Financial Regulation and Supervision in Corporate Governance of Banks

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This Article discusses and analyzes the role of financial regulation and the state's interference through financial supervision with corporate governance of banks from economic and political perspectives. It suggests that the limits of corporate law and financial regulation cause the state to use financial supervision as the effective tool for such interference. This Article also argues that the stakeholder model cannot legitimize the state's intrusion into the corporate governance of private banks through such non-legal measures as financial supervision. It looks into the alternative mechanisms in corporate law and financial regulation for the enhancement of corporate governance of banks from a comparative perspective.

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I. INTRODUCTION

The CEO of a big bank steps down. The bank has three candidates—A, B, and C—for the available CEO position. A and B have backgrounds as former high-ranking government officials. Only C is from the private sector. Surprisingly, the bank's board of directors—whose majority consists of outside directors—elects C for approval at the shareholders' meeting. A and B withdraw their applications before this happens to save face as well as to record their discord. Then, the government launches a massive scale special audit on the bank. The audit is so intense one bank employee dies from overwork. C resigns. A rumor starts to circulate that some of the outside directors of the bank committed wrongdoings and even criminal acts within their own organizations. Criminal and tax investigations begin to press charges on those outside directors. Eventually, those outside directors step down. People in the media start to talk about the drawbacks of the outside director system and the self-entrenchment of outside directors. The government releases new guidelines for board composition and functions. The bank in question reorganizes its board with new outside directors, apparently all with government backing and endorsement, and the board elects D as the new candidate. D is known to be very close to the President. At the bank's shareholders' meeting, D wins election as the new CEO.

This is what played out within KB Financial Group (KB) in the year 2010,[1] one of the biggest financial holding companies in Korea and once recognized internationally as having robust corporate governance.[2] The company's fate is hard to understand considering the ownership structure of the bank. KB's ownership is dispersed with majority foreign shareholders.[3] The foreign shareholders did not play any role in the bizarre process. Although the Korean Banking Act subjects domestic investors to a ceiling,[4] minority shareholders had no voice. In this scenario, it is hard to expect D to be independent from the government and to serve only the shareholders' or even public interests. Why were the shareholders silent, and what was the practical mechanism behind the story that made this happen? KB's case is not an isolated one by any means—most major Korean banks used to be owned and controlled by the government. Even though banks are now in private hands, they still operate under the heavy guidance and influence of the government for various reasons.[5] As far as the corporate governance of banks is concerned, the government quite often uses non-legal measures to exercise its power. The KB case dramatically shows the role of the government in bank corporate governance. The case also illustrates how the outside director system plays a confusing role in the process.

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1. *See* Se Young Lee, *KB Financial Names New President, Kookmin Bank CEO Nominee*, WALL STREET J. (July 26, 2010, 11:47 AM), http://www.wsj.com/articles/SB10001424052748703995104575390141778127582 (discussing KB's new appointments); Jeong Jin-Woo, *The Tough Nine Months in Search of the New Captain of KB Financial*, MONEY TODAY (June 15, 2010, 3:50 PM), (Kor.) (discussing KB's long road to appointing new leaders).

2. *See* CHRISTINE A. MALLIN, CORPORATE GOVERNANCE 331 (4th ed. 2013) (listing major awards and recognition KB received).

3. *See* Moon Jung-Hyun, *Foreigners' Shareholding at KB Reaches the New High*, YONHAP INFOMAX (May 20, 2015, 8:10 AM), http://news.einfomax.co.kr/news/articleView.html?idxno=158711 (Kor.) (reporting that as of May 2015, 71.18% of KB was owned by foreigners).

4. Korean Banking Act, Art.15, Para.1 (citing that currently, a ten percent ceiling applies for a resident and their group).

5. *Cf.* ANDREAS BUSCH, BANKING REGULATION AND GLOBALIZATION 26–28 (2009) (discussing goals and methods of state's intervention in the banking sector).

Just as KB is not an isolated case in Korea, Korea may not be an isolated case in the world, particularly within emerging markets. The role of the state in corporate governance, in general, and in corporate governance of banks in particular, may be substantial in emerging economies. It is well known the state often controls corporate governance of private firms in Russia through non-legal measures.[6] Even the United States does not remain immune from the problem, as shown in Bank of America's acquisition of Merrill Lynch in the global financial crisis.[7] The German financial supervisory authority also reportedly exercises such informal measures as special audits.[8] This Article focuses on the state interference of corporate governance of banks and looks at the issue from the perspective of financial regulation and supervision as additional and non-legal determinants, respectively, of bank corporate governance.

II. Corporate Governance of Banks After the Financial Crisis

The corporate governance of banks has always been treated differently than general corporate governance due to the special nature of the banks as deposit institutions.[9] Before discussing financial regulation and supervision in the corporate governance of banks, a quick look at the developments after the financial crisis is necessary. The years following the financial crisis have been characterized by a massive increase of financial regulation and tightening of financial supervision. Reform agendas all over the world address regulatory oversight of bank corporate governance and the quality of related supervision and enforcement.[10]

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6. *Cf.* YUKO ADACHI, BUILDING BIG BUSINESS IN RUSSIA: THE IMPACT OF INFORMAL CORPORATE GOVERNANCE PRACTICES 14 (2012) (showing how Russian businesses during the 1990s routinely relied on practices not entirely compatible with formal rules, in particular in the area of corporate governance). Although not in a bank, the Yukos affair must be the most publicized incident of the state's interference with corporate governance of a private corporation. *See generally* RICHARD SAKWA, THE QUALITY OF FREEDOM: KHODORKOVSKY, PUTIN AND THE YUKOS AFFAIR (2009) (arguing that the Yukos affair was generated by the struggle between the authorities, state capitalism, and business–market autonomy in Russia).

7. The testimony of Kenneth Lewis, the former CEO of Bank of America—as well as internal emails released by the House Oversight Committee—indicated that Bank of America was threatened with firings of management and board, as well as damaging the relationship between the bank and federal regulators, if Bank of America did not execute the acquisition of Merrill Lynch. *See* Dan Fitzpatrick & Kara Scannell, *Ex-BofA Chief Sued for Fraud*, WALL STREET J. (Feb. 4, 2010, 12:01 AM), http://www.wsj.com/articles/SB100014240527 48704041504575045210064928990 (discussing the tension between the SEC and Bank of America during litigation).

8. JAN LUDWIG, BRANCHENSPEZIFISCHE WIRTSCHAFTSAUFSICHT UND CORPORATE GOVERNANCE [INDUSTRY SPECIFIC ECONOMIC SUPERVISION AND CORPORATE GOVERNANCE] 286–87 (2012) (Ger.).

9. *See* Daniel K. Tarullo, Corporate Governance and Prudential Regulation, Remarks at Association of American Law Schools 2014 Midyear Meeting, Washington D.C. (June 9, 2014), http://www.federalreserve.gov/newsevents/speech/tarullo20140609a.htm#pagetop (discussing the unique corporate governance needs of banks); Klaus J. Hopt, *Corporate Governance of Banks after the Financial Crisis*, *in* FINANCIAL REGULATION AND SUPERVISION: A POST-CRISIS ANALYSIS 337, 337–39 (Eddy Wymeersch et al. eds., 2012); *see also* BASEL COMMITTEE ON BANKING SUPERVISION, ENHANCING CORPORATE GOVERNANCE FOR BANKING ORGANIZATIONS 19 (Feb. 2006) (requiring financial supervisors to consider corporate governance as "one element of depositor protection"). *See generally* L. Laeven & R. Levine, *Bank Governance, Regulation, and Risk Taking*, 93 J. FIN. ECON. 259 (2009) (discussing the factors involved in determining risk-taking by banks).

10. *See, e.g.*, John Armour & Jeffrey N. Gordon, *Systemic Harms and Shareholder Value*, 6 J. LEGAL ANALYSIS 35, 64 (2014) (discussing their proposal for risk oversight liability); NIAMH MOLONEY, EU SECURITIES AND FINANCIAL MARKETS REGULATION 360–61 (3d ed., 2014).

A. Economic and Legal Dimensions

Since the 1990s, corporate governance and finance scholarship have often discussed the legal origin of corporate governance.[11] The relationship between the legal origin and banking systems was also of great academic interest and, in particular, the bank-centered German economy and corporate governance received much attention.[12] The discussion, however, has not focused on corporate governance of banks but instead on the role of banks in corporate governance.

Since the global financial crisis, bank corporate governance has become a hot issue in the United States because many claim one cause of the global financial crisis was the poor corporate governance of banks and other financial institutions.[13] Although the claim remains contested,[14] the crisis also stimulated discussions on bank corporate governance in Europe.[15] As the European countries wanted to keep the conventional universal banking

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11. *See generally* Mark J. Roe, *Legal Origins, Politics, and Modern Stock Markets*, 120 HARV. L. REV. 460 (2006) (assessing whether a legal origin approach to corporate finance is better than political economy); Holger Spamann, *The "Antidirector Rights Index" Revisited*, 23 REV. FIN. STUD. 467 (2009) (criticizing the index as an accurate measure of shareholder protection); Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3 (2000) [hereinafter LLS&V, *Investor Protection*] (arguing for a legal approach to corporate governance in understanding investor protection); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998) [hereinafter LLS&V, *Law and Finance*] (analyzing the differences between common law and civil law protection of shareholders).

12. *See generally* John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1 (2001) (discussing the polarization of corporate structure between dispersed and concentrated ownership systems and introducing a third approach); Caroline Fohlin, *Does Civil Law Tradition and Universal Banking Crowd Out Securities Markets? Pre-World War I Germany as Counter-Example*, 8 ENTER. & SOC'Y 602 (2007) (criticizing the dichotomy of market and bank-based financial system classifications); Brian R. Cheffins, Investor Sentiment and Antitrust Law as Determinants of Corporate Ownership Structure: The Great Merger Wave of 1897 to 1903 (Dec. 2002) (unpublished manuscript), http://ssrn.com/abstract=348480 (arguing mergers and other corporate trends are influential on patterns of ownership). For studies of the German corporate governance in 1990s, *see generally* Hwa-Jin Kim, *Markets, Financial Institutions, and Corporate Governance: Perspectives from Germany*, 26 GEO. J. INT'L L. 371 (1995) (citing a vast literature).

13. *See generally* CORPORATE GOVERNANCE AND THE GLOBAL FINANCIAL CRISIS: INTERNATIONAL PERSPECTIVES (William Sun et al. eds., 2011) (debating whether the financial crisis was closely associated with corporate governance frameworks or the insufficient implementation of corporate governance codes and principles).

14. *See, e.g.*, MOLONEY, *supra* note 10, at 360; Brian R. Cheffins, *Did Corporate Governance "Fail" During the 2008 Stock Market Meltdown? The Case of the S&P 500*, 65 BUS. LAW. 1, 2 (2009) (arguing the significant fall of share prices in 2008 cannot be attributed to corporate governance problems).

15. For recent research, see generally *The Governance and Regulation of Financial Institutions: Lessons from the Crisis*, 8 RES. NEWSL. (European Corporate Governance Inst., Brussels, Belg.), Summer 2010 (outlining research regarding corporate governance of banking institutions and the financial crisis); *Corporate Governance and the New Financial Regulation: Complements or Substitutes?*, 9 RES. NEWSL. (European Corporate Governance Inst., Brussels, Belg.), Spring 2011 [hereinafter 9 RES. NEWSL.]; Peter O. Mülbert, *Corporate Governance of Banks*, 10 EUR. BUS. ORG. L. REV. 411 (2009) (reflecting on lessons from the 2008 financial crisis for banks' corporate governance); Jaap Winter, *The Financial Crisis: Does Good Corporate Governance Matter and How to Achieve It?*, *in* FINANCIAL REGULATION AND SUPERVISION: A POST-CRISIS ANALYSIS 368 (Eddy Wymeersch et al. eds., 2012) (arguing regulation of corporate governance of financial institutions is not the best approach to respond to the 2008 financial crisis); IRIS H-Y CHIU, THE LAW ON CORPORATE GOVERNANCE IN BANKS (2015); MICHAEL TAN, CORPORATE GOVERNANCE AND BANKING IN CHINA (2015) (exploring different models of corporate governance for Chinese firms in light of the 2008 financial crisis); CORPORATE GOVERNANCE VON KREDITINSTITUTEN [CORPORATE GOVERNANCE OF CREDIT INSTITUTIONS] (Karsten Paetzmann et al. eds., 2014) (GER.).

system, despite witnessing problems inherent in large and complex financial institutions,[16] the corporate governance of banks—along with prudential rule and improved financial supervision—has become more important as the alternative to a structural approach to financial regulation. The corporate governance of banks is not directly related to the business structure of universal banks. However, the size and complexity of a financial institution may impact its corporate governance and vice versa. Smartly regulating the corporate governance of banks can manage the risks inherent to universal banking. In particular, discussions focus on risk management, the pay of bank managers, and the bank directors' liabilities.[17] The discussion may spill over to nonbank corporations to the extent it does not conflict with the business judgment rule.

Although corporate law governs corporate regulation, corporate law is not oriented to protect the depositors and the economic system. Corporate law—as applied to banks—may actually work against the interests of outside entities with managers discharging their fiduciary duties to promote shareholders' interests, including taking risks. Therefore, reform after the financial crisis was largely carried out through prudential regulation directly involving corporate governance.[18] It has also been proposed that corporate governance of systemic firms, such as big banks, must be modified by relaxing shareholder value maximization mechanisms because financial regulation alone cannot solve the problems in the corporate governance of banks.[19] The argument continues by asserting that relaxing the shareholder value maximization norm would not increase agency costs because diversified shareholders have a strong interest in avoiding the managers' decisions that increase systemic risk.[20]

B. Comparative and International Dimensions

A substantial number of studies discuss the ownership and board structure of banks.[21]

16. Michael S. Barr, *Who's in Charge of Global Finance?*, 45 GEO. J. INT'L L. 971, 1012 (2014) ("[The United States, United Kingdom, and European Union] all accept that universal banking can be efficient but see the need for it to have structural safeguards."). For universal banking, see generally JORDI CANALS, UNIVERSAL BANKING: INTERNATIONAL COMPARISONS AND THEORETICAL PERSPECTIVES (1997) (discussing the relationship between banks and financial markets); ANTHONY SAUNDERS & INGO WALTER, UNIVERSAL BANKING IN THE UNITED STATES: WHAT COULD WE GAIN? WHAT COULD WE LOSE? (1994) (examining the arguments for and against a shift to universal banking in the United States).

17. *See, e.g.*, *Commission Green Paper on Corporate Governance in Financial Institutions and Remuneration Policies*, at 2–3, COM (2010) 284 final (June 2, 2010) (discussing regulation and corporate governance practices to strengthen the financial system after the 2008 crisis).

18. *See* Tarullo, *supra* note 9, at 7–10 (discussing how microprudential and macroprudential regulation address the balance between private and social interests by risk-takers).

19. *See* Armour & Gordon, *supra* note 10, at 38 (claiming that shareholder value maximizers undermine regulatory efforts).

20. *Id.* at 38–39.

21. *See generally* Daniel Ferreira et al., *Boards of Banks* (European Corporate Governance Inst., Finance Working Paper No. 289/2010, 2012), http://ssrn.com/abstract=1620551 (discussing the corporate governance of banks using data from 740 banks in 41 countries to evaluate the independence of outside directors); Pablo de

However, as the highly regulated financial industries of the world remain shielded from foreign competition and under the strong influence of path dependency, the corporate governance of banks presents a diverse picture and is subject to the political tradition of each individual jurisdiction. For instance, there may be concerns in emerging economies about state and political interference with corporate governance of banks. Comparative research may provide insight into the issue and contribute to the refinement and effective enforcement of principles and guidelines[22] for bank corporate governance articulated by international financial organizations.

The structural approach to financial regulation largely failed to get support outside of the United States.[23] For European countries, in particular, financial regulation and supervision appeal more to the international regulatory arbitrage issue[24] than the Glass–Steagall type approach. While the United States tries to apply the Dodd–Frank Act extraterritorially,[25] the international financial organizations, including the Basel Committee and Financial Stability Board,[26] also developed international financial law to address the problem.[27] International financial law also includes corporate governance in

Andres & Eleuterio Vallelado, *Corporate Governance in Banking: The Role of the Board of Directors*, 32 J. BANKING & FIN. 2570 (2008) (testing hypothesis on the dual role of boards of directors); Olubunmi Faleye & Karthik Krishnan, Risky Lending: Does Bank Corporate Governance Matter? (Aug. 2015) (unpublished conference paper), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1661837; James Fanto, *Paternalistic Regulation of Public Company Management: Lessons from Bank Regulation* (Brooklyn Law Sch. Legal Studies, Working Paper No. 49, 2006) (evaluating the effect of Sarbanes–Oxley on public firm management); Hanna Westman, The Role of Ownership Structure and Regulatory Environment in Bank Corporate Governance (Jan. 14, 2010) (unpublished manuscript), http://ssrn.com/abstract=1435041 (evaluating the relationship between regulator environment and bank ownership); CORPORATE GOVERNANCE IN BANKING: A GLOBAL PERSPECTIVE (Benton E. Gupp ed., 2007) (discussing international laws and recommendations dealing with corporate governance).

22. *See, e.g.*, BASEL COMMITTEE ON BANKING SUPERVISION, CORPORATE GOVERNANCE PRINCIPLES FOR BANKS 7 (Oct. 2014), http://www.bis.org/publ/bcbs294.pdf (listing the governance principles and guidelines for the banking industry).

23. *See* Hwa-Jin Kim, *A Global Structural Regulation of Financial Institutions?*, 52 SEOUL L.J. 169, 202 (2011) (reviewing the Glass–Steagall Act).

24. *See generally* Annelise Riles, *Managing Regulatory Arbitrage: A Conflict of Laws Approach*, 47 CORNELL INT'L L.J. 63 (2014) (evaluating international arbitrage issues and solutions); Amir N. Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 VA. J. INT'L L. 563 (1998).

25. *See* Richard Painter, *The Dodd–Frank Extraterritorial Jurisdiction Provision: Was It Effective, Needed or Sufficient?*, 1 HARV. BUS. L. REV. 195, 201 (2011) (discussing the battle over the extraterritorial application of the Dodd–Frank Act).

26. *Cf.* Stephany Griffith-Jones et al. eds., *The Financial Stability Board: An Effective Fourth Pillar of Global Economic Governance?* (2010), https://www.cigionline.org/publications/2010/6/financial-stability-board-effective-fourth-pillar-global-economic-governance (discussing the authority and role of the Financial Stability Board); Stavros Gadinis, *The Financial Stability Board: The New Politics of International Financial Regulation*, 48 TEX. INT'L L.J. 157, 159 (2013) (discussing the cooperation between the United States, the United Kingdom, and the European Union in establishing structural safeguards for international banking).

27. *See* Barr, *supra* note 16, at 991 (discussing the development of Financial Stability Board); EMILIOS AVGOULEAS, GOVERNANCE OF GLOBAL FINANCIAL MARKET: THE LAW, THE ECONOMICS, THE POLITICS 8–12 (2012); Pierre-Hugues Verdier, *The Political Economy of International Financial Regulation*, 88 IND. L.J. 1405, 1463 (2013) (discussing Basal III); Matthew C. Turk, *Reframing International Financial Regulation after the Global Financial Crisis: Rational States and Interdependence, Not Regulatory Networks and Soft Law*, 36 MICH. J. INT'L L. 59, 110–11 (2014); Eric J. Pan, *Challenge of International Cooperation and Institutional Design in Financial Supervision: Beyond Transgovernmental Networks*, 11 CHI. J. INT'L L. 243, 254 (2010).

its agenda and area of practice.[28] The importance of comparative study in bank corporate governance must be emphasized because it contributes to the developments of international law in the area. The international financial organizations will take the studies seriously and incorporate them into their legislative works to create more legitimate and effective international rules.

III. STATE INTERFERENCE THROUGH FINANCIAL SUPERVISION

Empirically proving the link between the financial supervision[29] and the corporate governance of banks remains difficult. Therefore, this Article takes two factors into account that make the corporate governance of banks special: (1) the limits of corporate law and financial regulation; and (2) the stakeholder corporate governance model. These two factors appear to legitimize government's involvement in bank corporate governance through practical non-corporate law and financial regulatory channels such as financial supervision.

A. Limits of Corporate Law and Financial Regulation

As discussed below in more detail, corporate law and financial regulation require bank directors to discharge fiduciary and even enhanced duties. Securities regulation also subject the banks to the disclosure obligations. Financial regulation further requires banks to submit information to the financial supervisory authorities. These are the special aspects of bank corporate governance that make it different from general corporate regulation. But all mechanisms may have limits.

The government interferes similarly to the "window guidance" shown in the KB case for many potential reasons. Some of the reasons are unacceptable and overreaching, such as corrupt sale of office, compensation for contribution to political campaigns, collective rent-seeking driven by cronyism, in-house power struggle, and so on.[30] Setting those

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28. *See generally* HENNIE VAN GREUNING & SONJA BRAJOVIC BRATANOVIC, ANALYZING BANKING RISK: A FRAMEWORK FOR ASSESSING CORPORATE GOVERNANCE AND RISK MANAGEMENT (3d ed. 2009) (referring to the Basel Committee and Financial Responsibility Board's governance of European banks).

29. Financial supervision collectively means the actual discretionary enforcement mechanisms, including grants, extension and revocation of banking license and sanctions, and pressing criminal charges for bank managers and employees based on audits, through which the government enforces financial regulation and other norms. For the concept of financial supervision, see Niamh Moloney, *Supervision in the Wake of the Financial Crisis: Achieving Effective 'Law in Action'—A Challenge for the EU*, *in* FINANCIAL REGULATION AND SUPERVISION: A POST-CRISIS ANALYSIS 71, 80–94 (Eddy Wymeersch et al. eds., 2012). *See generally* ALEXANDER THIELE, FINANZAUFSICHT: DER STAAT UND DIE FINANZMÄRKTE [FINANCIAL SUPERVISION: THE STATE AND THE FINANCIAL MARKETS] (2014) (Ger.) (a comprehensive research toward a reform of the German financial supervisory system from the perspective of constitutional law). In this Article, however, the term "financial supervision" is used more broadly and also implicates other government authority and influence in addition to the regulatory function.

30. Politics also plays an important role in corporate governance of Korean banks. At one time the CEOs of the four largest bank holding companies in Korea were called the "four kings" of the banking industry. *Cf.* Lee Ho-jeong, *Chairman of Woori Bows Out*, KOREA JOONGANG DAILY (Apr. 15, 2013), http://koreajoongangdaily.joins.com/news/article/Article.aspx?aid=2970151 (detailing the resignation of the CEO of a major banking group, a crony of the former President Lee Myung-bak). They are so called due to their powerful stature in the Korean political economy, backed by their close relationship with the President of Korea. One of them even served as Vice Prime Minister. The then Chairman of the Korea Financial Services Commission used to be his junior in the chain of command within the government. *Id.* They also symbolized the role of the government and politics in

reasons aside, the government might genuinely be concerned that the management and outside directors are self-entrenching; however, concern may be confused with self-interested motivation. Government officials are usually hardworking, honest people, but some may have different qualities and use the arguments of concern as a disguise. Even if the government's interference through financial supervision serves legitimate purposes, it comes with heavy costs because the government cannot be transparent. Sometimes interference may be the beginning of directed lending practices. No one can be held accountable if things go wrong.

The power to vote at a shareholder meeting provides a conventional way to address the issue, but sometimes it may not be practical and takes time. After all, the government is usually not a major shareholder of the bank. Financial regulation is an alternative. Among others, banks may be questioned by the financial supervisory authority for information not required by securities law. The authority may also conduct special audits.[31] Due to the limits of corporate law, financial regulation is the only tool to manage the divergence of interests between bank shareholders and society.[32] But such a mechanism does not justify the financial supervisory authority's direct interference with bank corporate governance. It is true, in principle, financial supervision should be carried out first through informal means, such as the German Federal Administrative Court confirmed.[33] That does, however, point to the technical way of using various informal means—for instance conversations between the supervisory authority and financial institutions—rather than non-legal measures.[34] After a few scandals in recent years, Korea enacted the Law on the Corporate Governance of Financial Corporations in July 2015.[35] The new law addresses such issues as independent directors, risk management committees, compliance officers, risk managers, and minority shareholder rights.[36] However, as far as the leadership and board structure are concerned, law on the books looks almost irrelevant, and financial regulation may not work well. This situation tempts governments to use non-legal measures and tries to rectify problems. Financial supervisory authority may come in very handy.

Financial regulation cannot initiate corporate acquisition and other forms of restructuring. The government may be pressed by many factors and intrude in the private sector decision-making process when the economy is severely distressed, as in the financial crisis. Still, Bank of America's management and board accommodated the government's wish not to contribute to the stability of the system, but to avoid jeopardizing the relationship with the government represented by the financial supervisory authorities—i.e.,

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the corporate governance of Korean banks. Even today, big banks' boards are occupied by outside directors elected through sometimes obvious political channels. Jo Hyun-Sook, *Three Outside Directors in Woori Bank Have Political Backing*, JOONGANG ILBO (Mar. 11, 2015, 12:02 AM) (Kor.), http://news.joins.com/article/17323938.

31. Hanno Merkt, *Transparenz der Banken und des Bankgeschäfts als Element der Corporate Governance von Banken* [Transparency of Banks and the Banking Business as an Element of the Corporate Governance of Banks], *in* HANDBUCH CORPORATE GOVERNANCE VON BANKEN 117 (Klaus J. Hopt & G. Wohlmannstetter eds., 2011) (GER.).

32. *See* Hopt, *supra* note 9, at 350–51 (bringing also the perspective of debtholders into the discussion).

33. THIELE, *supra* note 29, at 216.

34. *Id.* at 218.

35. Geumyung-hoesa-ui jibae-gujo-e goan-han bupryul [Law on the Corporate Governance of Financial Corporations], Act No. 13453, July 2015, art. 5 (S. Kor.).

36. Geumyung-hoesa-ui jibae-gujo-e goan-han bupryul [Law on the Corporate Governance of Financial Corporations], Act No. 13456, July 2015, art. 5–33 (S. Kor.).

to serve the long-term shareholder value maximization.[37] In that way, Bank of America can defend their decision.

If government interference is inevitable, perhaps using soft law measures, such as guidelines, recommendations, FAQs, Q&As, etc., may provide a better solution. Soft law measures are not directly binding or enforceable; however, market participants rarely ignore them.[38] Soft law measures are transparent and pose fewer legitimacy issues. In 2014, in an era of hard laws after the financial crisis, the Korean government created the Financial Corporate Governance Code.[39] The government action proved to be a smart approach, but it remains to be seen how effective the Code will be.

B. The State as a Stakeholder in the Corporate Governance of Banks

Government neither owns big businesses nor finances them. However, government involvement in the corporate governance of private companies has increased recently for various reasons.[40] The failure of a few large corporations, including financial institutions, can take down a big part of the economic system. It may also have adverse impacts on the job markets, which are politically sensitive. Therefore, government arranged acquisitions sometimes even provide bailout funds to facilitate the deal. For strategically crucial companies, governments act as the guardian against foreign capital as exemplified by the Unocal and Dubai Ports World cases.[41] The concept of systemic importance has replaced the concept of national security.[42] The global financial crisis called old principles into question. For the first time in its history, the U.S. government held major ownership stakes in large companies and financial institutions and played an active role in their

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37. Perhaps, the shareholders of KB implicitly agreed to the government's influence on the banks corporate governance based on understanding that the government's "presence" within the bank would better serve the interests of the bank and shareholders. The bank's business and operation are heavily regulated and the government possesses powerful weapons to control them.

38. MOLONEY, *supra* note 10, at 856. *See generally* Hwa-Jin Kim, *Taking International Soft Law Seriously: Its Implications for Global Convergence in Corporate Governance*, 1 J. KOREAN L. 1 (2001) (noting soft laws are predominantly used in international financial regulation); David Zaring, *Informal Procedure, Hard and Soft, in International Administration*, 5 CHI. J. INT'L L. 547 (2005); CHRIS BRUMMER, SOFT LAW AND THE GLOBAL FINANCIAL SYSTEM: RULE MAKING IN THE 21ST CENTURY (2012); INFORMAL INTERNATIONAL LAWMAKING (Joost Pauwelyn et al. eds., 2012); Lawrence L. C. Lee, *The Basel Accords as Soft Law: Strengthening International Banking Supervision*, 39 VA. J. INT'L L. 1 (1998); Daniel E. Ho, *Compliance and International Soft Law: Why Do Countries Implement the Basel Accord?*, 5 J. INT'L ECON. L. 647 (2002).

39. Press Release, Korea Fin. Servs. Comm'n (Dec. 24, 2014), http://www.fsc.go.kr/info/ntc_news_list.jsp?menu=7210100&bbsid=BBS0030.

40. *See generally* Jeffrey Gordon, *The Government as Investor/Owner in the U.S.*, *in* TRANSATLANTIC CORPORATE GOVERNANCE DIALOGUE (Sept. 2009) (discussing how the U.S. government becomes an "investor" or "owner" and the corporate governance consequences); Gèrard Hertig, *The Government as Investor/Owner in Europe*, *in* TRANSATLANTIC CORPORATE GOVERNANCE DIALOGUE (Sept. 2009) (discussing the reasons European governments invest in private corporations and their impacts on corporate governance).

41. *See* Jason Cox, *Regulation of Foreign Direct Investment After the Dubai Ports Controversy: Has the U.S. Government Finally Figured Out How to Balance Foreign Threats to National Security Without Alienating Foreign Companies?*, 34 J. CORP. L. 293, 300 (2008) (discussing the 2006 Dubai Ports scandal and Congress' consequential legislative action); Deborah M. Mostaghel, *Dubai Ports World under Exon-Florio: A Threat to National Security or a Tempest in a Seaport?*, 70 ALB. L. REV. 583, 604–05 (2007) (discussing the failed bid for Unocal Oil, a U.S. corporation, by a Chinese state-owned corporation).

42. *See generally* EDWARD M. GRAHAM & DAVID M. MARCHICK, U.S. NATIONAL SECURITY AND FOREIGN DIRECT INVESTMENT (2006) (finding many proposed reforms threaten to weaken the U.S. economy while failing to strengthen national security).

governance.[43]

The role of government has traditionally been important in the financial services industry. Governments have reason to get involved in the corporate governance of commercial banks because a number of governments are stakeholders for commercial banks as deposit insurance institutions.[44] In emerging countries, large banks have mostly been recently privatized.[45] Such governments and banks therefore fall in the shadow of a still fresh memory of the past. The role of the state became even more significant after the financial crisis, as many large banks in the United States and Europe were bailed out by their respective governments. Although governments hold a dominant position in the corporate governance of banks, they are not in the position to manage banks effectively. Therefore, the status of governments in bank corporate governance needs to be determined in a way that can assist financial regulatory reform.[46]

The direct intervention of the government in corporate governance of banks through non-legal measures may be defended as stakeholder activism.[47] Some think regulators and supervisors are stakeholders and may play the role of the principal.[48] While the conventional corporate governance model is built on the proposition that interest alignment between management and shareholders is of primary importance, the financial crisis proved interest alignment between management and a wider set of stakeholders can also be granted.[49] Since stakeholders do not have a legal right in corporate governance yet, such views may not receive strong support because it endorses the financial supervisory authority's exercise of power to change the corporate governance of banks. Nevertheless, it is still possible to understand strong government influence as a form of non-legal rules that shape the corporate governance of banks.[50] As a general principle, stakeholder interests are "only very generally included in the orientation for the board when directing

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43. Kim Hwa-Jin, *Gi-eop-ui so-yuji-baegujo-wa jeongbu-ui yeoghal* [*Government in Corporate Governance*], 408/409 KOR. BAR ASS'N J. 60/23 (2010) (Kor.).

44. *Cf.* Jennifer Carpenter et al., *Reforming Compensation and Corporate Governance*, *in* REGULATING WALL STREET: THE DODD–FRANK ACT AND THE NEW ARCHITECTURE OF GLOBAL FINANCE 493, 506–07 (Viral V. Acharya et al. eds., 2011) (summarizing key issues that regulatory reform should address and providing analysis of how the reforms will affect financial firms and markets).

45. *See* A. Michael Andrews, *State-Owned Banks, Stability, Privatization, and Growth: Practical Policy Decisions in a World Without Empirical Proof* (Int'l Monetary Fund, Working Paper WP/05/10, 2005).

46. Marcel Kahan & Edward Rock, *When the Government Is the Controlling Shareholder*, 89 TEX. L. REV. 1293, 1293 (2011) ("Corporate law provides a complex and comprehensive set of standards of conduct to protect noncontrolling shareholders from controlling shareholders who have goals other than maximizing firm value," but are designed with private parties in mind. "[W]hen the government is the controlling shareholder, the Delaware restrictions . . . are largely displaced, but hardly replaced, by federal provisions.").

47. For discussions on stakeholder governance for banks, see Hopt, *supra* note 9, at 352–55 (evaluating some proposals including board representation of the deposit insurer, imposing on the board the duty to act in the interest of labor, strengthening fiduciary duties, dropping limited liability, and mandating hybrid capital). *See generally* Jonathan Macey & Geoffrey Miller, *Double Liability of Bank Shareholders: History and Implication*, 27 WAKE FOREST L. REV. 31 (1992) (discussing 'double liability' rules for bankers in the United States until the 1930s).

48. *See* Hopt, *supra* note 9, at 342, 350 (citing such opinions, including one by the Basel Committee on Banking Supervision).

49. MOLONEY, *supra* note 10, at 357.

50. *Cf.* Curtis J. Milhaupt, *Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance*, 149 U. PA. L. REV. 2083, 2083 (2001) (analyzing a series of non-legal rules that have played a key role in Japanese corporate governance).

and controlling the company."[51] Referring to the stakeholder model may not be enough to justify government's interference with the corporate governance of banks through financial supervision and other non-legal measures.

IV. THE CASE FOR THE CONSTRUCTIVE LEGAL APPROACH

Emerging market economies, such as Korea, should take the orthodox approach to the corporate governance of the banks, i.e., using standard corporate law measures supplemented by financial regulation. One way to reform corporate governance to incorporate risk considerations consistent with prudential regulatory objectives is by broadening the fiduciary duties of boards and managements of the banks.[52] Broadening can be achieved by aligning corporate governance and financial regulations through imposing substantial requirements or constraints upon the banks' internal decision making process,[53] directing regulatory requirements and changing the incentives for bank employees,[54] and creating institutions and processes for risk management.[55]

A. Bank Directors' Duties and Liabilities

The level of a director's fiduciary duty owed to the corporation very much depends upon the size and business area of the corporation. The rule can be best understood in terms of bank director liability. The conventional protection provided by the business judgment rule may be weaker for bank directors. Such fiduciary duties include the duty to properly manage risks. By violating the duty to manage risks, the bank director can be held liable to the bank and shareholders, depending upon the jurisdiction.

Ever since *Briggs v. Spaulding*[56] established a standard of simple negligence for directors of federally chartered and insured banks, U.S. state courts find the duty of care applies more strictly for bank directors than for those of general corporations. *Litwin v. Allen* required a higher standard of care for bank directors than nonbank directors because banks are charged with serving the public interest, not just the interests of the bank shareholders.[57] Previously the tightening of judicial scrutiny of bank directors' fiduciary duties experienced a judicial backlash resulting in a strict application of the business judgment rule,[58] but the higher standard articulated in the older cases has largely been maintained.[59] Although the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) introduced the 'gross negligence' standard for directors of federally insured and chartered depositories,[60] states are free to set higher standards for bank

51. Hopt, *supra* note 9, at 338.
52. Tarullo, *supra* note 9, at 10.
53. *See id.* at 13–14 (discussing the benefits of imposing constraints on the banks' internal decision making process).
54. *See id.* at 11–13 (noting the benefits to adjusting regulatory requirements and worker incentives).
55. *See id.* at 14–17 (discussing the benefits of creating institutions and processes for risk management).
56. Briggs v. Spaulding, 141 U.S. 132, 151 (1891).
57. Litwin v. Allen, 25 N.Y.S.2d 667, 667 (N.Y. Sup. Ct. 1940).
58. *See* Mülbert, *supra* note 15, at 435–36 (discussing the application of a higher standard of care); J. B. Harris & C. T. Caliendo, *Who Says the Business Judgment Rule Does Not Apply to Directors of New York Banks?*, 118 BANKING L.J. 493, 495 (2001).
59. *See* Jonathan R. Macey & Maureen O'Hara, *The Corporate Governance of Banks*, 7 ECON. POL'Y REV. 91, 101 (2003) (discussing standard of care cases over time); Armour & Gordon, *supra* note 10, at 62–64.
60. *See* Macey & O'Hara, *supra* note 59, at 101 (discussing the standard of care created under FIRREA).

directors because the Supreme Court in *Atherton v. Federal Deposit Insurance Corporation*[61] ruled that state law defines the duty of directors of both state and federally chartered institutions.[62]

The scope of bank directors' duties and obligations expanded because of the role and structural environment of banks.[63] A bank's role includes the liquidity production which can cause a bank to fail due to the collective action problem among depositors, the deposit insurance fund that increases the risk of fraud and self-dealing by reducing incentives for monitoring,[64] the conflict between fixed claimants and shareholders due to the high debt-to-equity ratio and the existence of deposit insurance, and asset structure and loyalty problems.[65]

The German IKB's (Industriekreditbank's) former CEO stood trial for having misled shareholders and breached fiduciary duties. He was accused of not having properly managed risks involved in new financial products and economic developments.[66] The legal controversy over the scope of the business judgment rule[67] took place in terms of the management of the financial institution.[68] It seems, however, the German courts so far have handled the case within the conventional framework of directors' duties and liabilities in corporate law, not developing special liabilities rules for bank directors.[69]

On the other hand, Korean banks are required "to contribute to the stability of the

61. Atherton v. Fed. Deposit Ins. Corp., 519 U.S. 213, 230–31 (1997).

62. The Court held that "[FIRREA's] 'gross negligence' standard provides only a floor—a guarantee that officers and directors must meet at least a gross negligence standard. It does not stand in the way of a stricter standard that the laws of some States provide." *Id.* at 227.

63. *See generally* OFFICE OF THE COMPTROLLER OF THE CURRENCY, DUTIES AND RESPONSIBILITIES OF DIRECTORS, COMPTROLLER'S HANDBOOK § 501 (1998), www.occ.gov/publications/publications-by-type/comptrollers-handbook/directors1.pdf (describing the obligations of banks managers in the United States).

64. The bank director may breach the fiduciary duty to the bank even when the director acted in the short-term interest of the bank if the act exposed the bank to higher enterprise risk and caused the bank to be responsible for the increase of systemic risk. However, the bank director cannot be held liable for negligence in monitoring the enterprise risk. *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 130–31 (Del. Ch. 2009). *See generally* Franklin A. Gevurtz, *The Role of Corporate Law in Preventing a Financial Crisis: Reflections on In re Citigroup Inc. Shareholder Derivative Litigation*, 23 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 113 (2010) (discussing future strategies in preventing excessive risk-taking); Robert T. Miller, *The Board's Duty to Monitor Risk after Citigroup*, 12 U. PA. J. BUS. L. 1153 (2010) (discussing the impact of *Citigroup* on developments in risk-monitoring liability).

65. *See* Macey & O'Hara, *supra* note 59, at 97–99 (discussing special issues involving banks).

66. Vanessa Fuhrmans, *Former IKB Chief Convicted of Market Manipulation*, WALL STREET J. (July 15, 2010, 12:01 AM), http://www.wsj.com/articles/SB10001424052748703792704575366561218672260.

67. Germany formally introduced the business judgment rule in Article 93, paragraph 1 of Aktiengesetz in 2005. Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL I at 1089, last amended by Gesetz [G], July 23, 2013, BGBL I at 2586, art. 93 (Ger.), *translated in* Norton Rose Fulbright (Sept. 18, 2013), www.nortonrosefulbright.com/files/german-stock-corporation-act-109100.pdf. Article 754 of Swiss Code of Obligations stipulates directors' duties and liabilities. SCHWEIZERISCHES ZIVILGESETZBUCH [ZGB] [CIVIL CODE], Dec. 10, 1907, SR 220 (1911), as amended by Gesetz, Oct. 4, 1991, AS 733 786 (1992), art. 754. Although the business judgment rule has not been formally introduced in Switzerland yet, Swiss directors can be insulated from liabilities by fulfilling similar requirements as those for the application of the business judgment rule in the United States and Germany.

68. INT'L BAR ASS'N TASK FORCE ON THE FIN. CRISIS, A SURVEY OF CURRENT REGULATORY TRENDS 93 (2010).

69. *See generally* Holger Fleischer, *Financial Crisis and Directors' Liability on Trial: The Case of the Dusseldorf IKB Bank*, 12 EUR. CO. L. 69 (2015) (discussing the treatment of the IKB Bank case by the German courts).

financial markets and to the development of the national economy."[70] Accordingly, the Korean Supreme Court ruled bank directors must fulfill their fiduciary duties with utmost (enhanced) care.[71] The court ruled the failure of bank directors to get the loans repaid per se does not constitute a breach of their fiduciary duties. However, the role of banks differs from that of other companies.[72] Bank directors must fulfill their fiduciary duties with utmost (enhanced) care in: (1) the protection of the properties of depositors; (2) the maintenance of credit systems; and (3) the promotion of efficiency in finance brokering.[73] The court set out the following criteria which the directors of the banks were to assess when they decided on whether to grant loans: (1) the terms and conditions of the loan; (2) the loan amount; (3) the repayment plan; (4) the existence of collateral and its substance; (5) the status of the debtor's assets and business operations; and (6) the debtor's future business prospects.[74]

Corporate law seems to reflect prudential regulatory measures that involve corporate governance of the banks. This is good news because the banks' directors and managers will be more responsive to the broader interests, and by doing so make the divergence between private and social interests in risk-taking less serious.[75] It remains to be seen, however, if the developments may bring about a fundamental change in corporate law theories.

B. Risk Management[76]

It is widely believed bank managers were not prudent and the board of directors of banks did not prevent risky lending practices that led the world to the financial crisis. The banks' internal control system did not function properly.[77] The bank managers' risk appetite was too big, and they regularly ignored risk officers' warnings, with Goldman

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70. Banking Act, Act No. 5499, *amended by* Act No. 6691, Apr. 27, 2002, art. 1 (S. Kor.), *translated in* International Money Laundering Information Network, www.imolin.org/doc/amlid/Republic_of_Korea/Banking_Act_1998.pdf.

71. Supreme Court [S. Ct.], 2000Da9086, Mar. 15, 2002 (S. Kor.).

72. *See generally* Hwa-Jin Kim, *Directors' Duties and Liabilities in Corporate Control and Restructuring Transactions: Recent Developments in Korea*, 2006 OXFORD U. COMP. L.F. 2 (tracing the development of directors' duties in Korea).

73. *Id.*

74. Swiss law also recognizes higher levels of duty owed by the directors of financial institutions. *See* Peter V. Kunz, *Swiss Corporate Governance–an Overview*, *in* SWISS REPORTS PRESENTED AT THE XVIIITH INTERNATIONAL CONGRESS OF COMPARATIVE LAW 99, 132 (2010) (exploring Swiss financial institutions' duties of care).

75. *See* Tarullo, *supra* note 9, at 17 (discussing how regulatory objectives can encourage balanced risk-taking).

76. *See generally* Ngozi Vivian Okoye, BEHAVIOURAL RISKS IN CORPORATE GOVERNANCE: REGULATORY INTERVENTION AS A RISK MANAGEMENT MECHANISM (2015) (describing corporate risk management through regulation); *cf.* MOLONEY, *supra* note 10, at 360 (pointing out the ability of corporate governance requirements to support better risk management remains contested).

77. *See, e.g.*, Danièle Nouy, The Role of Internal Control and Internal Audit, Speech at the European Confederation of Institutes of Internal Auditing Conference (Sept. 22, 2015) https://www.bankingsupervision.europa.eu/press/speeches/date/2015/html/se150922.en.html; Senior Supervisors Group, Risk Management Lessons from the Global Banking Crisis of 2008 (Oct. 21, 2009) http://www.financialstabilityboard.org/wp-content/uploads/r_0910a.pdf?page_moved=1.

Sachs and BNP Paribas[78] being exceptions.

Banks fall at the center of risk[79] because a bank's business relies on taking risks.[80] The board of directors determines the risk tolerance and appetite of the bank and develops business strategies based on that decision. Therefore, risk management lies at the core of a bank manager's duty.[81] The severity of the 2008 financial crisis was because of how managers of big banks acquired and mismanaged huge risks,[82] and in the process, banks damaged the rest of the financial market and industry and the broader economy.[83] Banks should construct corporate governance in a way that could maximize the value of the bank as a business organization, while at the same time, minimizing systemic risk.[84] If bank managers take on excessive risk, shareholders may benefit short-term but be harmed in the long run through externalized costs to the system.[85] One study even argues that boards of directors are not supposed to minimize the agency costs but serve a public purpose such as stabilizing financial markets and politics.[86] John Coffee remains skeptical about empowering bank shareholders because the shareholders might be incentivized to take greater risk through increased leverage.[87] The European Commission's Green Paper of June 2, 2010 questions whether shareholder control of financial institutions is still realistic.[88] At this point, the entire discussion on the stakeholder model and sustainability

78. *See* Nicholas Calcina Howson, Commentary, *When "Good" Corporate Governance Makes "Bad" (Financial) Firms: The Global Crisis and the Limits of Private Law*, 108 MICH. L. REV. FIRST IMPRESSIONS 44, 48 (2009) (illustrating the different approaches of BNP and Goldman Sachs).

79. PHILIP WOOD, LAW AND PRACTICE OF INTERNATIONAL FINANCE 333–34 (2008).

80. *See* COMPTROLLER OF THE CURRENCY, THE DIRECTOR'S BOOK: THE ROLE OF A NATIONAL BANK DIRECTOR 10–15 (1997) (noting the business strategy of banks involves risk-taking); *see also* JAMES W. KOLARI & BENTON E. GUP, COMMERCIAL BANKING: THE MANAGEMENT OF RISK 12 (3d ed. 2005) (discussing the role of risk in the banking business); HANNA WESTMAN, CORPORATE GOVERNANCE IN EUROPEAN BANKS: ESSAYS ON BANK OWNERSHIP 5 (2009) (explaining the centrality of risk in banking); Jonathan R. Macey & Geoffrey P. Miller, *Bank Failures, Risk Monitoring, and the Market for Bank Control*, 88 COLUM. L. REV. 1153, 1194 (1988) (exploring how bank management handles risk).

81. MARTIN LIPTON ET AL., RISK MANAGEMENT AND THE BOARD OF DIRECTORS 2 (2008), https://corpgov.law.harvard.edu/2009/12/17/risk-management-and-the-board-of-directors-2/.

82. Stephen M. Bainbridge, Caremark *and Enterprise Risk Management*, 34 J. CORP. L. 967, 972 (2009).

83. Letter from Simon Johnson to Members of the Financial Stability Oversight Council (Nov. 7, 2010), baselinescenario.com/2010/11/07/making-the-volcker-rule-work.

84. *See generally* George G. Kaufman, *Bank Failures, Systemic Risk, and Bank Regulation*, 16 CATO J. 17 (1996) (noting the need for bank regulation and how a failure to recognize systemic risk can endanger an entire economy); Steven L. Schwarcz, *Systemic Risk,* 97 GEO. L.J. 193 (2008). For discussions on Germany, see Daniel Zimmer & Florian Fuchs, *Die Bank in Krise und Insolvenz: Ansätze zur Minderung des systemischen Risikos* [The Bank in Crisis and Insolvency: Approaches to Mitigation of Systemic Risk], 39 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 597 (2010) (Ger.) (discussing the effect of systemic risk on German banks and economies).

85. *See* 9 RES. NEWSL. *supra* note 15, at 1 (discussing long term harm felt by shareholders when bank managers make risky decisions).

86. *See generally* J. R. Booth et al., *Boards of Directors, Ownership, and Regulation*, 26 J. BANKING & FIN. 1973 (2002) (concluding "to the extent that regulations reduce the impact of managerial decisions on shareholder wealth, effective internal monitoring of managers becomes less important in controlling agency conflicts").

87. *See* 9 RES. NEWSL., *supra* note 15, at 5–6 ("[T]he more shareholder-friendly the corporate governance regime is at a financial institution, the more that financial institution will ride the rollercoaster of having high earnings in the boom years, and falling earnings and near-bankruptcy in the down years.").

88. *See* John Armour & Wolf-Georg Ringe, *European Company Law 1999–2010: Renaissance and Crisis* 39–41 (ECGI—Law Working Paper No. 175, 2011), http://papers.ssrn.com/sol3/papers.cfm?abstract

comes back to life.[89]

In 1998, Germany amended the Stock Corporation Act (*Aktiengesetz*) to introduce the director's duty to manage enterprise risk.[90] Article 91, section 2 of the *Aktiengesetz* provides the management board shall take suitable measures, particularly in surveillance measures, to ensure threats to the company are detected early.[91] Also, section 4.1.4 of the German Corporate Governance Code stipulates the management board of listed companies ensures appropriate risk management and risk control in the enterprise.[92] Article 25(a), section 1 of the German Banking Act (*Gesetz über das Kreditwesen*—KWG) provides an institution must have suitable protocols for managing, monitoring, and controlling risks and appropriate means to monitor the institution's financial situation with sufficient accuracy at all times. The KWG also provides an institution must have a proper business organization, an appropriate internal control system, and adequate security precautions for the deployment of electronic data processing.[93] Recently, the German Law on Modernization of Corporate Accounting (BilMoG) has introduced the concept of risk management into the German Commercial Code (*Handelsgesetzbuch*—HGB) and *Aktiengesetz*.[94] How the regulatory developments will lead to better risk management in

_id=1691688 (discussing the policy ideas behind the Green paper and the goals of the Commission moving forward in financial regulation).

89. *See, e.g.*, Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 440–41 (2001) (noting the uniformity of the shareholder model); Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance*, 50 HARV. INT'L L.J. 129, 130 (2009) (describing shareholder influence on managerial decision making).

90. *See* Harald Hau & Marcel P. Thum, *Subprime Crisis and Board (In-)Competence: Private vs. Public Banks in Germany* 23–24 (CESifo, Working Paper No. 2640, 2009) (finding the German supervisory board's in-competence in finance was related to losses in the financial crisis).

91. The original language of the article is as follows: "Der Vorstand hat geeignete Massnahmen zu treffen, insbesondere ein Überwachungssystem einzurichten, damit den Fortbestand der Gesellschaft gefährdende Entwicklungen früh erkannt werden." It may therefore be argued that the article only refers to "*Entwicklungen*" (developments), not "*Risiken*" (risks). However, there seems to be no difficulty in interpreting the article to duly recognize a director's duty to manage risk. THEODOR BAUMS, RISIKO UND RISIKOSTEUERUNG IM AKTIENECHT [RISK AND RISK MANAGEMENT IN STOCK CORPORATION LAW] (2010) (Ger.). The Korean Commercial Code does not explicitly provide corporate directors' fiduciary duty to manage risks.

92. HENRIK-MICHAEL RINGLEB ET AL., KOMMENTAR ZUM DEUTSCHEN CORPORATE GOVERNANCE KODEX [COMMENTARY ON THE GERMAN CORPORATE GOVERNANCE CODE] 179–85 (3d ed., 2008) (Ger.). Swiss law also recognizes the directors' duty to carry out risk assessment and risk management. They are obliged to define the company's risk appetite and tolerance and monitor possible risks. A director's duty to manage risks was introduced in Article 663(b) of the Swiss Code of Obligations in 2008 although scholars regarded such a duty as given under Article 716(a), paragraph 1 of the Code. Kunz, *supra* note 74, at 111–12. The Swiss Code of Best Practice for Corporate Governance of 2002, as amended, effective January 1, 2008, encourages listed companies and economically significant private companies in Switzerland to set up audit committees for risk management.

93. AKTIENGESETZ KOMMENTAR [STOCK CORPORATION ACT COMMENTARY] 1032–39 (Karsten Schmidt & Marcus Lutter eds., 2008) (Ger.); HANDBUCH DES VORSTANDSRECHTS [MANUAL BOARD RIGHTS] § 19 (Holger Fleischer ed., 2006) (Ger.); WERNER PAUKER, UNTERNEHMEN—RISIKO—HAFTUNG: DIE FUNKTION DER GESCHÄFTSLEITERHAFTUNG VOR DEM HINTERGRUND DER STEUERUNG UND VERTEILUNG UNTERNEHMERISCHER RISIKEN [BUSINESS—RISK—OF LIABILITY: THE ROLE OF BUSINESS DIRECTOR LIABILITY IN THE CONTEXT OF CONTROL AND DISTRIBUTION OF BUSINESS RISK] (2008) (Ger.).

94. Michael Kort, *Risikomanagement nach dem Bilanzrechtsmodernisierungsgesetz* [*Risk Management after the Accounting Law Modernization Act*], 39 ZEITSCHRIFT FÜR UNTERNEHMENS—UND GESELLSCHAFTS-RECHT 440 (2010) (Ger.). For banks and other financial institutions, see generally JOHN C. HULL, RISIKOMANAGEMENT: BANKEN, VERSICHERUNGEN UND ANDERE FINANZINSTITUTIONEN [RISK MANAGEMENT: BANKS, INSURANCE COMPANIES, AND OTHER FINANCIAL INSTITUTIONS] (2014) (Ger.). For the concept of "risk"

German universal banks remains to be seen.[95]

It is interesting to see the BaFin (German Federal Financial Supervisory Authority) developed special rules for financial services firms that link the compensation issue to risk management.[96] In August 2009, BaFin published an updated version of the Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement*). The rule requires financial institutions to maintain an appropriate risk management system pursuant to paragraph 25 of the KWG. Section 71 of the rule addresses the parameters of incentive systems for bank staff. According to KWG, incentive systems must harmonize with the general strategic targets of the bank. In particular, compensation systems must be designed so as not to encourage bank managers to take inappropriate risks. Back office employees, specifically those involved in risk control, also must be compensated in a way that appropriately reflects their responsibilities.

C. Bankers' Pay

It is now well known compensation arrangements in the banking industry arguably[97] motivated excessive risk taking.[98] Part of the bank managers' aggressive attitude regarding risks can be attributed to their compensation system.[99] One study, after looking at 306 financial institutions in 31 countries, concluded the higher the ownership of institutional investors and the ratios of bonuses in CEO compensation package, the higher the tendency for risk taking.[100] Now, the question of how to regulate bankers' compensation has been a hot issue. The problem, however, is that no matter how the bonus arrangements were made; they were not made to serve the shareholders' interests.

Most pay and bonus arrangements were linked to the actual performance of bank managers.[101] Therefore, private ordering may not solve the problem satisfactorily. Rather,

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under German law, see Schmidt & Lutter, *supra* note 93, at 1036; and Jochen Pampel & Dietmar Glage, *Unternehmensrisiken und Risiko-management [Business Risks and Risk Management]*, *in* CORPORATE COMPLIANCE: HANDBUCH DER HAFTUNGSVERMEIDUNG IM UNTERNEHMEN 84 (Christoph E. Hauschka ed., 2007) (Ger.).

95. For the role of risk committee and Chief Risk Officer, see Hopt, *supra* note 9, at 357–58.

96. LUDWIG, *supra* note 8, at 262–63.

97. *See* 9 RES. NEWSL., *supra* note 15, at 5 (summarizing John Coffee's assertion that Dodd–Frank was premised on the still debatable assumption that flaws in executive compensation formulas were responsible in significant part for the crisis).

98. Lucian A. Bebchuk et al., *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000–2008* 24 (Harvard John M. Olin Ctr. for Law, Econ., & Bus., Discussion Paper No. 657, 2010).

99. *See generally* Andrea Beltratti & Rene M. Stulz, *Why Did Some Banks Perform Better During the Credit Crisis? A Cross-Country Study of the Impact of Governance and Regulation* (European Corp. Governance Inst., Working Paper No. 15180, 2009) (discussing the relationship between bank performance and corporate governance during the financial crisis). For the corporate governance implications of the Dodd–Frank Act, see generally Stephen M. Bainbridge, *Dodd–Frank: Quack Federal Corporate Governance Round II* (UCLA Sch. of L., Law-Econ. Research Paper No. 10-12, 2010) (arguing Dodd–Frank regulation provides little real corporate governance).

100. David Erkens et al., *Corporate Governance in the 2007–2008 Financial Crisis: Evidence from Financial Institutions Worldwide*, 18 J. CORP. FIN. 389, 390 (2012).

101. Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 GEO. L.J. 247, 249 (2009); Lucian A. Bebchuck et al., *Written Testimony Submitted by Professor Lucian A. Bebchuk, William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance and Director of the Corporate Governance Program at Harvard Law School, Before the Committee on Financial Services United States House of Representatives Hearing on Compensation Structure and Systemic Risk* 6 (June 11, 2009),

government's direct intervention will do the job. The Dodd–Frank Act addresses the issue by requiring shareholders' non-binding resolution for CEO compensation and the golden parachute ("say on pay")[102] modeled after the United Kingdom's shareholder advisory vote on directors' compensation.[103] The Securities and Exchange Commission (SEC) possesses the authority to waive the requirement. Firms are required to set up a compensation committee with independent directors for that matter. Financial institutions with assets in excess of one billion dollars must disclose compensation arrangement including performance-linked bonuses.[104]

European countries also introduced the regulation on bankers' pay by promulgating guidelines. Under huge political pressure, banks in the United Kingdom, Germany, and France moved to limit bonuses in 2009.[105] In 2010, the European Union enacted legislation to force European banks to curb excessive pay to bankers.[106] Bankers in the European Union are barred from taking more than 30% of their bonus in cash since 2011 and risk losing some of the remainder should the bank's performance erode. Banks that do not fully comply with the rule have to set aside more capital to make up for the risk.[107] If national regulators determine a bank's compensation structure encourages risk, they can force the bank to place hundreds of millions of Euros more in its capital cushion as insurance. Banks that received government bailout funds also have to justify the compensation of their managers to the governments.[108] Switzerland, although not a member of the European Union, has also introduced limits on banker's pay.[109]

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http://www.law.harvard.edu/faculty/bebchuk/ Policy/FSC-written-testimony-June-11-09.pdf.

102. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 214 Stat. 1376, 1382 (2012). Dodd–Frank's "say on pay" became effective in January 2011.

103. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010); *see generally* Davis Polk & Wardwell LLP, *Summary of the Dodd–Frank Wall Street Reform and Consumer Protection Act, Enacted into Law on July 21, 2010*, (July 21, 2010), http://www.davispolk.com/dodd-frank/ (summarizing the Dodd–Frank Act); Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates, *Skadden Insights Special Edition: The Dodd–Frank Act* (July 2, 2010), http://www.skadden.com/newsletters /FSR_Test_3_alt.html.

104. In In re *Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 133 (Del. Ch. 2009), the Delaware Chancery Court looked into the bank managers' compensation issue. *See* Joseph W. Cooch, *In re Citigroup Inc. Shareholder Derivative Litigation: In the Heat of Crisis, Chancery Court Scrutinizes Executive Compensation*, 6 J. BUS. & TECH. L. 169, 169 (2011) (summarizing the case).

105. *See* Guido Ferrarini & Maria Cristina Ungureanu, *Economics, Politics, and the International Principles for Sound Compensation Practices: An Analysis of Executive Pay at European Banks*, 64 VAND. L. REV. 431, 459–64 (2011).

106. European Parliament Legislative Resolution of 7 July 2010 on the Proposal for a Directive of the European Parliament and of the Council Amending Directives 2006/48/EC and 2006/49/EC As Regards Capital Requirements for the Trading Book and for Re-Securitisations, and the Supervisory Review of Remuneration Policies, EUR. PARL. DOC. P7 TA(2010)0274 (2010). *Cf. Remuneration of Directors of Listed Companies and Remuneration Policies in the Financial Services Sector*, at 4, SEC (2009) 580 (Apr. 30, 2009). For the critical comments, see Guido Ferrarini et al., *Executive Remuneration in Crisis: A Critical Assessment of Reforms in Europe*, 10 J. CORP. L. STUD. 73, 73 (2010) (asserting the European Union needs to pay closer attention to its remuneration policies).

107. Liz Alderman, *Cap on Bank Bonuses Clears Hurdle in Europe*, N.Y. TIMES (July 7, 2010, 4:21 AM), http://dealbook.nytimes.com/2010/07/08/cap-on-bank-bonuses-clears-hurdle-in-europe/.

108. Manfred Schäfers, *Regierung will gegen Boni vorgehen*, FRANTFURTER ALLGERMAINE (Oct. 1, 2010), http://www.faz.net/s/RubD16E1F55D21144C4AE3F9DDF52B6E1D9/Doc~E5FA9A1CB36C248039D7BADA 76C5FA759~ATpl~Ecommon~Scontent.html.

109. *See* Adam C. Pritchard, *Populist Retribution and International Competition in Financial Services Regulation*, 43 CREIGHTON L. REV. 335, 352–53 (stating Switzerland has "stepped up with their own proposals

In the United Kingdom, the Financial Services Authority did issue the final form of the revised Remuneration Code (The Code) on December 17, 2010. The Code introduces significant restrictions on the way in which remuneration policies and structures are operated within financial institutions in the UK and beyond.[110] Scholars state "[t]he Code builds upon international standards set by the Financial Stability Board at a European level and goes beyond those standards in a number of key respects."[111] The Code subscribes to the principle of proportionality.[112]

Germany enacted the Law on the Appropriateness of Board Member Compensation (*Gesetz zur Angemessenheit der Vorstandsvergütung*—VorstAG) in 2009. Under the VorstAG, the total compensation for executives must reflect both the duties and responsibilities owed by them as well as the overall financial situation of the company.[113] The compensation contract must allow the downsizing of the compensation package in case the financial situation of the company deteriorates.[114] The supervisory board members may be held liable if they determined an inappropriate compensation package for an executive.[115] The annual general shareholders' meeting is entitled to approve the compensation package.[116]

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to limit bankers' pay").

110. *See generally* SHEARMAN & STERLING LLP, THE UK'S FINANCIAL SERVICES AUTHORITY ISSUES THE FINAL-FORM REMUNERATION CODE 1 (Dec. 28, 2010), http://www.shearman.com/~/media/Files/NewsInsights/Publications/2010/12/The-UKs-Financial-Services-Authority-Issues-the-__/Files/View-full-memo-The-UKs-Financial-Services-Author__/FileAttachment/ECEB122810FinalFormRenumerationCode.pdf (describing the Code).

111. *Id.* at 1.

112. *Id.* at 5.

113. Gesetz zur Angemessenheit der Vorstandsvergütung [VorstAG] [Act on the Appropriateness of Management Board Compensation], July 30, 2009, BGBI I.S. at 2479, art. 1, para. 1(a)) (Ger.), https://www.bundesanzeiger-verlag.de/fileadmin/Betrifft-Unternehmen/Arbeitshilfen/Transparenz/VorstAG_Managergehaelter.pdf.

114. VorstAG, art. 1, para. 1(b).

115. VorstAG, art. 1, para. 5(b).

116. VorstAG, art. 1, para. 6(b). *See generally* ANDREAS BERGER, VORSTANDSVERGÜTUNG: DIE VERGÜTUNGSPROBLEMATIK ALS LOGISCHE KONSEQUENZ DES GELTENDEN AKTIENRECHTS UND DIE FOLGEN FÜR DIE AUSGESTALTUNG DER REGELUNGEN [REMUNERATION: THE REMUNERATION PROBLEM AS A LOGICAL CONSEQUENCE OF THE PREVAILING COMPANY LAW, AND THE CONSEQUENCES FOR THE DESIGN OF THE ARRANGEMENTS] (2012) (Ger.) (discussing recent innovations in corporate law in the executive area); STEFAN OTTO, VORSTANDSVERGÜTUNG: GESETZLICHE OBERGRENZEN ALS GARANT FÜR ANGEMESSENHEIT? [REMUNERATION: LEGAL LIMITS AS A GUARANTOR FOR ADEQUACY?] (2012) (Ger.). Executive compensation, including bankers' pay, has also been a big issue in Switzerland. For legal rules and discussions regarding remuneration in Switzerland, see Kunz, *supra* note 74, at 113–14 (calling the issue a "[p]olitical [h]ot [p]otato" in Switzerland). Upon a citizen's initiative (Abzocker-Initiative), there was an affirmative national vote in March 2013. The initiative covers a lot of ground, including a proposal against rip-off salaries. It may not be understood as being designed solely for shareholder value, but it may also target some societal goals. PRICEWATERHOUSECOOPERS, EXECUTIVE COMPENSATION & CORPORATE GOVERNANCE 1, 14 (2010), https://www.pwc.ch/user_content/editor/files/publ_tls/pwc_executive_compensation_10_e.pdf (depicting "survey examining compensation structure in SMI and SMIM companies as well as Say-on-Pay"). The text of the initiative actually states that it was made "[t]o protect the economy, private property and the shareholders and in the spirit of sustainable corporate management." Alexander F. Wagner & Christoph Wenk, *Say-on-Pay in Switzerland: Binding Say-on-Pay and Its Impact on Shareholder Value*, PRICEWATERHOUSECOOPERS, Sept. 27, 2010, at 1, 20, https://www.pwc.ch/user_content/editor/files/publ_tls/pwc_excomp_sayonpay_100927.pdf (including the full text of the initiative). Daniel M. Häusermann, *Aktienrechtliche Umsetzung der "Abzocker"-Initiative: Spielraum und Rechtstechniken*, 108 SCHWEIZERISCHE JURISTEN-ZEITUNG 537 (2012) (Ger.).

Korea took the conventional approach to the management compensation issue, i.e., the disclosure, not substantial regulation, of management's compensation package. By doing so, the Korean Capital Markets Act requires disclosure of the total amount of all directors' remuneration as approved by the annual shareholders' meeting.[117] There is no special rule applicable to bank directors. However, since 2014, Korean companies, including banks and other financial firms, are required under Article 159, paragraph 2, No. 3 of the Capital Markets Act to disclose top five management pay on an individual basis.[118]

V. EXCURSUS: TORT LAW LIABILITY RULES FOR BANK DIRECTORS

It is understood that the extent to which "the law of tort fails to internalize systemic harms has been underappreciated."[119] Perhaps it would be a good idea to impose tort liabilities on bank directors under corporate law through connecting the breach of fiduciary duty to the bank for the systemic harms incurred to third parties.

Korean corporate law includes a very unique provision in this regard. Under Article 401 of the Korean Commercial Code, a director may be held jointly and severally liable to third parties for any damages incurred by such third parties resulting in the failure of such director to perform his or her duties, either willfully or by gross negligence.[120] This provision is unique because it holds directors liable to third parties for breach of their fiduciary duties owed to their own corporation. Third parties regularly incur losses due to the corporation's breach of their contract. Therefore, it is puzzling why the directors who decided to breach a third-party contract for the benefit of their corporation and shareholders were held liable to third parties. The Korean Supreme Court and other Korean courts have had a difficult line-drawing problem in identifying the circumstances where a breach of a third-party contract done for the benefit of the company constitutes a director's breach of fiduciary duty to the company.[121]

Perhaps this rule is best suited for non-bankruptcy cases where the bank managers and directors caused harm to third parties while doing their best for the bank and shareholders. A bank director can sign a risky contract with a third party on behalf of the bank by considering the interests of the firm and shareholders. In such a case, it is not easy to determine at a glance whether the act should be deemed the director's neglect of duty towards the corporation. The difficulty arises because it may be viewed neither as a breach of laws and regulations nor the articles of incorporation. Nevertheless, signing a risky contract may expose the corporation to the possibility of insolvency, thereby dealing a blow in achieving the company's business objectives while affecting the reliance on the company placed by its shareholders. However, a corporation also possesses a social aspect that should be sustainable, and such an act of a director may cause harm to the company as well as all of its interested parties, even though it is in the short-term interest of the

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117. Financial Investment Business and Capital Markets Act, Act No. 8635, Aug. 3, 2007, *amended by* Act No. 11845, May 28, 2013, Art. 159, Paragraph 2, No. 2 (S. Kor).

118. For developments in Japan, see generally Robert J. Jackson, Jr. & Curtis J. Milhaupt, *Corporate Governance and Executive Compensation: Evidence from Japan*, 2014 COLUM. BUS. L. REV. 111 (2014) (discussing a recent change in Japanese law regarding executive compensation).

119. Armour & Gordon, *supra* note 10, at 37.

120. The majority of commentators in Korea regard the liability as *sui generis* while some view it as tort liability. CHUL SONG LEE, CORPORATE LAW 780–81 (23rd ed. 2015) (Kor.).

121. *See* Kim, *supra* note 72 (discussing the Korea First Bank case); LEE, *supra* note 120, at 781–82.

company and shareholders. As banks create systemic risks, the sustainability consideration is more compelling to bank directors.

VI. Concluding Remarks

It is one thing for the government to specially regulate the corporate governance of banks through financial regulation. It is entirely another matter for the government to directly shape the corporate governance of the banks using non-legal measures like financial supervision. The politicization of corporate governance of banks creates a danger of the bank's condition deteriorating through internal power struggle, corruption, cronyism, and even directed lending. KB in Korea provides an example of how corporate governance issues have steadily compromised KB's standing in the Korean banking industry. As discussed in this Article, the stakeholder thesis cannot justify the government's direct intervention through financial supervision. Corporate governance of banks may be tightly regulated through special laws, but financial supervision must be saved for its conventional function.

This Article discussed corporate governance of banks from a comparative perspective. In the United States and Europe, the global financial crisis renewed the corporate governance of banks as an issue. However, corporate governance discussions in the United States and Europe are not significantly different from those of general corporations as the industry focuses on the supplement of prudential regulation for corporate law. On the other hand, in emerging economies like Korea, bank corporate governance remains very much a structural issue. Politics, government, and populist groups shape the corporate governance of banks in those countries. In emerging economies, the ownership and board structure of banks and the role of the state in bank corporate governance may be more salient than bank directors' fiduciary duties, risk management, and banker's pay. The emerging economies need to focus more on corporate law and financial regulation to improve the corporate governance of their banks before they use other measures, such as financial supervision.