

RISK MANAGEMENT MAGAZINE

Vol. 16, Issue 1
January – April 2021

EXCERPT

<https://www.aifirm.it/newsletter/progetto-editoriale/>



Banks' Corporate Governance: lessons learnt from the Great Financial Crisis

Enrica Rimoldi

Banks' Corporate Governance: lessons learnt from the Great Financial Crisis

Enrica Rimoldi (Independent analyst, Non-Executive Director, INSEAD Certificate in Corporate Governance)

Article submitted to double-blind peer review, received on 12th January 2021 and accepted on 21st April 2021

Abstract

After acknowledging that one of the key factors that contributed to the Great Financial Crisis were the failures by banks in their Corporate Governance, standard-setting bodies have reinforced banks governance standards in order to reduce the shortcomings observed during the crisis. In March 2020, the Bank for International Settlement issued the paper "Bank Boards – a review of post-crisis Regulatory approaches" that, taking stock of specific aspects of the post-crisis Regulatory approaches used in 19 jurisdictions to strengthen Board oversight at banks, reviews the "Fitness and Propriety" assessment that these jurisdictions use to ensure that bank Board members are suitably qualified.

Investigating the empirical evidence provided by scientific literature on the relationship among Corporate Governance and the profitability of the banks during the Great Financial Crisis, the results of this paper support some of the choices made by the Regulators to enhance the banks' Corporate Governance in order to mitigate similar risks that banks could face subsequently.

Come noto, uno dei fattori che contribuì alla Grande Crisi Finanziaria è ascrivibile alle carenze nella Corporate Governance delle banche. Con tale consapevolezza, i Regolatori hanno successivamente rafforzato gli standard di Corporate Governance delle banche e, nel Marzo 2020, la Bank for International Settlement ha emesso il documento "Bank Boards – a review of post-crisis Regulatory approaches". Tale elaborato rivede i criteri dei "Fitness and Propriety" assessments utilizzati da 19 giurisdizioni successivamente alla Grande Crisi Finanziaria per assicurare che i Board members delle banche siano adeguatamente qualificati al ruolo da ricoprire.

I risultati del presente elaborato - che investiga le evidenze empiriche provenienti dalla letteratura scientifica sulle relazioni tra la Corporate Governance e la profittabilità delle banche durante la Grande Crisi Finanziaria - supportano alcune scelte fatte dai Regolatori al fine di mitigare i rischi che le lacune in Corporate Governance emerse durante la Grande Crisi Finanziaria non si ripresentino in crisi successive.

Keywords

Accountability, Bank, Board, Chair, Committee, Corporate Governance, Financial Crisis, Fit & Proper, Fitness & Propriety, Pandemic, Profitability.

DOI 10.47473/2020rmm0084

1. Introduction

This paper investigates if the failure of banks during the Great Financial Crisis - actually the time when effective Corporate Governance should have been more vital - was effectively related to their Corporate Governance and the relationship, if any, between their Corporate Governance and performance.

*"Failures in Corporate Governance were one of the key factors that contributed to the Great Financial Crisis"*¹ is one of the most important lessons learnt on the Governance of banks from the so-called Financial crisis that, after the crisis entailed by Covid-19 started in March 2020, has become more current than ever.

The Great Financial Crisis exposed shortcomings in banks' Corporate Governance practices. Investigations by national authorities and international organizations found that bank Boards were constrained by "groupthink", deferred excessively to senior management, allocated insufficient time to oversee activities and lacked experience and knowledge. Other weaknesses included ineffective Board structures and poorly designed compensation frameworks that led to excessive risk-taking.

Following the Great Financial Crisis, standard-setting bodies have reinforced bank governance standards in order to reduce the shortcomings observed during the crisis. In March 2020, the Bank for International Settlement issued the paper "Bank Boards – a review of post-crisis Regulatory approaches" that, taking stock of specific aspects of the post-crisis Regulatory approaches used in 19 jurisdictions to strengthen Board oversight at banks, reviews the "Fitness and Propriety" (F&P) assessments that these jurisdictions use to ensure that bank Board members are suitably qualified. The contents of this paper are summarized in paragraph 2. Bank Boards – a review of post-crisis Regulatory approaches. Outline.

With the aim to better understand and give sense to the choices made by Regulators after the Great Financial Crisis, this paper refers to the relevant scientific literature on how (i) the performance in one crisis has strong predictive power for following crises and how (ii) independence, time commitment, board size and diversity of the Board members affected the banks' profitability during the Great Financial Crisis. The acknowledgment of this evidence could be considered by both the Chair of the Board in leading the Board and by the Nomination Committees in determining the composition of the Boards, in order to mitigate the risk that the performance in one crisis predicts the performance during the following crisis.

This work unfolds as follows: Section 2. Bank Boards – a review of post-crisis Regulatory approaches. Outline, Section 3. Empirical results and Section 4. Conclusions.

¹ Financial Stability Institute - FSI Insights on policy implementation No 25 - Bank Boards – a review of post-crisis Regulatory approaches, 17 March 2020 <https://www.bis.org/fsi/publ/insights25.htm>

2. Bank Boards – a review of post-crisis Regulatory approaches. Outline

On March 17, 2020 (at the beginning of the crisis entailed by Covid-19), the Bank for International Settlement issued the paper “Bank Boards – a review of post-crisis Regulatory approaches” (BIS F&P review) about the shortcomings in banks’ Corporate Governance practices revealed by the Financial Crisis occurred in years 2007 – 2008 (the so called Great Financial Crisis).

In particular, the study (i) reviews the Fitness & Propriety assessments used by 19 jurisdictions² to ensure that the banks’ Board members are suitably qualified and (ii) includes a survey on the guidance of Board composition and structure issued in the 19 jurisdictions.

The review of F&P assessment approaches identifies useful practices for supervisory authorities that can also be useful for banks. In particular, in F&P assessment authorities might consider, where appropriate:

- the search of Regulatory powers to approve Board candidates,
- the identification of which aspects of the Fitness criterion can be enhanced to help support desired outcomes. These include clarifying the “expertise” requirements of Board candidates (particularly of the Board Chair and the Chair of Board subcommittees); assessing the time commitment of Board candidates, considering their external obligations; incorporating the “independence of mind” concept, which goes beyond determining whether candidates have a conflict of interest; and
- outlining the role of interviews in the assessment process.

In determining formal independence, supervisory assessments might be improved by defining more concrete attributes for an Independent Non-Executive Director (INED); establishing maximum INED tenure limits; and monitoring how often INEDs dissent from the majority opinion.

Based on this paper, three are the key elements of a sound and effective banks’ Corporate Governance: (1) The Fitness and Propriety of the key decision-makers (Table 1), (2) the structure and composition of Boards and their Committees (Table 2) and (3) the accountability and remuneration process (Table 3). The most important topics highlighted by the BIS F&P review are summarized in the three tables below.

| Table 1 The Fitness and Propriety of the key decision-makers | |
|---|--|
| Selection process | <ul style="list-style-type: none"> • The initial and ongoing assessment of a person’s individual suitability is the bank’s responsibility • Many Boards have established a Nomination Committee to oversee the selection process • Given the importance of ensuring the Board and senior management of a bank have the optimal mix of skills and experience, Nomination Committees are often tasked with the implementation of tools that (i) can help to identify candidates that meet the specific needs of the bank and (ii) support the assessment of those candidates against the criteria set out by the Regulatory authorities (skills matrices) • The need of an open search processes for director roles is becoming more relevant • Supervisory authority should evaluate the processes and criteria used by banks in the selection of Board members and senior management but the approaches vary across the surveyed jurisdictions. Most jurisdictions incorporate the formal approval of directors as part of the Regulatory framework • While in ECB jurisdiction the Prior approval of an initial appointment is required only in some cases, for 13 out of 19 jurisdictions assessed, the prior approval is required for all banks. In case of renewal, for 7 out of 19 jurisdictions assessed, the approval is required (in ECB, the approval is required only in some cases) • Almost all jurisdictions have the power to remove or disqualify existing Board directors prior to the end of their mandate |
| Fitness and Propriety criteria | <ul style="list-style-type: none"> • The fit and proper assessment rests on a combination of principle-based and prescriptive guidance across surveyed jurisdictions • Proportionality is only applied with respect to the Fitness component of the F&P which typically covers aspects such as expected skills and experience. Proportionality does not apply to reputation and integrity features |
| Fitness criteria | <ul style="list-style-type: none"> • Of the two criteria, the “Fitness” element is where Regulatory requirements are less prescriptive • The Fitness subcomponent of the F&P assessment includes expertise, practical experience, conflicts of interest, time commitment and, in ECB jurisdiction, independence of mind • Expertise includes candidate’s education and theoretical knowledge • Practical experience focuses on the candidate’s current and previous business positions • Conflicts of interest: <ul style="list-style-type: none"> ○ banks are responsible for identifying any current or potential conflict: the assessment is based on criteria similar to those considered to determine whether a person is formally independent ○ must be (i) adequately disclosed, (ii) managed via a person who is not party to relevant discussions and (iii) avoided where significant. Importantly, these aspects apply to all directors at all times, and not only in relation to assessing formal independence • Time commitment: the comprehensive assessment considers not only the number of directorships held, but also the size, |

² The 19 jurisdictions are: Nigeria, South Africa, Brazil, Chile, United States, Australia, China, Hong Kong SAR, India, Malaysia, Philippines, Thailand, Belgium, ECB, Germany, Netherlands, Russia, United Kingdom, Bahrain.

nature, scale and complexity of the institutions where those directorships are held. The existence of any other professional or personal commitments is considered given the growing expectations regarding the amount of time that directors must commit to

- **Independence of mind:** In ECB jurisdiction, this feature is a key component of the F&P assessment process. By considering:
 - the candidate’s character, supervisory authorities assess their ability to constructively engage with directors and senior management and, where necessary, mitigate the risk of “groupthink”
 - the candidate’s behavioral attributes and the existence of relationships between the candidate and the bank, any factors which may impede them from taking an impartial perspective in discharging their responsibilities is taken into consideration. A link to the related party transactions strengthens this aspect of the framework
- **Interviews:** 10 out of 19 jurisdictions include interviews in the F&P assessment. Among others, interviews are an opportunity to sound out the candidate’s understanding of the supervisors’ expectations

Propriety criteria

- Of the two criteria, the “Propriety” element - that includes reputation and integrity features - is where Regulatory requirements are more prescriptive
- The definition of Propriety is consistent across the surveyed jurisdictions and rests on a consideration of whether the person has: been convicted of any crime relating to dishonesty and/or integrity; been the subject of an adverse finding in a civil action by any court; been adjudged bankrupt; been disqualified by a court or other competent bodies as a director or manager of a corporation; been a director of a company which has been wound up by a court on the application of creditors; failed to satisfy a judgment debt under a court order resulting from a business relationship; and a record of non-compliance with statutory codes as well as a record of disciplinary or other supervisory actions

Table 2
Structure and composition of Boards and their Committees

Board Diversity

- Both the Board’s composition and diversity are critical to its effectiveness: Effective Corporate Governance requires a Board of directors to listen, contribute, challenge and, when necessary, push back against senior management. A Board should comprise a mix of executive directors (EDs), non-executive directors (NEDs) and independent non-executive directors (INEDs), so that it can draw on a depth and breadth of insights, perspective and experience. A broad range of skills, competencies, philosophies, life experience and diversity encompass more than gender, age, and ethnicity. Only in such a way, diversity will bolster the Board’s strategic and risk-decision making abilities
- The Board and its Nomination Committee are responsible for ensuring that the Board collectively has the necessary skills, experience and expertise
- Most jurisdictions specify a minimum of three to five directors for a bank, with few specifying a maximum number and also require Boards to formulate a succession plan
- Some jurisdictions also set specific limits on the maximum tenure of an NED, to ensure that Boards benefit from fresh perspectives
- Several jurisdictions have Regulatory requirements or supervisory expectations for gender diversity: these are contained primarily within the respective Corporate Governance codes, most of which operate under a “comply or explain” rule, with disclosure and explanation required where an institution is not fully compliant with the defined principles
- Diversity helps Boards to answer the increasing need to consider the interests of a wider range of stakeholders
- Several jurisdictions have Regulatory requirements or supervisory expectations for gender diversity
- The Board’s composition, including the minimum number of Independent Non-Executive Directors as well as the types of Committees required, varies across jurisdictions, according to a bank’s size and the nature of its business operations. Some jurisdictions set specific limits on the maximum tenure of an INED
- There is no guidance on what constitutes the optimal size for a Board of directors and this will necessarily depend on the nature and scope of its business operations
- In jurisdictions where a dual Board structure has been adopted (including China, Germany and the Netherlands) requirements for employee representation equal to 33% of the supervisory Board members exist (or higher depending on the bank’s size)

The Chair

- The Board Chair is arguably the most important position in a Board
- Even if in some jurisdiction the separation of the Chair position from that of the Chief Executive Officer (CEO) continues to be actively debated, ECB jurisdiction the Chair of the Board in its supervisory function must not be simultaneously the Chief Executive Officer
- Most authorities have issued guidance on their expectations for Board Chairs given the nature of the role and its influence on the effectiveness of Corporate Governance
- Expectations on the requisite of expertise, practical experience and time commitments required for the position of Chair are higher than the expectations set for directors. Moreover, ECB requires more experience of prospective Board Chairs in relation to other Board nominees

Independent Directors

- The definition of independence focuses on the nature of the relationships between a director and a bank and is mostly based on when the director is not independent (negative criteria):
 - **Not to have professional relationships:** most definitions prescribe a period of at least two years within which a person must not have been employed in an executive role or been a material shareholder, professional adviser, consultant, supplier or a client of the bank
 - **Not to have personal relationships:** a person who is a family member or is otherwise related to a material shareholder or to the senior management of a bank is not considered independent
 - **Limited tenure on Board:** It ranges from 6 to 12 years, with an average of 9 years. The expiration of the tenure does

| |
|---|
| <p>not necessarily impede a director from remaining on the Board. However, the person is then no longer considered as independent</p> <ul style="list-style-type: none"> ○ Not to be major shareholder or associate: most definitions prescribe a period of at least 2 years within which the person must not be a material shareholder <ul style="list-style-type: none"> ● Supervisory requirements concerning independence will have the greatest impact where these incorporate the need to have a certain percentage of independent directors ● In a number of jurisdictions, the Chair of the Board and/or its Committees are required to be independent. Tenure also restricts this designation |
| <p>Board Committees</p> <ul style="list-style-type: none"> ● Specialized Committees are an accepted practice to increase efficiency and focus on specific areas ● The composition requirements are related to (i) the mix of INEDs and NEDs and (ii) who should be nominated Chair. It is worth noting that in ECB jurisdiction, the establishment of an Audit Committee, a Risk Committee and a compensation Committee is specifically stated: the mandate of each should be established in a formal charter and each Chair should be an INED ● The BCBS Guidelines³ specifically prescribe the establishment of an Audit Committee, a Risk Committee and a Compensation (or Remuneration) Committee, noting that the mandate of each should be established in a formal charter and that the Chairs should each be an INED. These guidelines also recommend that a Nomination Committee and an Ethics Committee be established ● Currently, two jurisdictions require banks to establish an Ethics or Culture Committee (Hong Kong SAR and South Africa) ● In jurisdictions where it is specified that the Chair of the Committees must be an INED, it is also commonly stated that the Chair of the Board cannot be the Chair of any Committees but can only be a Committee member ● Most jurisdictions require the Chair of each Committee to be an INED and, in addition, most jurisdictions also require the majority of the Committee members to be INEDs ● Specific Regulatory requirements for the composition of the Audit Committees are prescribed in most jurisdictions while less specific guidance is provided on the competencies expected from directors who are members of the Risk, Compensation and Nomination Committees ● Communication process: The BCBS Guidelines specifically note the need for (i) the Risk Committee and the Audit Committee to establish protocols to facilitate the exchange of information; and for (ii) the Compensation Committee to work closely with the Risk Committee in evaluating the incentives created by the remuneration system ● In ECB jurisdiction, Board Committees should not comprise the same directors, while the cross-participation of the Chairs at the meetings of other Committees is considered a constructive way to ensure that salient matters are referred to, and discussed across, Committees ● Lesson learnt: weaknesses in communication between Board Committees and between Senior Management and the Board of the Commonwealth Bank of Australia contributed to inefficient Corporate Governance. Proper and timely Board reporting by executive management in combination with informal Board meetings may help to better face this challenge |

| |
|--|
| <p>Table 3 Accountability and remuneration process</p> |
| <p>Accountability</p> <ul style="list-style-type: none"> ● Accountability for any failure in governance resides with the Board of directors as a collective body |
| <p>Remuneration policy</p> <ul style="list-style-type: none"> ● In ECB jurisdiction, the remuneration expectations of the members of the Board should be consistent with their powers, tasks, expertise and responsibilities. Fixed remuneration should be permanent, predetermined, non-discretionary and irrevocable, while variable remuneration should be based on performance ● The variable component of the remuneration, for each individual: <ul style="list-style-type: none"> ○ Shall not exceed 100% of the fixed component. Only with special approval may it be increased to 200% of the fixed component ○ At least 50% comprise a balance of shares, equivalent ownership rights, share-linked or equivalent non-cash instruments, in the case of non-listed institutions ○ At least 40% is subject to deferral arrangements |

3. Scientific literature

Taking into consideration the evidence of the document “Bank Boards - a review of post-crisis Regulatory approaches” briefly summarized above, the aim of this section is twofold: to underpin the main topics considered by Bank for International Settlement with the scientific literature available on bank governance and to highlight its correlation (if any) to the performance and value, which refer to before and during the Great Financial Crisis.

Without accessing to restricted scientific data bases, the research was done using the free scientific articles published online. At the beginning of the research, the sample was made up of 35 articles scouted by two principal keywords that must always be present (financial crisis and bank) and other five ancillary keywords (Corporate Governance, loan, director, Board, performance, women). As a second step, I selected articles published after the year 2009. Furthermore, in the third step, I considered the articles in which the sample selection or the evidence were related to European or American or worldwide

³ Guidelines on the corporate governance principles for banks, updated in 2015 by Basel Committee on Banking Supervision (BCBS) incorporating the key lessons from the Great Financial Crisis.

commercial banks (listed and non-listed). As the fourth and last step, I read the Abstract, the Introduction and the Conclusion of each of the 13 articles selected. Being aware that this sample is limited and not fully representative of all the available scientific literature on banks Corporate Governance, I believed that it was worth continuing with the analysis and share with the readers the results reached as reported in section 4. Conclusion.

Two general topics supported by the scientific literature on banks and the crisis that are worth reporting are related to (i) the learning curve of banks during the crisis and (ii) the relationship among Corporate Governance and regulations, market returns and the evaluation of banks during the crisis.

As for the **learning curve of banks during the crisis**, the study carried out by Fahlenbrach, Prilmeier and Stulz (2011) investigated whether banks' performance during the 1998 crisis - the crisis triggered by the default of Russia which set off a dramatic chain reaction within the entire global economic system - could be considered a prediction of the performance witnessed during the financial crisis of 2007 and 2008. They observed 347 banks and made 3 hypotheses: the first - the "learning hypotheses" - was based on the fact that organisations and executives that perform poorly in a crisis learn to do things differently and consequently cope better with the next crisis (negative correlation). The second - the "business model hypothesis" - was based on the fact that banks, after facing a crisis, did not change their business model, either because it would not have been profitable or for other reasons (positive correlation). The last - the "null hypotheses" - was based on the assumption that the returns during the two crises were unrelated. The authors found that banks that had been negatively affected in the 1998 crisis, subsequently, neither amended their business model nor became more risk adverse and that for each percentage point loss in the value of the equity in 1998, banks lost an annualised 66 bp during the financial crisis. Consequently, they concluded that the performance in one crisis has strong predictive power for the succeeding crisis.

Concerning the **relationship between Corporate Governance and performance** during the crisis, Cornett, McNutt and Tehranian in 2010 demonstrated that Corporate Governance was significantly correlated to 2008 market returns for larger banks but less for smaller banks. Conversely, they found that the decline in stock performance brought about by the weakness of Corporate Governance controls prior to and during the financial crisis was less significant for smaller banks.

Mixed empirical results were found by Peni and Vähämaa in 2011: while they found that the American listed commercial banks with stronger Corporate Governance had higher profitability in 2008, the results of the analysis also indicated that strong Corporate Governance practises did not create shareholder value in the banking industry during the market meltdown due to the negative effect on their stock market evaluation. Moreover, the authors demonstrated that banks with strong Corporate Governance - providing higher stock returns in the immediate aftermath of the crisis - mitigated its adverse effect on the credibility among stock market participants from March 2009 onwards.

Beltratti and Stulz (2011) found that there was no systematic evidence that a stronger regulation entailed better performance of Banks during the crisis. They found evidence that Banks from countries that imposed more restrictions in 2006 fared better during the crisis. Since there was no evidence that these banks had had fewer risks before the crisis, the authors hypothesized that banks with more restrictions on their activities before the crisis had higher returns. This being due to the fact that they did not have the opportunity to diversify their activities that were likely to perform poorly during the crisis.

Returning to the document "Bank Boards - a review of post-crisis Regulatory approaches", I highlight here below the conclusions of the scientific literature on Independence, Time commitment, Board size and Diversity during the financial crisis.

Independence

The definitions of independence provided by surveyed jurisdictions is set out from a negative standpoint (that is, the focus is on when a director is not considered independent) and is based on the nature of the relationships between a director and a bank (see Table 2). All surveyed jurisdictions provide some guidance on independence. Many of them prescribe at least a two-year time limit within which a person must not have engaged in such relationships. In addition, most countries have made the independence assessment time-bound by restricting the period a director can remain on the Board and still be considered independent.

Moreover, some countries include in the Fitness criteria the concept of "independence of mind" which goes beyond determining whether candidates have a conflict of interest and is related to the ability to challenge directors and senior management and avoid (or at least mitigate) the risk of groupthink (see Table 1).

Based on the scientific literature, during the financial crisis (i) the level of independence decreased, (ii) the bank with shareholder-friendly Boards generally fared worse as a consequence of the higher risk assumed before the crisis.

The results of the study carried out by Cornett, McNutt and Tehranian in 2010 was related to the change in Corporate Governance measures put in place by banks during the Great Financial Crisis and to how this shift negatively affected their performance. In general, they found that during the crisis, banks reported a decrease in performance and those with weak Corporate Governance controls didn't perform as well as the others. In particular, they observed the decrease of the Board's independence and that Boards failed to meet more frequently than before the financial crisis, and also that CEOs continued to serve also as Board Chair. These changes were more evident for the largest banks.

Analysing the performance of a sample of 164 banks in 32 countries, Beltratti and Stulz (2011) found that not necessarily the so called "good governance" is put in place in the interest of shareholders as they found no particular relationship between the banks' performance during the crisis and the standard values of Corporate Governance. In particular, they found that banks with more shareholder-friendly Boards⁴ generally fared worse during the crisis. This being due to the fact that they, in order to

⁴ Shareholders-friendly Boards could be defined as those who act in the best interest of bank shareholders.

create more value for shareholders before the crisis, left the bank more exposed to risks that adversely arose during the crisis and led to the realization of not-forecasted poor outcomes. Regardless of the independence of the Board members, indeed, Beltratti and Stulz found consistency between the risks taken by the bank before the financial crisis and the huge and unexpected significant losses accounted for during the crisis.

Consistent results were reached by Aebi, Sabato and Schmid. Indeed, in 2011, they demonstrated that, before the crisis, banks were pushed by the Board toward both the maximization of the shareholder wealth and the risks that were assumed to create wealth. During the credit crisis, these choices turned out poorly. Moreover, Erkens, Hung and Matos in 2012 - using a data set made up of 296 financial firms from 30 countries that were at the centre of the crisis - found that banks with both more independent Boards and higher institutional ownership had worse stock returns during the crisis. This was because banks that took more risk prior to the crisis resulted in larger shareholder losses during the crisis and because banks with more independent Boards raised more equity capital during the crisis which then resulted in the transfer of wealth from existing shareholders to debtholders.

Conversely, Grove, Patelli, Victoravich and Pisun (2011) did not find a consistent association between non-independent directors and performance.

Time commitment

When considering time commitment, included in the Fitness section of the F&P assessment, factors such as the number of directorships held, the size, nature, scale and complexity of the institutions where those directorships are held and the existence of any other professional or personal commitments and circumstances, form part of the Regulatory assessment process (see Table 1).

Time commitment is not a feature measurable per se: indeed, the scientific literature analyzed include concepts such as busy directors and Board meeting frequency that can be assumed as expression of the Time commitment.

Grove, Patelli, Victoravich and Pisun (2011) did not find the concave relationship between busy directors (both insider or outsider) and supposed performance: this means that when directors become too busy, or when there are too many busy directors sitting on the Board, the Board's ability to monitor effectively and efficiently is not significantly reduced.

As for the relationship between the number of Board meetings and the performance of the banks, in 2011 Grove, Patelli, Victoravich and Pisun demonstrated that the Board meeting frequency is positively associated with financial performance. In contrast, Bussoli in 2013 - analyzing to what extent the size of the Board affected the performance of Italian listed banks between 2006 and 2009 - evidenced inefficiencies in Corporate Governance due to the significant and inverse relationship between the profitability of the banks and the average attendance at Board of directors' meetings and at Committees' meetings. However, Bussoli found a direct relationship between the intensity of the activity of the Committees and the performance of the bank that can be read as a result of the attitude and the ability of Committees to limit the inefficiency of the Board.

Board size

The structure and the composition of Boards and their Committees, along with the F&P of key decision-makers, are some of the common Regulatory elements which provide a sound basis for the effective Corporate Governance of banks.

There is no definite Regulatory guidance on what constitutes the optimal size for a Board as it depends on the nature and scope of the business of the bank: while larger Boards can draw on a broader range of skills, capabilities and perspectives, smaller Boards may find decision-making more efficient, thereby providing more time for strategic discussion. Moreover, most jurisdictions specify a minimum of three to five directors for a bank, with few specifying a maximum number (see Table 1 and 2).

Grove, Patelli, Victoravich and Pisun (2011) demonstrated that Board size has a concave relationship with bank performance and loan quality as an increase in Board size is associated with financial performance. However, when the Board becomes too large, the increase can impair performance. Moreover, they showed that large Boards do not effectively monitor the lending activities of the bank that, in turn, results in lower asset quality.

Based on the Regulatory guidance, the role of the Chair remains pivotal in both large and small Boards: moreover, a number of jurisdictions retain the power to approve the dual-hatting of the Chair and CEO positions even if they restrict this discretion to limited circumstances assessed on a case-by-case basis. Consistent results were highlighted by Grove, Patelli, Victoravich and Pisun (2011) which demonstrated that CEO duality is negatively associated with financial performance.

Diversity

BCBS Guidelines state that a Board should comprise individuals with a balance of skills, diversity and expertise that should be correlated with the size, complexity and risk profile of the bank. The G20/OECD Principles also recognize the importance of bringing diversity of thought to Board discussions, stating that "*countries may wish to consider measures such as voluntary targets, disclosure requirements, Boardroom quotas and private initiatives that enhance gender diversity on Boards and in senior management*". Regulators expect that Board diversity help to mitigate against 'group think' and to expand the Board's focus to a broader range of stakeholders (see Table 2).

Consistent results were found in scientific literature: Bussoli in 2013 demonstrated the existence of a significant direct relationship between the percentage of women on the Boards and the performance of the banks.

Three Italian women researchers, Schwizer, Saoana and Cucinelli in 2013 contributed to the research on diversity considering not only gender but also nationality: they investigated the relationship between Board diversity and the performance and the cost of equity of Italian listed companies between 2007 – 2009. They concluded that the presence of women determined an

increase in the frequency of the meetings of both the Board and the Audit Committee. On the other hand, they found that, due to logistic reasons, the presence of foreign members had a negative impact on the internal organization. Lastly, the research did not highlight any relationship with diversity (in terms of gender and nationality) and the cost of equity.

Enlarging the sample, similar results were reached by Andries, Seyed and Stoica in 2017 using a dataset of 156 banks from Central and Eastern Europe during 2005-2012. They assessed that banks with more women directors or chairwomen assumed lower risk and reached higher performance. The analysis first showed that banks with a chairwoman and a higher proportion of women among Board members recorded a higher level of profitability and tended to have a lower level of credit losses. Additionally, the results suggested that the higher the number of women among Board members, the greater the stability of the bank during the Great Financial Crisis. The results also revealed that the local regulatory framework affected the relationship between board gender diversity and bank performance and risk.

Islam and Md Nurul in 2020, with a sample made up of 102 U.S. listed commercial banks, found that NPLs are negatively related to board independence, CEO duality and the number of Committee meetings. Moreover, they found that, during the Great Financial Crisis, a large board size and the presence of women directors may also help lower NPLs.

4. Conclusion

The above-mentioned scientific literature - that, as said above, does not fully represent the empirical analysis available - supports the strengthening of the Corporate Governance of Banks introduced by the Regulators after the Great Financial Crisis as a measure to mitigate the risk that the performance in one crisis predicts the performance for the succeeding crisis.

In addition, this sample of scientific literature shows mixed results on the nexus between Corporate Governance and bank performance. Firstly, it supports the actions put in place by Regulators in order to strengthen the banks' Corporate Governance that, during the Great Financial Crisis, was significantly correlated to the banks' market returns in 2008. Moreover, banks with strong Corporate Governance - even if they did not create shareholder value in the banking industry during the market meltdown due to the negative effect on their stock market evaluation - mitigated the adverse effect of the crisis on their credibility among stock market participants from March 2009 onwards. Based on this scientific literature, it is also true that banks from countries that imposed more restrictions in 2006 fared better during the Great Financial Crisis because, thanks to such restrictions, they did not have the opportunity to diversify their activities that were likely to perform poorly during the crisis.

The enhancement of the requirements on independence introduced by the Regulator after the Great Financial Crisis mitigated the risk that, during the next crises, the level of independence of Boards decreased and the Board failed to meet more frequently. Contrasting results were found in this scientific literature regarding the relationship between shareholder-friendly Boards and performance during the crisis. Any consistent association between non-independent directors and performance was demonstrated.

As supported by the above-mentioned scientific literature, during the Great Financial Crisis the Board's ability to monitor effectively and efficiently was not significantly reduced even in the presence of busy directors. Nevertheless, the significant and inverse relationship between the profitability of the banks and the average attendance at Board of directors' meetings and at Committee meetings, evidenced inefficiencies in Corporate Governance. The request for Committees by the Regulators increased the performance of banks during the crisis due to the direct relationship between the intensity of activities carried out by the Committees and the performance of the bank.

During the Great Financial Crisis, Board size had a concave relationship with bank performance and loan quality: an increase in Board size was associated with financial performance however when the Board became too large the increase impaired performance. Without prejudice to the proportionality principle, the prescription of a high number of minimum seats on the Board could represent a weakness in Corporate Governance. CEO duality is also negatively associated with financial performance.

As far as the gender diversity concerns, the scientific literature analyzed reported that the higher the women on Boards, the lower is the risk assumed and the greater the profitability and the stability of banks are.

Enrica Rimoldi

Bibliography

1. Abdul Gafoor C.P., Mariappan V., Thyagarajan S., (2018), "Board characteristics and bank performance in India", *IIMB Management Review*
2. Adams R.B., Mehran H., (2008), "Corporate Performance, Board Structure, and Their Determinants in the Banking Industry", *Federal Reserve Bank of New York Staff Reports n. 330*
3. Aebi V., Sabato G., Schmid M., (2011), "Risk management, corporate governance, and bank performance in the financial crisis", *Journal of Banking & Finance 36*
4. Andries, A. M., Seyed M., Stoica O., (2017), "The Impact of Board Gender on Bank Performance and Risk in Emerging Markets", <https://ssrn.com/abstract=3041484> or <http://dx.doi.org/10.2139/ssrn.3041484>
5. Beltratti A., Stulz R. M., (2011), "The Credit Crisis Around the Globe: Why Did Some Banks Perform Better?" *Fisher College of Business Working Paper Series*
6. Bekiaris M., Efthymiou T., Koutoupis A. G., (2013), "Economic crisis impact on corporate governance & Internal audit: the case of Greece", *Corporate Ownership & Control / Volume 11, Issue 1*
7. Blinco S., Galbarz M., Hohl S., Zamil R., (2020). "Bank boards – a review of post-crisis regulatory approaches", *Financial Stability Institute Insights on policy implementation No 25*
8. Boon-Hui Chai B., Tan P.S., Goh T.S., (2015), "Banking Services that Influence the Bank Performance", *6th International Research Symposium in Service Management, IRSSM-6*
9. Bubbico R., Giorgino M., Monda B., (2012), "The impact of Corporate Governance on the market value of financial institutions: empirical evidences from Italy", *MPRA Paper 45419, University Library of Munich, Germany*
10. Bussoli C, (2013), "Corporate governance and bank performance in Italy", *Financial System in troubled water, Routledge international studies in money and banking, pages 40-61*
11. Carney R.W., Child T.B., Li X., (2020), "Board connections and crisis performance: Family, state, and political networks", *Journal of Corporate Finance 64*
12. Cornett, Marcia & Mcnutt, Jamie & Tehranian, Hassan, (2010), "The financial crisis, internal corporate governance, and the performance of publicly-traded U.S. bank holding companies", *SSRN Electronic Journal. 10.2139/ssrn.1476969*
13. Dedu V., Chitan G., (2013), "The influence of internal corporate governance on bank performance - an empirical analysis for Romania", *Procedia - Social and Behavioral Sciences 99*
14. Eluyela D.F., Akintimehin O.O., Okere W., Ozordi E., Osuma G.O., Ilogho S.O., Oladipo O.A., (2018), "Board meeting frequency and Firm performance: examining the nexus in Nigerian deposit money banks", *Helyon 4 (2018) e00850*
15. Eluyela D.F., Akintimehin O.O., Okere W., Ozordi E., Osuma G. O., Ilogho S.O., Oladipo O.A., (2018), "Datasets for board meeting frequency and financial performance of Nigerian deposit money banks", *Data in Brief 19 1852 -1855*
16. Erkens D.H., Hung M., Matos P., (2012), "Corporate governance in the 2007–2008 financial crisis: Evidence from financial institutions worldwide", *Journal of Corporate Finance 18*
17. Esubalewa A.A., Raghurama A., (2020), "The mediating effect of entrepreneurs' competency on the relationship between Bank finance and performance of micro, small, and medium enterprises (MSMEs)", *European Research on Management and Business Economics 26*
18. Fahlenbrach R., Prilmeier R., Stulz R.M., (2011), "This time is the same: using bank performance in 1998 to explain bank performance during the recent financial crisis", *National Bureau of Economic research NBER Working Paper n. 17038*
19. Garcia-Alcober M.P., Prior D., Tortosa-Ausina E., Illueca M., (2019), "Risk-taking behavior, earnings quality, and bank performance: A profit frontier approach", *BRQ Business Research Quarterly*
20. Grove H., Patelli L., Victoravich L.M., and Xu T., (2011), "Corporate Governance and Performance in the Wake of the Financial Crisis: Evidence from US Commercial Banks", *Corporate Governance: An International Review*, 19(5): 418–436
21. Islam, Md Nurul, (2020), "The Impact of Board Composition and Activity on Non-Performing Loans", *Awards for Excellence in Student Research and Creative Activity. 7.* https://thekeep.eiu.edu/lib_awards_2020_docs/7
22. Karas A., (2020), "Russian bank data: Reasons of bank closure", *Data in brief 29 105343*
23. Lafuente E., Vaillant Y., Vendrell-Herrero F., (2019), "Conformance and performance roles of bank boards: The connection between non-performing loans and non-performing directorships", *European Management Journal*
24. Mkhairer A., Werner R.A., (2020), "The relationship between bank size and the propensity to lend to small firms: New empirical evidence from a large sample", *Journal of International Money and Finance 110*
25. Naser N, (2019), "A Comprehensive Analysis of European Banking Soundness Theoretical Study", *Financial Markets, Institutions and Risks, Volume 3, Issue 2*
26. Onakoya A.B.O., Ofoegbu D.I., Fasanya I.O., (2012), "Corporate governance and bank performance: a pooled study of selected banks in Nigeria", *European Scientific Journal*, December edition vol. 8, No. 28, ISSN: 1857 – 7881 (Print) e - ISSN 1857- 7431
27. Peni E., Vähämaa S., (2012), "Did Good Corporate Governance Improve Bank Performance during the Financial Crisis?", *J Financ Serv Res, 41:19-35*
28. Schwizer P., Soana M.G., Cucinelli D, (2013), "The advantages of board diversity. An empirical analysis of the Italian market.", *Financial System in troubled water, Routledge international studies in money and banking, pages 79-96*
29. Staikouras P.K., Staikouras C.K., Agoraki M.E.K., (2007), "The effect of board size and composition on European bank performance", *Eur J Law Econ 23:1-27*
30. Takacs A., Szucs T., Kehl D., Fodor A., (2020), "The effect of fair valuation on banks' earnings quality: empirical evidence from developed and emerging European countries", *Helyon 6*
31. Tu DQ. Le, Ngo T., (2020), "The determinants of bank profitability: A cross-country analysis", *Central Bank Review 20 65-73*
32. Tunay K.B., Tunay N., Akhisar I. (2015), "Interaction Between Internet Banking and Bank Performance: The Case of Europe", *Procedia - Social and Behavioral Sciences 195*
33. Villanueva-Villar M., Rivo-López E., Lago-Peñas S., (2016), "On the relationship between corporate governance and value creation in an economic crisis: Empirical evidence for the Spanish case", *BRQ Business Research Quarterly, 19, 233-245*
34. Zaharia D.L., Lazar A., Tilea D.M., (2013), "The Role of Internal Audit regarding the Corporate Governance and the Current Crisis", *5th World Conference on Educational Sciences – WCES 2013*
35. Zephaniah C.O., Ogbab I.E., Izogo E.E., (2020), "Examining the effect of customers' perception of bank marketing communication on customer loyalty", *Scientific African 8*