# How to Regulate the Regulators: Applying Principles of Good Corporate Governance to Financial Regulatory Authorities

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## I. INTRODUCTION

There are currently extensive public debates about fixing perceived deficiencies of the

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Securities and Exchange Commission (SEC), the Federal Reserve System, and other regulatory authorities.[1] Financial regulatory authorities are also at the center of intensive academic discussions in international commercial law. Many of them are concerned with the regulatory tools to supervise financial firms and markets, but there is also a growing literature that focuses on the financial regulatory authorities themselves. Here, following Juvenal's famous phrase *quis custodiet ipsos custodes*, the literature has often been concerned with the question of *who* should regulate the regulators.[2] This Article argues we should extend the debate and ask not just who should regulate the regulators, but also *how* they should be regulated.[3]

The question of how to regulate organizations is not unique to financial regulatory authorities. Thus, it is worth exploring whether there are general principles for organizations in different fields. This Article contributes to this debate. Yet, it is also clear that such general principles could only be phrased at a high degree of abstraction. Therefore, this Article will draw on lessons learned from corporate governance, a field where questions of good governance have been discussed in depth.[4] Even though private sector companies differ from financial regulatory authorities, this Article will show that some analogies can be made.[5]

On the side of financial regulatory authorities, there can also be forms of public-private structural hybrids if they are established as limited companies, such as the U.K.'s regulatory authorities.[6] This Article focuses on the more common status of financial regulatory authorities as independent bodies of public law with own legal personality, such as the SEC in the U.S. and most regulatory authorities in continental Europe.[7] This is also distinguished from the less common scenario where the regulatory authority is a unit of the government with some independence but without a separate legal personality.[8]

This article fills a gap in the literature on financial regulatory authorities as it maps the general suitability of lessons from corporate governance for financial regulatory authorities. It therefore aims for a broader scope than the majority of the existing literature, which mainly focuses on the structure of a specific financial regulatory authority in a specific jurisdiction. The corresponding limitation is that it is beyond the scope of this

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1. *E.g.*, Christopher Matthews, *What (If Anything) Can Fix the SEC?*, TIME (Jan. 28, 2013), http://business.time.com/2013/01/28/what-if-anything-can-fix-the-sec/; Peter Conti-Brown, *To Fix the Fed, Simplify It*, N.Y. TIMES (July 29, 2015), https://www.nytimes.com/2015/07/29/opinion/to-fix-the-fed-simplify-it.html.

2. *See, e.g.*, Susan E. Dudley, *Improving Regulatory Accountability: Lessons from the Past and Prospects for the Future*, 65 CASE W. RES. L. REV. 1027 (201); Kurt Bayer, *Quis Custodiet Ipsos Custodes?—Who Supervises the Supervisors?*, 7 EURO. J. ECON. & ECON. POL'Y: INTERVENTION 50 (2010).

3. This discussion also includes the relationship between the "who" and "how," *see infra* Part IV.C.

4. *See infra* Part III.B.

5. It should also be noted that the history of corporations is closely linked to the public sector since the East India Companies and other colonial joint-stock companies were conveyed public-law rights of sovereignty. *See, e.g.*, Jennifer Hill, *Public Beginnings, Private Ends – Should Corporate Law Privilege the Interest of Shareholders?*, *in* 1 INTERNATIONAL CORPORATE LAW 17 (Fiona Macmillan ed., 2000).

6. These are the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA).

7. *E.g.*, the *Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin) in Germany, the *Commissione Nazionale per le Società e la Borsa* (Consob) in Italy, and the *Comisión Nacional del Mercado de Valores* (CNMV) in Spain.

8. *Cf.* Steven Seelig & Alicia Novoa, *Governance Practices at Financial Regulatory and Supervisory Agencies* 9 (Int'l Monetary Fund, Working Paper No. WP/09/135, 2009), http://dx.doi.org/10.5089/9781451872828.001 (analyzing data based on a survey of supervisors in 103 countries).

Article to assess how the implementation of our suggestions could be embedded in the precise national and institutional context of the corresponding financial regulatory authority. However, this Article suggests that there is an urgent need to reflect on the structure of financial regulatory authorities at a general level given the growth of international regulatory activity in this field.[9]

This article is structured as follows: Part II presents an overview of the academic and policy literature on the governance and institutional design of financial regulatory authorities. Part III analyzes the conceptual differences and similarities between financial regulatory authorities and private firms. Based on these general considerations, Part IV turns to the question how far specific standards of good corporate governance can and should be applied to the governance of financial regulatory authorities. Part V concludes.

## II. OVERVIEW OF GENERAL ACADEMIC AND POLICY LITERATURE ON THE GOVERNANCE AND INSTITUTIONAL DESIGN OF FINANCIAL REGULATORY AUTHORITIES

There is no general agreement about the proper governance and institutional design of financial regulatory authorities. The academic debate is also fragmented due to the fact that many publications only address issues of specific authorities: for example, in the U.S., the governance of the Federal Reserve has been the subject of study by several scholars,[10] and in Europe the consolidation of authorities has been a main point of discussion.[11] By contrast, as explained in the introduction, this Article—and this Part—focuses on the more general international academic and policy literature.

The tasks of financial regulatory authorities as supervisors of banking, insurance, and securities markets relates to an initial divide between different institutional designs. A frequent point of reference is a report by the Group of Thirty,[12] an international body composed of central bank governors, private sector financial experts, and leading economists. This report outlines the different approaches (institutional, functional, consolidated or "twin peaks") in 17 jurisdictions. Some have found that the need to give special consideration to problems of systemic risk and financial instability reflects more recent trends of institutional design.[13] Overall, however, real-world supervisory systems often mix models, reflecting the conclusion that there is unlikely to be a one-size-fits-all solution for the right supervisory oversight structure.[14]

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9. In particular through the Group of 30, the BCBS, IOSCO, and IAIS. *See infra* Part II.

10. *See generally* PETER CONTI-BROWN, THE POWER AND INDEPENDENCE OF THE FEDERAL RESERVE (2016) (discussing the Federal Reserve); Kathryn Judge, *The Federal Reserve: A Study in Soft Constraints*, 78 L. & CONTEMP. PROBS. 65 (2015).

11. *See generally* Veerle Colaerts, *European Banking, Securities and Insurance Law: Cutting through Sectoral Lines?*, 52 COMMON MKT. L. REV. 1579 (2015) (discussing the consolidation of authorities in Europe); Eddy Wymeersch, *The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors*, 8 EUR. BUS. ORG. L. REV. 237 (2007).

12. GROUP OF 30, THE STRUCTURE OF FINANCIAL SUPERVISION: APPROACHES AND CHALLENGES IN A GLOBAL MARKETPLACE (2008), http://group30.org/images/uploads/publications/G30_StructureFinancialSupervision2008.pdf. For recent trends, see Martin Melecky & Anca Maria Podpiera, *Institutional Structures of Financial Sector Supervision, Their Drivers and Historical Benchmarks*, 9 J. FIN. STABILITY 428 (2013).

13. Anita Anand et al., *Institutional Design and the New Systemic Risk in Banking Crises*, *in* SYSTEMIC RISK, INSTITUTIONAL DESIGN, AND THE REGULATION OF FINANCIAL MARKETS 1 (Anita Anand ed., 2016).

14. *E.g.*, Eilís Ferran, *Institutional Design: The Choices for National Systems*, *in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION 100 (Niamh Moloney et al. eds., 2015); Donato Masciandaro, *Politicians and*

For more specific questions of governance design, possible starting points are the (non-binding) principles published by the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO), and the International Association of Insurance Supervisors (IAIS).[15] These principles contain brief sections on the role of the respective financial regulatory authorities, with some further details also discussed in the literature.[16]

The need for independence of the financial regulatory authority is mentioned in all of these principles,[17] and the literature has also explored how far, in reality, supervisors can be classified as independent.[18] In the BCBS and IAIS Principles, there is a section on the questions of appointment and removal of the governing body of the financial regulatory authority, stating that its members should be appointed for a minimum term and can only be removed from office "for reasons specified in law or if (s)he is not physically or mentally capable of carrying out the role or has been found guilty of misconduct."[19] The literature discusses further distinctions, for example, how far such appointment and dismissal decisions are in the competence of the government or the legislature.[20]

The BCBS Principles also relate the independence requirement to the finances of the financial regulatory authority, recommending "budgetary processes that do not undermine autonomy and adequate resources."[21] More specifically, a document by the Financial Stability Board expresses a preference for funding through fees paid by the regulated industry (as opposed to drawing on the general fund).[22] The literature on this topic has explored further approaches, such as, how it may be possible to create the right financial incentives for regulators.[23]

All three principles would also generally require a financial regulatory authority to be "accountable."[24] Some of the literature explains that this may create tension with the requirement of independence.[25] Yet, it is clear that without accountability there is the risk

*Financial Supervision Unification Outside the Central Bank: Why Do They Do It?*, 5 J. FIN. STABILITY 124 (2009).

15. BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION (2012), https://www.bis.org/publ/bcbs213.pdf [hereinafter BCBS]; INT'L ORG. OF SEC. COMM'N, OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION (2010), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf [hereinafter IOSCO]; INT'L ASS'N OF INSURANCE SUPERVISORS, CORE PRINCIPLES (2015), https://www.iaisweb.org/page/supervisory-material/insurance-core-principles//file/58067/icp-updated-november-2015 [hereinafter IAIS].

16. *See generally* DESIGNING FINANCIAL SUPERVISION INSTITUTIONS: INDEPENDENCE, ACCOUNTABILITY AND GOVERNANCE (Donato Masciandaro & Marc Quintyn eds., 2007) [hereinafter DESIGNING FINANCIAL SUPERVISION].

17. BCBS, *supra* note 15, princ. 2; IOSCO, *supra* note 15, princ. A.2; IAIS, *supra* note 15, princ. 2.

18. N. Nergiz Dincer & Barry Eichengreen, *The Architecture and Governance of Financial Supervision: Sources and Implications*, 15 INT'L FIN. 309, 313–14 (2012). *See also* Chris Hanretty & Christel Koop, *Shall the Law Set Them Free? The Formal and Actual Independence of Regulatory Agencies*, 7 REG. & GOVERNANCE 195, 214 (2013).

19. BCBS, *supra* note 15, princ. 2.2. *See also* IAIS, *supra* note 15, princ. 2.2.

20. Seelig & Novoa, *supra* note 8, at 13.

21. BCBS, *supra* note 15, princ. 2. *See also* IAIS, *supra* note 15, princ. 2.4.

22. FINANCIAL STABILITY BOARD, INTENSITY AND EFFECTIVENESS OF SIFI SUPERVISION 5–6 (2010), www.fsb.org/wp-content/uploads/r_101101.pdf.

23. M. Todd Henderson & Frederick Tung, *Pay for Regulator Performance*, 85 S. CAL. L. REV. 1003, 1003 (2011); JOHN ARMOUR ET AL., PRINCIPLES OF FINANCIAL REGULATION 571–73 (2016).

24. BCBS, *supra* note 15, princ. 2; IOSCO, *supra* note 15, princ. A.2; IAIS, *supra* note 15, princ. 2.

25. Eva H.G. Hüpke et al., *Accountability Arrangements for Financial Sector Regulators*, 39 IMF ECON.

that regulators may "deviate from their task of guarding finance for the benefit of society as a whole."[26] The principles provide only a few specific examples, namely that financial regulatory authorities have some reporting duties,[27] that regulators should avoid conflicts of interest and implement risk mitigation strategies,[28] and that statutory liability may be possible for actions taken in bad faith.[29] The corresponding literature addresses some further aspects, for example, the linkage between transparency and accountability,[30] possible procedural requirements,[31] and variations of actual liability of regulators.[32]

Some of the literature relates this topic to other fields where the need for accountability has been discussed. Research by Quintyn and Taylor and Armour et al. refers to the political dimension of financial regulatory authorities: thus, by assuming that politicians and regulators, as their appointees, may act selfishly, the situation can be presented in terms of a principal-agent relationship.[33] Similarly, Enriques and Hertig provide suggestions on how to improve the governance of financial supervisors, partly drawing on concepts such as the principal-agent theory.[34]

It follows that there is some asymmetry in the general academic and policy literature on the governance and institutional design of financial regulatory authorities: the choice between institutional, functional, consolidated and "twin peaks" approaches is discussed in detail, while specific questions of governance are only addressed in a fragmentary way. Thus, this Article will focus on these latter topics, suggesting that insights from corporate governance can be potentially rewarding.

## III. CONCEPTUAL DIFFERENCES AND SIMILARITIES BETWEEN FINANCIAL REGULATORY AUTHORITIES AND COMPANIES

How far can we identify parallels between financial regulatory authorities and corporations? This part aims to explore this topic at a conceptual level: the first section discusses the literature on the differences between private and public-sector firms and their application to financial regulatory authorities; the second addresses conceptual similarities between the governance of financial regulatory authorities and corporations.

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ISSUE 2, 3–4 (2006). *See also* Nergiz Dincer & Eichengreen, *supra* note 18, at 323.

26. Ferran, *supra* note 14, at 117. *See also* JAMES R. BARTH ET AL., GUARDIANS OF FINANCE: MAKING REGULATORS WORK FOR US (2012).

27. BCBS, *supra* note 15, princ. 2.3; IOSCO, *supra* note 15, princ. A.1; IAIS, *supra* note 15, princ. 2.1.1.

28. BCBS, *supra* note 15, princ. 2.4; IOSCO, *supra* note 15, princ. A.8; IAIS, *supra* note 15, princ. 2.12.

29. BCBS, *supra* note 15, princ. 2.9; IAIS, *supra* note 15, princ. 2.10.

30. Ferran, *supra* note 14, at 119.

31. Seelig & Novoa, *supra* note 8, at 18.

32. PABLO IGLESIAS-RODRIGUEZ, THE ACCOUNTABILITY OF FINANCIAL REGULATORS: A EUROPEAN AND INTERNATIONAL PERSPECTIVE (2013).

33. Marc Quintyn & Michael Taylor, *Robust Regulators and their Political Masters: Independence and Accountability in Theory*, *in* DESIGNING FINANCIAL SUPERVISION, *supra* note 16; ARMOUR ET AL., *supra* note 23, at 553–76 (referring to the political dimension of financial regulatory authorities). The role of private interests is also emphasized by Marco A. Espinosa-Vega et al., *Some Implications of Systemic Risk and the Design of Regulatory Architecture*, *in* MACROPRUDENTIAL REGULATORY POLICIES THE NEW ROAD TO FINANCIAL STABILITY? 207–14 (Stijn Claessens et al. eds., 2011).

34. Luca Enriques & Gerard Hertig, *Improving the Governance of Financial Supervisors*, 12 EUR. BUS. ORG. L. REV. 357 (2011) (explaining how to further improve the governance of financial supervisors).

### *A. The Literature on Differences Between Private and Public Sector Firms and Their Application to Financial Regulatory Authorities*

The distinction between the private and public sector has often been discussed in the academic literature on public administration.[35] Most studies in this field, however, address public utilities whereas only some articles discuss other public-sector institutions, such as regulators or ministries.[36] Financial regulatory authorities are subsumed under the latter; they are service-granting public institutions that do not provide society with public utility services.

Considering the scarcity of studies relating to differences between private sector firms and regulatory authorities, some insights can be deduced from the literature comparing private sector firms to public utility firms. In this section, these insights will be adjusted, where needed, to fit financial regulatory authorities and better assess the existing financial supervisory models. Thus, unless stated otherwise, the differences between public institutions and private sector firms highlighted here are also applicable to financial regulatory authorities.

The main difference between public institutions and private sector firms is that public sector institutions are held by the government while private sector firms are held by natural persons or other companies as their shareholders.[37] This results in two immediate differences: the way the firms are financed and the way the firms are controlled.[38] Private sector firms are financed through revenues paid by their consumers, by credit which they borrow from banks, and by securities issued on the stock market. Public institutions instead are funded mainly from taxpayer money.[39] The second factor, control, refers to the fact that private sector firms are controlled by market forces, i.e. supply and demand, as opposed to public institutions, which are controlled by political powers and pressures.[40] This is especially true when the public institutions are not financially independent from government, i.e. when their budgets depend on government decisions, which is the case for many financial regulatory bodies around the world.[41] In such cases, the public institutions may be subject to political pressure, which might undermine their professional judgment and lead to suboptimal decision-making.

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35. *See* Rhys Andrews et al., *Dimensions of Publicness and Organizational Performance: A Review of the Evidence*, 21 J. PUB. ADMIN. RES. & THEORY i301 (2011). *See generally* Soonhee Kim & Hyangsoo Lee, *The Impact of Organizational Context and Information Technology on Employee Knowledge-Sharing Capabilities*, 66 PUB. ADMIN. REV. 370 (2006) (referring to public sector institutions); George A. Boyne, *Public and Private Management: What's the Difference?*, 39 J. MGMT. STUD. 97 (2002) (referring to public utilities).

36. For articles addressing institutional issues relating to non-public utilities companies include, see Andrew Rudalevige, *The Structure of Leadership: Presidents, Hierarchies, and Information Flow*, 35 PRESIDENTIAL STUD. Q. 333, 335–36 (2005) and Matthew C. Stephenson, *Information Acquisition and Institutional Design*, 124 HARV. L. REV. 1422, 1432 (2011).

37. Hal G. Rainey et al., *Comparing Public and Private Organizations*, 36 PUB. ADMIN. REV. 233, 233–44 (1976). Note that we focus on private sector firms incorporated as companies, not other legal forms (partnerships, cooperatives etc.).

38. *See* Boyne, *supra* note 35, at 98; Andrews et al., *supra* note 35, at i301–i319.

39. GARY L. WALMSLEY & MAYER N. ZALD, THE POLITICAL ECONOMY OF PUBLIC ORGANIZATION: CRITIQUE AND APPROACH TO THE STUDY OF PUBLIC ADMINISTRATION 9 (1973). *See also* Andrews et al., *supra* note 35, at i302; Boyne, *supra* note 35, at 98 (continuing to recognize these differences).

40. Boyne, *supra* note 35, at 98; Andrews et al., *supra* note 35, at i302.

41. For information regarding the structure of financial regulatory bodies around the world, see generally the country chapters in GROUP OF 30, *supra* note 12.

These three main differences—the identity of the controller, the way in which the legal entity is financed, and the way in which it is controlled—have an effect on the organizational behavior of the entity.[42] This goes back to the theory of the firm and to incentives to monitor. Dispersed ownership in the context of public institutions means being owned by the state; which, theoretically, should lead to lower efficiency in the public sector.[43] The reason behind this phenomenon is an incentive problem: in contrast to private sector firms, which are supposed to maximize their shareholders' profits, no individual voter will directly gain from a more efficient organizational design for public institutions.[44] This causes a difference in the amount of monitoring in each type of entity: in a private sector firm the shareholders are incentivized to monitor the managers and provide them with incentive schemes which will increase shareholders' profits. Incentive schemes, in turn, drive innovation and efficiency, as the manager's compensation is often tied to the company's performance—either through shares or through remuneration programs and bonuses. By contrast, public institution managers do not usually get a salary increase if they improve organizational design.[45] As monitoring, or lack thereof, does not directly influence any particular individual, it becomes a "public good"—very few people are incentivized to monitor a public agency, as their efforts will very likely exceed their gains.[46]

Although financial regulators do not produce tangible products, monitoring them may create several problems. First, monitoring financial products is a complicated task requiring expertise.[47] As a result, the monitoring of financial regulators requires expertise and competence in appreciating the problems and solutions applied by the regulator. Clearly, there are only a handful of people who might have the requisite expertise and knowledge to assess the regulatory work. Second, very much in line with consumers serviced by a public utility firm, the individual consumer of financial regulatory services will not directly benefit from a more efficacious design of financial regulatory authorities, and so does not have the right incentives to promote a more efficiently designed regulatory authority.

The above-mentioned concerns with the monitoring of public sector institutions might also escalate the problem of a captured agent. In the absence of monitoring, it is easier for the public servant to bring into account his own utility function and be lured into lucrative opportunities from the industry in exchange for favoritism in the area of which he is in charge. The actions of a captured public agent will accord with the benefit of the capturing group, rather than the good of the general public.[48] Such actions might include withholding information and disseminating partial information to tilt the final decision in directions

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42. Boyne, *supra* note 35, at 99. *See generally* Kim & Lee, *supra* note 35 (explaining the effects of these differences in the context of employee knowledge-sharing capabilities); BARRY BOZEMAN, ALL ORGANIZATIONS ARE PUBLIC: COMPARING PUBLIC AND PRIVATE (1987).

43. *See generally* Kenneth Clarkson, *Some Implications of Property Rights in Hospital Management*, 15 J.L. & ECON. 363 (1972); Andrews et al., *supra* note 35; Koldo Zabalza & Jesus Matey, *Strategic Management Development from the State-Owned Company to the Private Company*, 7 J. MOD. ACCT. & AUDITING 48 (2011).

44. At least in most Anglo-Saxon countries, see *infra* Part III.B.i.

45. Boyne, *supra* note 35, at 99.

46. *Id.*

47. David Llewellyn, *The Economic Rationale for Financial Regulation*, 1 FIN. SERVS. AUTH. OCCASIONAL PAPERS IN FIN. REG. 1, 23–25 (1999).

48. *See generally* George J. Stigler, *The Economic Theory of Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971); Sam Peltzman, *Toward A More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976) (displaying the nature of governmental regulation as a commodity which businesses seek).

beneficial to the regulated firms.

Another problem of political, as opposed to economic control, is that of multiple sources of authority,[49] when those who have the authority contradict each other. It is very likely that in order to mitigate this problem, public institutions will develop complex bureaucratic mechanisms to make sure that all authorities are satisfied. Take, for example, the structure of financial regulatory authorities in France. France has many interconnected regulatory bodies, sometimes with overlapping responsibilities. The interconnectivity of the French regulatory bodies—which is reflected by the fact that the heads of a regulatory body can, and do, sit on the board of other regulatory bodies—might be partially explained by the need to satisfy all those who have the authority and political power.[50]

According to Boyne, the three distinctions between public institutions and private sector firms are not just conceptual but also empirical. The empirical evidence on these issues suggests that they are not perfect proxies for each other, implying that all three differences—ownership, funding, and control—should be taken into account when evaluating the effects of being a public institution.[51] As financial regulatory authorities are public institutions these differences are also relevant for our discussion.

Beyond the impact of being a public institution in general, the literature on differences between public sector and private sector managers identifies four main theoretical effects of being a public-sector institution:[52] the connection between being a public sector institution and organizational environments, organizational goals, organizational structures, and the values of managers. These aspects are worth considering in more detail below.

*i. Differences in Organizational Environments*

Public sector institutions differ from private sector firms in several aspects. The organizational differences have been summed up by the literature as follows:[53]

*Complexity*: Public sector institutions are generally more complex than private sector firms as their managers are facing different stakeholders with contradictory demands. Furthermore, public sector institutions tend to be more bureaucratic due to a number of reasons that have little to do with efficiency, such as their multiple sources of authority, and pressure to provide jobs for people who are close to politicians, evidenced by the French case, mentioned earlier.

*Intrusion*: Public sector institutions are easily influenced by external pressures and events.[54] This influence is especially true when the budget of the public-sector institution depends on government decisions.

*Instability*: Due to external political pressure, public sector institutions tend to change their strategies more frequently than private sector firms. This can be seen in the frequent changes to the financial regulatory structures undertaken by countries across the world.[55]

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49. BOZEMAN, *supra* note 42; Kim & Lee, *supra* note 35, at 372.
50. *See* GROUP OF 30, *supra* note 12, at 96–103.
51. Boyne, *supra* note 35, at 98.
52. *Id.* at 99.
53. *See id.* at 100; Kim & Lee, *supra* note 35, at 372; Andrews et al., *supra* note 35, at i304–i307.
54. *See generally* Richard A. Posner, *Theories of Economics Regulation*, 5 BELL J. ECON. & MGMT. SCH. 335 (1974). *See also* Stigler, *supra* note 478, at 3–21. Regulation is supplied in response to pressure from political interest groups.
55. *See generally* Donato Masciandaro & Marc Quintyn, *Regulating the Regulators: The Changing Face*

*Lack of competition*: Public sector institutions usually do not compete with other public-sector institutions in order to provide their services. Usually, the state will want to minimize the public resources invested in the public-sector institutions and so, in the name of efficiency, will try not to form two public sector institutions that have overlapping responsibilities. If the state succeeds in doing so, it means that consumers have no choice other than to engage with one specific public sector institution, no matter how bad its services are. In addition, as public-sector institutions do not receive their revenues from true "consumers," their willingness to respond to consumer demand drops. The consumers cannot influence the quality of the service they receive.[56] Another relevant point relates to the market for corporate control. In private sector firms admitted to stock markets, managers are incentivized to prove themselves in order to avoid being dismissed following a takeover of the company. This is not the case for public sector firms where managers are appointed for long terms, sometimes even for life.

It follows that it is difficult to incentivize efficiency in public sector institutions. Moreover, there are differences in the nature, purpose, and scope of structural reform. In the private sector, viable organizational reforms are selected by the markets. We therefore assume that such organizational reforms are efficient, or else they would not occur. A public-sector institution reform, on the other hand, does not occur as a result of market power and competition, but rather as a result of the political atmosphere of the time. It is therefore much harder to detect the reason behind such reform, and evaluate whether it is efficient or not. This is one of the reasons some scholars suggest that competition between different regulatory bodies might be beneficial—and that indeed, to some extent, such competition takes place among U.S. financial regulatory authorities.[57] Others disagree, claiming that such competition undermines the regulatory goals these entities are supposed to produce, and encourages unwanted behavior by the regulated firms, such as forum shopping.[58] The answer is not conclusive and this question is still open for debate.[59]

*Different agency problems*: Although both financial regulatory authorities and private sector firms suffer from agency problems, the types of agency problems are somewhat different. In private sector firms a distinction can be made between three types of agency problems: those between minority and controlling shareholders, those between creditors and shareholders, and those between management (board of directors) and shareholders. In public sector firms (financial regulatory authorities included), the agency problems usually exist between the public and the bureaucrats and between bureaucrats and politicians. This may create captured agent problems or other inefficiencies, but these problems are different

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*of Financial Supervision Architectures Before and After the Crisis*, 6 EUR. COMPANY L. 187 (2009).

56. *See generally* WILLIAM A. NISKANEN, BUREAUCRACY AND REPRESENTATIVE GOVERNMENT (1971). *See also* Andrews et al., *supra* note 35, at i304.

57. *See, e.g.*, John C. Coffee Jr., *Competition Versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation*, 50 BUS. LAW. 447 (1995) (explaining the benefits of regulatory competition).

58. *See, e.g.*, Daniel B. Schwarcz, *Regulating Insurance Sales or Selling Insurance Regulation?: Against Regulatory Competition in Insurance*, 94 MINN. L. REV. 1707, 1710–12 (2010); Howell E. Jackson, *Centralization, Competition, and Privatization in Financial Regulation*, 2 THEORETICAL INQ. L. 649, 658–59 (2001).

59. *See generally* Wolfgang Kerber, *The Theory of Regulatory Competition and Competition Law*, *in* ECONOMIC LAW AS AN ECONOMIC GOOD, ITS RULE FUNCTION AND ITS TOOL FUNCTION IN THE COMPETITION OF SYSTEMS 27–44 (Adelheid Puttler et al., eds., 2009). *See also* ARMOUR ET AL., *supra* note 23, at 565–66 (further explaining the debate behind regulatory bodies).

than those created in private sector firms. In addition, due to the fact that, typically, a public-sector institution cannot go bankrupt (since it is backed up by the state), the agency problem between creditors and shareholders is non-existent. However, this also means creditor incentives to monitor the public-sector institution do not exist.

### *ii. Differences in Goals*

While private sector firms typically have one major goal, which is to maximize profits, public-sector institutions often have many different goals, such as pleasing the different stakeholders, and promoting values such as justice, equality, and fairness.[60] Even though financial regulatory authorities are mainly concerned with efficiency considerations, they too have many other goals such as consumer protection, promoting competition, and promoting values of justice and fairness. Take, for example, the wide spectrum of goals in Section 2 of the American Securities Exchange Act of 1934. It defines the goals of the SEC as follows:

> For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are effected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports, to remove impediments to and perfect the mechanisms of a national market system for securities and a national system for the clearance and settlement of securities transactions and the safeguarding of securities and funds related thereto, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions.[61]

This difference between public-sector institutions and private sector firms results in a different type of managerial regime: managers of public-sector institutions must be aware of the different, sometimes contradictory, goals they are asked to achieve, and must navigate between them. According to Boyne, public sector institutions, as opposed to private sector firms, are also vaguer with regards to their goals, since their organizational policies are dictated by politicians rather than by professional managers.[62] This is especially true when the independence of the financial regulatory authority is weaker, such as when its budget is dependent on political considerations.[63] This creates a difference in the need for clarity: in order to get policies adopted, politicians need to gain wide support for the change from many diverse groups.[64] In these surroundings, lack of clarity is an asset as it is more difficult to object to a less clear change.[65] These political pressures hamper

60. Boyne, *supra* note 35, at 98–122.
61. 15 U.S.C. § 78b (1934).
62. *See* Boyne, *supra* note 35, at 101.
63. *Id.*
64. *Id.*
65. *Id.*

the work of public-sector institutions, as performance targets and measurements are inherently unclear, and management according to objectives is discouraged.[66]

### *iii. Differences in Organizational Structures*

The organizational structures of public-sector institutions and private sector firms reflect some of the same arguments as the differences in goals. As a result of having many sources of authority and the consequent need for political compromise, public sector institutions tend to be more bureaucratic.[67] The complex and bureaucratic structure of public sector institutions is also caused, in part, by demands set by monitoring bodies, which are abundant in the public sector, and by requirements of accountability.[68] As a result of public-sector bureaucracy organizations, stagnation and formalization leads to significant delays and inefficiencies.[69]

Managers of public-sector institutions typically have less autonomy than their colleagues in private sector firms, especially when it comes to firing, hiring, and promoting employees.[70] This is due to the rigid rules of government employment contracts and the fact that they are in the public eye, and are thus subject to public criticism.[71] This of course makes it harder for managers in public sector institutions to control their employees, as there are no substantial reward or punishment tools—at least when compared to the private sector.[72] Moreover, public sector institutions have ambiguous performance measurements which make it hard to convince employees that sharing knowledge will be worth their while.[73] As public sector institutions, financial regulatory authorities also suffer from these drawbacks. It makes them less efficient and more prone to stagnation and, in doing so, hurts their ability to regulate the rapidly evolving industry.

### *iv. Differences in Employees' Commitment and Values*

The last difference between public and private sector entities has been identified in the literature as a difference in the values of employees and managers.[74] However, the literature disagrees on the direction of these differences[75]: while some consider managers in public sector institutions as manipulative agents who try to abuse the system in order to escape accountability,[76] another camp views these managers as less materialistic agents, who are concerned with serving the public and promoting the public good with which they are entrusted.[77] The truth is likely to lie somewhere in the middle. In their research, Mayer

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66. *Id.*

67. Boyne, *supra* note 35, at 101.

68. *Id.* at 109–12.

69. Barry Bozeman et al., *Red Tape and Task Delays in Public and Private Organizations*, 24 ADMIN. & SOC'Y 290, 290–91 (1992).

70. Boyne, *supra* note 35, at 101.

71. *Id*. at 101–02; Kim & Lee, *supra* note 35, at 370–85.

72. *See* Boyne, *supra* note 35, at 101 (describing these difficulties).

73. Kim & Lee, *supra* note 35, at 370–85.

74. *See* Boyne, *supra* note 35, at 102; Bradley E. Wright, *Public Service and Motivation: Does Mission Matter?*, 67 PUB. ADMIN. REV. 54, 54–55 (2007).

75. Dorit Rubinstein Reiss, *Account Me In: Agencies in Quest of Accountability*, 19 J.L. & POL'Y 611, 614 (2009).

76. *Id.* at 616.

77. *See id.* at 642 (displaying and example of this view); Boyne, *supra* note 35, at 102.

et al. analyzed the ethical behavior patterns of 904 employees and 195 managers in 195 departments. Their research backs up the findings from the social learning and social exchange theories and suggest that ethical behavior is transmitted top down from one managerial layer to the one beneath it.[78] These findings suggest that managers of public sector institutions will behave, on average, in accordance with the ethics and norms dictated to them from the top.[79]

Putting this debate aside, scholars tend to agree that the differences in salary, remuneration, and goals of public sector institutions attract different employees than those who choose to work for private sector firms.[80] As public-sector institutions, financial regulatory authorities are entrusted with promoting a public good, and they tend to have missions of broader scope and greater impact than those of private sector firms.[81] Thus, employees who choose to work for the public sector are thought to be more altruistic and less concerned with financial remuneration than their colleagues in the private sector.[82] This has been found to be true in a number of empirical studies which tested the value employees attach to helping others as opposed to the value or utility they derive from financial rewards.[83]

This gulf between public and private sector entities dictates a need for a different type of management in public sector entities. It also has implications for the organizational structure. The differences, to the extent that they exist, between public and private sector entities call for a slightly different evaluation of problems relating to organizational design and structure. For example: knowledge-sharing is important both in the public and the private sector. Researchers have found that organizations which transfer knowledge efficiently are more productive than those which do not.[84] For private sector firms, information-flow is essential in order to meet consumer demands and remain competitive. Even though public-sector institutions are not subject to competitive market forces, knowledge-sharing is important for them as well. In the public sector, there is a growing focus on result-oriented services and performance. These services require greater information and knowledge-sharing capabilities.[85] Employee turnover makes it essential to collect, preserve, and share knowledge within the organization. Moreover, as the world becomes more complex, cooperation between different government institutions is needed. In order to do so, government institutions need to share their knowledge with one another.[86] It is important to identify the optimal environment for enhancing employee knowledge-sharing capabilities. Capabilities of knowledge-sharing with other institutions are also significant as they are often essential for the work of the institutions. Financial regulatory authorities are no exception: information sharing within and between them is important

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78. David M. Mayer et al., *How Low Does Ethical Leadership Flow? Test of a Trickle-Down Model*, 108 ORG. BEHAV. & HUM. DECISION PROCESSES 1–2 (2009).

79. *Id.* at 11.

80. Wright, *supra* note 74, at 54–55.

81. *Id.*

82. *Id.* at 54–64.

83. Bradley E. Wright, *Public-Sector Work Motivation: Review of Current Literature and a Revised Conceptual Model*, 11 J. PUB. ADMIN. RES. & THEORY 559 (2001); Boyne, *supra* note 35, at 102.

84. Kim & Lee, *supra* note 35, at 370–85.

85. *Id.* at 370.

86. OECD, THE LEARNING GOVERNMENT: INTRODUCTION AND DRAFT RESULTS OF THE SURVEY OF KNOWLEDGE MANAGEMENT PRACTICES IN MINISTRIES/DEPARTMENTS/AGENCIES OF CENTRAL GOVERNMENT (2003).

both, in order to perform the day-to-day supervisory tasks, but also in order to mitigate a financial crisis once it has begun.[87]

*B. General Similarities Between the Governance of Financial Regulatory Authorities and Corporate Governance*

The previous section has shown that there are some profound differences between private sector firms (such as corporations) and public-sector firms (such as financial regulatory authorities). By contrast, the following will explain why, in some respects, there are also conceptual similarities between the corporate governance of companies and the governance needed for financial regulatory authorities. Corporate governance is mostly discussed in relation to firms that are owned by individuals or other companies. In addition, there is a growing interest in the corporate governance of state-owned enterprises (SOEs).[88] Since financial regulatory authorities too are controlled by the state, there are likely to be additional similarities between them and the corporate governance of SOEs. The following therefore distinguishes between the similarities of financial regulatory authorities to the corporate governance of all firms on the one hand and that of SOEs on the other.

*i. Similarities to Corporate Governance of all Firms*

For companies (and corporate law), a core topic is the relationship between the shareholders (initially the founders) and the directors and managers of the company, for example, the way the shareholders can appoint and dismiss the directors. This relationship is often phrased as the principal-agent problem of corporate governance,[89] with most scholars identifying the shareholders as the "owners" of the company.[90] A related view to justify the position of shareholders is the democratic or political model of the company. In this respect, the shareholders are sometimes seen as the "citizens" of the company,[91] while others regard them as akin to the company's "parliamentarians," so that the general meeting is to be regarded as the parliament of the company and thus as its "highest body."[92] Furthermore, it is frequently stressed that the notion that the company is a political entity implies separation and limitation of powers.[93]

The situation for financial regulatory authorities is similar. On the one hand, we have

87. Hadar Y. Jabotinsky, *The Federal Structure of Financial Supervision: A Story of Information-Flow*, 22 STAN. J. L. BUS. & FIN. 52, 55 (2017).

88. *See generally* Curtis J. Milhaupt & Mariana Pargendler, *Governance Challenges of Listed State-Owned Enterprises Around the World: National Experiences and a Framework for Reform*, 50 CORNELL INT'L L. J. 473 (2017); Christopher Chen, *Solving the Puzzle of Corporate Governance of State-Owned Enterprises: The Path of the Temasek Model in Singapore and Lessons for China*, 36 NW. J. INT'L L. & BUS. 303 (2016); Giuseppe Grossi et al., *Corporate Governance and Accountability of State-Owned Enterprises: Relevance for Science and Society and Interdisciplinary Research Perspectives*, 28 INT'L J. PUB. SECTOR MGMT. 274 (2015); Samuel Nana Yaw Simpson, *Boards and Governance of State-Owned Enterprises*, 14 CORP. GOVERNANCE 238 (2014).

89. This is the "vertical agency," *see* REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 29–32 (3d ed. 2017), as distinguished from the "horizontal agency" (the relationship between majority and minority shareholders).

90. To read more about the debate see, for example., David C. Donald, *Shareholder Voice and its Opponents*, 5 J. CORP. L. STUD. 305 (2005); Paddy Ireland, *Company Law and the Myth of Shareholder Ownership*, 62 MOD. L. REV. 32 (1999).

91. Donald, *supra* note 90, at 308.

92. MATHIAS M. SIEMS, CONVERGENCE IN SHAREHOLDER LAW 150–68 (2008).

93. *See, e.g.*, Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39, 52–53 (2000).

bureaucrats responsible for running the organization, say, the directors and managers of the regulatory authority (the regulators). On the other hand, as with the political model of corporate governance, there are different analogies that can be drawn for the question about the "principal": it can either be seen as the state represented by the government or the general public represented by the legislature.[94] Focusing on the state/government, for financial regulatory authorities, it is crucial to understand what powers they have, for example, how difficult it is to dismiss the head of the regulatory authorities. Focusing on the public/parliament, for example, it can be asked what the public/parliament can do if the regulator is captured due to agency problems. In both cases, it is also clear that some balance has to be struck: on the one hand, there should be some means with which the shareholders/state/public can intervene in the affairs of the company/regulatory authority; on the other hand, micro-managing all details would be counter-productive.

In the corporate governance debate, a recent argument is that it is not only necessary to have legal rules on shareholder rights but also on shareholder duties.[95] A particular focus is directed to the position of institutional investors, for example, how far they have an obligation toward their own investors to be active and vigilant.[96] The parallel to financial regulatory authorities is that the government, acting on behalf of the state, may need to consult with the legislature and follow the interest of the general public in matters related to the monitoring of the regulatory authority. Here too, the issue can arise whether the state faces liability if the regulator breaches their duties, causing damage to the organization or third parties.[97]

This leads to another topic at the core of corporate law: directors' duties. The discussion usually concerns duties of care and loyalty. Specifically, conflicts of interest raise issues regarding directors' duties, including questions about a continuing duty of loyalty of past directors. Another question concerns the ultimate target of directors' duties: is it to benefit shareholders, the company as a whole, all relevant stakeholders, or the general public?[98] While the goals of financial regulatory authorities are different from those of companies,[99] here too, the issue arises in how the persons in charge can most effectively achieve these goals. As financial regulatory authorities also enjoy a degree of autonomy, it matters how their duties are defined and implemented, for example, how instances of conflict of interest should be addressed. Another relevant issue—in parallel to the shareholder/stakeholder debate—is whether their actions should strictly be aligned to those of the current government or whether they should enjoy a greater degree of freedom to consider wider public interests.

In corporate law, the directors form part of the board of directors (or, in a two-tier system, either the management board or the supervisory board).[100] In the corporate governance literature many structural questions are related to the company's board. For

94. *Cf.* Tom W. Bell, *What Can Corporations Teach Governments About Democratic Equality?*, 31 SOC. PHIL. & POL'Y 230, 233 (2015) (suggesting the answer to the question "who owns a city," may well be "nobody").

95. *E.g.*, SHAREHOLDERS' DUTIES (Hanne Birkmose ed., 2017).

96. *E.g.*, IRIS H-Y CHIU, THE FOUNDATIONS AND ANATOMY OF SHAREHOLDER ACTIVISM (2010).

97. *See* IGLESIAS-RODRIGUEZ, *supra* note 32.

98. For reading on these topics, see, e.g., COMPARATIVE CORPORATE GOVERNANCE: A FUNCTIONAL AND INTERNATIONAL ANALYSIS (Andreas M. Fleckner & Klaus S. Hopt eds., 2013).

99. *See supra* Part III.A.ii (discussing the differences in goals between the private and public sector).

100. For an overview, see OECD, OECD CORPORATE GOVERNANCE FACTBOOK 93–113 (2017), www.oecd.org/daf/ca/corporate-governance-factbook.htm.

example: should directors be independent? Should the CEO also be the chairman of the board? Should there be committees for special topics (appointment, remuneration, auditing, etc.)? How big should boards be? How often should they meet? Should there be gender quotas or other personnel requirements, for example, for board members sitting on the audit committee? For financial regulatory authorities, such topics are also relevant when their key personnel acts in the form of collective bodies (boards, councils, committees, etc.). In addition, these points of discussion can be linked to the general scholarship of organizational design given that most organizations include both forms of cooperation and checks and balances.[101]

The final parallel to mention is that, for larger companies in particular, there are often special requirements of accountability, for example, disclosure requirements for the benefit of the shareholders and the public, as well as internal and external auditing.[102] Similarly, financial regulatory authorities need to be accountable. They may need to produce information about their operations and may face internal and/or external audits. For them, it is also relevant to ask whether any disclosure is done for the benefit of the current government or whether they also owe some accountability to the general public.[103] Likewise, both companies and regulatory bodies may, in some circumstances, not disclose certain information due to legitimate reasons of privacy and professional secrecy.

### *ii. Similarities to Corporate Governance of SOEs*

For SOEs, further similarities to financial regulatory authorities can be identified. To start with, due to the state ownership, such companies are expected to a have a higher degree of social responsibility. Thus, in this respect, SOEs are akin to non-profit organizations and social enterprises.[104] Financial regulatory authorities may resemble SOEs as both have aims related to public policy. While, naturally, it can be expected that they do not waste financial resources, their prime aim is not to make profit but to act in the public's interest in pursuing their given objectives.

Another important similarity is that in both cases, the state has two positions: law-maker of the underlying rules and the controller of the entity for the benefit of the public. The fact that politicians act on behalf of the state can lead to problems of conflict of interest. On the one hand, they may want to expose misconduct happening in the SOE/regulatory authority. On the other hand, forthcoming elections may mean that they are keen to avoid any uproar. It can therefore be argued that both SOEs and regulatory authorities, as government-controlled entities, may be potentially unstable due to the influence of external political pressures and events.

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101. *See, e.g.*, Luis Garicano & Luis Rayo, *Why Organizations Fail: Models and Cases*, 54 J. ECON. LIT. 137 (2016); W. Richard Scott, *Reflections on a Half-Century of Organizational Sociology*, 30 ANN. REV. SOC. 1 (2004); Milton Harris & Artur Raviv, *Organization Design*, 48 MGMT. SCI. 852 (2002). A related line of research explores the convergence of organizational structures, starting with Paul DiMaggio & Walter Powell, *The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields*, 48 AM. SOC. REV. 147 (1983).

102. For such rules of securities regulation see, for example, *Securities Markets*, EUR. COMM'N., http://ec.europa.eu/finance/securities/index_en.htm (last visited September 14, 2018).

103. *See supra* Part II and *infra* Part IV.E.

104. But note that there is also some variation: for example, it is possible to distinguish between SOEs which pursue economic activities and those which pursue public policy objectives. *See infra* Part IV.D (discussing Part III of the OECD Guidelines on Corporate Governance of State-Owned Enterprises 2015).

In addition, both financial regulatory authorities and SOEs face less market pressure than private companies. While this may make it harder to monitor them, it may also be suggested that the reduced dependence on market forces could make them act in a way that is more accountable to public interests.[105] Thus, overall, the dynamics of state influence may either be positive or negative, depending on the institutional quality of the state in question (lack of corruption, respect for the rule of law etc.).

Furthermore, it is possible that the public dimension of SOEs and financial regulatory authorities impacts further elements of the governance structure. For example, some countries require the appointment of employee representatives as board members for SOEs but not for other companies.[106] For such organizations, it is also more plausible than for privately owned companies to argue that more people are needed on the board, such as public representatives from consumer groups, NGOs etc.[107] After the global financial crisis of 2008 and the subsequent nationalization of some financial institutions, the remuneration of executives of SOEs has become a point of discussion and concern, given that public resources are at stake.[108] With respect to the remuneration of executives of financial regulatory authorities, questions regarding their pay and how to incentivize them through pay have also been raised in the literature.[109]

Overall, the conceptual comparison of financial regulatory authorities with both the corporate governance of all firms and SOEs in particular shows that there are sufficient conceptual similarities to contemplate whether tools of good corporate governance can be suitable for financial regulatory authorities. Thus, on the basis of this conclusion that some principles are potentially relevant for both organizations, the subsequent part will explore how far such forms of "transplantation" may be commendable. This will shift our attention to those specific instruments of governance which can be relevant for both financial regulatory authorities and companies.

## IV. Good Corporate Governance and the Governance of Financial Regulatory Authorities

This Part will mainly focus on the G20/OECD Corporate Governance Principles from 2015 and the OECD Guidelines on Corporate Governance of State-Owned Enterprises from 2015 [hereinafter OECD Principles and OECD SOE Guidelines] for standards of good corporate governance.[110] For issues not fully covered in the OECD Principles or

105. *See supra* Part III.A (discussing the lack of competition for public authorities).

106. For an overview of the situation in the EU Member States, see *Board-Level Representation*, EUR.TRADE UNION INST., www.worker-participation.eu/National-Industrial-Relations/Across-Europe/Board-level-Representation2 (last visited Sept. 10, 2018).

107. For further discussion, see *infra* Part IV.B.

108. *See* Elisa Henderson, *Quasi-Nationalisation in the UK Banking Crisis: A Problematic Policy Option*, 31 FIN. ACCOUNTABILITY & MGMT. 463 (2015) (discussing the public's concerns over SOE executives' pay).

109. *See* Henderson & Tung, *supra* note 23.

110. OECD, G20/OECD PRINCIPLES OF CORPORATE GOVERNANCE (2015), www.oecd.org/daf/ca/principles-corporate-governance.htm (Click on link for "English" under "Download the full text," then click "PDF" link near "Click to access" text) [hereinafter OECD PRINCIPLES]; OECD, OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE OWNED ENTERPRISES (2015), www.oecd.org/corporate/guidelines-corporate-governance-soes.htm (click on the "English" linke under "Download the 2015 edition of the Guidelines," then click "PDF" link near "Click to access" text) [hereinafter OECD SOE GUIDELINES].

OECD SOE Guidelines, some references will be made to selected domestic corporate laws.

We choose the OECD Principles for the following reasons: in the Preamble, the OECD Principles explain that "there is no single model of good corporate governance," but that they aim to build on their "common elements."[111] This search for commonalities is also reflected in the Principles' coverage of the mainstream topics of corporate governance, such as the rights of shareholders and the responsibilities of the board.[112] Indeed, the laws of most developed countries—which also tend to be OECD members—widely correspond to the Principles.[113] Furthermore, they have a global appeal: in the first instance, the Principles are soft law aimed at law makers in less developed economies. At the level of companies, they may simply have to apply domestic laws based on the Principles. In addition, as far as those laws leave options for companies, the Principles function as guidance for good practice, in particular for larger companies.[114]

The OECD SOE Guidelines refer to the OECD Principles, suggesting that "the state should strive toward full implementation of the OECD Principles of Corporate Governance when it is not the sole owner of SOEs, and of all relevant sections when it is the sole owner of SOEs."[115] The rationale for considering both the OECD Principles and the OECD SOE Guidelines is that, on the one hand, the OECD Principles are helpful, as they are a relatively pure version of the main themes of corporate governance. On the other hand, the OECD SOE Guidelines already adjust for the state ownership; thus, they are bound to be more similar to the issues concerning financial regulatory authorities, but less "pure" in how they identify themes of corporate governance.

Each of the following sections starts with an outline of selected core issues of corporate governance. With regards to financial regulatory authorities, we will then address two questions: (i) how far *does* the governance of these regulatory authorities correspond with standards of good corporate governance; and, as far as this is not the case, (ii) *should* their governance be aligned with the corporate governance standards?

### *A. Appointment to the Board*

In corporate law, the appointment and possible dismissal of board members raises a number of legal questions. The OECD Principles for good corporate governance are, however, not very specific on that matter. They mention in general terms that it is one of the rights of shareholders to elect and remove members of the board.[116] In most domestic laws there are more details. For example, in Germany an appointment is fixed for five years with dismissal only for good reasons, while in other countries the situation is more flexible, often with appointments of one to three years and no specific requirements for a dismissal resolution (yet, often also with the need to pay compensation).[117]

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111. OECD PRINCIPLES, *supra* note 110, at 10.

112. *Id.* at 9–11.

113. SIEMS, *supra* note 92, at 227.

114. *See* Mathias M. Siems & Oscar Alvarez-Macotela, *The G20/OECD Principles of Corporate Governance 2015: A Critical Assessment of their Operation and Impact,* 4 J. BUS. L. 310, 310–11 (2017) (discussing the Principles' use for large and small companies).

115. OECD SOE GUIDELINES, *supra* note 110, Recommendation IV.A.

116. OECD PRINCIPLES, *supra* note 110, princ. II.A, item 5.

117. CBR EXTENDED SHAREHOLDER PROTECTION INDEX 1990–2013 (30 Countries) (Mathias Siems ed., 2016), https://www.repository.cam.ac.uk/handle/1810/256566 (click on link labeled "cbr-spi-30-countries-codebook-and-methodology.pdf")/ (with a comparative overview of dismissal rights in its variable 6; contrast

Appointment and dismissal of financial regulators and of the boards of their authorities is related to questions regarding the independence of the regulatory authority. In order to be able to supervise the markets effectively, financial regulators need to be as independent as possible from government. Therefore, some jurisdictions, but not all, appoint their regulators and/or the board members of the regulatory authority for a given amount of time, during which they cannot be dismissed.[118] Members of the Board of Governors of the Federal Reserve System, for example, are appointed by the President with approval of the Senate for a set term of 14 years.[119] This raises other accountability concerns—if the regulators and/or the board members of the authority cannot be dismissed, what other mechanisms can be applied in order to keep them accountable and make sure that they promote the public welfare? Part of the solution relates to the composition of the supervisory board and the executive personnel inside the financial regulatory authority. In other words, the type of people appointed to sit on the board of the financial regulatory authority and their position in life has an effect on questions relating to accountability.

With regards to who can be appointed, in domestic corporate law, as well as under the OECD Principles, there are usually no restrictions or particular personnel requirements. By contrast, the OECD SOE Guidelines include the general statement that all board members "should be nominated based on qualifications and have equivalent legal responsibilities."[120] Exceptions to this general starting point exist for disqualified persons, typically someone who had been responsible for a criminal bankruptcy.[121] There can also be specific requirements for specific industries, for example, in some countries financial regulation provides special appointment rules for boards of banks and other financial firms.[122] In corporate law, it is not seen as a problem to appoint someone as a director who, later on, may have a conflict of interest for some of the board resolutions; indeed, it is fairly common that directors sit on the boards of multiple companies. Rather, the intervention takes place once a conflict of interest arises. According to the provision of the OECD Principles on related-party transactions, for example, "members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation."[123]

The situation for regulators or for the people sitting on the board of the regulatory

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Germany, p. 42, with the U.K., p. 104).

118. Country reports in GROUP OF 30, *supra* note 12 (country reports); William Howard Taft, *Boundaries Between the Executive, the Legislative and the Judicial Branches of the Government,* 25 YALE L.J. 599, 608 (1916); Lisa Schultz Bressman & Robert B. Thompson, *The Future of Agency Independence,* 63 VAND. L. REV. 599, 600 (2010); Aziz Z. Huq, *Removal as a Political Question,* 65 STAN. L. REV. 1, 3–5 (2013); Peter Conti-Brown, *The Institutions of Federal Reserve Independence,* 32 YALE J. REG. 257, 258–61 (2015).

119. 12 U.S.C. § 241 (2015).

120. OECD SOE GUIDELINES, *supra* note 110, Recommendation VII.C.s.2.

121. This is usually discussed within the wider context of creditor protection. *See, e.g.*, KRAAKMAN ET AL., *supra* note 89, at 130.

122. *See, e.g.*, Directive 2013/36/EU 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, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, art. 91, 2013 O.J. (L 176) (restricting the number of directorships a director may hold as well).

123. OECD PRINCIPLES, *supra* note 110, princ. II.F.2. There are also conflict of interest provisions for shareholders, see *id.* princ. III.C (stating that "[i]nstitutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments").

authorities is quite similar, as some countries do allow directors to sit on more than one board as long as they have the general qualifications (and sometimes not even that).[124] In fact, in some countries, the situation is so intertwined that from an economic point of view, the structure of the financial regulatory authorities is questionable, as it removes their independence and makes them more vulnerable to political interference due to the fact that politicians sit on the board of directors of most supervisory authorities.

France is a good example of an intertwined system because it has many regulatory authorities and the members of their boards usually sit on more than one board. For example, the Director General of the Treasury, which is part of the Ministry of Economy, Finance and Industry (MINEFI)—the French body responsible for the issuance and approval of new financial regulation—is also a member of the governing boards of the prudential supervisor (the CB), the authority which is entrusted with licensing banks and insurance companies (CECEI), and the insurance supervisory authority (CEA). A commissioner is also provided by the government to sit on the boards of the insurance systemic supervisory authority (the ACAM) and the authority which supervises and regulates the public's savings (AMF). The governing board of the prudential supervisory authority, the Banking Commission (CB), comprises the head of the central bank, the finance minister, the head of the ACAM, and four members who are appointed by the treasury. The governing board of the committee of Credit Institutions and Investment firms (CECEI), which is responsible for licensing credit providers, comprises the head of the central bank, a Ministry of Finance commissioner, the head of the securities authority (AMF), the head of the deposit guarantee authority (FGD), and eight other members appointed by the Treasury. The commissioner of the central bank (BDF) also sits on the board of the Insurance and Mutual Societies Supervisory Authority (ACAM) which is the main French insurance supervisor.[125] Coordination between the authorities is maintained mainly through the Board of Financial Sector Authorities (CACESF), which is basically a committee of supervisors consisting of the heads of the Bank of France (BDF), the Financial Markets Authority (AMF), and the Insurance and Mutual Societies Supervisory Authority (ACAM).[126] This situation weakens the independence of the financial regulatory authorities and increases the political influence over them.

What follows from these similarities and differences between corporate governance and financial regulatory authorities for the normative question of whether the latter can draw on models of the former? We have seen that, at least in some jurisdictions, it is relatively straight-forward to dismiss members of the board of directors. Yet, for financial regulatory authorities, the BCBS and IAIS Principles favor restrictions on the possibility of dismissal;[127] indeed, given the need to protect the independence of financial regulators, we caution against rules for dismissal without cause.

As a point of similarity, we have seen that, in general, neither of the two fields of law restrict the person to be appointed or the number of positions any individual can hold. However, there are some restrictions according to the specific corporate governance rules for financial firms, in particular with regards to the personal characteristics of board

124. On skill requirements for the appointment to the governing body of financial regulatory authorities in some countries, see Seelig & Novoa, *supra* note 8, at 13. For a specific example from the U.S., see *infra* Part IV.B.

125. GROUP OF 30, *supra* note 12, at 98–100 (country reports).

126. *Id.*

127. *See supra* Part II.

members and the number of directorships per person. These rules should guide the appointments of financial regulators: for instance, given the problems outlined above (e.g., in France), we would recommend reducing the number of financial regulatory authorities in one jurisdiction and free their boards from political intervention, for example by prohibiting the nomination of politicians to the boards of the financial regulatory authorities.

Another issue is how to incentivize regulators to regulate in times where it may come at personal cost to them. If we take the financial crisis of 2008 as an example, we find that regulators hesitated to intervene when the market was burgeoning.[128] In such a situation it is extremely difficult for a regulator to regulate against the industry as they may be accused of hampering or destroying business. In some cases, especially where the regulator's term is not set in advance, they may even lose their job and be subject to public criticism. It is understandable that under these circumstances the regulator might be reluctant to step in and intervene. Yet, the public good demands that the regulator will take on personal risks in exactly these cases.

While some of the academic literature on financial regulatory authorities discusses the topic of setting the right incentives,[129] we suggest that important lesson can be learned from corporate governance examples. Some have argued that compensation arrangements granted to corporate managers can mitigate agency problems by encouraging risk-taking behaviors and providing incentives to optimize the long-term performance of the firm.[130] An analogy can be drawn to financial regulators as, in the aforementioned scenario, we would like to incentivize the regulator to take on more risk and regulate according to the public welfare.[131] One could consider compensating regulators who are dismissed by the politicians from the regulatory authority following their regulatory actions: for instance, a sort of "golden parachute," this may pay for their temporary unemployment—and, if this lasts until their retirement age, to install some sort of voluntary early retirement mechanisms for regulators who take on the risk and regulate against the public and political opinion of the time.[132] Adopting such a mechanism might help to reduce regulatory capture,[133] as it decreases the regulator's dependency on the regulated firms.

### *B. General Board Composition*

Another organizational question is whether there are rules about the ideal general

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128. FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES XVIII (2011).

129. *See supra* Part II (reviewing the academic public literature on institutional design of financial regulatory authorities).

130. Samuel R. Gray & Albert A. Cannella, *The Role of Risk in Executive Compensation*, 23 J. MGMT 517, 517–18 (1997). *See also supra* Part III.B (comparing governing of financial regulatory authority and corporate governance).

131. To be sure, one has to be aware of the fact that this solution might increase moral hazard problems. *Cf.* Bengt Holmstrom, *Moral Hazard and Observability*, 10 BELL J. ECON. 74 (1979). Therefore, some external observability mechanism is needed to make sure that the right regulatory decisions are accepted.

132. An analogy in corporate governance are "golden parachutes"; yet, it is controversial how they affect shareholder value, see e.g. Lucian Bebchuk et al., *Golden Parachutes and the Wealth of Shareholders*, 25 J. CORP. FIN. 140 (2014).

133. *See also supra* Part III.A.1 (discussing the differences between private sector firms and public institutions).

composition of the board of directors. In corporate law, three themes are frequently discussed. First, in some two-tier countries,[134] some members of the supervisory board are appointed by the company's employees. Details are very diverse, for example as regards the percentage of employee representatives on this board,[135] while the OECD Principles only refer to such participation at a general level.[136] There are also suggestions for other models. The UK government currently considers introducing forms of employee and stakeholder involvement without imposing mandatory board participation.[137] There is also the interesting proposal of wider stakeholder representation through "stakeholder councils" with representatives from employees, consumers, suppliers and the general public.[138]

Secondly, today it is widely suggested that public companies should have a good number of independent non-executive directors on the board, possibly even a majority. In most, though not all, countries, independence is defined in a way that these directors should neither be executives of the company nor have any linkages to the company's shareholders.[139] Independent directors play a crucial role for cases where conflicts of interests arise. The OECD Principles therefore state that "[b]oards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest."[140] A related point is whether the CEO can also be the chairman of the board. While some companies (and countries) favor such a system with a strong leader,[141] most corporate governance codes recommend a split, as do the OECD SOE Guidelines, suggesting that "[g]ood practice calls for the Chair to be separate from the CEO."[142]

Thirdly, there is also the trend to encourage (or possibly to regulate) greater board diversity, for example, in terms of gender diversity. The OECD Principles only have the cautious statement that "[b]oards should regularly carry out evaluations to appraise their performance and assess whether they possess the right mix of background and competences."[143] The OECD SOE Guidelines have two general references to board

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134. *See also supra* Part III.B.1.

135. For an overview, see *Board Level Representation*, EUR. TRADE UNION INST., www.worker-participation.eu/National-Industrial-Relations/Across-Europe/Board-level-Representation2 (last visited Sept. 10, 2018).

136. OECD PRINCIPLES, *supra* note 110, princ. IV.C.2 ("Mechanisms for employee participation should be permitted to develop.").

137. DEP'T FOR BUS., ENERGY, & INDUS. STRATEGY, CORPORATE GOVERNANCE REFORM: THE GOVERNMENT RESPONSE TO THE GREEN PAPER CONSULTATION 26–27 (2017), https://www.gov.uk/government/consultations/corporate-governance-reform (follow the "Corporate governance reform: government response" hyperlink).

138. Shann Turnbull, *A Sustainable Future for Corporate Governance Theory and Practice*, 9 CORP. GOVERNANCE 347 (2012).

139. For a recent comparison, see INDEPENDENT DIRECTORS IN ASIA: A HISTORICAL, CONTEXTUAL AND COMPARATIVE APPROACH (Harald Baum et al. eds., 2017).

140. OECD PRINCIPLES, *supra* note 110, princ. VI.E.1 (referring to examples of "ensuring the integrity of financial and non-financial reporting, the review of related party transactions, nomination of board members and key executives, and board remuneration").

141. Notably, this has traditionally been the case in France. *See* Benjamin Mojuyé, *French Corporate Governance in the New Millennium: Who Watches the Board in Corporate France*, 6 COLUM. J. EUR. L. 73 (2000).

142. OECD SOE GUIDELINES, *supra* note 110, Recommendation VII.F, second sentence.

143. OECD PRINCIPLES, *supra* note 110, princ. VI.E.4.

diversity.[144] Some domestic corporate laws and corporate governance codes provide more details, with some suggesting a certain minimum ratio of female board members to male (such as 1/3 or 1/2).[145]

For financial regulatory authorities, questions regarding the composition of the board are also of great significance, though with some different focal points. Some (but not all) regulatory authorities are instructed by law to include directors from diversified backgrounds on their boards. If we take the Board of Governors of the Federal Reserve System for example, the U.S. law specifically demands that:

> In selecting the members of the Board, not more than one of whom shall be selected from any one Federal Reserve district, the President shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country. In selecting members of the Board, the President shall appoint at least 1 member with demonstrated primary experience working in or supervising community banks having less than $10,000,000,000 in total assets.[146]

This type of board composition insures that the regulatory authority has the capabilities to cater to all banks, large or small, in the U.S. banking system, and that all interests are represented on the board.

With regard to the independence of directors and executive personnel of financial regulatory authorities, the main concern is the relationship to the government. If the government influences their appointment, their independence might be questionable, as would their ability to make decisions favorable to the public's general welfare when pitted against the government's wishes.[147] Thus, in these circumstances, the decision about appointment is not primarily about delegating power but entrusting someone who is even more committed to the task of the institution than the principal.[148] Consequently, the question of who decides on the budget of the organization is of particular importance because if the regulatory authority depends on the government for budgetary approval, its independence is damaged; separating the budget of the regulatory authority from government is therefore highly recommended.[149]

Another topic related to the appointment of senior executives refers to restrictions on appointments of financial regulatory authorities' personnel. Many jurisdictions have post-employment restrictions on employees of financial regulatory authorities, usually in the form of cooling-off periods, which restrict them from working for the supervised industry after leaving office (discussed in the next Part). Some jurisdictions also have cooling-off periods for people entering the regulatory authority from the private sector. For example, under the Obama administration, the U.S. set a two-year cooling-off period under which

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144. OECD SOE GUIDELINES, *supra* note 110, Recommendations II.F.2 and VI.A.5

145. *See generally* Siri Terjesen et al., *Legislating a Woman's Seat on the Board: Institutional Factors Driving Gender Quotas for Boards of Directors*, 128 J. BUS. ETHICS 233 (2015).

146. 12 U.S.C. § 241 (1933).

147. Neal Devins & David E. Lewis, *Not-So Independent Agencies: Party Polarization and the Limits of Institutional Design*, 88 B.U. L. REV. 459, 469–77 (2008); Peter L. Strauss, *The Place of Agencies in Government: Separation of Powers and the Fourth Branch*, 84 COLUM. L. REV. 573, 587–91 (1984). *See also* Hanretty & Koop, *supra* note 18.

148. For this distinction, see Giandomenico Majone, *Two Logics of Delegation: Agency and Fiduciary Relations in EU Governance*, 2 EUR. UNION POL. 103–04 (2001).

149. For further details on this point see *infra* Part IV.D.

all employees entering the public sector are not allowed to work on anything related to their previous positions in the private sector.[150]

What recommendations can be drawn from corporate governance for financial regulatory authorities for the issues related to the composition of the board or equivalent positions? To some extent, we see that different issues are at stake. Only for financial regulators, the relationship to the supervised industry is of crucial importance, thus leading to the restrictions discussed in the previous paragraph, while such rules do not exist for companies.

Yet, as we have seen, a somewhat parallel situation is the enhanced role of independent directors in cases where some of the other directors cannot vote due to a conflict of interest. Beyond this specific point, we suggest that the role of independent directors is a topic where financial regulatory authorities can learn from corporate governance. The purpose of independent directors is to strengthen the checks and balances within the organization—an insight that can also be applied to financial regulatory authorities. The academic literature has shown that it can be advantageous for a financial regulatory authority to have a "strong CEO";[151] here too however, it is worth referring to the recommendation of most corporate governance standards that the CEO and the chairman of the board should be two people. Thus, we submit that the top personnel also needs to be embedded in a system of checks and balances.

There are also lessons to be learned from the general trends to ensure board diversity in corporate governance. We suggest financial regulatory authorities should also consider having rules which institutionalize inclusive governance, for example, through forms of employee participation. The specific idea of including societal actors as part of the board of government institutions has already been raised in the general academic literature about public services.[152] As mentioned previously, a core element of a well-functioning governmental institution is the accountability of the bureaucrats working in those institutions.[153] Such accountability can be reached by direct societal participation. In the case of financial regulatory authorities, having public representatives from a wide range of stakeholders (not only employees but, depending on the authority, also customers of financial products, legal experts, traders, etc.)[154] sit on the governing board might help increase the accountability of the other directors. In addition, it is highly recommended that a public committee appoints the regulators, which should include experts as well as public representatives.

### *C. Other Relevant Persons and Bodies*

While the board of directors (or the two boards in a two-tier system) is a fixed point in corporate governance, other persons and bodies also play an increasingly important role. This is partly due to changes at firm level, but partly also due to the provision of binding

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150. Exec. Order No. 13490, 3 C.F.R. § 13490 (2010).

151. Enriques & Hertig, *supra* note 34, at 366–69.

152. *See, e.g.*, Samuel Paul, *Accountability in Public Services: Exit, Voice and Control*, 20 WORLD DEV. 1047, 1048 (1992); John Ackerman, *Co-Governance for Accountability: Beyond "Exit" and "Voice*,*"* 32 WORLD DEV. 447 (2004).

153. Ackerman, *supra* note 152, at 448 and *supra* Part II (discussing accountability of bureaucrats).

154. *See also* Seelig & Novoa, *supra* note 8, at 13 (finding that at present it is mainly insurance supervisors who have industry representatives on their boards).

or non-binding general rules.

In public companies, it is now relatively common to have at least some board committees. The rationale behind these committees is that they can enable a system of checks and balances and that the members of these committees may have special expertise for the tasks of the respective committee. There is a wide range of committee topics prevalent in practice and discussed in the literature, such as, audit, nomination, remuneration (compensation), executive, planning (strategy), internal control (corporate governance; appeals), corporate social responsibility (CSR; ethics; environmental), finance (investment), and compliance committees.[155]

The OECD Principles also suggest that boards should set up committees, in particular with respect to audit, risk management and remuneration, whereby "their mandate, composition and working procedures should be well defined and disclosed by the board."[156] Considering specific laws, for example, in the EU, audit committees are required for listed companies, remuneration committees are recommended on a "comply-or-explain" basis, while the establishment and operation of other committees (say, for CSR) are left to the companies.[157]

Financial regulatory authorities have some committees, but there is no uniformity as not all regulatory authorities are created equal. For example, the Federal Reserve has the following committees: Committee on Board Affairs, Committee on Consumer and Community Affairs, Committee on Economic and Financial Monitoring and Research, Committee on Financial Stability, Committee on Federal Reserve Bank Affairs, Committee on Bank Supervision, Subcommittee on Smaller Regional and Community Banking, and a Committee on Payments, Clearing, and Settlement.[158] Other financial regulatory authorities, in contrast, do not have committees at all.[159] Note that none of the committees of the Federal Reserve deals with the Fed itself. Rather, most existing committees are coordinating committees, which are established in order to increase coordination and cooperation between a few different regulatory authorities. Such committees may deal with systemic risk in the local market and regulated institutions that are too big to fail[160] or with data transmission between the authorities.[161]

In corporate law, apart from audit committees, lawmakers have also turned their attention to the auditing of companies more generally. The main focus is on external

155. *See generally* Philip Stiles, *Board Committees*, *in* THE OXFORD HANDBOOK OF CORPORATE GOVERNANCE 177 (Mike Wright et al. eds., 2013); HEIDRICK & STRUGGLES, TOWARDS DYNAMIC GOVERNANCE 2014: EUROPEAN CORPORATE GOVERNANCE REPORT, 17–22 (2013), www.heidrick.com/~/media/Publications%20and%20Reports/European-Corporate-Governance-Report-2014-Towards-Dynamic-Governance.pdf (including some data on committees in practice).

156. OECD PRINCIPLES, *supra* note 110, princ. VI.2. *See also* OECD SOE GUIDELINES, *supra* note 110, Recommendation VII.H.

157. Council Directive 2014/56/EU, art. 39, 2014 O.J (L 158) (EC) 196; Commission Recommendation 2005/162/EC, 2005 O.J (L 52) (EC) 54.

158. *Board of Members*, FED. RES., www.federalreserve.gov/aboutthefed/bios/board/default.htm.

159. *See* GROUP OF 30, *supra* note 12 (noting financial regulatory authorities that do not utilize committees).

160. For example, the Financial Stability Committee in Mexico, which is formulated when a financial institution is "too big to fail." GROUP OF 30, *supra* note 12, at 81. It comprises representatives from the CNBV, IPAB, the Bank of Mexico, and SHCP. *Id.* This mechanism exists although it has never been tested in reality. *Id.*

161. For example, the Italian Financial Stability Committee's (FSC) main task is to enable the smooth transfer of information between the authorities in order to prevent and mitigate a future financial crisis. *Id.* at 111. Each of the authorities established a unit which is tasked with supporting the work of the FSC if and when required. *Id.*

auditing with a tendency to provide detailed rules following recent scandals concerning both companies and the audit profession.[162] The OECD Principles also address external auditors, stating that they "exercise due professional care in the conduct of the audit," and that the annual audit by "an independent, competent and qualified, auditor" should insure that "the financial statements fairly represent the financial position and performance of the company in all material respects."[163] The OECD SOE Guidelines provide a similar statement but also mention internal audit procedures monitored by the board and the audit committee.[164]

Finally, for listed companies in particular, outside persons and bodies play a role in matters of the company. In this respect, the OECD Principles recommend that persons such as proxy advisors, analysts, brokers, and rating agencies should "disclose and minimize conflicts of interest that might compromise the integrity of their analysis or advice."[165] Regulatory details go beyond questions of corporate governance and can often be found in rules of securities regulation, for example, as regards duties of financial analysts and rating agencies.[166]

As already mentioned, one of the most pertinent questions for financial regulatory authorities is who shall regulate the regulators.[167] This goes back to problems of monitoring and accountability. The survey by Seelig and Novoa reports that the majority of financial regulatory authorities use both internal audits and external audits (conducted by either private audit firms or government auditors).[168] Auditing of financial regulatory authorities may also be done incidentally while reviewing the country for preparation of country reports by international organizations such as the International Monetary Fund, the World Bank, and the OECD.[169]

Still, the literature suggests that there is often a lack of regular and consistent monitoring of the structure of financial regulatory authorities and of the conduct of the financial regulators themselves. Thus, Barth et al. propose the remedy of an independent "Sentinel" whose task would be to monitor financial regulatory authorities on a regular basis.[170] Yet, creating a new body is unlikely to solve the problem of monitoring and accountability as it may simply shift the problem to the question "[w]ho will watch over the Sentinel?"[171]

This leads us again to the possible lessons that can be learned from corporate governance for financial regulatory authorities. To start with, we recommend that financial regulatory authorities should have audit committees to monitor their work. In addition, and as far as our recommendation to detach the regulatory authority's budget from the state's

162. *See, e.g.*, Hatice Kubra Kandemir, *The EU Law on Auditing and the Role of Auditors in the Global Financial Crisis of 2008*, 10 INT'L J. DISCLOSURE & GOVERNANCE 213 (2013).

163. OECD PRINCIPLES, *supra* note 110, princs. V.D, C.

164. OECD SOE GUIDELINES, *supra* note 110, Recommendation VII. *See also* OECD PRINCIPLES, *supra* note 110, princ. VI.B (for external auditing).

165. OECD PRINCIPLES, *supra* note 110, princ. D.

166. *See, e.g.*, NIAMH MOLONEY, EU SECURITIES AND FINANCIAL MARKETS REGULATION 634–98 (2nd ed. 2014).

167. *See supra* Part I.

168. Seelig & Novoa, *supra* note 8, at 20.

169. *See, e.g.*, *Reports on the Observance of Standards and Codes (ROSCs)*, IMF (Jan. 3, 2018), www.imf.org/external/NP/rosc/rosc.aspx.

170. BARTH ET AL., *supra* note 26.

171. ARMOUR ET AL., *supra* note 23, at 570.

and make it financially independent is accepted, we also recommended creating remuneration (compensation) committees that decide on the remuneration scheme for the top bureaucrats inside the financial regulatory authorities.

Trends in corporate governance exemplify the need for the external monitoring of organizations. In our view, a model of peer review is a possible option. It could be implemented in a way that the government asks similar sector regulators from other countries with expertise in the questions under investigation[172] to conduct such a peer review. The implementation of such a procedure can take some inspiration from Romano's suggestion for a peer review mechanism in the Basel framework of banking regulation.[173] In the E.U., it could also be linked to the "open method of coordination" among authorities.[174] Moreover, an analogy to companies is possible because, in an increasingly interconnected world, many large multi-national corporations are subject to scrutiny by more than one supervisory authority; thus, there is already some acceptance of the involvement of foreign authorities.

Another relevant concern when dealing with financial regulatory authorities relates to its former employees. Here, two types of problems might occur: first, it is a common practice that regulatory authorities hire former employees to provide them with external opinions after their term with the regulatory authority is over. Sometimes these former employees are already consulting other firms on the market. This might create a conflict of interest and render their opinions biased. Second, former employees might switch sides and start working for the industry on issues which they have previously dealt with inside the regulatory authorities.[175] If these issues have not yet been completed, such as a regulation which is still in draft stages, switching sides and representing the industry in the regulatory process might hurt the public interest as the former regulator has been armed with backstage information, which might assist him in sabotaging the regulation.

It is for this reason that some jurisdictions impose restrictions on former regulators with regards to their post-employment.[176] Such rules can therefore be seen as implementing the recommendation of the BCBS, IOSCO, and IAIS Principles to avoid conflict of interests.[177] We suggest that they can also be supported by an analogy to the situation in corporate governance and the corresponding rules of securities regulation, which show that a sound legal framework not only requires good rules for the core bodies of the company (board, shareholders, etc.) but also other relevant persons in the wider sphere of the corporations, such as analysts and advisors.

### *D. Powers and Responsibility of Boards*

The starting point of most corporate laws is that the board of directors has a wide

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172. In some circumstances, this may mean that the other regulator would need to belong to a country of the same legal tradition (e.g., both being common law countries).

173. Roberta Romano, *For Diversity in the International Regulation of Financial Institutions: Critiquing and Recalibrating the Basel Architecture*, 31 YALE J. REG. 1, 30 (2014).

174. *See generally Glossary of Summaries*, EUR-LEX, http://eur-lex.europa.eu/summary/glossary/open_method_coordination.html (last visited Sept. 13, 2018).

175. *See generally*, Sophie A. Shive & Margaret M. Forster, *The Revolving Door for Financial Regulators*, 21 REV. FIN. 1445 (2017) (empirically examining the situation in the US).

176. In Canada, both scenarios are addressed. *See* Conflict of Interest Act, S.C. 2006, c 9, s 2, art 34(1)–(2) (Can.).

177. *See supra* Part II.

range of powers. For example, the OECD Principles provide that the board should fulfill certain key functions listing a number of non-exhaustive items.[178] In the OECD SOE Guidelines the powers are phrased in a general way that boards "should be assigned a clear mandate and ultimate responsibility for the enterprise's performance" and that details should be defined in legislation.[179]

A limitation of the power of boards is the need for shareholder approval in a restricted number of circumstances. For example, the OECD Principles refer to "fundamental corporate changes" such as amendments to the company's articles of association.[180] As far as shareholders are competent, shareholders can, generally speaking, use their voting power without any restrictions, but there is also a growing debate about the acceptance of shareholders' duties.[181] For SOEs in particular, the OECD SOE Guidelines go further in stating that "the state should act as an informed and active owner" and that it should also ensure transparency and accountability.[182]

For financial regulatory authorities, the situation is again more complicated. The powers of the regulatory authority are usually dictated by law. However, with regards to their functions and guidelines, the abundance of regulatory authorities in different jurisdictions creates a wide range of standards. This is evident in setting the goals of the authority. For some financial regulatory authorities, the organizational goals of the authority are clearly dictated by law, while for others the law is silent and goals are provided in the strategic plans or annual working programs.[183]

As long as the board of directors is competent, most corporate laws do not allow the shareholders of public companies to intervene in the decisions of the directors.[184] The independence of the directors in the day-to-day running of the company is often seen as a legal advantage of the company.[185] The OECD Principles therefore state that "the board should be able to exercise objective independent judgement on corporate affairs."[186] The OECD SOE Guidelines are explicit that independence is also related to independence from the state as a shareholder: "the government should allow SOEs full operational autonomy to achieve their defined objectives and refrain from intervening in SOE management" and "the state should let SOE boards exercise their responsibilities and should respect their independence."[187] In some civil law countries, a set of codified rules on corporate groups addresses the similar point that the parent company needs to respect the autonomy of the

178. OECD PRINCIPLES, *supra* note 110, princ. D.

179. OECD SOE GUIDELINES, *supra* note 110, Recommendation VIII.A.

180. OECD PRINCIPLES, *supra* note 110, princ. II.B.

181. *See supra* Part III.B.i (detailing requirements of transparency).

182. OECD SOE GUIDELINES, *supra* note 110, Recommendation II. This can also be associated with the growing use of shareholder stewardship codes. *See* Mikko Rajavuori, *Governing the Good State Shareholder: The Case of the OECD Guidelines on Corporate Governance of State-Owned Enterprises*, 29 EUR. BUS. L. REV. 103 (2018) (analyzing and comparing the Stewardship Code with the SOE guidelines).

183. Jabotinsky, *supra* note 87.

184. *See* SIEMS, *supra* note 92, at 152–55 (also for the exceptional position of Chinese corporate law).

185. *E.g.*, Stephen Bainbridge, *Preserving Director Primacy by Managing Shareholder Interventions*, *in* RESEARCH HANDBOOK ON SHAREHOLDER POWER 231 (Jennifer G. Hill & Randall S. Thomas eds., 2015). It can also be related to the separation of ownership and control as famously identified by ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

186. OECD PRINCIPLES, *supra* note 110, princ. VI.E.

187. OECD SOE GUIDELINES, *supra* note 110, Recommendations II.B and II.C.

subsidiary.[188]

For public bodies in general, a distinction should be made between two cases: delegation of power where the agent simply has to comply with all of the principal's instructions; and delegation to appoint an independent agent who is detached from the principal.[189] The latter situation applies to financial regulatory authorities. As explained in the previous part, their independence is essential to allow regulators to make professional decisions that serve the public's interest, without any political concerns. In particular, dependence on politicians for budgetary approval or any other need, might interfere with the regulators' strategic, long-term thinking, and force them to calculate their moves based on short-term political constraints.

Another important question of corporate governance is how directors should use their discretion. The OECD Principles state, on the one hand, that "board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders," while on the other hand the board should also "take into account the interests of stakeholders."[190] These statements reflect a widespread position of many corporate laws. To start with, there are general duties of directors, often phrased as fiduciary duties.[191] The interests of shareholder play a role but there is no pure notion of "shareholder primacy" which directors have to follow. Rather, they have to consider the interests of the company as a whole, also with the possibility of taking into account the interests of employees and other stakeholders.[192]

The OECD SOE Guidelines go further in emphasizing the wide responsibility of SOEs and their boards. They make it clear that the "state exercises the ownership of SOEs in the interest of the general public" and that the ultimate purpose of these companies "should be to maximize value for society."[193] Correspondingly, it is said that boards of directors of SOEs should "effectively carry out their functions of setting strategy and supervising management, based on broad mandates and objectives set by the government."[194] This means that the directors should implement the public purpose for which the SOE was established. As far as SOEs undertake economic activities, they should ensure that there is fair competition and a level playing field in the marketplace.[195]

With regards to financial regulatory authorities, this touches on one of the interesting points regarding their roles—should sector regulatory authorities, in our case financial regulatory authorities, take into account other considerations, such as promoting or maintaining competition in the markets, considering environmental consequences of their regulatory instructions, narrowing social gaps, etc.[196] The answer to this question is

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188. E.g., in Germany. For a comparison, see Klaus J. Hopt, *Groups of Companies: A Comparative Study of the Economics, Law, and Regulation of Corporate Groups*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 603 (Jeffrey Gordon & Wolf-Georg Ringe eds., 2018).

189. *See* Majone, *supra* note 148 (detailing delegation guidelines in EU governance); *supra* Part IV.B.

190. OECD PRINCIPLES, *supra* note 110, princ. VI.A, VI.C.

191. CARSTEN GERNER-BEUERLE ET AL., STUDY ON DIRECTORS' DUTIES AND LIABILITY, EUROPEAN COMM'N (2013), http://eprints.lse.ac.uk/id/eprint/50438 (click on "Download" link for PDF).

192. For the debate, see, e.g., Jonathan Mukwiri, *Myth of Shareholder Primacy in English Law*, 24 EUR. BUS. L. REV. 217 (2013). The role of stakeholders in corporate governance is also addressed in OECD PRINCIPLES, *supra* note 110, princ. IV and OECD SOE GUIDELINES, *supra* note 110, Recommendation V.

193. OECD SOE GUIDELINES *supra*, note 110, Recommendations I, I.A.

194. *Id.* Recommendation VII.B.

195. *Id.* Recommendation III.

196. Maher M. Dabbah, *The Relationship Between Competition Authorities and Sector Regulators*, 70

unclear. In some cases, the law specifically demands that the regulators take into account other objectives, while in other cases the law is silent on this point.

What normative lessons can be drawn from corporate governance for financial regulatory authorities with regards to these topics of powers and responsibilities? We have seen that in corporate governance, there are precise rules that determine the powers of the board of directors and the shareholders. With regards to financial regulatory authorities, it is clear that the government should respect their independence. Apart from this general position, which is also supported by the literature and the BCBS, IOSCO, and IAIS Principles,[197] there is a lack of clarity about the precise details of this relationship. Thus, we suggest that analogous rules as in corporate governance would be helpful: stating that regulators act independently while also clarifying the limits of their powers in relation to the government, for example.

With respect to the budget of the financial regulatory authority, it is highly recommended to keep the budget of the authority separate from the state budget and instead fund its activities from fees levied on the regulated industry. The preference for fee-based funding is in line with the position of the Financial Stability Board.[198] For details about the relationship between the state and the regulatory authority, the best parallel in corporate law is the situation of corporate groups. In codifications of the law of groups of companies (or else, in case law dealing with such scenarios), it is made clear that despite the group structure, the parent company and the subsidiary are separate legal entities. This means that their finances need to be kept strictly separate and transfer payments are only possible under restricted circumstances. We suggest that such rules could be well transferred to the relationship between the government and financial regulatory authorities.

Finally, this section addressed the topic of directors' duties in corporate law. Here too, analogies are possible for financial regulators as they can be said to be subject to duties of care and loyalty. As in corporate governance, there are cases where it becomes relevant how far passivity, say a lack of monitoring by the top personal of the regulatory authority, can lead to corresponding breaches of duty. Moreover, as the direction of directors' duties is increasingly understood to include considerations of the public interest and stakeholders, it is clear that financial regulatory authorities also serve the public's interest (as often explicitly stated for SOEs).[199] This precept does not allow the financial regulatory authority to circumvent their main obligations, for example, to impose a fine in case of misconduct. However, in the practice of any complex organization, be it a large company or a financial regulatory authority, many decisions cannot only be based on simple bright-line rules: thus, as there are degrees of discretion,[200] there is also the corresponding need of the law to provide guidance.

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CAMBRIDGE L. J. 113, 117 (2011).

197. *See supra* Part II.

198. *Id.*

199. In addition, and different from companies, they are also obliged to comply with specific public law requirements, such as the principle of proportionality, being accepted in most countries though with variations in detail. *See, e.g.*, PROPORTIONALITY: NEW FRONTIERS, NEW CHALLENGES (Vicki C. Jackson & Mark Tushnet eds., 2017).

200. Similar: ARMOUR ET AL., *supra* note 23, at 570–71 ("constraining discretion").

### *E. Transparency of Objectives and Operations*

The objectives of a company are usually specified in the articles of association and, therefore, are transparent to the public through commercial registers. The OECD Principles also state that disclosure should include material information on the company's objectives.[201] However, in practice, corporate laws and registers often allow wide objectives in order to facilitate the operation of companies in changing economic conditions.[202] Stricter standards may be necessary for SOEs. According to the OECD SOE Guidelines, an ownership policy has to include information about, for example, the rationales for state ownership and the responsible persons implementing this policy.[203] Correspondingly, it is then also said that the "government as a shareholder should avoid redefining SOE objectives in a non-transparent manner."[204]

Turning to further transparency obligations, there are some circumstances where shareholders can obtain specific pieces of information: in the run-up to the general meeting through the agenda and the accompanying documents, and in many countries at the general meeting through the opportunity to ask questions to the directors.[205] In return, as a more recent development, there may be some disclosure obligations for shareholders, specifically for institutional investors. For example, according to the OECD Principles, "[i]nstitutional investors acting in a fiduciary capacity should disclose their corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights."[206]

Public transparency obligations of companies listed on a stock exchange are usually based on rules of securities law, following the rationale that effective disclosure fosters capital market's pricing mechanism and allocation of capital. Most of these obligations concern regular disclosure, for example, through annual reports. In addition, most securities laws require companies to provide "ad-hoc" disclosure of major events. Typically, today, all of this information is available online, for example, on the website of the stock exchange, the supervisory authority and/or the company.[207]

Despite their focus on corporate (not securities) law, the OECD Principles include some statements that refer to public transparency obligations. For example, it is said that it should be ensured that "timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company," and that "channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users."[208] According to the OECD SOE Guidelines too, SOEs "should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance

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201. OECD PRINCIPLES, *supra* note 110, princ. V.A.2.

202. There is also some variation between countries. *See, e.g.,* ANDREAS CAHN & DAVID C. DONALD, COMPARATIVE COMPANY LAW: TEXT AND CASES IN THE LAWS GOVERNING CORPORATIONS IN GERMANY, THE U.K., AND THE U.S.A. 150–57 (2d ed. 2018) (discussing incorporation procedures and liability for transactions).

203. OECD SOE GUIDELINES, *supra* note 110, Recommendation I.B.

204. *Id.* Recommendation B.s.2.

205. *E.g.* in OECD PRINCIPLES, *supra* note 110, princs. II.A.3, II.C.3.

206. *Id.* princ. III.A. *See also supra* Part III B.2.i.

207. *See, e.g.*, Christof Beuselinck et al., *Financial Reporting, Disclosure, and Corporate Governance*, *in* THE OXFORD HANDBOOK OF CORPORATE GOVERNANCE (Mike Wright et al. ed., 2013).

208. OECD PRINCIPLES, *supra* note 110, princ. V.

and auditing standards as listed companies."[209] Furthermore, there is often a disclosure obligation of listed companies to "comply or explain" with the relevant domestic standards of corporate governance. In the OECD Principles too, it is indicated that they should be transparent about the content and the implementation process of any governance code.[210]

As far as financial regulatory authorities are concerned, their disclosure requirements are, at present, much narrower. Some financial regulatory authorities conduct audits on the regulated firms, and those remain confidential. Information about the work of a financial regulatory authority might be found partly on the authority's website—which will usually include the regulations it publishes—or in country reports conducted by international organizations. Other parts of the regulatory work might be exposed during court procedures against the authority. But most of its work remains far from the public's eye.[211]

The academic literature sometimes suggests that financial regulatory authorities need to become more transparent.[212] We propose that rules of corporate governance and, to a lesser extent, securities law, can be a model for the transparency obligations of financial regulatory authorities. To start with, it is recommended to set both the general mandate[213] and the more precise goals of financial regulatory authorities clearly by law. The goals of the authority are highly relevant to its work, for example, with regards to collection of information. If the goals are clearly defined in the founding laws, then employees of the financial regulatory authority collect more relevant information.[214]

Beyond this specific point, more formalized and extensive public disclosure is well overdue for financial regulatory authorities. Exposing parts of the regulatory work to the public is crucial for the regulatory authority's accountability. It is recommended to publish the committee board meetings' agendas or minutes of the regulatory authority. Another important public disclosure relates to the CVs and conflict of interest agreements signed by employees of the regulatory authorities. Such specific recommendations should then also consider whether and how such transparency is implemented for corresponding topics in company and securities law, notwithstanding evident differences.[215]

Furthermore, it is suggested that it would be worth developing a set of international governance rules that financial regulatory authorities should follow on a "comply or explain" basis. So far, it is merely the case that financial regulatory authorities have their own internal codes of conduct[216] and that the BCBS, IOSCO and IAIS Principles contain rudimentary recommendations for the governance of financial regulatory authorities.[217] We suggest going further. The corporate governance standards operating on such a basis are widely seen as a successful model in company and securities law. A similar approach

209. OECD SOE GUIDELINES, *supra* note 110, Recommendation VI.

210. OECD PRINCIPLES, *supra* note 110, princ. V.A.9.

211. For example, the request from U.K. bank regulators to disclose more information about lenders in order to avoid another financial crisis which was raised by Andrew Tyrie, the head of the Treasury select committee. Caroline Binham, *Watchdog Urged to Disclose more Information about Banks*, FIN. TIMES (June 7, 2016), https://www.ft.com/content/5a64bf68-2cb9-11e6-a18d-a96ab29e3c95.

212. ARMOUR ET AL., *supra* note 23, at 567–68; Ferran, *supra* note 14, at 119–21; Enriques & Hertig, *supra* note 34, at 372–78.

213. For the differences in institutional design, see *supra* Part II.

214. *See also* Binham, *supra* note 211.

215. In particular the fact that some of the disclosure obligations of listed companies are due to having publicly traded shares. *See supra* Part III.A and III.B.

216. *See* Seelig & Novoa, *supra* note 8, at 17.

217. *See supra* Part II.

is used elsewhere for quasi-public bodies already, namely with the "Santiago Principles" which are designed to promote good governance, accountability, and transparency for the sovereign wealth funds.[218]

Finally, at present, there are no clear rules on how far regulators and regulatory authorities need to keep governments informed about their affairs, how far governments can demand specific information (say, if they expect misconduct), and how far the government needs to provide information about the regulatory work to the public. By contrast, most corporate laws have clear rules about the "push" and "pull" information flow between directors and shareholders, and there are also some transparency obligations for institutional investors. Thus, here too, we suggest that an analogy is apt for the role of the government as it relates to financial regulators and the regulatory authorities for which they work.

## V. CONCLUSION

Today's codifications of corporate law often provide extensive rules of several hundred pages. Drawing on the experience of corporate governance for the governance of financial regulatory authorities is not meant to suggest that there should be equally extensive codifications. However, it can also be noted that the basic position is similar. While in corporate law codified rules specify some details, companies also have some flexibility to structure the organization of their affairs, for example, through provisions in the articles of association. As regards financial regulatory authorities, lawmakers can (and should) provide a regulatory framework which specifies certain core topics but, within this framework, the regulator also has some flexibility. Thus, in both scenarios, law plays an important role, though it is clear that the legislative micro-management of all details would not be sensible.

The main interest of this Article was to examine the feasibility of applying rules of corporate governance to the governance of financial regulatory authorities. Our main normative suggestions are as follows: (i) reduce the number of financial regulatory authorities in one jurisdiction and free their boards from political intervention, for example, by prohibiting the nomination of politicians to the boards of the financial regulatory authorities; (ii) the budget of the authority should be independent from government both in the way it is funded and in the way it is decided upon; (iii) incentivize regulators to regulate in times of crisis with early retirement mechanisms for regulators; (iv) diversify the board of directors of the regulatory authorities by having public representatives and experts sit on the governing board. Furthermore, we contend that both the directors of the regulatory authority and the regulators themselves should be subject to duties of care and loyalty; (v) we recommend audit and remuneration committees; in addition, peer review by similar sector regulators from other countries should be introduced; (vi) employment of former employees of the financial regulatory authority should be restricted in order to avoid capture and unwanted conflict of interests; (vii) the goals of the financial regulatory authority should be clearly set by law and more formalized and extensive public disclosure of the regulatory work is well over due.

In principle, these suggestions can apply to any financial regulatory authority

218. *See Santiago Principles*, INT'L FORUM OF SOVEREIGN WEALTH FUNDS, www.ifswf.org/santiago-principles (last visited Sept. 10, 2018).

established as an independent body with its own legal personality.[219] This is not to deny that, from a normative perspective, any implementation of these suggestions would also need to consider the precise national and institutional context in question, such as differences in domestic politics and the possible divide between prudential and non-prudential financial regulatory authorities.[220] In addition, it is clear that, from a positive perspective, the implementation of our suggestions may be more or less challenging depending on the precise context.

For future research, it would also be worthwhile to address other lessons that can be learned from good governance standards of one type of organization for another one. Notably, one could ask the reverse of the question posed in this article, namely: what can corporate governance learn from the governance of financial regulatory authorities? We would suggest that this could be fruitful as this article already identified some relevant topics, for example prolonging the appointment periods of members of the board of directors, hardening conflict of interest rules (going further than disclosure and in sometimes even prohibiting board membership due to conflicts of interest), introducing "cooling-off" periods for directors and executives, and introducing peer review mechanisms to discipline the board of directors.

219. *See supra* Part I.
220. *See supra* Part II.