Amy Hillmann and others find that firm age, number of directors and total risk, calculated as the standard deviation in daily stock returns over a company's fiscal year, are significantly associated with female board representation, but refrain from inferring whether the lesser risk is

51 *See* David A.H. Brown, Debra L. Brown & Vanessa Anastasopoulos, Women on Boards: Not Just the Right Thing . . . But the "Bright" Thing 3-6 (2002), *available at* http://www.conferenceboard.ca/e-library/abstract.aspx?did=374 (by subscription); Credit Suisse Research Inst., Gender Diversity and Corporate Performance 19 (2012), *available at* https://www.credit-suisse.com/newsletter/doc/gender_diversity.pdf.

52 This argument is, of course, unrelated to gender-specific features, but generically refers to heterogeneity within the board.

53 Rachel Croson & Uri Gneezy, *Gender Differences in Preferences*, 47 J. Econ. Literature 448, 453 (2009) (summarizing that different intensity of emotions, overconfidence and perceptions of risk as threat or challenge are among the features most often referred to explain gender differences).

54 *See* Nick Wilson & Ali Altanlar, *Director Characteristics, Gender Balance and Insolvency Risk: An Empirical Study* (Univ. of Leeds, Working Paper, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1414224.

55 Maurice D. Levi, Kai Li & Feng Zhang, *Director Gender and Mergers and Acquisitions* 3 (Univ. of British Columbia, Working Paper, 2013), *available at* http://ssrn.com/abstract=2054709.

the reason for, or consequence of, female board membership.[56] To the same extent that gender could affect firm and acquisition risks, these risks could affect gender choices. Female directors may be appointed to boards that are already risk-averse due to other organizational features.

Besides that, other empirical studies do not confirm that female board representation ensures lower risk-taking. Vathunyoo Sila and others find "no evidence that gender diversity influences corporate equity risk or vice versa."[57] Renée Adams and Patricia Funk find that female directors' values differ from women's values generally and that female directors are *more* risk-loving than male directors.[58] Allen Berger and others find that "changes [in the executive board] that result in a higher proportion of female executives . . . lead to a more risky conduct of business."[59]

Wilson and Altanlar explain the correlation between boardroom gender balance and risk reduction also by reference to studies showing that women are more risk-averse drivers, gamblers, and investors than men.[60] Drawing analogies between driving, gambling and investing on the one hand and board decisions on the other is troublesome: boards decide collectively, after extensive reporting and discussions among board members. Group decision-making influences the individual board member's contribution to the board decision. In contrast, driving, investing and gambling are individual actions. Further, board decisions affect shareholders, employees and other stakeholders: presumably, board members will take into account those interests and, at least in contexts where shareholder welfare considerations prevail, may well make less risk-averse decisions than they would if they had to decide

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56 Amy Hillmann, Christine Shropshire & Albert A. Cannella, Jr., *Organizational Predictors of Women on Corporate Boards*, 50 Acad. Mgmt. J. 941, 942, 948 (2007).

57 *See* Vathunyoo Sila, Angelica Gonzalez & Jens Hagendorff, *Women on Board: Does Boardroom Gender Diversity Really Affect Firm Risk?* 20-21 (Univ. of Edinburgh Bus. Sch. Working Paper, 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2379025.

58 *See* Renée B. Adams & Patricia Funk, *Beyond the Glass Ceiling: Does Gender Matter?*, 58 Mgmt. Sci. 219, 234 (2012); *cf. also* Adams & Ferreira, *supra* note 45, at 303.

59 Allen N. Berger, Thomas Kick & Klaus Schaeck, *Executive Board Composition and Bank Risk Taking* 7 (Deutsche Bundesbank Discussion Paper No. 03, 2012), *available at* http://www.bundesbank.de/Redaktion/EN/Downloads/Publications/Discussion_Paper_1/2012/2012_03_06_dkp_03.pdf?__blob=publicationFile.

60 Wilson & Altanlar, *supra* note 54, at 14. See especially James P. Byrnes, David C. Miller & William D. Schafer, *Gender Differences in Risk Taking: A Meta-Analysis*, 125 Psychol. Bull. 367 (1999).

for themselves. Finally, the empirical evidence on women's risk aversion in investing is mixed,[61] and, interestingly, unfavorable in studies, like Adams and Funk's,[62] focusing on female directors or top managers as opposed to women in general. For example, with regard to executives, Zahid Iqbal, Sewan O and H. Young Baek find that female executives engage in less diversification-related stock sales than male executives.[63]

Even assuming that female directors are more risk-averse than male directors, gender may not be the ultimate explanation for this. Ann Marie Hibbert, Edward Lawrence and Arun Prakash explain the reported risk aversion with the lower level of women's education as compared to men's.[64] In light of past gender discrimination within the corporate world, a lower level of risk could in fact reflect lesser (risk) management experience in gender-diverse boards, given that practical experience with risk management helps build up board members' confidence that risks can be controlled and managed. The lower-risk effect of female board membership would then vanish when societies achieve the desirable state of gender equality at the top of financial (and nonfinancial) firms. In any event, we would tend to reject the idea that regulators have meant to exploit female board members' lower level of education and/or experience to reduce the overall risks banks take, while at the same time emphasizing expertise as a requirement for board members.[65]

Supporters of diversity could finally emphasize the role of individual banks' implementation choices: the board itself or its nomination committee, the argument could go, is to set the bank-specific diversity policy and can consider each bank's peculiarities accordingly. Despite the vague wording, the political expectation is crystal clear. In light of the required disclosure of each bank's diversity policy, the screening of diversity practices by national

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61 *See, e.g.*, Renate Schubert et al., *Financial Decision-Making: Are Women Really Risk-Averse?*, 89 Am. Econ. Rev. 381, 382-84 (1999).

62 *See* Adams & Funk, *supra* note 58.

63 Zahid Iqbal, Sewan O & H. Young Baek, *Are Female Executives More Risk-Averse Than Male Executives?*, 34 Atlantic Econ. J. 63, 64 (2006).

64 Ann Marie Hibbert, Edward Lawrence & Arun Prakash, *Are Women More Risk-Averse Than Men?*, 25 Gender Mgmt. 586 (2010) (finding that if "individuals have the same level of education irrespective of their knowledge of finance, women are no more risk averse than men").

65 *See* CRD IV, arts. 91(1), (7) (requiring that "[m]embers of the management body . . . possess sufficient knowledge, skills and experience to perform their duties"); *see also* CRD IV, art. 76(3) (requiring that risk committee members shall have "appropriate . . . expertise to fully understand and monitor the risk strategy and the risk appetite of the institution").

regulators, and the harmonizing character of the forthcoming EBA guidelines,[66] it is almost carved in stone that each bank sets a diversity threshold in the mid-range of the political expectations, even where such an approach may prove harmful for that bank.

B. Enhanced Board Members' Duties and Liabilities

Throughout the crisis, spectacular bank collapses have been followed by enforcement actors' statements that there would be no viable liability claim against directors (and officers) for breach of their duties.[67] Hence the conviction, often expressed by commentators, that legal systems are too benevolent *vis-à-vis* faulty bankers.[68] In 2010, the European Commission launched a consultation on the corporate governance of financial institutions, in which it also asked market participants to comment on a generic proposal to move in the direction of strengthening bank director civil and criminal liability.[69] "The vast majority of respondents" opposed the idea and the Commission seemingly decided not to follow up on that.[70]

However, by beefing up the duties that bank directors are expected to discharge and by providing for harsh administrative penalties in case of violations, the CRD IV appears to have indeed increased the risk for bank

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66 *See supra* text accompanying note 38.

67 *See* Fin. Serv. Authority Bd., The Failure of the Royal Bank of Scotland 7 (2011) (criticizing the Board of the Royal Bank of Scotland for proceeding with inadequate due diligence on ABN Amro before acquisition, but stating that "an enforcement case for inadequate due diligence would have minimal chances of success"); *see also* Report of Anton R. Valukas, Exam'r at 22, *In re* Lehman Bros. Holdings Inc., No. 08-13555 (JMP) (Bankr. Ct. S.D.N.Y. Mar. 11, 2010), *available at* http://lehmanreport.jenner.com/VOLUME%201.pdf (stating that poor risk decisions at Lehman were insufficient to successfully claim a duty of care breach on the part of Lehman's directors and officers).

68 *See, e.g.*, Steven Davidoff Solomon, *Despite Worries, Serving at the Top Carries Little Risk*, N.Y. Times, June 7, 2011, http://dealbook.nytimes.com/2011/06/07/despite-worries-serving-at-the-top-carries-little-risk/?_r=0.

69 Commission Green Paper on Corporate Governance in Financial Institutions and Remuneration Policies, at 17, COM (2010) 284 final (June 2, 2010).

70 *See* Commission Feedback Statement: Summary of Responses to Commission Green Paper on Corporate Governance in Financial Institutions and Remuneration Policies, at 18 (2010), *available at* http://ec.europa.eu/internal_market/consultations/docs/2010/governance/feedback_statement_en.pdf; *see also id.* at 5 (presenting a chart that shows the percentage of consultation respondents by category (those under the heading "financial services industry" being thirty-one percent)).

directors of paying damages or facing administrative sanctions. More precisely, article 91(8) of the CRD IV provides that "[e]ach member of the management body shall act with honesty, integrity and independence of mind to effectively assess and challenge the decisions of the senior management where necessary and to effectively oversee and monitor management decision-making." Intriguingly, the vague wording of those director duties may find a more precise definition in guidelines issued by EBA: pursuant to article 91(12)(c) of the CRD IV, EBA will have to provide guidelines on "the notions of honesty, integrity and independence of mind of a member of the management body as referred to in paragraph 8."[71]

Until EBA clarifies the content of such duties, it is hard to gauge their exact contours and their novelty compared to hitherto applicable bank directors' duties at the member state level.[72] Arguably, however, they are likely to have an impact on board members' behavior in connection with the new harmonized regime on administrative penalties. More precisely, article 67(1)(p) of the CRD IV requires member states to provide for administrative penalties if "an institution allows one or more persons not complying with Art. 91 to become or remain a member of the management body." Reference to article 91 of the CRD IV in its entirety implies that a bank has a precise duty to remove a director who fails to comply with its prescriptions. At the same time, individual board members breaching those duties will be subject to administrative penalties of significant size (up to €5,000,000 or double the loss incurred as a consequence of the violation[73]) and to be made public unless that is disproportionate.[74]

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71 For a critique of this provision, see also Jaap Winter, *The Financial Crisis: Does Good Corporate Governance Matter and How to Achieve It?*, *in* Financial Regulation and Supervision: A Post-Crisis Analysis 368, 385-86 (Eddy Wymeersch, Klaus J. Hopt & Guido Ferrarini eds., 2012).

72 We note in passing that the CRD IV-enhanced director duties appear to be much more broadly framed and to have a much wider scope of application than the enhanced duty of oversight recently advocated by John Armour & Jeffrey N. Gordon, *Systemic Harms and the Limits of Shareholder Value*, 6 J. Legal Analysis 35, 64-74 (2014). While the CRD IV's wording may cover any kind of negligent board members' behavior at any European bank or investment firm, Armour and Gordon propose a more focused obligation to "oversee systems to assess potential downside consequences of the firm's business strategies and to factor these into its decision-making appropriately" with specific regard to certain business matters, *id.* at 68-69; further, that obligation would only apply to board members of systemically important financial institutions, *id.* at 70.

73 CRD IV, arts. 67(2)(f)-(g).

74 CRD IV, art. 68.

To understand why the provisions on directors' duties and administrative penalties will seriously increase their liability risk, consider that, after a managerial decision proves harmful to the bank, the banking supervisor may easily find that a violation of the duty to effectively challenge management decisions had occurred: hindsight bias easily leads to a finding that a director negligently failed to challenge a managerial decision, if it proves harmful to the bank. It would be surprising if banking supervisors, in the new post-crisis environment of "heavy-touch" regulation and enforcement, were reluctant to find directors in breach of the duties specified in article 91(8) of the CRD IV. Given that banking supervisors have all the evidence ready at hand due to the banks' reporting obligations and the supervisor's access to all internal documents, enforcement on their part is easy and likely.

The new duties may also affect civil liability regimes, especially in countries where the standards courts deploy to judge directors' liability are already much stricter than Delaware-style *Caremark* duties.[75] For instance, Italian and German courts hold outside directors and supervisory board members, respectively, liable even for negligently failing to spot irregularities and violations of relevant laws.[76] Of course, even European courts tend to deny that they may second-guess a managerial decision on its merits,[77] but hindsight bias is pervasive and

75 *See In re* Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959 (Del. Ch. 1996). Delaware courts are very close to requiring scienter to hold directors liable for breach of their duty of oversight. *See* Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006).

76 For Italy, see, for example, Cass., sez. II, 5 febbraio 2013, n. 2737, Foro it. 2013, I, 2577 (It.) (holding that all directors have a duty of oversight and may be exempt from administrative sanctions for the inadequacy of internal procedures relating to the provision of investment services only if they prove that they took action or that their oversight was impossible due to other directors' obstructive behavior). For Germany, see Oberlandesgericht Karlsruhe [OLG Karlsruhe], Sept. 4, 2008, Die Aktiengesellschaft 2008, 900 (Ger.) (holding that each member of the supervisory board has a personal duty to initiate extraordinary board meetings and/or board resolutions of the supervisory board with the aim to interfere with illegal acts committed by members of the management board; negligent violation of that duty leads to personal liability). For an overview of director liability for duty of care violations under German law see also Gerhard Wagner, *Officers' and Directors' Liability Under German Law — A Potemkin Village*, 16 Theoretical Inquiries L. 69, 81-82 (2015).

77 For Italy, see, for example, Cass., sez. I, 12 febbraio 2013, n. 3409, in Foro it., Mass., 2013, 109 (It.). For Germany, see Hans-Joachim Mertens & Andreas Cahn, *in* Kölner Kommentar zum Aktiengesetz [Cologne Commentary on the German Stock Corporation Law] § 93 ¶ 12, 667 (Wolfgang Zöllner & Ulrich Noack eds., 3d ed. 2010).

makes that statement little more than a rhetorical concession. Where, as in Europe, negligence is sufficient for liability purposes, courts will find it easy to single out the red flag that a board member, on close enough inspection, should have seen and acted upon by challenging management decisions.

One may counter that there is little new in article 91(8) of the CRD IV: implicitly, as the argument would go, even prior to the CRD IV, EU national banking laws already expected bank directors to exercise a heightened level of care in their oversight of management. And making that explicit only helps directors better understand what their duties are to their bank. This argument is hard to contradict, given that only time will tell whether supervisors and courts will stiffen their interpretation of director duties or stick to the pre-CRD IV case law.[78]

What is instead easy to predict is that the very increase in banks' (and their directors') awareness of such duties, as newly spelt out in the CRD IV and EBA's guidelines, may affect the way boards function and their members behave. Tight liability standards for directors have well-known negative consequences, such as "overprecaution, refusals of good people to serve, demands for increased insurance, indemnification rights, and compensation of residual risk."[79] But there are further, less obvious negative implications of setting the bar very high.

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78 It is also unclear how CRD IV director duties will interact with the business judgment rule that national courts and, at least in theory, even banking supervisors may apply. Wherever the distinction between civil and public law is relevant, as in Germany and Austria, member states may implement provisions spelling out director duties as public law, creating no interference with company law doctrines such as the business judgment rule, or as private law, and hence providing explicit coordination rules or leaving the task of coordination to the courts. On the impact of European financial regulation on member states' private law, see Case C-604/11, Genil 48 SL v. Bankinter SA, 2013 W.L.R. (D) 213 (holding that the contractual consequences of violations of investment firms' duties *vis-à-vis* clients are a matter of national law). Silence on the business judgment rule in the CRD IV may also be interpreted as denial of the business judgment rule as a defense for bank directors. However, in light of the limited exculpatory value of the business judgment rule in at least some European countries, *see* Luca Enriques & Dirk Zetzsche, *The Risky Business of Regulating Risk Management*, 10 Eur. Comp. & Fin. L. Rev. 271, 291 n.93 (2013), this reading, even if it gains traction among member states, would not change the liability regime significantly.

79 Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 Geo. L.J. 797, 818 (2001).

First of all, there will be instances in which the board will have to decide either to do things as is best practice, state of the art, widely held to be the best course of action — in a word, as the herd would do it — or to try something new and/or different. If risk of (civil or administrative) liability for board business decisions (and failure to challenge them) is real, which course of action will directors prefer? Of course, it will be the easier one to justify *ex post*, i.e., the one that follows in the rest of the industry's footsteps. Ironically, few disagree with the proposition that bank managements' herd behavior was one of the catalysts of the financial crisis.[80]

Second, an increased (civil or administrative) liability risk may lead to a stronger tendency to stick to the previously chosen course of action, no matter whether the board had made the decision or just failed to object to it as soon as it was informed about it. Even once a decision is shown to be questionable, a change of strategy or anyhow abandoning the chosen path may highlight that previous decisions or omissions were wrong/harmful and hence immediately intensify the risk of liability.[81] Sticking to previous choices and waiting for better times will at least delay the day of reckoning. In the best case scenario, i.e., if favorable changes in the circumstances occur, lucky boards avoid it altogether. That is why staying put may be better than promptly reacting to previous mistakes, even though, should things go wrong, directors may face increased liability for acquiescing to those mistakes.[82]

To conclude, enhanced board duties will increase liability risk, especially in the European context where the business judgment rule hardly insulates directors from the consequences of managerial mistakes. That, in turn, increases banks' tendency to do things as others in the industry do them, i.e., herd behavior. Finally, it makes it less likely that managerial mistakes will be timely corrected.

C. The Downside of Mandating Unfriendly Boards

Diversity requirements and enhanced director duties (chief among these, the duty to challenge management decisions with independence of mind) are aimed at strengthening the role of banks' boards as an effective and critical monitor of top management. In the decades prior to the financial crisis, the policy tool to

80 *See, e.g.*, Willem H. Buiter, Lessons from the Global Financial Crisis for Regulators and Supervisors, Paper Presented at the Global Financial Crisis: Lessons and Outlook Workshop, IFW, Kiel (May 8-9, 2009), *available at* http://eprints.lse.ac.uk/29048/1/Lessons_from_the_global_financial_crisis.pdf.

81 *See* Langevoort, *supra* note 79, at 826.

82 *See supra* note 76 and accompanying text.

attain that objective for public corporations more generally was a push toward more formally independent boards, i.e., boards in which a given portion of directors had no ties with executive directors or other insiders.[83] A policy shift has thus occurred in the banking regulation area[84]: from formal independence to independence of mind as proxied by individual board members' diverse traits and reinforced by the threat of civil and administrative sanctions in the event of acquiescent behavior.

Such a shift is also the product of empirical evidence failing to show a positive correlation (or even finding a negative one) between board independence and various measures of banks' performance, before and during the crisis.[85] The literature tends to explain those empirical findings with the lack of firm-specific knowledge that formal independence implies.[86]

But an alternative explanation may well be that more inquisitiveness within the boardroom creates countervailing problems that make unfriendly boards no more effective than ones dominated by CEOs. A more confrontational and less trustful atmosphere within the boardroom can lead CEOs to provide less information to boards, to seek less advice from the board itself, and to incur higher influence costs *vis-à-vis* informationally distant board members.[87] In

83 *See, e.g.*, Suzanne Le Mire & George Gilligan, *Independence and Independent Company Directors*, 13 J. Corp. L. Stud. 443, 450-52 (2013).

84 *Id.* at 474 (noting "a growing recognition that a reliance on formal independence, as it has been conceived in corporate governance regulation, is unsatisfactory" and presenting a concept of "substantial independence" comprising four dimensions (capacity, status, power and relationships)); *see also* Davies & Hopt, *supra* note 50, at 326; Hopt, *supra* note 15, at 249.

85 *See, e.g.*, Jacob de Haan & Razvan Vlahu, *Corporate Governance of Banks: A survey* 21-23 (De Nederlansche Bank, Working Paper No. 386, 2013), *available at* http://www.dnb.nl/en/binaries/Working%20Paper%20386_tcm47-294339.pdf.

86 *Id.*

87 *See* Renée B. Adams & Daniel Ferreira, *A Theory of Friendly Boards*, 62 J. Fin. 217 (2007); Langevoort, *supra* note 81, at 811-14, 826; Licht, *supra* note 39, at 605-07. *But see* Terry McNulty, Phillip Ormrod & Chris Florackis, *Boards of Directors and Financial Risk During the Credit Crisis*, 21 Corp. Governance 58 (2013) (surveying studies showing that cognitive conflict is positive for board dynamics and providing empirical findings in support of the view that board effort and cognitive conflict are positively correlated with (nonfinancial) firms' lower risk exposure. However, their findings deal with norm-induced cognitive conflicts and board effort (in other words, they hold regulation constant and hence look into differences at firm level, which can only be voluntary). They do not (and in fact could not) show that law-induced cognitive conflict will lead to the same result.).

practice, they will find ways to communicate outside the board with those members that do not make trouble, selectively disclosing information to them and prearranging majorities to mute discussion within the boardroom. Such a course of action will lead to even more confrontational behavior on the part of dissident board members. If all information that can remain undisclosed is not provided in the boardroom, there is the risk that highly disruptive, sterile discussions about how to conduct board meetings and what information the board should receive, as opposed to what strategies to adopt, how to manage risk, etc., will take center stage.

Of course, the CRD IV's emphasis on board members' expertise[88] and the requirement for induction programs[89] may reduce information asymmetries within the board and, hence, the risk of negative board dynamics. But the information gap between outside directors and insiders is bound to remain huge no matter how well-trained and expert board members are.

We have just preconized that diversity requirements and the newly spelt-out director duties will lead to a genuinely more confrontational style of board interactions. But at banks where insiders can influence the nomination process, a different kind of board dynamics may well be the outcome of EU lawmakers' attempt to impose independence of mind within boardrooms.

First, banks may comply with diversity requirements in form but not in substance, by systematically choosing less skilled, less active and less assertive members with a diverse background. In that case, diversity requirements will be used strategically to obtain no less friendly boards than without them. Second, because violations of the duty of independence may lead to an administrative penalty for the bank itself, it will be the direct responsibility of the compliance officer (or the company's secretary) to ensure that evidence will be available of a vibrant discussion within the board and of directors' inquisitiveness. Members of a friendly, cohesive board, possibly working effectively with the bank's top management, will have to pretend to be asking tough questions and appear to be confrontational so as to avoid being fined as weak CEO puppets. When mere appearance is the outcome, it will be a matter neither of formal nor of substantial independence. In such cases, theatrical (in fact, farcical) independence is all that attempts to impose independence of mind can achieve. We leave it to the reader to judge whether any benefits can stem from this kind of board dynamics, while noting that the opportunity costs of playing the farce and documenting it are, if not substantial, at least hard to dispute.

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88 *See supra* note 65.
89 *See infra* Section II.C.

To conclude, the CRD IV's push towards unfriendly boards may prove counterproductive. It may lead to excessive emphasis on informational and procedural issues to the detriment of sound business judgment as well as to reduced information flows and discussion quality at the board level. As an outcome, bank governance will be weakened rather than strengthened.

II. Petrifying Corporate Governance Trends

In this Part we show that some CRD IV governance provisions reflect current trends in boardroom best practices. When practices become law, they take on the standardizing, one-size-fits-all character of regulation. Also, the *current* best practices as described in member states' corporate governance codes are perpetuated and experimentation is precluded or at least hindered. This "petrification effect" reduces banks' ability to adapt to change. In turn, as with the diversity requirement, those banks for which already the best practice standards are *not* suitable are left with suboptimal board rules.

We provide three examples of our petrification claim in this Part: the separation of chairman and CEO (Section A), limits on directorships (Section B), as well as mandatory induction and self-evaluation (Section C). We conclude with a side glance at who benefits from — and therefore may have pushed for — these types of rules (Section D).

A. Separation of Chairman and CEO

An increasing number of listed companies in the United States have separated the roles of board chair and CEO in the last twenty years, a practice that has for long been very common in the United Kingdom.[90] The commonly held view among corporate governance reformers is that it will be harder for an imperial CEO to dominate the board if someone else chairs it. In other words, the board can more effectively monitor the CEO with a separate chair.[91]

Post-crisis policy papers on bank governance reform put this topic forward as one deserving of policymakers' attention.[92] However, they have tended not to recommend mandatory separation of the two roles, recognizing that "a one

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90 *See, e.g.*, Dan R. Dalton & Idalene F. Kesner, *Composition and CEO Duality in Boards of Directors: An International Perspective*, 18 J. Int'l Bus. Stud. 33, 39 (1987).

91 *See, e.g.*, Michael C. Jensen, *The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems*, 48 J. Fin. 831, 866 (1993).

92 *See, e.g.*, OECD, *supra* note 15, at 43-44; Laura Ard & Alexander Berg, *Bank Governance. Lessons from the Financial Crisis (Crisis Response, Note No. 13)*,

size fits all approach is difficult in this area."[93] Similarly, the Dodd-Frank Act went no further than directing the U.S. Securities and Exchange Commission (SEC) to impose disclosure on why the board has chosen CEO-chair duality or separated the two roles.[94]

The CRD IV has gone much further in the direction of nudging companies into separating the two roles. According to article 88(1)(e), "the chairman of the management body in its supervisory function of an institution must not exercise simultaneously the functions of a chief executive officer within the same institution, unless justified by the institution and authorized by competent authorities." This provision appears to be an extremely sticky default in favor of separating the two roles.

The reason why most banks can be expected to stick to it instead of filing a request for an authorization to do otherwise is twofold. First, each bank has a limited reserve of political capital that it can deploy with supervisory agencies. Only in exceptional circumstances can they be expected to spend it to persuade the banking supervisor into authorizing duality. Second, once the lawmaker has clearly indicated a preference for separation, it is politically riskier for the supervisor to authorize duality than to reject the bank's request. In fact, the bank may later flourish or fail. In the latter case, should it fail with a chairman-CEO that had been previously authorized, the chances are high that someone will put two and two together and blame the supervisor for allowing duality. If the request for a derogation from separation of the two roles had been rejected, it is much less likely that anyone would connect the two facts, because separation will be seen as normal. Needless to say, in either case failure may well have nothing to do with duality or separation, but what counts is the risk that the media and policy entrepreneurs will make the connection and criticize the supervisor.

How justified is the new sticky default in favor of separation? The number of studies, theoretical and especially empirical, delving into the question whether separation is more efficient than duality is huge, but the evidence is inconclusive at best: neither theory nor empirical studies have come to firm conclusions on whether firms are better governed either way.[95] Studies

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at 5, World Bank Grp. (Mar. 2010), https://openknowledge.worldbank.org/handle/10986/10207.

93 OECD, *supra* note 15, at 46; *accord* Basel Comm. on Banking Supervision, Principles for Enhancing Corporate Governance 12 (2010), *available at* www.bis.org/publ/bcbs176,pdf.

94 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 972, 124 Stat. 1376 (2010).

95 *See* Renée Adams, Benjamin E. Hermalin & Michael S. Weisbach, *The Role of Boards of Directors in Corporate Governance: A Conceptual Framework*

specifically addressing banks and searching for correlations between duality/separation and performance or risk-taking have found little evidence of any such correlations.[96]

There are good, intuitive reasons for letting companies make their own determinations whether the two roles should be combined or separate. In short, "the implications of CEO duality are a function of firm-specific costs and benefits."[97] How beneficial separation of the two functions is for an individual bank depends on a number of features, including whether the CEO's incentives are aligned with her principals' interests, via compensation or share ownership, how independent and effective other board members are in monitoring the CEO, and whether the CEO has already built a good reputation.[98] The costs of separating the two roles similarly vary as a function

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and Survey, 48 J. Econ. Literature 58, 81-82 (2010); Jay Dahya & Nickolaos Travlos, *Does the One Man Show Pay? Theory and Evidence on the Dual CEO Revisited*, 6 Eur. Fin. Mgmt. 85, 87-90, 92-97 (2000).

96 *See* Vincent Aebi, Gabriele Sabato & Markus Schmid, *Risk Management, Corporate Governance, and Bank Performance in the Financial Crisis*, 36 J. Banking & Fin. 3213, 3222 (2012); Hugh Grove, Lorenzo Patelli, Lisa M. Victoravich & Pisun T. Xu, *Corporate Governance and Performance in the Wake of the Financial Crisis: Evidence from US Commercial Banks*, 19 Corp. Governance 418, 430 (2011); Allen Berger, Björn Imbierowicz & Christian Rauch, *The Roles of Corporate Governance in Bank Failures During the Recent Financial Crisis* 24 (Eur. Banking Ctr., Discussion Paper No. 23, 2012), *available at* http://ssrn.com/abstract=2163546; Anna Kryvko & Peter Reichling, Corporate Governance and Performance of European Commercial Banks, Paper Presented at the International Conference "Improving Financial Institutions: The Proper Balance Between Regulation and Governance," Helsinki, Fin. (Apr. 19, 2012), *available at* http://virtusinterpress.org/IMG/pdf/Helsinki_conference_paper_13.pdf. *But see* Krista B. Lewellyn & Maureen I. Muller-Kahle, *CEO Power and Risk Taking: Evidence from the Subprime Lending Industry*, 20 Corp. Governance 289, 298 (2012); Olubunmi Faleye & Karthik Krishnan, When Is Bank Governance Important? Board Effectiveness, Banking Industry Distress, and Borrower Risk, Paper Presented at the 23rd Australasian Fin. & Banking Conference, Sydney, Austl. (Dec. 15-17, 2010), *available at* http://ssrn.com/abstract=1661837.

97 Aiyesha Dey, Ellen Engel & Xiaohui Liu, *CEO and Board Chair Roles: To Split or Not to Split?*, 17 J. Corp. Fin. 1595, 1608 (2011).

98 *See* Olubunmi Faleye, *Does One Hat Fit All? The Case of Corporate Leadership Structure*, 11 J. Mgmt. & Governance 239, 243-45 (2007); Joseph P. O'Connor, Richard L. Priem, Joseph E. Coombs & K. Matthew Gilley, *Do CEO Stock Options Prevent or Promote Fraudulent Financial Reporting?*, 49 Acad. Mgmt. J. 483, 494 (2006).

of numerous variables: the same factors affecting the benefits of separation will lead to variations in the cost of monitoring the separate chairman.[99] Whether separation leads to rivalries and confusion regarding who is in charge will depend on the personalities involved.[100] The organizational complexity of the bank will affect how costly it is for the CEO to share information with the chairman.[101] Further, internal board dynamics may or may not lead to confusion regarding who is to blame for mismanagement[102] and may affect other directors' tendency to monitor less and rely instead on the separate chair to do the monitoring.[103] Finally, banks doing business in a highly uncertain and fast-changing environment will put a premium on unity of command, because this allows for speed of decision-making.[104] For such banks (i.e., for all banks in a financial crisis setting), the costs of separation will be higher.

Pushing all banks in the direction of separating the two functions can hardly be predicted to lead to their safer management: separation may (or may not) improve things at previously badly managed banks and worsen them at well-managed ones. There is neither a theoretical rationale nor available empirical evidence to suggest that the aggregate benefits from mandatory CEO-chair separation at badly managed banks will be higher than the costs attaching to it in well-run banks. Needless to say, arguing that in the absence of separation between the two roles the European banking system came to the verge of disaster simply would prove too much, also because CEO-chair duality was relatively uncommon in Europe on the eve of the crisis[105] and is nowadays even less so, at least among the largest banks.[106]

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99 James A. Brickley, Jeffrey L. Coles & Gregg Jarrell, *Leadership Structure: Separating the CEO and Chairman of the Board*, 3 J. Corp. Fin. 189, 193-94 (1997).

100 Ryan Krause, Matthew Semadeni & Albert A. Cannella, Jr., *CEO Duality: A Review and Research Agenda*, 40 J. Mgmt. 256, 265 (2013).

101 Faleye & Krishnan, *supra* note 96, at 242.

102 Brickley et al., *supra* note 99, at 195.

103 *See* O'Connor, Priem, Coombs & Gilley, *supra* note 98, at 494.

104 Brian K. Boyd, *CEO Duality and Firm Performance: A Contingency Model*, 16 Strategic Mgmt. J. 301, 305 (1995).

105 *See* David Ladipo & Stilpon Nestor, Bank Boards and the Financial Crisis: A Corporate Governance Study of the 25 Largest European Banks 29 (2009).

106 *See* Daria Khalilulina & Stilpon Nestor, The New Normal: A Summary Report on the Corporate Governance of Europe's Top 25 Banks 19 (2012).

B. Limits on Directorships

Banks have lately been complaining about how hard it is to recruit qualified nonexecutive directors.[107] Directors' recruitment will become even more challenging following CRD IV's legally binding limits on directorships for individual board members of large banks. Article 91(3) of the CRD IV provides that, unless they are appointed by the government, directors of larger banks shall hold no more than four nonexecutive directorships (or one executive directorship if they hold two nonexecutive directorships).[108] In this case as well, large banks may petition competent authorities to authorize a member of the management body to hold one additional nonexecutive directorship. Competent authorities shall regularly inform EBA of such authorizations. For the same reasons outlined above to explain why we cannot expect frequent authorization of CEO-chair duality,[109] we predict that such kinds of authorizations will be seldom requested and even more rarely granted.

While France and Germany among major jurisdictions limit directorships by way of statute,[110] in other European states those limits have been the subject

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107 *See* Ladipo & Nestor, *supra* note 105, at 27; *see also* Grant Kirkpatrick, *The Corporate Governance Lessons from the Financial Crisis*, 1 OECD J.: Fin. Mkt. Trends 61, 81 (2009).

108 For further specifications, see CRD IV, arts. 91(4)-(5). The privilege accorded to board members representing a member state is perplexing, and vividly highlights, to say the least, the limited faith by policymakers themselves in the fact that board limits are justified. Otherwise, why should they exempt their own board members from such a requirement? On sovereign privileges in financial regulation and the case for repealing them see generally Christian Kersting, *Combating the Financial Crisis: European and German Corporate and Securities Laws and the Case for Abolishing Sovereign Debtors' Privileges*, 48 Tex. Int'l L.J. 269, 304-22 (2013).

109 *See supra* Section II.A.

110 For France, see Code de commerce [C. com.] art. L225-21 (Fr.) (no more than five directorships in French companies). For Germany, see Aktiengesetz [AktG] [Stock Company Act], Sept. 6, 1965, BGBl. I at 1089, as amended, art. 100, § 2(1) (Ger.) (up to ten board memberships or up to five chairmanships). The German limit on supervisory board memberships (which was originally set at twenty) goes back to the Stock Corporation Reform Act of 1937 where it was meant to limit the influence of individuals on the economy as a whole (in light of the ruling party's intention to control all parts of society). The limit was lowered to ten in 1965. *See* Hans-Joachim Mertens & Andreas Cahn, *in* Kölner Kommentar zum Aktiengesetz, *supra* note 77, § 100 ¶ 2. The limit was further tightened by changing how board chairmanships were counted in the wake of the Metallgesellschaft insolvency, which was widely seen as the outcome of

of recommendations in nonbinding corporate governance codes.[111]

Economists have no answer as to whether a cap, let alone which cap, should be imposed on directorships. As Anil Shivdasani and David Yermack have put it, "the optimal number of directorships is an unresolved issue."[112] The empirical evidence on the impact of director busyness is similarly inconclusive, as regards both corporations' performance generally and banks' riskiness.[113] Studies showing a negative correlation between directors' busyness and performance may fail to consider that, as one study shows, busy directors are more likely to be selected in companies in which the CEO has stronger control over the nomination process,[114] which in turn could mean, more generally, too much power. Excessive CEO power, rather than directors' busyness, may thus explain lower performance at those companies.[115] Nor would the correlation between CEO power and director busyness justify a limit on directorships as a tool to ensure that the CEO will have less power thanks to better monitoring: if the CEO has influence over the nomination process, she will likely manage to select equally ineffective and/or less visibly busy directors. When there is value in having a director with multiple directorships on board,[116] then imposing such a limit will have no benefits in terms of curbing the CEO's excessive power, while at the same time preventing the bank from gaining from the busy director's experience and connections.

Consider also that limits on board seats are too blunt an instrument to ensure that board members will "commit sufficient time to perform their functions in the institution," as article 91(2) of the CRD IV requires. How can that goal be achieved by looking only at directorships held, when board members can be

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a corporate governance failure. *See* the Begründung des Gesetzentwurfs zum KontraG [Government's official reasoning on the law enhancing corporate control and corporate transparency], BT-Drs. 13/9712 (Parliament's Publications) of 28 January 1998, at 15 f (Ger.). Basically, German politicians back then experienced the same pressure "to do something" as European politicians in the wake of the financial crisis.

111 *See, e.g.*, Fin. Reporting Council, The UK Corporate Governance Code 14 (2012) (setting a limit of four fulltime executive directors); Corporate Governance Comm., Corporate Governance Code 9 (2011) (It.) (recommending that listed companies' boards set themselves a limit on directorships).

112 Anil Shivdasani & David Yermack, *CEO Involvement in the Selection of New Board Members: An Empirical Analysis*, 54 J. Fin. 1829, 1847 (1999); *see also* Adams, Hermalin & Weisbach, *supra* note 95, at 89.

113 *See* de Haan & Vlahu, *supra* note 85, at 17-18.

114 *See* Shivdasani & Yermack, *supra* note 112, at 1847.

115 *See* Adams, Hermalin & Weisbach, *supra* note 95, at 90.

116 *See id.* at 89-90.

professional directors sitting on boards as their exclusive occupation, full-time executives in other large corporations, busy attorneys working twenty-four/seven, or even high-flying academics unwilling to subtract too much of their time from research? How can policymakers expect that a seasoned director with long previous experience as a banker and an outsider who has to learn anew the specifics of bank management and financial markets will need the same time to perform their tasks and duties?

In fact, the variance in the time needed to perform exactly the same board task by different individuals in any given institution is intuitively high. Depending also on how focused they are on their principal occupation, for some even a second directorship is too much to handle, for others an unnecessary constraint. In addition, introducing a limit on directorships exclusively for banks' boards[117] may well have the effect of segregating the market for bank directorships from the market for directorships in general: to avoid the limit, professional directors, especially women, who are currently in high demand across the board, may simply decide not to accept bank directorships, an outcome that is at odds with the diversity requirement discussed in Section I.A.

C. Induction and Self-Evaluation

Our last target are two seemingly innocuous provisions that inscribe into law the practice of providing training and induction for new board members[118] and of periodic self-evaluation exercises.[119]

While neither of these requirements lacks common sense, their formalization into banking regulation may easily lead (smaller) banks hitherto lacking any formal induction program or self-evaluation practices to engage in standardized box-ticking exercises — possibly trumping informal (yet idiosyncratically effective and cost-efficient) tools — to train new directors and evaluate the board's performance. Similarly, the "juridification" of such best practices may lead banks with induction and self-assessment programs already in place to adapt such programs, or stick to the industry standards, even when those standards are not suited to them. In a recent paper criticizing risk management juridification, we have highlighted the reasons why embedding such a tool into the law entails pressure towards standardization.[120] The same reasons apply with regard to induction programs and self-evaluation practices.

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117 Or a stricter limit, in countries like Germany and France, where there is a less stringent general limit to directorships. *See supra* note 112.

118 CRD IV, art. 91(9).

119 CRD IV, art. 88(2)(b).

120 Enriques & Zetzsche, *supra* note 78, at 293.

In short, these requirements will have to be implemented in a verifiable way, i.e., it will have to be possible for the supervisor to understand how the bank has implemented these requirements and to check whether they are complied with in practice. The supervisory authority cannot be expected to have deep inside knowledge of the peculiarities of each and every individual bank: it will compare a firm's induction programs and self-assessment exercises with the standard ones it considers to be best practices. Any deviation or customization will imply additional supervisory effort, first to understand the contents of the idiosyncratic methods and then to assess whether they are acceptable/justified. A strong bias toward uniformity ensues: those who have already adopted industry standards will stick to them. Those with idiosyncratic programs had better replace them with standard ones. Once again, it may be the case that idiosyncratic programs perform on average worse than standard ones. But one wonders what theory could justify such a belief.

D. A Note: And the Winners Are…

Before concluding, it is worth asking in passing who benefits from "petrifying" governance rules such as those we have previously focused on, if banks and society as a whole are likely to suffer. Many of the CRD IV bank governance measures described here, and precisely the diversity requirements, the limits on directorships, and the rules imposing training and induction programs and self-evaluation exercises, will push up EU banks' demand for corporate governance consultancy services. Not only may banks, especially smaller ones, genuinely lack the skills and experience that are needed to comply with these new governance provisions, but it may also be convenient for them to demand such services to reduce the risk of failure to adequately implement the new governance measures: a consultant will be better aware of what the supervisor deems acceptable and adequate, so that banks may reasonably rely on its advice in adapting to the new rules.

Further, there will be tasks which any bank will find extremely convenient to outsource. It will be almost impossible, for example, to abide by the new board diversity requirements without the assistance of a headhunting firm. Recruitment services for banks' boards, in turn, will become more difficult to carry out than in the past. A suitable set of candidates will now have to have diverse backgrounds and complementary skills,[121] not to mention that limits on directorships will drain the pool of potential candidates. All of that will justify higher consultancy fees.

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121 *See* CRD IV, art. 91(1) ("The overall composition of the management body shall reflect an adequately broad range of experiences.").

Finally, some of the very best practices that have been inscribed into law, namely training and induction programs and self-assessment exercises, are already carried out with the assistance of consultants.[122] For banks that have not formalized such programs and practices yet, it will only be natural to turn to consultants once induction, training and self-assessment become mandatory.

Hence, from the plethora of bank governance reforms that the European Union has been churning out, at least one clear winner emerges: corporate governance consultancy and recruitment services providers. They share the podium, of course, with policymakers and politicians who have shown to have done not just "something," but a lot, to restore trust, and bank supervisors, who have gained a wide range of regulatory and supervisory powers over banks' boards. These three groups together have enough clout to impose the rules we have focused on in this section even though they may well negatively affect banks and society as a whole.

III. Conclusion: Soft Implementation and Unprioritized Enforcement as Regulatory Responses

Our analysis has covered the core bank board provisions in the CRD IV, arguing that they are meritless and counterproductive. First of all, we have shown how the diversity requirements and the newly spelt-out director duties, which are intended to overcome the problems of CEO-dominated boards and groupthink, may introduce problems of their own in the way boards perform their oversight and advisory functions. Second, various provisions petrify existing corporate governance best practices, and in so doing impose costs on banks that would be better off adopting (or maintaining) a different solution (such as a chairman/CEO or a board in which also a busy professional director with the right expertise keeps his seat). Making induction and training and self-assessment exercises mandatory, finally, may easily lead to expensive and standardized box-ticking exercises, to the detriment of more customized solutions at the level of individual banks (and at sizeable benefit to governance consultants).

These governance rules do not live up to the principles of "good" or at least "better regulation," a standard to which the European Commission[123] and

122 *See, e.g.*, Maria Cristina Ungureanu, *Board Evaluation — A Window into the Boardroom*, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (May 31, 2013), http://blogs.law.harvard.edu/corpgov/2013/05/31/board-evaluation-a-window-into-the-boardroom/.

123 *See* Daniela Weber-Rey, *Effects of the Better Regulation Approach on European Company Law and Corporate Governance*, 4 Eur. Comp. & Fin. L. Rev. 370,

some of the European regulators have subscribed. In particular, the measures criticized herein lack proportionality, insofar as, with due exceptions, they apply to all bank boards — even those that are "best in class." For most of them, there is no way to tell whether they will enhance efficiency and financial stability or have the opposite effect: their one-size-fits-all character only justifies the prediction that they may improve governance at some banks as likely as worsen it in others. The problem is that there is no evidence whatsoever to predict that the net benefits will be positive, while the transition and implementation costs for all banks are certain.

Supporters of the CRD IV board rules could further argue that the costs of corporate governance rules are low compared to the overall size of financial markets and their relevance to society; hence, one should not worry about these small extra costs when so much is at stake. But this argument holds water only for large banks. Small and mid-size banks — whose competitive position already suffers from the lack of an implicit bailout option — suffer more from the fixed costs and the inflexibility of the board rules we have focused on. From a systemic perspective, it is these small and medium banks that should benefit from post-crisis legislation: these are the banks that can challenge the oligopolistic and moral hazard-prone equilibrium resting upon large, too-big-too-fail banks.

Despite these detrimental effects, the CRD IV board rules may nevertheless be praised for their trust-restoration effect. In fact, crisis regulation may be less about efficiency and proportionality, and more about short-term restoration of trust in the stability of financial markets.[124] The systemic positive effects on public confidence may outweigh the net negative effects at the level of

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393-94, 397-99 (2007); Charlie McCreevy, European Comm'r for Internal Mkt. & Serv., Harmonisation and Better Regulation, Speech at the Irish Brokers Association Lunch, Dublin, Ir. (Oct. 20, 2006), *available at* http://europa.eu/rapid/press-release_SPEECH-06-619_en.htm?locale=EN.

124 In this Article we cast no doubt on whether post-crisis reforms have indeed contributed to restoring trust in financial markets. Further, we do not challenge John Coffee's far-reaching argument that well-organized special interest groups influence legislation in non-crisis settings. *See* Coffee, *supra* note 10, at 1019 (arguing that crisis legislation is a temporary "republican triumph," where the majority as "latent group" takes over from better organized interest groups). However, any crisis legislation that does not go hand in hand with long-term efficiency *furthers* (rather than challenges) the restoration of hegemony by the special interest groups once things are back to normal: inefficient rules provide the starting point for subsequent reform legislation. The fact that the item is on the legislature's agenda (again) facilitates the work of special interest groups aiming to influence legislation in their own favor.

individual firms: after all, if people stop keeping their money in bank accounts today we do not need to worry about banks' profitability tomorrow. So let us impose overly harsh measures today as a signal that we will do whatever it costs, and worry tomorrow about tomorrow. Put this way, quack provisions can be justified as trading off relatively low long-term costs for very high short-term benefits. We admit that this short-term signal may have been important in handling the crisis: given the little we know about crisis psychology, we cannot exclude that overly harsh, even useless or harmful measures effectively played a trust restoration role.

For this reason, Roberta Romano argued in favor of sunset provisions, i.e., confirmation of crisis legislation by Congress or Parliament after some years.[125] The problem with that idea is that legislation contingent on periodic review and confirmation does *not* credibly signal policymakers' commitment to restoring confidence. The same political entrepreneurs that drive crisis legislation would unmask legislation with a sunset provision as a strategic effort to mislead the public into thinking that lawmakers are serious about bank regulation. The lack of trust in financial markets and regulation would persist. Put differently, the fact that CRD IV governance rules "hurt" (i.e., reduce efficiency) demonstrates and reinforces the policymakers' unconditional commitment to restoring trust (the "whatever it takes" rhetoric[126]).

If efficiency and costs are of secondary importance short-term, while suboptimal rules harm banks *and* society in the long run, how should European policymakers proceed? Repeal of the rules criticized herein is no viable option either, both from a short-term perspective, because the crisis is too fresh in the public's memory, and with a longer term view, because it would make

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125 *See* Romano, *supra* note 3, at 1595 ("It would be prudent for Congress, when legislating in crisis situations, to include statutory safeguards that would facilitate the correction of mismatched proposals by requiring, as in a sunset provision, revisiting the issue when more considered deliberation would be possible."); *id.* at 1600 ("Sunset refers to periodic review of regulatory programs, with termination possible if not renewed by Congress."); *see also* Roberta Romano, *Regulating in the Dark*, *in* Regulatory Breakdown: The Crisis of Confidence in U.S. Regulation 86 (Cary Coglianese ed., 2012).

126 Mario Draghi's commitment to saving the single European currency at all costs has been deemed to restore trust for the very reason that his commitment was not contingent on anything, in particular not limited by budgetary constraints. *See* Mario Draghi, President, Eur. Cen. Bank, Speech at the Global Investment Conference, London, U.K. (July 26, 2012), *available at* http://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html ("Within our mandate, *the ECB is ready to do whatever it takes to preserve the euro*. And believe me, it will be enough.") (emphasis added).

any later effort to similarly restore trust via quack legislation harder if another financial crisis struck later on.

We submit that European and national policymakers and supervisors should temper the intensity of implementation rules and enforcement efforts. Implementing legislation and guidelines to be adopted by the European Commission and EBA before the end of 2015 should avoid (1) hastening to issue the new rules; (2) using language that stiffens and/or broadens the scope and intensity of CRD IV governance provisions; or (3) adding detailed descriptions of required behavior.[127] In turn, because any supervisory authority has to prioritize, given that its resources will never be enough to ensure compliance with all regulation by all supervised banks, we submit that European and national banking supervisors should refrain from including bank board provisions among those they single out as priorities in their day-to-day supervision and enforcement activity. For instance, having avoided issuing elaborate and precise rules on board diversity, they may refrain from questioning individual boards' degree of diversity other than in the most blatant cases. Of course, tacit coordination should be ensured at the various government levels, so that no national supervisor will risk a negative reaction on the part of European institutions for being less than strict in ensuring compliance with these rules. This strategy would also have the advantage that if banks were to resume misbehaving, i.e., regain pre-crisis overconfidence and/or show signs of reckless behavior, European policymakers and supervisors could easily and swiftly gear up and apply Level 1 rules[128] in full force.[129]

One may counter that this "safe and sound" approach to implementation and enforcement of board rules risks deceiving the public: after having been

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127 At the same time, the European Commission and EBA could provide examples of behavior held to be in compliance with the new regime.

128 European legislation comprises various levels. While so-called Level 1 legislation is jointly enacted by the European Commission, the Parliament, and the Council, Level 2 legislation, containing more detailed implementing measures, is proposed by the European Supervisory Agencies (ESAs; in our case: EBA) and adopted by the European Commission. See, for example, CRD IV, art. 94(2) on employees that have a material impact on the banks' risk profile. In addition to these, EBA may issue guidelines of its own. See, for example, CRD IV, art. 91(12)(b) regarding the necessary knowledge, skills and expertise of the banks' board members.

129 An additional advantage of this approach would be that a simple move to stricter enforcement would require no change in legislation. Hence, there will be much less scope for special interest groups' pressure to avoid or dilute such a move by regulators. On the relevance of financial institutions as a lobby and, in normal times, its effectiveness in blocking financial regulation reforms, see *supra* text accompanying note 10, and *supra* text accompanying note 124.

given the impression that policymakers had done whatever it took to restore trust, when the next crisis unravels, the public may find out that this was not in fact the case because of lax implementation and enforcement. At which point, it may be even more difficult to restore trust via new rules than after the 2007-2008 financial crisis. However, this scenario is highly unlikely. While we do not know how and when the next financial crisis will hit, the objection holds water only if the next crisis occurs while the CRD IV board rules still form a part of the public's memory. Even then, it will take an exceptionally gifted political entrepreneur or a genius econometrician to determine that the loose implementation of bank board rules was at the root of the crisis. And even if such a correlation is argued to exist, that will only allow future policymakers to put the blame on those who were in charge of supervision and show that *they* will do things better than in the past, adding even more precise prescriptions at the statutory level. All in all, the soft implementation approach we propose would preserve the short-term signal to the public while limiting the long-term harm of inappropriate governance regulation.[130]

130 In fact, this is what happened in the United States. Some Dodd-Frank Act implementing rules are yet to be written (which indicates systematic delay) or have been watered down at the implementation stage also by carving out broad exemptions. For an overview, see Coffee, *supra* note 10, at 1037, 1065. Note that the scope of EU banking law is defined at Level 1, *see supra* note 128: in contrast to the U.S. regulatory agencies, neither the European Commission nor EBA may introduce broad exemptions in implementing legislation. Regardless of whether the delay and watering down are signals of regained influence by special interest groups over the political process or an indication that crisis-experienced U.S. regulators do distinguish between the short-term political symbolism and the long-term costs of quack legislation, in implementing the CRD IV board rules European institutions could well draw inspiration from the U.S. Dodd-Frank Act experience.