

Lawyering Up

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This Article is the first to analyze a sea change in bank governance—the precipitous rise of lawyer-directors in the past two decades. Using novel empirical evidence, we show that lawyer-directors are associated with efficient changes in risk management and significant increases in bank value. Banks with lawyer-directors assume more risk in ordinary circumstances and less risk when a crisis arises, in each case making those banks more valuable.

Understanding that change in governance is vital in light of the COVID-19 crisis, which has transformed the risks that banks face. We show that—beyond new regulation, as others have proposed—having a director who “thinks like a lawyer” is likely to make boards more effective in managing new risks. Lawyer-directors add value to boards by drawing on advocacy skills to analyze opposing points of view, an essential quality in managing risk. They are more likely to make complex information more accessible to a board and to build a consensus among different points of view. Lawyer-directors, of course, are also skilled at assessing litigation and regulatory risks, which have grown significantly in recent years.

Our findings challenge the standard framing of the board. Improving board efficacy requires a more nuanced understanding than has happened to date of the effect on boards of board composition and directors’ skills. We use the example of bank lawyer-directors to begin addressing that shortcoming. Beyond banks, however, our findings underscore the need for a new approach to analyzing what really matters for boards and corporate governance.

I. INTRODUCTION

Economic crises resemble Tolstoy's unhappy families—each crisis exists in its own unhappy way.¹ The financial crisis of 2008 arose out of flaws in the subprime mortgage market and the instruments used to finance it.² Now, just 13 years later, a second financial crisis is tied to a global pandemic and its effects on the real economy. From these crises, two lessons are already clear: first, if it ever was true, the statement that a global financial crisis is “once in a lifetime” is no longer true today. The decades-long period of financial calm leading up to the 2008 crisis may have been the aberration rather than the tumult of the last 13 years.³ Second, it is a fool's errand to attempt to predict how the next crisis will arise. The two recent crises had very different causes and affected the financial sector in very different ways.⁴ Regardless of how well changes in regulation responded to the 2008 crisis,⁵ the nature and scale of the current pandemic-induced crisis was never even considered.⁶ Regulating for the next financial crisis, based on the conditions of the last,⁷ is simply misplaced.

In this Article, we demonstrate that banks⁸ have come to realize the value of efficiently responding in real-time to changes in risk. As obvious as this sounds, it contradicts the standard framing of bank regulation. That framing presupposes that a

1. LEO TOLSTOY, ANNA KARENINA 1 (Richard Pevear & Larissa Volokhonsky, trans., Viking Penguin, 2001) (1878) (“All happy families are alike; each unhappy family is unhappy in its own way.”)

2. The 2008 financial crisis is the subject of a wide array of studies. For a review of these studies, see generally Andrew W. Lo, *Reading about the Financial Crisis: A Twenty-One-Book Review*, 50 J. ECON. LIT. 151 (2012).

3. See, e.g., JAMES K. GALBRAITH, THE END OF NORMAL: THE GREAT CRISIS AND THE FUTURE OF GROWTH (2014) (challenging the view that the economic growth from the 1950s to the 2000 represented a “normal performance” and that full recovery was to be expected after 2008); Peter S. Goodman, *Why the Global Recession Could Last a Long Time*, N.Y. TIMES [https://perma.cc/C5NE-7V7Y] (Apr. 1, 2020), https://www.nytimes.com/2020/04/01/business/economy/coronavirus-recession.html (suggesting that the current crisis might be destined to be the new normal for years to come).

4. The 2008 crisis arose from a massive financial shock that moved into the real economy and caused economic activity to contract. The current pandemic is a public health crisis, where containment efforts are affecting the real economy, with devastating consequences for the financial sector. See Stephen S. Roach, *The 2008 Financial Crisis and Covid-19: A False Comparison*, FIN. NEWS (Mar. 20, 2020, 6:52 AM), https://www.fn.london.com/articles/the-08-financial-crisis-and-covid-19-a-false-comparison-20200320 [https://perma.cc/39G3-CMYW].

5. For an overview of the post-2008 reforms, see generally INTERNATIONAL MONETARY FUND, GLOBAL FINANCIAL STABILITY REPORT: A DECADE AFTER THE GLOBAL FINANCIAL CRISIS: ARE WE SAFER? (2018), https://www.elibrary.imf.org/view/IMF082/25319-9781484375594/25319-9781484375594/ch02.xml?lang=en [https://perma.cc/V3HU-4BN3]. For a recent critical assessment of post-2008 regulatory reforms, see Darrell Duffie, *Financial Regulatory Reform After the Crisis: An Assessment*, 64 MGMT. SCI. 4835 (2018).

6. See Marie-Paule Laurent et al., *Banking Models after Covid-19: Taking Model-Risk Management to the Next Level*, MCKINSEY & CO. (May 5, 2020), https://www.mckinsey.com/business-functions/risk/our-insights/banking-models-after-covid-19-taking-model-risk-management-to-the-next-level [https://perma.cc/JFY4-JFW4] [hereinafter MCKINSEY, *Banking Models after Covid-19*] (“The models that financial institutions depend on to run their businesses simply did not account for such a crisis.”).

7. See Charles K. Whitehead, *Reframing Financial Regulation*, 90 B.U. L. REV. 1, 2 (2010) (“Financial regulation is often reactive. New regulation seals up leaks in the financial system—usually following a crisis, a shift in the markets, or other change that threatens financial stability.”).

8. The terms “bank” and “banks” in this Article refer to institutions that are identified as financial institutions within Standard Industrial Classification (SIC) codes 6000-6999, including commercial banks, investment banks, and insurance companies.

bank's managers are largely unable or unwilling to optimize the risks to which banks are exposed, principally due to the risk-taking incentives of the banks' diversified shareholders. The result, within the traditional framing, is a need for new or stricter regulation to circumscribe the greater risk to which banks are exposed.⁹

Our findings draw that framing into question. Rather than bank managers who incur too much risk, our study uncovered a sea change—unprompted by new regulation—in bank governance that is aimed to more effectively manage bank risk.¹⁰ Increasingly, bank boards are “lawyering up” to address the new and significant risks to which banks are exposed. In 1999, only about 40% of banks had a lawyer on the board.¹¹ Today, that level has risen to more than 70%, a staggering 73% increase.¹² The rise is too precipitous to be a coincidence. Using a matching methodology to mitigate endogeneity concerns,¹³ our results show that when a lawyer is on the board, a bank assumes more risk in ordinary (non-crisis) times and less risk when a crisis arises—braking and accelerating risk-taking in valuable ways.¹⁴ During a financial crisis, it is natural to focus on the “bad risk” that can harm bank value.¹⁵ However, effective risk management

9. See, e.g., MATHIAS DEWATRIPOINT & XAVIER FREIXAS, THE CRISIS AFTERMATH: NEW REGULATORY PARADIGMS 11–45 (2012) (suggesting that the combination of excessive risk-taking by bank shareholders and managers and the inability of regulators to mitigate this problem resulted in the 2008 financial crisis); John C. Coffee, Jr., *Systemic Risk After Dodd-Frank: Contingent Capital and the Need for Regulatory Strategies Beyond Oversight*, 111 COLUM. L. REV. 795, 795 (2011) (arguing that shareholder pressure for greater risk-taking is a major source of systemic bank risk); Douglas W. Diamond & Raghuram G. Rajan, *The Credit Crisis: Conjectures About Causes and Remedies*, 99 AM. ECON. REV. 606, 607–08 (2009) (describing a “culture of excessive risk taking that had overtaken banks”).

10. A short feature related to earlier versions of the analysis in this Article appeared in the May 2020 issue of *The Practice*, a digital magazine published by the Center on the Legal Profession at Harvard Law School. See Scott B. Guernsey et al., *Banking on the Lawyers*, PRACTICE (2020), <https://thepractice.law.harvard.edu/article/banking-on-the-lawyers/> [<https://perma.cc/5SXM-8WJX>]. We thank the editors of *The Practice* for conducting interviews with prominent lawyer-directors, some of which we include later in this Article. Those interviews provide valuable evidence in support of the role of lawyer-directors that complements our own analysis.

11. See *infra* Fig. 1 (showing the percentage of banks in our sample with a lawyer-director for each year from 1999 to 2017).

12. See *infra* Fig. 1.

13. A matching methodology means that we compare the risk of banks with a lawyer-director (the “treated” banks) to the risk of a set of “control” banks that shared core characteristics with the treated banks, but did not have a lawyer-director. See *infra* text accompanying notes 116–118. Specifically, this methodology helps us mitigate the endogeneity concern that changes in bank risk (the dependent variable) might be due to changes in some omitted variable rather than the presence of a lawyer-director (the independent variable). On the reliability of matching to address endogeneity concerns, see generally GUIDO W. IMBENS & DONALD B. RUBIN, CAUSAL INFERENCE FOR STATISTICS, SOCIAL, AND BIOMEDICAL SCIENCES: AN INTRODUCTION 401–04 (2015) (“Matching estimators based on direct comparisons of outcomes for observationally equivalent ‘matched’ units that received different levels of a treatment are among the most intuitive estimators for treatment effects.”). For a treatment of matching tailored for a legal audience, see K.J. Martijn Cremers, Saura Masconale & Simone Sepe, *Activist Hedge Funds and the Corporation*, 94 WASH. U. L. REV. 261, 266, 282–85 (2017).

14. This is consistent with recent empirical evidence showing that risk committees that maximize shareholder wealth operate in such a way that “the risk committee at time has the impact of reducing risk-taking and at other times has the opposite impact.” See René M. Stulz et al., *Why Do Bank Boards Have Risk Committees?* (Fisher Coll. of Bus. Working Paper Series, Working Paper No. 2021-12), <https://ssrn.com/abstract=3893882> [<https://perma.cc/P8FJ-DYDP>].

15. See René M. Stulz, *Risk Management, Governance, Culture, and Risk Taking in Banks*, FRBNY ECON. POL’Y REV., Aug. 2016, at 43 (“I call risks that are only danger bad risks.”).

also addresses “good risk,” in which uncertain opportunities that are likely to be profitable are identified and pursued.¹⁶ As a result, our data show that bank value (as measured by Tobin’s Q)¹⁷ increased by 5.7% in the year immediately after a lawyer joined a bank’s board and continued to increase in the following years.¹⁸

These findings suggest that what goes on *inside* the board and *who the directors are* is as important, if not more important, than current regulation, whether in the form of higher capital requirements or rules requiring directors to be independent or financially literate.¹⁹ While our study underscores the value of director expertise, it more broadly suggests that the current approach is too narrow and too static. Other types of expertise may be as relevant—perhaps more relevant—for today’s banks, including legal expertise. Moreover, rather than compliance with static regulation, we find that effective risk management requires striking a balance between curbing bad risk, on the one hand, and leaving bank managers the flexibility to pursue good risk, on the other.²⁰

This need to flexibly manage risk is greatest as banks begin to consider the “new normal” that will follow the COVID-19 pandemic. For example, due to the pandemic’s economic impact, models that banks have used to assess the likelihood a borrower will default must now be reconsidered.²¹ Banks must also begin to assess the legal and regulatory issues involved in monitoring employees who continue to work from home.²² How quickly the economy will return to pre-crisis growth levels, and what will happen if there are later pandemics, must also be weighed. Finally, banks must consider the likelihood that the post-crisis world will provide business opportunities that did not exist before. New technology-based businesses may make banking easier in a world where social distancing and cashless transactions have become the norm in how banks interact with customers.²³

These changes, and the risks and opportunities they entail, cannot be addressed through fixed regulation. Instead, they require directors who can fluidly respond to changes in risk as they evolve. In other words, if there is a change in the risk affecting a bank, the bank benefits by having managers who can efficiently respond to that risk as it arises. To that end, we find empirical evidence that lawyers are more likely to be elected

16. *Id.*

17. Tobin’s Q is, roughly, the ratio of a firm’s market value of assets to the book value of assets. See Eugene F. Fama & Kenneth R. French, *Testing Trade-Off and Pecking Order Predictions About Dividends and Debt*, 15 REV. FIN. STUD. 1, 8 (2002). For a discussion of the advantages and limitations of the use of Tobin’s Q as a measure of firm value, see *infra* note 91 and accompanying text.

18. See *infra* Tbl. 4 (presenting results on the value impact of lawyer-directors in banks).

19. See *infra* Part V.A.

20. See *infra* Part II.A.

21. See MCKINSEY, *Banking Models after Covid-19*, *supra* note 6 (“Financial institutions must now urgently review their model strategies. They need to develop and apply both efficient short-term actions and a long-term plan to improve model resilience.”).

22. See OFFICE OF THE COMPTROLLER OF THE CURRENCY, SEMIANNUAL RISK PERSPECTIVE: FROM THE NATIONAL RISK COMMITTEE (2020), <https://www.occ.gov/publications-and-resources/publications/semiannual-risk-perspective/files/pub-semiannual-risk-perspective-spring-2020.pdf> [<https://perma.cc/3VFU-BA4Q>] [hereafter, OCC RISK REPORT] (“Operational risk is heightened as banks amended business processes and engaged third parties to support widespread remote work capabilities . . .”).

23. See Mohit Joshi & Markos Zachariadis, “Phygital”: A Banking Strategy for the New Isolation Economy, WORLD ECON. F. (June 5, 2020), <https://www.weforum.org/agenda/2020/06/phygital-strategy-isolation-economy/> [<https://perma.cc/J2VH-YWRY>] (“The pandemic has accelerated most banks’ digitalization initiatives.”).

to a bank's board when the bank is underperforming, including, in particular, during a financial crisis.²⁴ We interpret this evidence to indicate that lawyer-directors are elected with the expectation they will help improve bank value. Moreover, the rise of lawyer-directors when the bank is underperforming suggests they are particularly valuable when effective risk management—the ability to enhance value by fluidly responding to changes in risk as they evolve—has become critical.²⁵

But why are lawyers—and not other experts²⁶—so well-positioned to manage a bank's risks, including those arising from COVID-19?²⁷ Our answer, supported by further empirical evidence, is that there is value in “thinking like a lawyer.” Drawing on information economics,²⁸ we suggest that a lawyer's training as an advocate—to question assumptions and consider different viewpoints—promotes the gathering of more information and the reduction of “group thinking” among directors.²⁹ We see evidence of this in the increased likelihood of having a lawyer-director when the CEO is on the board.³⁰ As advocates, we expect lawyer-directors to be less inclined to defer to the CEO (or any other single source of information). Thus, banks are more likely to benefit from a lawyer-director's ability to mitigate the risk of a CEO-director's excessive influence over the board.

By facilitating consensus, a lawyer's negotiation and mediation skills can also assist a board's decision-making.³¹ Lawyers are trained to find a common ground on which to resolve disputes. Consequently, lawyer-directors can help mediate different points of view, for example, between directors who are “banking literate” and those who are non-experts, as one way to encourage effective interaction among board members. In support, we find that the value of having a lawyer-director is greater in banks whose directors have diverse educational and professional backgrounds³²—that is, banks with expert and non-expert directors may benefit by having a lawyer-director who can bridge multiple perspectives.

Of course, a lawyer's value also springs from a substantive knowledge of the law. In particular, lawyers are experts at assessing litigation and regulatory risks, which have

24. See *infra* Part III.C.

25. See *infra* Part III.D.2 (discussing bank value and lawyer-directors relative to risk exposure).

26. To date, proposals to include experts on bank boards have almost exclusively focused on one kind of expertise—financial skills. See, e.g., Jonathan Macey & Maureen O'Hara, *Bank Corporate Governance: A Proposal for the Post-Crisis World*, FRBNY ECON. POL'Y REV., Aug. 2016, at 85, 103.

27. Could the value-enhancing results we find be replicated by a lawyer who advises, rather than joins, a bank's board? We think not. A lawyer-director is more likely than outside counsel to attend board meetings and have access to information needed to properly advise the board. See Robert H. Mundheim, *Should Code of Professional Responsibility Forbid Lawyers to Serve on Boards of Corporations for Which they Act as Counsel?*, 33 BUS. LAW. 1507, 1514 (1978); Micalyn S. Harris & Karen L. Valihura, *Outside Counsel as Director: The Pros and Potential Pitfalls of Dual Service*, 53 BUS. LAW. 479, 483 (1998). A lawyer-director may also become aware of new information at an earlier stage, enabling her to flag concerns as they arise. See Harris & Valihura, *supra*, at 482–83. Directors and managers are also more inclined to follow the advice of a colleague who shares equal responsibility for its outcome. See Craig C. Albert, *The Lawyer-Director: An Oxymoron?*, 9 GEO. J. LEGAL ETHICS 413, 417–18 (1996). That may be particularly true of lawyer-directors in light of the higher standards to which the courts have held them. See Mundheim, *supra*, at 1508 (raising questions regarding lawyers on boards).

28. See *infra* notes 143–145 and accompanying text.

29. See *infra* Part IV.A.

30. See *infra* Tbl. 2 (showing which bank characteristics predict the appointment of a lawyer-director).

31. See *infra* Part IV.B.

32. See *infra* Tbl. 6 (presenting results on the value impact of having more intellectual diversity on a bank's board).

grown significantly as banks have come to face greater litigation and regulation in the aftermath of the 2008 crisis.³³ Not surprisingly, we find that banks with more exposure to these risks especially benefit from having a lawyer on the board.³⁴

To date, the literature on boards and risk management has been fairly coarse—often conceiving of the board as a “black box,” with only a limited account of the directors “inside” the box and how they fulfill their risk management duties.³⁵ As a result, regulators and academics lack a clear understanding of how directors interact and the effect of that interaction on how risks are managed. What is clear from our findings is that the standard framing of the board is outdated and must be revisited. This Article begins to penetrate the black box, beyond lawyer-directors on bank boards, to emphasize the importance of an individual director’s characteristics to effective corporate governance and board leadership.

We proceed as follows. In Part II, we explain why risk management is challenging and, at the same time, valuable for banks. We also discuss the complexities that bank risk creates for regulation. In Part III, we introduce data on the increasingly frequent election of lawyers to bank boards and the value to a bank of a lawyer-director’s ability to manage risk. With this evidence, in Part IV, we explain and support with further empirical evidence the value of having a bank director who “thinks like a lawyer.” Specifically, we identify three skill sets that are likely to assist lawyers in their board service and, in particular, in identifying, assessing, and managing risk. Part V then discusses certain of the normative implications of our analysis, offering an alternative to the current regulatory approach to effective risk management and corporate governance.

II. BANK RISK AND REGULATION

A. Risky Business

Managing risk is at the heart of a bank’s business. One sees this, for example, in the basic business model for commercial banks. Within the traditional framing, a commercial bank relies on its depositors for funds it then lends to borrowers. Doing so requires the bank to balance the interests of its depositors, who seek the flexibility to withdraw funds at any time, with the interests of its borrowers, who seek a stable, long-term source of capital.³⁶ A commercial bank’s operations depend largely on its ability to balance those

33. See *infra* notes 42–44 and accompanying text (noting the increase in regulation and compliance in banking).

34. See *infra* Tbl. 7 (presenting results on the value impact of a lawyer-director in banks with greater litigation and regulatory risks).

35. See Timothy F. Malloy, *Regulating by Incentives: Myths, Models, and Micromarkets*, 80 TEX. L. REV. 531, 535 (2002) (describing the traditional black-box model and arguing that regulation should take into consideration that corporations are *not* black boxes). Unlike the corporate legal scholarship, the management literature has paid more attention to the need to go beyond the black-box approach to board decision-making. See, e.g., Daniel P. Forbes & Frances J. Milliken, *Cognition and Corporate Governance: Understanding Board of Directors as Strategic Decision-Making Groups*, 24 ACAD. MGMT. REV. 489, 490 (1999) (proposing a model of board processes that integrates the literature on boards with the literature on group dynamics and workgroup effectiveness); Andrew M. Pettigrew, *On Studying Managerial Elites*, 13 STRATEGIC MGMT. J. 163, 164 (1992) (arguing that research on boards should focus on their actual behavior, supplementing our knowledge of what boards look like with evidence of what boards actually do).

36. See Douglas W. Diamond & Raghuram G. Rajan, *Liquidity Risk, Liquidity Creation, and Financial Fragility: A Theory of Banking*, 109 J. POL. ECON. 287, 287–88 (2001) (arguing that the goal of mediating liquidity

competing interests, as well as the credit and liquidity risks that arise from them. The bank must monitor its borrowers' ability to repay their obligations (credit risk),³⁷ as well as ensure that money is available for depositors who wish to withdraw funds (liquidity risk).³⁸ Since risk is intrinsic to banking, how it is managed affects bank value.³⁹

Managing risk, however, is a challenge. It requires a bank's managers to identify and define the bank's risks, assess their magnitude, gauge optimal risk-and-return tradeoffs, pursue profitable opportunities, and mitigate the likelihood of bad outcomes.⁴⁰ Taking too little risk and foregoing valuable opportunities can be as damaging to a bank's business as the losses that can result from incurring too much risk. In effect, more than for other businesses, virtually any decision by a bank's managers can be reduced to a risk decision that increases or decreases the bank's value.⁴¹

needs between depositors and borrowers helps explain why these two functions are combined in a bank); see also Whitehead, *supra* note 7, at 9–14 (discussing intermediation costs).

37. Credit risk is the likelihood a borrower will default or otherwise fail to meet its payment obligations. See BASEL COMMITTEE ON BANKING SUPERVISION, PRINCIPLES FOR THE MANAGEMENT OF CREDIT RISK 1 (2020), <https://www.bis.org/publ/bcb75.htm> [<https://perma.cc/F3GV-EYS3>].

38. Liquidity risk is the likelihood a bank is unable to meet its short-term financial demands by converting assets into cash without incurring a loss. See Jean Tirole, *Illiquidity and All Its Friends*, 49 J. ECON. LIT. 287, 288–90 (2011) (providing an in-depth treatment of the risks connected to illiquidity, including market freezes, fire sales, financial contagion, insolvency, and bailouts). Banks issue liquid claims in the form of deposits or other deposit-like products. Overnight repurchase transactions (repo) are the classic example of deposit-like products. Under a repo agreement, a party (i.e., a bank) sells securities to another party (the repo holder) and agrees to buy back the securities in the near term at a higher price, in substance using the securities as collateral for a short-term borrowing. See Gary Gorton & Andrew Metrick, *Securitized Banking and the Run on Repo*, 104 J. FIN. ECON. 425, 425 (2012). Those deposits are “transformed” by the bank into illiquid assets such as medium- to long-term loans. Banks can maintain the mismatch between liquid liabilities and illiquid assets due to their superior ability to generate private information about specific borrowers and diversify risk across a portfolio of borrowers. See Douglas W. Diamond, *Financial Intermediation and Delegated Monitoring*, 51 REV. ECON. STUD. 393, 393 (1984) (developing a formal analysis of the informational advantages of financial intermediaries).

39. See Harry DeAngelo & René M. Stulz, *Liquid-Claim Production, Risk Management, and Bank Capital Structure: Why High Leverage is Optimal for Banks*, 116 J. FIN. ECON. 219, 219 (2015) (arguing that a bank's ability to issue claims that are valued because of their liquidity depend on its risk, so that risk management is central to a bank's business model).

40. See Stulz, *supra* note 15, at 47 (“There is, for each bank, a level of risk such that the value of the bank is maximized for shareholders. This level of risk is not zero. Good governance should ensure that the firm chooses this level of risk.”); Charles K. Whitehead, *Destructive Coordination*, 96 CORNELL L. REV. 323, 336 (2011) (“A risk manager is understood to . . . seek strategies that minimize risk (relative to return) . . .”).

41. The mean-variance model from corporate finance helps illustrate this point. See RICHARD BREALEY, STEWART MYERS & FRANKLIN ALLEN, *PRINCIPLES OF CORPORATE FINANCE* 174 (13th ed. 2020). The mean-variance model weighs risk, expressed as variance or the volatility of an asset's returns, against expected returns. In brief, it helps investors identify the greatest return for a certain level of risk or the least risk at a certain level of return, facilitating the design of efficient investment portfolios. As applied to bank investments, the value of a bank can be expressed as $V(R, \sigma)$, meaning that bank value is a function of return (R) and risk/variance (σ , sigma, representing standard deviation, which is the square root of variance). Note that, in light of the several types of risk that banks must manage, “risk” (σ) is better interpreted as a bank's risk management function. Under this interpretation, the application of the mean-variance model to banks does more than tell us that bank value depends on expected returns from a bank's assets and the bank's ability to manage its overall risk. Rather, returns are an inverse function of risk, so that if investors are willing to accept more risk, they can invest in projects with higher returns (and vice versa). Accordingly, R can be written as $R(\sigma)$, since return is a function of risk under this recharacterization, and bank value can be rewritten as $V(R(\sigma), \sigma)$. This means that any management decision affecting value (V) is ultimately a risk decision, whether indirectly though the choice of bank projects $R(\sigma)$ or directly through risk management choices (σ).

For example, a commercial bank may seek to enhance its profits by increasing returns on its investment portfolio (such as on the loans it extends) or lowering the cost of the funds it borrows (such as on the deposits it receives). Yet, both changes entail new risks—new credit risk to the extent the bank lends to riskier borrowers at higher interest rates, and new liquidity risk to the extent the drop in what depositors are paid increases the likelihood they will withdraw funds. In addition, those changes may expose the bank to new regulatory risk—the application of new or changed regulation in light of the change in business. Regulatory risk grew substantially after the 2008 crisis,⁴² with litigation increasing in line with the roll-out of new regulations,⁴³ to the point where the cost of complying with regulation has become a primary factor when a bank considers altering its strategic direction.⁴⁴ Changing its business may also expose the bank to operational risk,⁴⁵ resulting in execution faults or other failed interactions with clients as the bank adopts new business practices. Operational risk exploded after the 2008 crisis, largely due to a rise in litigation that, to date, has cost banks about \$250 billion.⁴⁶ Thus, changing the bank’s operations—in this case, how it invests or borrows—raises new risks that directly affect its performance.

42. See, e.g., Steve Culp, *Managing Regulatory Risk a Major Hurdle for Banks*, FORBES (May 8, 2012, 10:18 AM), <https://www.forbes.com/sites/steveculp/2012/05/08/managing-regulatory-risk-a-major-hurdle-for-banks/#480ebc8a131c> [<https://perma.cc/9QW2-286W>] (discussing several forms of new regulatory risks brought about by the proliferation of new bank regulatory measures after the 2008 financial crisis); *The Past Decade Has Brought a Compliance Boom in Banking*, ECONOMIST (May 2, 2019), <https://www.economist.com/finance-and-economics/2019/05/02/the-past-decade-has-brought-a-compliance-boom-in-banking> [<https://perma.cc/58GD-LW99>] (explaining regulatory changes after the 2008 crisis).

43. James E. McNulty & Aigbe Akhigbe, *Bank Litigation, Bank Performance and Operational Risk: Evidence from the Financial Crisis 4* (Jul. 7, 2014) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2463373 [<https://perma.cc/29JL-5H4C>]. For example, banks continue to pursue, or be the targets of, residential mortgage-related lawsuits; in fact, many banks are still not clear of the lawsuits arising out of the 2008 financial crisis. See Philip R. Stein, *A Decade on, Crisis Era Litigation Still Bedevils Banks*, AM. BANKER (Apr. 4, 2018), <https://www.americanbanker.com/opinion/a-decade-on-crisis-era-litigation-still-bedevils-banks> [<https://perma.cc/SGT7-QMER>].

44. See EY & INSTITUTE OF INTERNATIONAL FINANCE, *REMAKING FINANCIAL SERVICES: RISK MANAGEMENT FIVE YEARS AFTER THE CRISIS 5* (2013), [https://www.ey.com/Publication/vwLUAssets/Remaking_financial_services_risk_management_five_years_after_the_crisis_Complete/\\$FILE/EY-Remaking_financial_services_risk_management_five_years_after_the_crisis.pdf](https://www.ey.com/Publication/vwLUAssets/Remaking_financial_services_risk_management_five_years_after_the_crisis_Complete/$FILE/EY-Remaking_financial_services_risk_management_five_years_after_the_crisis.pdf) [<https://perma.cc/6FRT-S8LH>] (“One of the bigger challenges is the increased cost of regulation, both in terms of increased capital requirements, as well as the internal costs to keep up with regulation. The challenge is to adhere to the regulatory changes, to incur the costs . . . and still turn out a profit . . .”).

45. See BASEL COMMITTEE ON BANKING SUPERVISION, *BANK FOR INT’L SETTLEMENTS, INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENTS AND CAPITAL STANDARDS 144* (2006), <https://www.bis.org/publ/bcbs128.pdf> [<https://perma.cc/HPY8-CMQE>] (including operational risk in the main risks faced by banks). See also Douglas Robertson, *So That’s Operational Risk! (How Operational Risk in Mortgage-Backed Securities Almost Destroyed the World’s Financial Markets and What We Can Do About It)* 1 (OCC Econ. Working Paper, Working Paper No. 2011-1), <https://www.occ.gov/publications-and-resources/publications/economics/working-papers-archived/pub-econ-working-paper-2011-1.pdf> [<https://perma.cc/Y2V5-K78V>] (defining operational risk as “the risk of loss from inadequate or failed internal processes, people, and systems, or from external events”).

46. See Tracey Samuelson, *Following the Money: What Happened to a Nearly \$17 Billion Bank Settlement?* MARKETPLACE (Sept. 19, 2018), <https://www.marketplace.org/2018/09/19/17-billion-bank-settlement-where-did-money-go/> [<https://perma.cc/W8XN-V33Z>].

B. Risk-taking Incentives

Significantly, within the traditional framing of a bank, a bank's managers are understood to have incentives to incur greater risk than optimal. Those incentives partly reflect tensions among a bank's capital stakeholders. On the one hand, the potential losses to a bank's shareholders are capped at the amounts they invest in the bank, whereas their returns, tied to the bank's profits, are potentially unlimited. On the other hand, the bank's principal liabilities are comprised of the products it offers—for example, deposits by commercial banks—whose returns are fixed at an agreed rate or formula. The result is a split in incentives, with shareholders (who elect the bank's managers) preferring a riskier investment strategy, and with customers (who invest in the bank's products) preferring less risk so long as they receive their pre-agreed return.⁴⁷

A bank's managers may also be inclined to incur greater risk if they do not bear the full cost of their risk-taking decisions. For example, banks are vulnerable to “runs” by depositors and other short-term borrowers.⁴⁸ This is primarily due to the potential imbalance between liquid liabilities and illiquid assets; no bank can satisfy all of its creditors if they demand repayment *en masse*. In the event of rumors about a bank's instability, depositors may anticipate the worst and rush to withdraw funds, forcing even solvent banks into bankruptcy.⁴⁹ The wider effect on the financial markets and the real economy can be substantial.⁵⁰ Consequently, the cost of incurring risk extends well beyond the bank manager who makes the risk decision—a negative externality that is unlikely to be fully considered when deciding what risks the bank should assume.

Much of financial regulation, therefore, restricts the amounts and types of risk that banks can incur, directly through requirements that circumscribe the riskiness of a bank's investment assets and its capital structure, and indirectly through rules regarding the bank's net worth, capital, or surplus, that effectively cap the bank's risk-taking activities. Together, those regulations limit a bank's risk by moderating both the asset and liability sides of its balance sheet.

C. Dynamic Risk, Static Regulation

Risk, however, is dynamic, which makes regulating it difficult. What is optimal for a bank today may not be optimal tomorrow. That need for a fluid approach to managing risk

47. See Clifford W. Smith, Jr. & Jerold B. Warner, *On Financial Contracting: An Analysis of Bond Covenants*, 7 J. FIN. ECON. 117, 118–19 (1979) (pioneering the study of what they referred to as the “asset substitution” problem between shareholders and creditors). In banks, this problem is exacerbated by banks' highly leverage capital structures and the distortions caused by deposit insurance and other safety nets on the incentives of debtholders to monitor shareholders. See Simone M. Sepe, *Regulating Risk and Governance in Banks: A Contractarian Perspective*, 62 EMORY L.J. 327, 375–78 (2012).

48. The seminal model of financial intermediation and bank runs was developed in Douglas W. Diamond & Philip H. Dybvig, *Bank Runs, Deposit Insurance, and Liquidity*, 91 J. POL. ECON. 401, 402–03 (1983).

49. See *id.* at 402 (“[B]ank runs cause real economic problems because even ‘healthy’ banks can fail . . .”).

50. This effect has become even more significant in modern banking due to the increase in interbank transactions and the fact that banks increasingly invest in similar assets and rely on similar means to fund their business. See, e.g., Jean-Charles Rochet & Jean Tirole, *Interbank Lending and Systemic Risk*, 28 J. MONEY, CREDIT & BANKING 733, 733 (1996) (discussing interbank transactions and the risks arising therefrom). These features of modern banking make it more likely that investors will interpret a crisis at one bank to be a signal that other banks face the same problems, triggering systemic effects. See Sepe, *supra* note 47, at 346–49 (discussing the contagion effects of increased interbank correlation).

contrasts with the fixed asset-and-liability requirements typically imposed by regulation. One sees this in the challenges raised by COVID-19. Banks typically manage credit risk using decades of historical data to assess the likelihood of a borrower's default.⁵¹ Risk can be balanced across borrowers, industries, and geographies, using that data to determine whether some borrowers in some parts of the country are more or less likely to default depending on their economic circumstances. The pandemic, however, has rendered many of those risk models moot by uniformly raising the risk of loan defaults across all sectors and geographies,⁵² fundamentally reshaping entire industries.⁵³ Unprecedented government support may ease some credit problems,⁵⁴ but an uptick in new infections means that banks must continue to monitor changes in the risks to which they are exposed. Beyond credit risk, the COVID-19 pandemic has created a wave of other risks that banks must address—such as a surge in reliance on information technology (IT) systems through remote banking⁵⁵ and a spike in cyber-fraud affecting the banks' customers.⁵⁶ The nature and scope of these risks have evolved with the pandemic, making them difficult to regulate as they and other risks continue to affect bank performance.

In addition to lacking needed flexibility, fixed requirements can also distort a bank's risk-taking decisions. There must be a careful balance; otherwise, “[i]n regulating potential risks . . . too little leaves the system vulnerable, but too much makes it unprofitable for regulated institutions to provide financial intermediation.”⁵⁷ For example, following the 2008 crisis, banks became subject to the heightened capital requirements of the Basel III Accord⁵⁸ and the Dodd-Frank Act.⁵⁹ Under those requirements, banks must maintain

51. See MCKINSEY, *Banking Models after Covid-19*, *supra* note 6 (“[M]ost models draw on historical data, without the access to high-frequency data that would enable recalibration.”).

52. See *id.* (examining the many inadequacies of current banks' risk models in light of the changes brought about by the COVID-19 pandemic).

53. See *Combating COVID-19: Insights by Sector*, DELOITTE, <https://www2.deloitte.com/in/en/pages/about-deloitte/articles/in-about-deloitte-covid-19-insights-collection-by-sectors.html> [<https://perma.cc/5KEG-4CVB>] (analyzing the impact of the current pandemic on different industries).

54. See *OECD Policy Responses to Coronavirus (COVID-19): Government Support and the COVID-19 Pandemic*, ORG. FOR ECON. COOP. & DEV. (Apr. 14, 2020), <http://www.oecd.org/coronavirus/policy-responses/government-support-and-the-covid-19-pandemic-cb8ca170/> [<https://perma.cc/5D8J-E6CD>] (analyzing governmental measures introduced to mitigate the economic consequences of the COVID-19 pandemic).

55. See OCC RISK REPORT, *supra* note 22, at 2, 15.

56. See *id.* at 13.

57. *Will New Regulations Avert Another Meltdown?*, KNOWLEDGE@WHARTON (Sept. 12, 2018), <https://knowledge.wharton.upenn.edu/article/ten-years-crisis-will-new-regulations-avert-another-meltdown/> [<https://perma.cc/YFB4-68G3>] [hereinafter, *Wharton New Regulations*] (quoting Wharton Finance Professor Krista Schwarz); see also Stulz, *supra* note 15, at 55 (arguing that “when risk is managed mostly through limits, the risk capacity of the bank is used less efficiently . . .”).

58. See BASEL COMMITTEE ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, *BASEL III: A GLOBAL REGULATORY FRAMEWORK FOR MORE RESILIENT BANKS AND BANKING SYSTEMS* (2011), <https://www.bis.org/publ/bcbs189.htm> [<https://perma.cc/3CZK-2F6A>] (suggesting a framework for higher capital maintenance to minimize risk). The 2009 Basel III Accord was complemented by additional measures in 2017, sometimes referred to as Basel IV. See BASEL COMMITTEE ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, *BASEL III: FINALISING POST-CRISIS REFORMS* (DEC. 2017), <https://www.bis.org/bcbs/publ/d424.pdf> [<https://perma.cc/8CRC-6YUZ>].

59. Specifically, Basel III was implemented in the United States through the Dodd-Frank Act and Federal Reserve rulemaking. See Dodd-Frank Act 12 U.S.C. § 5371; *Basel Regulatory Framework*, BD. GOVERNORS FED.

capital equal to at least 12% of their risk-weighted assets⁶⁰—a measure to provide a buffer in the event of a liquidity crisis, as well as to constrain excessive risk-taking.⁶¹ Capital regulation, however, by requiring banks to minimize leverage, can limit a bank’s ability to pursue valuable investment opportunities. Higher capital requirements may force a bank to lower the amounts it can lend. Fewer loans may lower a bank’s revenues, causing its managers to compensate by increasing the percentage of loans to riskier borrowers so as to charge higher interest rates.⁶² The result may be an increase in the bank’s overall credit risk in a way not anticipated by the original regulation.

Regulation also tends to be backward-looking, designed in response to the last crisis but not necessarily reflecting the next crisis. As a result, new regulation almost inevitably lags change in the financial markets. Post-1929 legislation, for example, created a federal deposit insurance program to deter bank runs by depositors. Regulation also capped interest rates on bank deposits—intended to reduce bank risk by minimizing competition among banks, but also prompting large institutions to move from commercial banks to invest in a less-regulated “shadow banking system” that offered higher returns.⁶³ Chief among the shadow banks were money market funds (MMFs), which invest in low-risk debt instruments, such as Treasury bills and commercial paper. In fall 2008, investors grew concerned over the financial stability of some of the largest MMFs, resulting in approximately \$480 billion in MMF redemptions.⁶⁴ In response, MMFs were forced to rapidly liquidate their holdings, causing shocks to the real economy as firms that borrowed from MMFs were forced to look elsewhere.⁶⁵ In effect, regulation designed to minimize the risk of runs on banks facilitated a shift in the financial markets that permitted (and exacerbated) runs on MMFs.

Finally, “one size fits all” standards can affect individual banks differently. Take, for example, regulatory change following the 2008 crisis that expanded the risk management responsibilities of a commercial bank’s board,⁶⁶ including new independence requirements to minimize potential conflicts of interest.⁶⁷ Today, a majority of a commercial bank’s risk committee must be “independent”—non-executives with limited economic ties to the

RES. SYS., <http://www.federalreserve.gov/supervisionreg/basel/USImplementation.htm> (last updated Mar. 8, 2021) [<https://perma.cc/LJ75-PXXS>] (listing the Federal Reserve’s rulemaking).

60. See BASEL COMMITTEE ON BANKING SUPERVISION, BANK FOR INT’L SETTLEMENTS, GUIDELINES: CORPORATE GOVERNANCE PRINCIPLES FOR BANKS 4 (2015), <https://www.bis.org/bcbs/publ/d328.pdf> [<https://perma.cc/SUUL-HL3E>].

61. The standard reference on this topic is Daesik Kim & Anthony M. Santomero, *Risk in Banking and Capital Regulation*, 43 J. FIN. 1219, 1230 (1988).

62. See, e.g., Sepe, *supra* note 47, at 386–89 (generally discussing the limitations of capital requirements); Anjan V. Thakor, *Capital Requirements, Monetary Policy, and Aggregate Bank Lending: Theory and Empirical Evidence*, 51 J. FIN. 279, 281 (1996) (showing that higher capital requirements may increase credit rationing and negatively affect economic growth); Charles K. Whitehead, *The Goldilocks Approach: Financial Risk and Staged Regulation*, 97 CORNELL L. REV. 1267, 1280–83 (2012) (noting that increased capital requirements may force bank managers to invest in higher-yielding, riskier portfolios).

63. See *Wharton New Regulations*, *supra* note 57.

64. See Whitehead, *supra* note 7, at 24.

65. *Id.*

66. See BASEL COMMITTEE ON BANKING SUPERVISION, *supra* note 60, at 15; Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 951–57, 124 Stat. 1376, 1899-1907 (2010) (codified in scattered sections of 12 U.S.C. and 15 U.S.C.).

67. See Enhanced Prudential Standards, 12 C.F.R. § 252.22 (2021) (final rule adopted by the Board of Governors of the Federal Reserve System to implement Dodd-Frank Act § 165).

bank—with at least one member experienced in identifying, assessing, and managing the risks of large, complex banks.⁶⁸ The question remains whether this approach to bank governance is likely to improve risk management, and at what expense. After all, directors who know how to manage a bank’s risk may also be closest to the bank and, therefore, less likely to qualify as “independent.”⁶⁹ Some have proposed that a bank’s directors also be banking “literate,”⁷⁰ in particular, “familiar[] with risk modeling, valuation of complex derivatives, synthetic asset replication, hedging strategies, and so on.”⁷¹ This may improve a board’s understanding of the technicalities of risk, but without addressing the particular risks to which an individual bank is exposed. For example, in the digital era, having a director with technological expertise may be as important, or more important, than a director who is literate in risk modeling and derivatives.⁷² In light of COVID-19, a director with public health expertise who understands the likely impact of future health crises on the bank’s customers may also be valuable. Likewise, global markets may call for directors with experience in international relations or economics. The point is that board expertise is important, but banks have better information than regulators on what skills will benefit them the most—raising the likelihood that a one-size-fits-all approach to required expertise will miss the mark. In fact, as we see in the next Part, a skill set that banks seem to need, but which has gone largely unnoticed by academics and regulators alike, is the one that lawyers bring to the board.

* * *

Risk management is critical to how a bank performs. First, bank risk is dynamic, which makes managing it difficult. What is needed is a real-time approach to managing the risks to which individual banks are exposed. Second, regulation is ineffective if it fails to reflect changes in risk and the environment in which banks operate. Uniform requirements may create their own problems by limiting a bank’s ability to manage risk effectively. To that extent, regulation alone is unlikely to optimize bank value.

As the next Part explains, banks have increasingly responded to changes in risk through the composition of their boards. This runs contrary to the standard framing of bank risk, which presumes that the risk-reward calculus favored by shareholders will push a bank’s managers to incur too much risk. As we show below, the effect of a lawyer-director on bank value provides the bank’s stakeholders with incentives to select directors to manage risk more effectively than the standard framing presupposes.

III. ENTER THE LAWYERS

Over the past two decades, lawyer-directors have increasingly joined bank boards.

68. *Id.*

69. See Christopher M. Bruner, *Corporate Governance Reform in Post-Crisis Financial Firms: Two Fundamental Tensions*, 60 ARIZ. L. REV. 959, 980–81 (2018) (highlighting the tension between independence and expertise); Martin Edwards, *Expert Directors*, 90 COL. L. REV. 1051, 1069–71 (2019) (examining the limitations of independence requirements).

70. See Macey & O’Hara, *supra* note 26, at 86, 103.

71. *Id.* at 103.

72. See Edwards, *supra* note 69, at 1056, 1094–102 (suggesting that appointing cybersecurity experts to a board is likely to be beneficial to mitigate the information costs and high risks involved by cybersecurity issues such as securing information technology resources, preserving trade secrets, protecting personal data belonging to customers and employees, and preventing and mitigating data breaches).

Why lawyers instead of other experts? In this Part, we introduce empirical evidence regarding lawyer-directors at banks and begin to investigate the characteristics of lawyer-directors and banks that are more likely to be associated with having a lawyer on the board, seeking to answer that question.

Our results show that banks with lawyer-directors assume more risk in times of non-crisis and less risk when a crisis arises, in each case in a way that increases bank value. As we document, banks with a lawyer-director experienced a 5.7% increase in value in the year immediately after a lawyer joined the board, and the increase in value persisted in the following years.⁷³ Thus, the empirical evidence suggests that a likely explanation for the rise of lawyer-directors at banks is their ability to mitigate excessive risk-taking without jeopardizing the bank's ability to also pursue risky, yet profitable, opportunities. The next question, which we explore in Part IV, is how lawyers do this.

Before turning to our analysis, we note that two of us previously considered a similar rise in lawyer-directors at public, non-financial firms.⁷⁴ The trend in that study was less significant than in banks but still remarkable. As that study showed, the portion of public companies in the S&P 1500 index with a lawyer-director rose from 24.5% in 2000 to 43.9% in 2009—an overall increase of almost 20% across a nine-year period.⁷⁵ The study also found the increase in lawyer-directors to be associated with an increase in firm value.⁷⁶

This Article moves beyond that study in two critical respects. First, managing risk is a central feature of a bank's business model.⁷⁷ This characteristic makes banks distinct from other non-financial businesses, calling for a separate analysis of how banks are governed and the role of lawyer-directors in doing so. Second, from an empirical research perspective, banks are “special.” The common presumption is that regulation shapes how banks are organized and operated, causing a bank's governance to be endogenously determined.⁷⁸ In other words, variations among banks are presumed to reflect differences in regulation rather than governance models. Differences in board composition, therefore, should be unlikely to have any meaningful impact on bank governance and bank value.⁷⁹ Our findings suggest the opposite is true—namely, that who is on the board affects bank value, in part, through changes in risk management.

As we describe below, our empirical analysis employed a matching methodology, under which the risk and value of banks with a lawyer-director (the “treated” banks) were compared to a set of “control” banks that shared core characteristics—including regulatory exposure—but did not have a lawyer-director. To the extent regulation conditions bank governance, the expectation was that matched banks would respond similarly to like regulation. This, in turn, allowed us to assume some firm-level exogeneity where the

73. See *infra* Tbl. 4 (presenting results on the value impact of lawyer-directors in banks).

74. See Lubomir P. Litov, Simone M. Sepe & Charles K. Whitehead, *Lawyers and Fools: Lawyer-Directors in Public Corporations*, 102 GEO. L.J. 413 (2014).

75. See *id.* at 415.

76. The value transmission channels included enhanced board monitoring, better management of litigation and regulatory risks, and more effective executive compensation structures. See *id.* at 439–67.

77. See *supra* Part II.A.

78. See, e.g., A. Burak Güner et al., *Financial Expertise of Directors*, 88 J. FIN. ECON. 323, 324–26 (2008); David Yermack, *Higher Market Valuation of Companies with a Small Board of Directors*, 40 J. FIN. ECON. 185, 189 (1996). These are the standard reasons why the study by two of us of lawyer-directors in public corporations excluded financial institutions from the analysis. See Litov, Sepe & Whitehead, *supra* note 74, at 429.

79. More technically, the empirical hypothesis is that cross-sectional and time-series variations among banks would be insignificant or not well identified, since the observed variations would be attributable to differences in how banks respond to regulation. See, e.g., Güner, *supra* note 78, at 324–26.

residual variation we observed across treated and control banks (with and without a lawyer-director, respectively) did not depend on regulation but on something else. Our finding of statistically significant differences between treated and control banks suggests that having a lawyer on the board matters.

A. Data and Data Sources

In our investigation of lawyer-directors in banks, we employed data from several sources. For each of those sources, the relevant observation period was from 2000 to 2017. Overall, our sample included 12,343 bank-years of observations⁸⁰ for which we obtained information on lawyer-directors from the BoardEx database,⁸¹ information on bank fundamentals from the Compustat database, and publicly-traded stock price observations from the Center for Research in Security Prices (CRSP) database.⁸²

Appendix Table A1 provides definitions of all the variables we used. In particular, the main explanatory variable, *Lawyer-Director*, indicates whether a bank has at least one lawyer-director, where a lawyer-director is any director with one or more of the following academic qualifications: Juris Doctor, Bachelor of Laws, Master of Laws, Doctor of Jurisprudence, Doctor of Canon Law,⁸³ Doctor of Civil Law,⁸⁴ Doctor of Juridical Science,⁸⁵ Doctor of Law, Doctor of Law and Political Science, Legum Doctor,⁸⁶ or Licentiate of Laws.⁸⁷ Although the training and skills evidenced by each qualification vary, those variations are sufficiently minor so that any graduate can be considered a lawyer for purposes of our analysis. More specifically, to construct the Lawyer-Director dummy, we used individual director and company profile information from BoardEx and merged it with the Compustat/CRSP file.⁸⁸

As to our main dependent variables, we explored the impact of *Lawyer-Director* on firm-level risk (*Bank Risk*) using the natural logarithm of Z-score, which is a standard proxy of a firm's insolvency risk.⁸⁹ A high Z-score indicates a firm with low insolvency

80. To be included in the sample, financial firms (excluding real estate firms) had to have no missing observations for the key dependent and independent variables employed in our regression analyses. More particularly, all the financial firms we tracked operated in the SIC code industry range from 6000 to 6999.

81. BoardEx data on director characteristics begins in 1999, but our sample began in 2000 since we used pre-determined (one-year lagged) covariates in our regression analyses.

82. We also used litigation measures from Audit Analytics and institutional ownership information from Thomson Reuters.

83. Doctor of Canon Law is the doctoral-level terminal degree in the studies of canon law of the Roman Catholic Church. It can also be an honorary degree awarded by Anglican colleges.

84. Doctor of Civil Law is a degree offered by some universities, such as the University of Oxford, instead of the more common Doctor of Laws (LLD) degrees.

85. Doctor of Juridical Science (or Doctor of the Science of Law) (abbreviated S.J.D. or J.S.D., respectively, from the Latin for these degrees) is a research doctorate in law equivalent to the more commonly awarded Ph.D. It is offered primarily in the United States (where it originated), and in Canada and Australia.

86. Legum Doctor is the Latin equivalent of Doctor of Laws, where both titles designate a doctorate-level academic degree in law, or an honorary doctorate, depending on the jurisdiction.

87. A licentiate is a degree below that of a Ph.D. awarded by universities in some countries. Many countries have degrees with this title, but they may represent different educational levels.

88. We merged the separate director education and experience profile datasets using BoardEx's unique director identifications. This information was merged into BoardEx's company profile sample using unique company and board identifications. We then combined the BoardEx data with the Compustat/CRSP merged file using CIK codes.

89. The Z-score measure was first introduced by Andrew D. Roy, *Safety First and the Holding of Assets*,

risk, and a low Z-score indicates a firm with high insolvency risk, but for ease of interpretation, we multiplied our Z-score values by negative one (-1) so that an increase in the measure corresponded to an increase in risk. In light of the many risks that can lead a bank to insolvency,⁹⁰ we interpreted Z-score as capturing the sum of all these risks, in effect, a measure of the bank's overall riskiness.

Next, for *Bank Value*, we followed the empirical finance literature on corporate governance and used Tobin's Q—the ratio of the market value to book value of a bank's assets⁹¹—using financial data from Compustat.

Finally, to control for factors that could impact *Bank Risk* or *Bank Value*, other than the presence of a *Lawyer-Director*, we included in our regressions the following standard control variables (all defined in Appendix Table A1):⁹² the value of a bank's total book assets (*Size*); the number of years since a bank first appeared in Compustat (*Age*); total revenue in millions of dollars in year *t* divided by revenue in millions of dollars in year *t*-1 (*Revenue Growth*);⁹³ whether a bank has negative net income during a fiscal year (*Loss*); a bank's debt-to-equity ratio (*Debt-to-Equity*); the ratio of capital expenditures over the book value of the bank's total assets (*CAPX/Assets*); the percentage of a bank owned by

70 *ECONOMETRICA* 431, 432 (1952), and further developed by John H. Boyd & Stanley L. Graham, *Risk, Regulation, and Bank Holding Company Expansion into Nonbanking*, 10 *FED. RES. BANK OF MINNEAPOLIS Q. REV.* 2, 6 (1986), and John H. Boyd et al., *Bank Holding Company Mergers with Nonbank Financial Firms: Effects on the Risk of Failure*, 17 *J. BANKING & FIN.* 43, 47 (1993). It has since become the standard proxy of bank risk. See, e.g., Luc Laeven & Ross Levine, *Bank Governance, Regulation and Risk Taking*, 93 *J. FIN. ECON.* 259, 261 (2009). Specifically, firms with a high Z-score have a lower probability of insolvency and greater financial stability, where a bank's Z-score is calculated as follows: $Z = (ROA + CAR)/\sigma(ROA)$. See Roy, *supra*, at 439 (explaining insolvency risks with the Z-score). In our calculation, ROA and CAR are return on assets and the capital-to-asset ratio (the ratio of equity to assets), respectively, averaged over the sample period (2000–2017), and $\sigma(ROA)$ is the standard deviation of ROA calculated over the same window. Since Z is highly skewed, we use the measure's natural logarithm consistent with the approach taken in prior work. See, e.g., Laeven & Levine, *supra*, at 261 (discussing bank risk calculations with the Z-score).

90. See *supra* Part II.A.

91. More specifically, Tobin's Q is the ratio of a firm's market value (defined as the firm's total liabilities, minus its deferred taxes and investment tax credits, plus the value of its preferred stock and the market value of its common stock) divided by the replacement cost of its assets. See Fama & French, *supra* note 17, at 8. [the parenthetical was just confusing]. The measure was introduced in James Tobin, *A General Equilibrium Approach to Monetary Theory*, 1 *J. MONEY, CREDIT & BANKING* 15, 18 (1969). Since then, it has become a commonly recognized proxy for market valuation. See, e.g., Philip G. Berger & Eli Ofek, *Diversification's Effect on Firm Value*, 37 *J. FIN. ECON.* 39, 40 (1995); Larry H. P. Lang & René M. Stulz, *Tobin's q, Corporate Diversification, and Firm Performance*, 102 *J. POL. ECON.* 1248, 1249–50 (1994); Randall Morck et al., *Management Ownership and Market Valuation: An Empirical Analysis*, 20 *J. FIN. ECON.* 293, 294 (1988). One major advantage of Tobin's Q is its computational simplicity. This measure, however, is not without its critics. First, market prices do not necessarily reflect the marginal cost of capital, but instead may reflect the average cost of capital. In that case, firm value may not be properly captured by Tobin's Q. See Joao Gomes, *Financing Investment*, 91 *AM. ECON. REV.* 1263, 1264–65 (2001); Eric B. Lindenberg & Stephen A. Ross, *Tobin's q Ratio and Industrial Organization*, 54 *J. BUS.* 1, 8–9 (1981). Second, Tobin's Q may not reflect an accurate valuation of the firm due to market irrationality. Irrationality could be significant if investor sentiment drives valuations in the stock market. See Malcolm Baker et al., *When Does the Market Matter? Stock Prices and the Investment of Equity-Dependent Firms*, 118 *Q. J. ECON.* 969, 969 (2003) (stating that the Keynesian view believes stock prices contain an important element of irrationality).

92. We adjusted all the continuous variables in our controls for extreme outliers by winsorizing at the 2.5% level in both the left and right tails of their distributions.

93. We use the term *Revenue Growth* because we are examining banks, but this variable appears as *Sales Growth* in the Compustat dataset.

institutional shareholders weighted by the bank's market capitalization (*Institutional Ownership*);⁹⁴ the natural logarithm of one plus the number of financial litigation occurrences, where "financial litigation" is the sum of bank, consumer credit, derivatives, financial reporting, financial fraud, insurance, and securities litigation ($\ln(\text{Financial Litigation})$); whether a bank's director is also the bank's CEO (*CEO Director*); whether a director was never employed by a bank, was not related to a key employee of the bank, and never worked for a major stakeholder of the bank (*Outside Director*); and the ratio of male to female directors on a bank's board (*Director Gender*).

B. Lawyer-Directors on the Rise

In our empirical analysis, we started with a simple observation: The number of lawyer-directors in banks has grown exponentially in the past twenty years. Figure 1 illustrates the magnitude of that change.

FIGURE 1. PERCENTAGE OF BANKS WITH A LAWYER-DIRECTOR.

Figure 1 shows the percentage of banks in our sample with a lawyer-director for each year from 1999 to 2017.



As Figure 1 shows, the rise of lawyer-directors in banks from 1999 to 2017 was precipitous. In 1999, the percentage of banks with at least one lawyer-director comprised 42.8% of our sample. The percentage then increased substantially, reaching an apex of 76.5% in 2014. Overall, the average year-over-year increase in lawyer-directors on bank

94. This control seems especially relevant in light of recent studies that find that mega-asset managers, such as BlackRock, Vanguard, and State Street, have come to hold increasingly large blocks of bank shares. See Yesha Yadav, *Too-Big-to-Fail Shareholders*, 103 MINN. L. REV. 587, 593–94 (2019) (noting that from 2011 to 2017 there was a drastic rise in asset managers acquiring blocks of bank shares).

boards was 4.1%, while the total change in *Lawyer-Director* from 1999 to 2017 was a staggering 73%. In Appendix Figure A1, we include additional data showing that the rise of lawyer-directors was similar across different types of banks (with the average year-over-year increase in lawyer-directors in each category ranging from 3.4% to 5.8%).⁹⁵ The rise was most pronounced in commercial banks, from 39.9% in 1999 to a soaring 74.4% in 2017.⁹⁶

These numbers should cause us to pause. As shown in Figure 1, the rise in lawyer-directors began in 1999, well before the 2008 crisis. The increase was precipitous between 1999 and 2005, after which there continued to be a rise in lawyer-directors but at a more gradual rate. Neither the 2008 crisis nor the post-crisis risk management regulations had a noticeable effect (positive or negative) on the number of lawyer-directors on bank boards. Does this mean the rise was unrelated to bank risk? We consider this question in Part III.D below. There, we offer evidence that a lawyer-director is associated with efficient changes in risk management and increases in bank value. In fact, lawyer-directors are most associated with increases in bank value when a bank is underperforming, including during a financial crisis. This evidence suggests a more likely reading of Figure 1: The growth of lawyer-directors reflected a general change in how a bank's stakeholders chose to govern banks, not tied to a particular crisis, but as we discuss below,⁹⁷ motivated by a lawyer's ability to manage both "good" and "bad" risk.⁹⁸

In Table 1, we next considered whether there were characteristics of lawyer-directors, other than being a lawyer, that explained their rapid rise. In performing this analysis, we conjectured that if lawyer-directors share other characteristics, apart from being lawyers, then those characteristics could explain their increasing numbers. In that case, rather than the rise being of lawyers on boards, we might find it to be of directors with other characteristics who also happened to be lawyers.

TABLE 1. SUMMARY OF LAWYER-DIRECTOR CHARACTERISTICS.

This table sets out a sample summary of the characteristics of lawyer-directors in banks during the period from 2000 to 2017, considering firm-years when there was at least one lawyer-director and presenting the average, mean, median, and 25th and 75th percentiles of (i) the lawyer-directors' age (*Lawyer-Director Age*), (ii) the percentage of lawyer-directors who were CEOs or executives (*Lawyer-CEO* and *Lawyer-Executive*, respectively), (iii) the percentage of male lawyer-directors (*Lawyer-Male Director*), and (iv) the percentage of lawyer-directors who held a Master of Business Administration degree (*Lawyer-MBA Director*).

Law Director Characteristics:	2000 – 2017					
	Mean	St. Dev.	P25	Median	P75	Obs.
<i>Lawyer – Director_t</i>	0.671	0.470	0	1	1	12,343
<i>Lawyer – Director Age_t</i>	70.31	8.140	65.5	71	75.67	8,276

95. See App. Fig. A1.

96. See App. Fig. A1.

97. See *infra* Part III.C–D.

98. See text accompanying notes 36–41.

<i>Lawyer – Executive_t</i>	0.443	0.376	0.083	0.333	1	8,276
<i>Lawyer – CEO_t</i>	0.112	0.272	0	0	0	8,276
<i>Lawyer – Male Director_t</i>	0.891	0.255	1	1	1	8,276
<i>Lawyer – MBA Director_t</i>	0.155	0.644	0	0	0	8,276

As set out in Table 1, the lawyers in our sample were usually men (about 89%) and had an average age of about 70 years old. They were almost as likely to be bank officers as outsiders (about 44% being officers), but they were unlikely to be the CEO (only about 11%). They were also unlikely to hold a Master of Business Administration (MBA) degree (about 16%). This evidence suggests that lawyer-directors in our sample did not share other characteristics that explained their rise on bank boards.⁹⁹ In particular, since lawyer-directors were unlikely to have received an MBA or also serve as the bank's CEO, it seems unlikely that financial and business expertise provided a primary explanation for their board positions.¹⁰⁰

The fact that lawyer-directors were almost as likely to be bank officers as independent also deserves special attention. This evidence suggests that, more often than not, lawyer-directors were not selected because they satisfied the board's independence requirements (especially the more demanding requirements introduced by the post-2008 regulatory reforms).¹⁰¹ Rather, it suggests that independence was less relevant than a director's substantive skills. In Part IV, we revisit the special skills that lawyers bring to a bank's board. Before doing so, in the next two sections, we present our results on those bank features that are more likely to be associated with lawyer-directors and, more importantly, the relationship among lawyer-directors, bank risk, and bank value.

C. What Predicts a Lawyer-Director?

Are there bank features that predict the presence of a lawyer-director? Answering this question matters because it provides a first indication of the reasons for the rise of lawyer-directors in banks. To perform this analysis, we used a logistic regression model over our full sample period from 2000 to 2017, with *Lawyer-Director* as the dependent variable and a menu of pre-determined (lagged by one-year) bank-level, director-level, and macro-level explanatory variables that may matter most in the decision to elect a lawyer to the board.¹⁰²

99. The fact that lawyer-directors are predominantly men is in line with the general composition of boards, where between 70% and 80% of directors are men. See Ann L. Owen & Judit Temesvary, *Gender Diversity and Bank Boards of Directors and Performance*, BD. GOVERNORS FED. RSRV. SYS.: FEDS NOTES (Feb. 12, 2019), <https://doi.org/10.17016/2380-7172.2270> [<https://perma.cc/D8YN-QJW7>]. This result, however, does not permit us to draw any inferences, especially in light of the mixed results obtained by a large body of empirical studies on board composition and gender effects in corporate governance. See, e.g., Renee B. Adams & Hamid Mehran, *Bank Board Structure and Performance: Evidence for Large Bank Holding Companies*, 21 J. FIN. INTERMEDIATION 243 (2012); Allen N. Berger et al., *Executive Board Composition and Bank Risk Taking*, 28 J. CORP. FIN. 48 (2014).

100. This does not exclude the possibility that lawyer-directors may have acquired financial expertise over the course of their careers, although in that case one would also expect more bankers on the board.

101. See *supra* notes 66–68 and accompanying text (enumerating post-2008 reforms).

102. Since our interest is focused on predicting a bank's initial election of a lawyer-director (and not whether the bank retained or elected another lawyer-director later), we exclude all firm-year observations from the analysis after a *Lawyer-Director* was initially elected by a bank.

Table 2 presents the results of our analysis.

TABLE 2. PREDICTING LAWYER-DIRECTORS.

This table presents a logit analysis of the decision to employ a lawyer-director from 2000 to 2017. In all specifications, we included industry and year fixed effects and estimated standard errors using firm-level clustering. Additionally, for ease of comparison, we standardized all continuous predictor variables to have a mean of zero and a variance of one.¹⁰³

Dep. Variable: <i>Lawyer – Director</i> _{<i>t</i>}	2000 – 2017		
	(1)	(2)	(3)
Variables			
<i>Bank Value</i> _{<i>t-1</i>}	0.180** (2.09)	0.241*** (2.56)	0.228** (2.43)
Δ <i>Bank Value</i> _{<i>t-1</i>}	-0.143** (-2.11)	-0.142** (-1.99)	-0.123* (-1.77)
<i>Size</i> _{<i>t-1</i>}		0.222*** (2.80)	0.152* (1.68)
<i>Ln(Age)</i> _{<i>t-1</i>}		-0.087 (-1.00)	-0.145 (-1.59)
<i>Revenue Growth</i> _{<i>t-1</i>}		0.305*** (4.68)	0.273*** (4.06)
<i>Loss</i> _{<i>t-1</i>}		0.167 (0.79)	0.168 (0.78)
<i>Debt-to-Equity</i> _{<i>t-1</i>}		0.054 (0.80)	0.083 (1.26)
<i>CAPX/Assets</i> _{<i>t-1</i>}		-0.093 (-1.06)	-0.100 (-1.12)
<i>Inst. Ownership</i> _{<i>t-1</i>}		0.009 (0.12)	-0.026 (-0.36)
<i>Bank Risk</i> _{<i>t-1</i>}		-0.078 (-1.22)	-0.057 (-0.87)
<i>Ln(Financial Litigation)</i> _{<i>t-1</i>}			0.163* (1.72)
<i>Ln(Class Action Litigation)</i> _{<i>t-1</i>}			-0.172 (-1.47)
<i>CEO Director</i> _{<i>t-1</i>}			0.540*** (3.10)
<i>Outside Director</i> _{<i>t-1</i>}			0.290 (1.54)
<i>Financial Crisis</i> _{<i>t-1</i>}			2.219*** (5.09)
Industry and Year Fixed Effects	Yes	Yes	Yes
# of Unique Firms	1,379	1,379	1,379
N	6,949	6,949	6,949
Pseudo R ²	0.042	0.056	0.080

Table 2 shows certain bank characteristics that predict the presence of a lawyer-

103. In this and all the following tables, the estimated *t*-statistics are based on robust standard errors clustered by firm and are reported in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% level, respectively.

director. Column (1) of Table 2 shows banks with higher valuations (as proxied by Tobin's Q) were more likely to have at least one lawyer-director on the board. For instance, a 1% increase in *Bank Value* translated to a 19.7%¹⁰⁴ increase in the likelihood of a bank having a lawyer-director. Conversely, banks whose market values were rising were less likely to have a lawyer-director. Specifically, we found that a 1% increase in that rise translated to a 13.3%¹⁰⁵ decrease in the likelihood of having a lawyer-director.¹⁰⁶ Considered together, these findings suggest that adding a lawyer to the board reflected recent underperformance by the bank with the expectation that the new addition would enhance value.¹⁰⁷

That conclusion is supported by the additional finding, in column (3), that lawyers were much more likely to be on a bank's board during a crisis. For example, during the 2008 crisis (*Financial Crisis*, an indicator equal to one during 2007 to 2009), banks were 8.5% more likely to have a lawyer-director on the board compared with non-crisis times¹⁰⁸—another indication that adding a lawyer-director was associated with a drop in performance, but with the goal of improving value over time. In particular, since a lawyer's ability to manage risk is arguably more relevant during a financial crisis, the finding in column (3) seems to suggest that this skill may explain the rise of lawyers on bank boards, especially when a bank is underperforming.

Firm size (*Size*) and revenue growth (*Revenue Growth*) reflect a bank's use of leverage to fund its investments¹⁰⁹ and, consistent with prior studies, we employed them as proxies for bank complexity.¹¹⁰ Both proxies were also associated with the presence of a lawyer-director. Specifically, as shown in column (2), when a bank's size increased by 1%, the bank became 24.9%¹¹¹ more likely to have a lawyer-director. This seems to indicate that the benefits of having a lawyer-director grew with the bank's size or complexity. Since size

104. The 19.7% economic significance was calculated by computing the exponent of the coefficient estimate of *Bank Value* minus 1 ($=\exp(0.180)-1$).

105. The 13.3% economic significance was calculated by computing the exponent of the coefficient estimate of Δ *Bank Value* minus 1 ($=\exp(-0.143)-1$).

106. Column (2) of Tbl. 2 applies a number of predetermined firm-level predictor variables to the specifications in column (1), verifying that the economic and statistical significance of the regression estimates of *Bank Value* (coefficient = 0.241 and t -stat = 2.56) and Δ *Bank Value* (coefficient = -0.142 and t -stat = -1.99) are qualitatively similar to column (1).

107. The combined results of *Bank Value* and Δ *Bank Value* suggest that the direction of the relationship between *Lawyer-Director* and *Bank Value* runs from "right to left"—that is, having a lawyer-director correlated with greater *Bank Value* rather than the other way around (a negative association with *Bank Value* or a greater *Bank Value* correlating with having a lawyer-director).

108. The 8.5% economic significance represents the marginal effect at the mean and was calculated by computing $(\exp(0.095*2.219)/(1+\exp(0.095*2.219))^2)*2.219$, where 0.095 is the mean for *Financial Crisis* in the reduced 2007-2009 sample of 1,379 unique firms and 6,949 firm-year observations and 2.219 is the coefficient of *Financial Crisis* in Tble. 2.

109. See Charles K. Whitehead, *Size Matters: Commercial Banks and the Capital Markets*, 76 OHIO ST. L.J. 765, 781–94 (2015) (discussing the growth in assets, leverage, and total risk of investment banks during the period leading up to the 2008 financial crisis).

110. On the use of firm size and revenue growth as proxies for organizational complexity, see generally K.J. Martijn Cremers, Lubomir P. Litov & Simone M. Sepe, *Staggered Boards and Long-Term Firm Value, Revisited* 126 J. FIN. ECON. 422 (2017); Augustine Duru, Dechun Wang & Yijiang Zhao, *Staggered Boards, Corporate Opacity and Bank Value*, 37 J. BANK. & FIN. 341 (2013); and John E. Core, Robert W. Holthausen & David F. Larcker, *Corporate Governance, Chief Executive Officer Compensation, and Firm Performance*, 51 J. FIN. ECON. 371 (1999).

111. The 24.9% economic significance was calculated by computing the exponent of the coefficient estimate of *Size* minus 1 ($=\exp(0.222)-1$).

and complexity are commonly associated with greater risk,¹¹² this finding is also consistent with the premise that lawyer-directors are effective risk managers.

Column (3) of Table 2 shows that electing a lawyer-director also correlated with a bank having higher levels of overall litigation, including regulatory litigation ($\ln(\text{Financial Litigation})$), as well as having a CEO who served on the bank's board (*CEO Director*). The fact that banks with higher litigation levels were more likely to elect a lawyer-director is unsurprising in light of the legal expertise lawyer-directors bring to decisions about lawsuits. The greater likelihood of having a lawyer-director when the CEO was on the board requires more explanation. There may be several reasons for this association. CEO-directors, for example, may have been more interested in including lawyers on the board, partly because they were aware of other banks with lawyer-directors, or because they thought there would be value in having a lawyer on the board of a regulated business, such as a bank. Alternatively, this association may have reflected the value of interaction between CEOs and lawyer-directors. Predictably, a CEO-director—due to her superior knowledge of the bank—will influence the board's approach to risk management.¹¹³ The result may be a less-informed risk management process, particularly since the CEO's view of risk is likely to affect the information the bank's board receives. In general, lawyer-directors are better positioned to offset that influence. This is because, as Part IV.A describes, lawyers are trained to be advocates—to ask questions, to critically analyze opposing points of view, and to persuade others of their position. Therefore, one can expect them to be less inclined to defer to the CEO (or any other source of information), helping promote a more-informed decision-making process.

In sum, Table 2 suggests that banks that are likely to benefit the most from having a lawyer-director are those that are underperforming, weathered the 2008 crisis, are large and complex, have greater litigation and regulatory risks, and have a CEO who is also a director. Furthermore, Table 2 suggests that adding a lawyer-director is likely to improve bank value, and this value likely results from enhanced risk management (especially in times of crisis). We verify this inference—that having a lawyer on a bank's board adds value through better risk management—in the following section.

D. Lawyers, Bank Risk, and Bank Value

In this section, we assess the effect on bank risk of having a lawyer on a bank's board, as well as the impact of a lawyer-director on bank value. We empirically show that lawyer-directors increase bank value through effective risk management. With a lawyer-director, the bank is more likely to optimize risk-taking by mitigating risks when the chances of loss are greater and pursuing risks when they are more likely to benefit the bank.

112. See, e.g., Ricardo Correa & Linda S. Goldberg, *Bank Complexity, Governance, and Risk* (Int'l Fin. Discussion Papers, Paper No. 1287, 2020), <https://www.federalreserve.gov/econres/ifdp/files/ifdp1287.pdf> [<https://perma.cc/7NDU-SKJE>] (discussing the effect of complexity on bank holding companies' broader risk profiles).

113. That influence may include increasing risk to inefficient levels if the CEO has incentives to do so—not unlikely in light of the shareholders' interest in greater risk and skewed CEO pay packages. See Sepe, *supra* note 47, at 343–46 (discussing how equity-based compensation tends to make bank managers as risk-liking as bank shareholders).

1. Bank Risk

We begin by examining the impact of a *Lawyer-Director* on *Bank Risk* (as proxied by the banks' logged Z-score, scaled by negative one).¹¹⁴ Empirically, the challenge in performing this analysis is endogeneity—the ever-present possibility that correlation will be mistaken for causation.¹¹⁵ In particular, one needs to exclude changes in the dependent variable (here, *Bank Risk*) that might be due to changes in some omitted variable other than the independent variable (here, the presence of a *Lawyer-Director*). For instance, a bank's set of investment opportunities (which is unobservable and, hence, impossible to measure empirically) could correlate positively with both electing a lawyer-director and changes in bank risk, leading to an omitted variable bias that creates the appearance of a correlation between *Lawyer-Director* and *Bank Risk* when one does not exist.

In the empirical literature, a primary response to concerns over endogeneity is the use of a matching methodology.¹¹⁶ Using this methodology, the risk of banks with a lawyer-director (the “treated” firms) is compared to the risk of a set of “control” firms, where the control firms are selected due to shared essential characteristics with the treated firms, but without having a lawyer-director. The intuition is that comparing banks with a lawyer-director to banks that share essential, *observable* characteristics, but do not have a lawyer-director, decreases the likelihood that significant differences in *unobservable* (and, thus, omitted) factors will bias the regression estimates.

Furthermore, the use of matching allows us to address the objection that bank governance features are unlikely to matter because they are largely conditioned by bank regulation. By comparing firms that share similar observable characteristics—including exposure to similar regulations—we can assume some firm-level exogeneity where the role of a lawyer-director is unlikely to be explained by differences in regulation.

Specifically, in our analysis, we used a propensity score matched sample¹¹⁷ to match each treated firm with a *Lawyer-Director* to a control firm without a *Lawyer-Director*.¹¹⁸

114. See *supra* note 89 and accompanying text.

115. See K.J. Martijn Cremers, Simone M. Sepe & Saura Masconale, *Is the Staggered Board Debate Really Settled?*, 167 U. PA. L. REV. ONLINE 9, 20–29 (2018) (illustrating the advantages and disadvantages of different empirical methodologies in addressing endogeneity concerns).

116. See sources cited *supra* note 13.

117. Under propensity score matching, one collapses a multitude of covariates to a scalar propensity score, which is the probability that an observation receives treatment given the covariates, estimated by some logistic regression. Relative to other matching methodologies, this procedure maximizes the number of matches between treated and control firms. For an exhaustive discussion of propensity score matching, see Marco Caliendo & Sabine Kopeinig, *Some Practical Guidance for the Implementation of Propensity Score Matching* (Inst. for the Study of Labor, Discussion Paper No. 1588, 2005), <https://www.iza.org/publications/dp/1588/some-practical-guidance-for-the-implementation-of-propensity-score-matching> [<https://perma.cc/AW4J-F9LS>].

118. In particular, we used propensity scores based on *Bank Value*, *Size*, *Institutional Ownership*, and *Bank Risk* and exact matching by two-digit SIC codes to build our matched dataset, which is summarized in App. Tbl.A2. We matched based on *Bank Value* and *Bank Risk* to ensure that our two main dependent variables of interest were similar between the treated and untreated control groups before the election of a *Lawyer-Director*. We also matched based on *Size* since we found this to be an important predictor of a bank's decision to elect a *Lawyer-Director* (see Tbl. 2). Lastly, we matched based on *Institutional Ownership* to ensure that the treated and control firms had similar levels of shareholder monitoring (governance). Panel A of App. Tbl.A2 shows the pre-treatment year (*t-1*) summary statistics for treated and control firms and the results of tests for significant differences in means (test statistics in parentheses) between the two groups. Panel B of App. Tbl.A2 presents the full matched sample summary statistics over the estimation window, (*t-5*) to (*t+5*).

during the four- and five-year period following the initial year in which a *Lawyer-Director* first joined the matched, treated firm (where the initial year of employment ($t = 0$) is always excluded from the panel). Using the matched sample, we then regressed *Bank Risk* on $Treated\ Lawyer \times Post$, where *Treated Lawyer* was an indicator equal to one (zero) for firms with (without) a lawyer-director, and *Post* was an indicator equal to one in the years after a bank first elected a lawyer-director and zero otherwise. In addition, since Table 2 suggests that the 2008 crisis increased the likelihood of banks having a lawyer-director, we divided our sample between *Normal Times* and the *Financial Crisis* using a triple interaction analysis where *Financial Crisis* was an indicator equal to one during 2007 to 2009 and *Normal Times* included all other years outside that range. In fact, based on the results in Table 2, we conjectured that the impact of a *Lawyer-Director* on *Bank Risk* could be different in *Normal Times* and the *Financial Crisis*. Table 3 shows our results.

TABLE 3. LAWYER-DIRECTORS AND BANK RISK.

This table reports the results for matched panel regressions of the natural logarithm of Z-score (multiplied by negative one (-1)) on various interaction variables. The main variables of interest, *Bank Risk*, *Treated Lawyer* \times *Post* \times *Normal Times*, *Treated Lawyer* \times *Post* \times *Financial Crisis*, *Treated Lawyer* \times *Post*, *Treated Lawyer*, and *Post*, and the other interaction terms, were measured contemporaneously, whereas the remaining controls were lagged by one period. The variables *Normal Times* and *Financial Crisis* are subsumed by the industry \times year fixed effects.

Dep. Variable: <i>Bank Risk</i> _{<i>t</i>}	(t - 4) to (t + 4)			(t - 5) to (t + 5)		
	(1)	(2)	(3)	(4)	(5)	(6)
Variables						
<i>Treated Lawyer</i> _{<i>t</i>} \times <i>Post</i> _{<i>t</i>}	0.033 (0.33)	-0.274* (-1.68)	0.079 (0.68)	0.021 (0.21)	-0.337** (-2.04)	0.116 (1.07)
<i>Treated Lawyer</i> _{<i>t</i>} \times <i>Post</i> _{<i>t</i>} \times <i>Normal Times</i> _{<i>t</i>}		0.346* (1.79)			0.422** (2.21)	
<i>Treated Lawyer</i> _{<i>t</i>} \times <i>Post</i> _{<i>t</i>} \times <i>Financial Crisis</i> _{<i>t</i>}			-0.265* (-1.93)			-0.415*** (-3.14)
<i>Treated Lawyer</i> _{<i>t</i>} \times <i>Normal Times</i> _{<i>t</i>}		-0.172 (-1.11)			-0.221 (-1.43)	
<i>Treated Lawyer</i> _{<i>t</i>} \times <i>Financial Crisis</i> _{<i>t</i>}			0.156 (1.42)			0.267*** (2.58)
<i>Post</i> _{<i>t</i>} \times <i>Normal Times</i> _{<i>t</i>}		-0.392** (-2.20)			-0.476*** (-2.68)	
<i>Post</i> _{<i>t</i>} \times <i>Financial Crisis</i> _{<i>t</i>}			0.289** (2.31)			0.427*** (3.51)
<i>Post</i> _{<i>t</i>}	-0.013 (-0.14)	0.315** (2.02)	-0.070 (-0.67)	-0.005 (-0.06)	0.397** (2.50)	-0.104 (-1.03)
Control Variables	Yes	Yes	Yes	Yes	Yes	Yes
Firm Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Industry \times Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
# of Unique Firms	662	662	662	675	675	675
N	4,683	4,683	4,683	5,614	5,614	5,614
Adjusted R ²	0.651	0.662	0.678	0.627	0.628	0.628

Table 3, columns (1) and (4), show that the average effect of a lawyer-director on bank risk was insignificant in the four and five years after she joined the board.¹¹⁹ On its face, this result contradicts our claim regarding the value of lawyer-directors in managing bank risk. Recall, however, that effective risk management is not simply risk reduction, but rather a determination of a bank's optimal risk-and-return tradeoff.¹²⁰ This may entail

119. In all our regressions, we included firm and industry \times year fixed effects to control for time-invariant and time-varying heterogeneity at the firm and industry levels (where industry fixed effects were defined using three-digit SIC code industry definitions). Including these higher-order fixed effects provided additional robustness to our methodology, allowing us to control for common sources of industry- or time-dependent unobserved heterogeneous variation. See Todd A. Gormley & David A. Matsa, *Common Errors: How to (and Not to) Control for Unobserved Heterogeneity*, 27 REV. FIN. STUD. 617, 617 (2014); Jonathan M. Karpoff & Michael D. Wittry, *Institutional and Legal Context in Natural Experiments: The Case of State Antitakeover Laws*, 73 J. FIN. 657, 657 (2018). Note that we were able to include firm fixed effects in the matched sample specifications since we required treated financial firms to have at least one year in which lawyer-directors were not present on the board (although this eliminated roughly 50% of the banks in our sample that always had a Lawyer-Director).

120. See *supra* note 40 and accompanying text.

different levels of risk under different circumstances.

Further examination confirms this point. When we disentangled our sample of banks into *Normal Times* and *Financial Crisis* (in columns (2)-(3) and (5)-(6)), we found that the insignificant average effect that lawyer-directors had on risk over the full period (2000-2017) was attributable to the cancelling effect of lawyer-directors during non-crisis and crisis periods. In ordinary circumstances (*Normal Times*), having a lawyer-director was more likely to increase bank risk, but in times of crisis (*Financial Crisis*), having a lawyer-director was more likely to reduce risk—canceling out a lawyer-director’s overall effect on bank risk during our full sample period. For instance, column (5), which considers changes in *Bank Risk* within ten-year estimation windows, shows that banks with lawyer-directors increased *Bank Risk* by 9.5%¹²¹ relative to the sample mean during *Normal Times*, while they decreased *Bank Risk* (in column (6)) by 9.4%¹²² relative to the sample mean during the *Financial Crisis*. The findings are qualitatively the same when we consider changes in *Bank Risk* during *Normal Times* and the *Financial Crisis* within eight-year estimation windows.¹²³

Overall, the results of Table 3 are consistent with our hypothesis that lawyer-directors are effective risk managers.¹²⁴ Banks with lawyer-directors assumed more risk during *Normal Times* when it was more likely that greater risk-taking made economic sense and could produce profitable investment opportunities. Likewise, banks with lawyer-directors

121. The 9.5% economic significance of the increase in *Bank Risk* during *Normal Times* was calculated by dividing the coefficient of $Treated Lawyer_t \times Post_t \times Normal Times_t$ (=0.422) by the treated and control firms’ *Bank Risk* mean over the t plus or minus 5-year window (=4.431, see App. Tbl.A2.Panel B).

122. The 9.4% economic significance of the decrease in *Bank Risk* during *Financial Crisis* was calculated by dividing the coefficient of $Treated Lawyer_t \times Post_t \times Financial Crisis_t$ (=−0.415) by the treated and control firms’ *Bank Risk* mean over the t plus or minus 5-year window (=−4.431, see App. Tbl.A2.Panel B).

123. We did not find significant increases or decreases in bank risk over the ($t \pm 1$), ($t \pm 2$), and ($t \pm 3$) estimation periods, although the signs were consistent with the ($t \pm 4$) and ($t \pm 5$) results. Specifically, the untabulated (but available upon request) coefficients for shorter estimation periods were: (i) −0.095 (0.137) with a *t*-statistic of −0.36 (0.39) for the ($t \pm 1$) matched sample in *Normal Times (Financial Crisis)*; (ii) −0.061 (0.013) with a *t*-statistic of −0.23 (0.06) for the ($t \pm 2$) matched sample in *Normal Times (Financial Crisis)*; and (iii) −0.057 (0.079) with a *t*-statistic of −0.26 (0.51) for the ($t \pm 3$) matched sample in *Normal Times (Financial Crisis)*. There are two likely reasons for the different results over shorter and longer estimation periods. First, it takes time for a new lawyer-director to implement operational strategies that increase or decrease risk. Second, the number of matched firms during the 2008 financial crisis was greatly reduced when we looked at the shorter estimation periods. Using the four- and five-year periods allowed us to increase the sample size to an amount necessary to detect the impact of lawyer-directors on bank risk during *Normal Times* and *Financial Crisis*.

124. We report robustness results in the Appendix. There, we estimated pooled panel regressions of the effect of *Lawyer-Director* on *Bank Risk* (see App. Tbl.A3). For the summary statistics of the pooled panel, see App. Tbl.A4). In pooled panel regressions, the coefficient of *Lawyer-Director* was only identified through changes in *Bank Risk*, indicating the difference in average *Bank Risk* before versus after a change in the presence of a lawyer-director on the bank’s board. The pooled panel regressions of App. Tbl.A3 (columns 1-3) pointed to a negative association between *Bank Risk* and *Lawyer-Director*. While pooled panel regressions are less able to address endogeneity concerns, what matters are the additional results we obtained when we examined the effect of *Lawyer-Director* on *Bank Risk* by considering other roles a lawyer-director can hold in the firm. As shown by columns (4) and (5), having a *Lawyer-Executive* or a *Lawyer-CEO* on the board did not result in a differential reduction in risk. Rather, all the risk reduction was associated with the impact of *Lawyer-Director* on *Bank Risk* (whether or not the lawyer-director was a CEO or executive). The finding that the effect on bank risk was tied to a lawyer’s role as a director, rather than whether she was in a “control position” (as CEO or an executive), suggests the effect is tied to the lawyer’s skills as a director and not simply to whether she had greater control over the bank’s operations.

reduced their risk exposure during the *Financial Crisis* when it was more likely that risk-taking would result in losses.

The empirical evidence, therefore, suggests that the rise of lawyer-directors reflected a change in how bank stakeholders chose to govern banks—a change motivated, at least in part, by a lawyer-director’s ability to flexibly manage bank risk. Lawyer-directors seemed especially apt at adapting risk-taking to changing circumstances. In that respect, the rise of lawyer-directors appeared to remedy a principal shortcoming of bank regulation—namely, a rigid approach to risk management that constrains “bad” risk at the expense of a bank’s ability to pursue “good” risk.¹²⁵ If that is correct, having a lawyer-director should also be associated with an increase in bank value. We verify that association next.

2. Bank Value

Table 4 presents our results on the impact of lawyer-directors on bank value in our matched sample using a differences-in-differences approach. Specifically, we regressed *Bank Value* on *Treated Lawyer* × *Post* within five separate estimation windows, ranging from two, four, six, eight, and ten years around the first time a treated firm employed a lawyer-director (and where the initial year of employment ($t = 0$) was always excluded from the panel).

TABLE 4. LAWYER-DIRECTORS AND BANK VALUE.

This table reports the results for matched panel regressions of Tobin’s Q on treated and post-indicator variables over varying estimation windows. The main variables of interest, *Bank Value*, *Treated Law* × *Post*, *Treated Law*, and *Post*, were measured contemporaneously, whereas the remaining controls were lagged by one period.

Estimation windows:	($t \pm 1$)	($t \pm 2$)	($t \pm 3$)	($t \pm 4$)	($t \pm 5$)
Dep. Variable:					
<i>Bank Value_t</i>					
Variables	(1)	(2)	(3)	(4)	(5)
<i>Treated Lawyer_t</i> × <i>Post_t</i>	0.070*** (2.75)	0.050*** (3.13)	0.036** (1.98)	0.048** (2.09)	0.042* (1.85)
<i>Post_t</i>	-0.064** (-2.39)	-0.041*** (-2.78)	-0.028* (-1.68)	-0.041** (-2.06)	-0.037* (-1.81)
Control Variables	Yes	Yes	Yes	Yes	Yes
Firm Fixed Effects	Yes	Yes	Yes	Yes	Yes
Industry×Year Fixed Effects	Yes	Yes	Yes	Yes	Yes
# of Unique Firms	492	681	688	695	699
N	1,174	2,720	3,940	5,052	6,041
Adjusted R ²	0.842	0.867	0.861	0.849	0.840

As expected, Table 4 shows that banks with a *Lawyer-Director* had higher valuations than banks without a *Lawyer-Director*.¹²⁶ For instance, column (1) shows that, in the year

125. See *supra* text accompanying notes 57–62.

126. We also provided a robustness check of the positive association between *Bank Value* and *Lawyer-*

immediately after a lawyer-director joined a bank, *Bank Value* increased by 5.7%¹²⁷ compared to the sample mean one year prior to the lawyer-director joining. Similar findings appear in columns (2) to (5), which show that a bank's value continued to increase up to the fifth year after a lawyer joined a bank's board.¹²⁸

Thus, Table 4 provides strong support for the inference that lawyer-directors in banks contributed to efficient changes in bank risk—changes that increased bank value by optimally balancing “good” and “bad” risks under changing circumstances. In light of the importance of risk to banks,¹²⁹ it also seems reasonable to expect a lawyer's risk management skills to matter most when a bank's risk-taking goes awry—that is, in situations when the bank's board needs to act swiftly to rein-in risk. This would explain why, as shown in Table 2, banks were more likely to hire lawyer-directors during the 2008 crisis. We tested this further by exploring the effect on bank value of having a lawyer-director during a financial crisis. Empirically, we did this by interacting *Lawyer-Director* with *Financial Crisis* and then estimating the interacted impact on *Bank Value*.¹³⁰ Table 5 shows our results.

Director in App. Tbl.A5 by using pooled panel regressions. Our results were unchanged.

127. The 5.7% economic significance of the increase in *Bank Value* was calculated by dividing the coefficient of *Treated Lawyer_t × Post_t* (=0.070) by the treated firms' *Bank Value* mean in the year before treatment (t-1) (=1.234, see App. Tbl.A2.Panel A).

128. For example, relative to the full sample mean, *Bank Value* was 3.1% greater for *Treated Lawyer* banks (banks with a lawyer-director) in the third year after a lawyer was elected to the board compared to the third year prior to the lawyer-director joining the bank (where the 3.1% economic significance for the increase in *Bank Value* was calculated by dividing the coefficient of *Treated Lawyer_t × Post_t* (=0.036) by the treated and control firms' *Bank Value* mean over the t plus or minus 5-year window (=1.148, see App. Tbl.A2.Panel B)).

129. See *supra* Part II.A.

130. Here we used pooled panel regressions, rather than a matched sample, since investigating interactions requires a larger number of observations and these were only provided by pooled panel samples.

TABLE 5. LAWYER-DIRECTORS, FINANCIAL CRISIS, AND BANK VALUE.

This table reports the results for pooled panel regressions of Tobin's Q on the interaction of *Lawyer-Director* and *Financial Crisis* during the sample period from 2000 to 2017. The main variable of interest, *Bank Value*, was measured contemporaneously, whereas *Lawyer-Director* \times *Financial Crisis*, *Lawyer-Director*, *Financial Crisis*, and the remaining controls were lagged by one period. Columns (1)-(2) specify industry and year fixed effects, while column (3) employs higher dimensional industry \times year fixed effects.¹³¹

Dep. Variable: <i>Bank Value</i> _t	2000 – 2017		
	(1)	(2)	(3)
Variables			
<i>Lawyer Director</i> _{t-1} \times <i>Financial Crisis</i> _{t-1}	0.043* (1.76)	0.018* (1.79)	0.019* (1.90)
<i>Lawyer Director</i> _{t-1}	0.021 (0.70)	0.025* (1.89)	0.026** (2.00)
<i>Financial Crisis</i> _{t-1}	-0.152*** (-4.49)	-0.086*** (-4.37)	Omitted
Significance of Joint Effect: [<i>Lawyer Director</i> _{t-1} \times <i>Financial Crisis</i> _{t-1}] + [<i>Lawyer Director</i> _{t-1}]	0.064** (2.31)	0.043*** (3.01)	0.045*** (3.18)
Control Variables	No	Yes	Yes
Industry and Year Fixed Effects	Yes	Yes	No
Industry \times Year Fixed Effects	No	No	Yes
# of Unique Firms	1,530	1,530	1,530
N	12,343	12,343	12,343
Adjusted R ²	0.175	0.440	0.461

As expected, Table 5 (columns (2) and (3), including the full set of control variables) shows a positive and significant association between *Lawyer-Director* and *Bank Value* (2.2%¹³² and 2.3%,¹³³ respectively), as well as a differential increase in value for banks with a *Lawyer-Director* during the *Financial Crisis* (1.6%¹³⁴ and 1.7%,¹³⁵ respectively). This means banks that weathered the 2008 crisis benefited the most from having a lawyer-

131. See *supra* note 119 (discussing higher-order fixed effects).

132. The 2.2% economic significance of the increase in *Bank Value* was calculated by dividing the coefficient of *Lawyer Director*_{t-1} in column 2 (=0.025), which included industry and year fixed effects, by the average *Bank Value* in our pooled sample during the period 2000 to 2017 (=1.133, see App. Tbl. A4).

133. The 2.3% economic significance of the increase in *Bank Value* was calculated by dividing the coefficient of *Lawyer Director*_{t-1} in column 3 (=0.026), which included higher-order fixed effects, by the average *Bank Value* in our pooled sample during the period 2000 to 2017 (=1.133, see App. Tbl. A4).

134. The 1.6% economic significance of the differential increase in *Bank Value* was calculated by dividing the coefficient of *Lawyer Director*_{t-1} \times *Financial Crisis*_{t-1} in column 2 (=0.018), which included industry and year fixed effects, by the average *Bank Value* in our pooled sample during the period 2000 to 2017 (=1.133, see App. Tbl. A4).

135. The 1.7% economic significance of the differential increase in *Bank Value* was calculated by dividing the coefficient of *Lawyer Director*_{t-1} \times *Financial Crisis*_{t-1} in column 3 (=0.019), which included higher-order fixed effects, by the average *Bank Value* in our pooled sample during the period 2000 to 2017 (=1.133, see App. Tbl. A4).

director, consistent with our presumption that a lawyer's risk management skills are likely to be especially valuable during a crisis.¹³⁶

IV. THE VALUE OF THINKING LIKE A LAWYER

Part III showed that lawyer-directors increase bank value through effective risk management—not simply by reducing risk, but by optimizing risk-taking in ways that balance good and bad risk under changing circumstances. The question is, what is it about lawyers' skills that have so far escaped attention? In this Part, we demonstrate that, as former Harvard Law School Dean Martha Minow described, “there are some basic habits of mind and approaches to problems that legal training offers”¹³⁷ that are an asset in how boards work, especially in banks.

Specifically, we identify three skill sets—reflecting a combination of the training, experience, and practice that lawyers gain throughout their careers—that are likely to assist lawyers as directors, in particular, in identifying, assessing, and managing risk. Those skills echo what Maria Green, former general counsel at Ingersoll Rand (and a director at a number of companies), also observed in practice, namely, that “[t]hings like issue spotting, negotiation, and other ‘thinking like a lawyer’ habits of the mind . . . are critical in the boardroom.”¹³⁸

First, lawyers are advocates—or, more prosaically, contrarian thinkers—who are trained to question assumptions and consider multiple viewpoints. Drawing on information economics studies,¹³⁹ we argue that a lawyer's advocacy skills are likely to promote the gathering of more, and more accurate, information, minimize the risk of “group thinking” among directors, and support unbiased decision-making.¹⁴⁰ Second, lawyers are trained to be negotiators and mediators, which can assist in facilitating board communication, finding a common ground among directors, and making complex information more accessible to non-expert directors. Third, experienced lawyers have unique skills in processing information about litigation and regulation, which have become significant sources of a bank's risk exposure.¹⁴¹ Together, these skills add value to a board's decision-making process, in particular, in how boards choose to manage risk. We describe these skills and their value in more detail below.

136. Providing additional support for this inference, when we tested the Significance of Joint Effect (the interacted impact of having a lawyer-director and being in a financial crisis), we found a positive and significant total effect for banks. Specifically, columns (2) and (3) suggest a total incremental increase in *Bank Value* over the period from 2000 to 2017 of 3.8% to 4.5% for banks with at least one lawyer-director relative to the sample average (where the 3.8% economic significance for the total incremental increase in *Bank Value* was calculated by dividing the coefficient of Significance of Joint Effect in column 2 (=0.043), which included industry and year fixed effects, by the average *Bank Value* in our pooled sample during the period 2000 to 2017 (=1.133, see App. Tbl. A4), and the 4.5% economic significance was calculated analogously).

137. See *What Boards Want*, PRACTICE (May/June 2020), <https://thepractice.law.harvard.edu/article/what-boards-want/> [<https://perma.cc/5HXM-N6X3>] [hereinafter *What Boards Want*] (interview with Martha Minow).

138. See *Lawyer-Director or Director-Lawyer*, PRACTICE (May/June 2020), <https://thepractice.law.harvard.edu/article/lawyer-director-or-director-lawyer/> [<https://perma.cc/9C2B-KUAK>] [hereafter, *Lawyer-Director*] (interview with Maria Green).

139. See *infra* notes 143–145 and accompanying text.

140. One of us previously explored the implications of advocacy for the governance of banks generally. See Sepe, *supra* note 47, at 372–75 (arguing that bank directors should be selected to ensure they can act as “advocates”).

141. See *supra* notes 42–44 and accompanying text.

A. Advocates

Advocacy is an essential part of a lawyer's education. Lawyers are trained to be advocates—traditionally in the courtroom, but also as negotiators in the boardroom. Lawyers ask critical questions, develop hypotheses, make assumptions, and extract information. From this, they produce compelling narratives and arguments that are designed to persuade others.¹⁴²

Economics studies point to the informational advantages of advocacy—framed, more generally, as a process that relies on competition in producing and collecting information¹⁴³—for collective decision-making. The rationale is that rivalry among advocates improves the decision-making process by raising the quality of information on which decisions can be made. Advocacy does so by constraining the bias that may result from a person's tendency to convey information based on her own preferences.¹⁴⁴ It follows that group decision-making, where group members share the same characteristics, is more likely to produce biased results. Advocacy reduces that likelihood by enriching the decision-making process with multiple, heterogeneous sources of information.¹⁴⁵

Drawing on these studies, we argue that a lawyer's advocacy skills can promote more informed decision-making and, hence, improve a bank's risk management. Lawyer-directors are skilled at critically analyzing an issue, asking challenging questions, and demanding (more) supporting evidence before a decision is made. As Dean Minow noted:

[As a lawyer-director] you ask questions like: “What's the entire picture and what's the order in which to proceed in thinking about those issues? How do I divide areas where people disagree from areas where people agree?” These are skills one learns in civil procedure or in writing a complaint and an answer.¹⁴⁶

Lawyers are also able to advocate positions, even unpopular ones, as part of a board's decision-making process. Peter Solmssen, a lawyer and former director at Siemens, describes this approach:

You're trained as a lawyer to be suspicious of any proposition, and so you pick apart statements that are made to you and question them You see a sentence that seems artfully incomplete, or you see a way of phrasing a financial

142. See Philip N. Meyer, *How Lawyers' Can Craft a Case Narrative to Spark Jurists' and Jurors' Interests*, ABA J. (Jan. 1, 2015), https://www.abajournal.com/magazine/article/how_lawyers_can_craft_a_case_narrative_to_spark_jurists_and_jurors_interest [<https://perma.cc/XX3E-AVW9>].

143. The seminal economic contribution on the informational and organizational value of advocacy systems is Mathias Dewatripont & Jean Tirole, *Advocates*, 107 J. POL. ECON. 1, 4 (1999) (providing a formal discussion of the use of such systems in various organizational contexts); see also Hyun Song Shin, *Adversarial and Inquisitorial Procedures in Arbitration*, 29 RAND J. ECON. 378, 378–80 (1998) (showing that decisional procedures in which “the opposing parties are invited to make their cases” are superior to procedures in which the arbitrator adjudicates “on the basis of the information [she] uncovered,” because the former “allocate[s] the burden of proof in an effective manner, thereby extracting the maximal informational content”); Paul Milgrom & John Roberts, *Relying on the Information of Interested Parties*, 17 RAND J. ECON. 18, 19 (1986) (providing a model on decisional mechanisms that rely on information provided by interested parties).

144. See Augustin Landier et al., *Optimal Dissent in Organizations*, 76 REV. ECON. STUD. 761, 769–73, 775 (2009) (providing a model that conceptualizes the value of dissent and preference heterogeneity in organizational models and information production).

145. See Sepe, *supra* note 47, at 373–74.

146. *What Boards Want*, *supra* note 137 (interview with Martha Minow).

conclusion, which just from the language tells you that there's something missing there. The slightly suspicious and cynical mind that is baked into you in law school, and certainly reinforced in the practice of law, is a useful perspective for a director.¹⁴⁷

These skills are likely to reduce group-thinking by the board and, instead, promote critical consideration of the issues at hand. Doing so is especially relevant in light of the findings of several regulatory reform committees that group-thinking was a key deficiency in board performance and risk management before the 2008 crisis.¹⁴⁸

A lawyer-director's advocacy skills are also likely to help her balance the incentives for greater risk-taking that arise from the banks' traditional reliance on asset transformation and leverage.¹⁴⁹ At the very least, one would expect lawyer-directors—and, as a result, the board as a whole—to base their decisions on evidence that reflects all sides of the issue being considered. The results in Table 2, regarding bank characteristics that predict a lawyer-director, support that inference. Those results show that a bank was more likely to have a lawyer-director when the CEO was on the board.¹⁵⁰ This suggests that a lawyer's advocacy skills may be especially valuable when the presence of a CEO-director could bias the decision-making process.

B. Mediators

Lawyers are also mediators and negotiators, trained “to find common ground or ways to resolve a dispute.”¹⁵¹ Those skills matter for directors. As Kenneth Chenault, a lawyer, former CEO of American Express, and a current or former director at Facebook, Airbnb, and Berkshire Hathaway, explained:

[L]egal training gives you the ability to synthesize facts and issues and see what might be some common themes that emerge. . . . The legal training of intellectual inquiry and the need really to understand the facts in an objective way is critically important in board service. . . . [Because] increasingly what is needed in the boardroom is judgment. And part of what you need is someone who is able to dispassionately listen to different perspectives on an issue.¹⁵²

As mediators, lawyers are trained to listen to different parties, balance competing interests, and identify a common ground for agreement, which can facilitate board communication and promote effective interaction among directors. This explains why having a lawyer on the board is valuable even when she is *not* a financial expert. Lawyer-director Peter Solmssen describes this aspect of a lawyer's directorship:

147. *Lawyer-Director*, *supra* note 138 (interview with Peter Solmssen).

148. See, e.g., Sir David Walker, A Review of Corporate Governance in UK Banks and Other Financial Industry Entities 42, 53 (2009) (unpublished manuscript), <https://www.accaglobal.com/content/dam/accaglobal/PDF-technical/corporate-governance/cdr898.pdf> [<https://perma.cc/65SK-G5K7>]; Shivaram Rajgopal et al., Bank Boards: What Has Changed Since the Financial Crisis? 1, 10, 13 (2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2722175 [<https://perma.cc/H9Q6-32CK>].

149. See *supra* Part II.B.

150. See *supra* Part III.C.

151. See *What Boards Want*, *supra* note 137 (interview with Martha Minow).

152. *Lawyer-Director*, *supra* note 138 (interview with Kenneth Chenault).

It's funny because as the lawyer, in an odd way, you are insulated because people assume you don't know anything about the technology or business But if you rather naively say, 'Now, wait a minute. How can that be going up if that's going down?' or something like that, then the whole room goes, 'Huh.'

The argument for requiring experts—in particular, financial experts—to sit on bank boards rests partly on concerns that non-experts lack the analytical tools and experience needed to manage a bank,¹⁵³ especially in areas as complex as bank risk.¹⁵⁴ Although this concern has merit, it misses a larger point—namely, that diversity among bank directors has value precisely because not everyone understands a bank's business in the same way. Non-experts may have valuable, non-technical information that is relevant to the matter at hand. Moreover, while non-experts may struggle with technical aspects of bank risk, they can still contribute to the decision-making process with questions that challenge assumptions held by directors who are closer to the industry.¹⁵⁵

Nevertheless, as a practical matter, non-experts are more likely to over-rely on experts' opinions in reaching a decision. This reliance may be truer for banks, since non-experts are likely to be outsiders with less insight into a bank's operations and time constraints that make it difficult to gain those insights.¹⁵⁶ Under the circumstances, non-experts on a bank's board may make decisions based on, in the jargon of economists, "second-order" beliefs that primarily rely on the experts' (first-order) beliefs.¹⁵⁷ As a result, the contributions of non-experts may get lost, resulting in less well-developed information as the basis for a board's decisions.

In that respect, lawyer-directors enable banks to more fully benefit from the diverse information of experts and non-experts by facilitating communication among them. Lawyers are taught to ask "digestible" questions that can be understood by a wide audience of clients, counterparties, and laymen sitting on juries. They learn how to convey complex information through heuristic shortcuts—often in the form of hypotheticals and analogies—which can make technical information more easily accessible. Lawyers are also trained to analyze and present the relevant facts, reassemble them for a purpose, and match those facts with explanations and analytical theories.¹⁵⁸ Consequently, lawyer-directors can assist non-experts in forming their own first-order beliefs by breaking down, and even challenging, complex information.¹⁵⁹

153. See Robert C. Pozen, *The Big Idea: The Case for Professional Boards*, HARV. BUS. REV. 50 (Dec. 2010), <http://hbr.org/2010/12/the-big-idea-the-case-for-professional-boards/ar/6> [<https://perma.cc/TWZ3-P4C2>] (observing that the lack of expertise among directors is a "perennial" problem that explains why most directors struggle to understand a company's business).

154. See Macey & O'Hara, *supra* note 26, at 86 (arguing that bank directors require greater expertise because of "the greater complexity and opacity of banks, and the increased challenges in monitoring these complex institutions").

155. Cf. Ronald C. Anderson et al., *The Economics of Director Heterogeneity*, 40 FIN. MGMT. 5 (2011) (highlighting the value of heterogeneity on boards of directors).

156. See Stephen M. Bainbridge & M. Todd Henderson, *Boards-R-Us: Reconceptualizing Corporate Boards*, 66 STAN. L. REV. 1051, 1064–65 (2014) (observing that many outsiders have full-time jobs elsewhere and hence can only devote limited time to running the business for which they are directors).

157. On first- and second-order beliefs and, more generally, the epistemological problems of testimony, see Peter J. Graham, *Transferring Knowledge*, 34 NOÛS 131 (2000).

158. See Meyer, *supra* note 142 (describing how lawyers are taught to become effective story-tellers to keep juries interested).

159. The management literature refers to this set of communication skills as "cross-training." See J. Richard

Of course, lawyers are not the only ones who can facilitate a board's decision-making. For example, professors may be as well-positioned as lawyers to bridge the information gap between experts and non-experts.¹⁶⁰ Other directors, based on their training and career experience, may also assist in assessing complex information and making it accessible to others. In addition, non-experts may reach decisions on their own without relying on experts' opinions in forming their beliefs. Thus, one can expect intellectual diversity on a board to be associated with greater bank value. Our theory of lawyer-directors, however, suggests that electing a "mediator" to the board is likely to add even greater value to the bank's decision-making process, especially when the board is diverse. To test this inference, we performed an additional empirical test. We began by assessing whether banks whose directors have a diverse set of educational and professional skills—that is, more "intellectual diversity" (as measured by *Board Intellectual Diversity*)—have greater value.¹⁶¹ Next, we investigated the source of that value. Table 6 shows our results.¹⁶²

TABLE 6. BOARD INTELLECTUAL DIVERSITY AND BANK VALUE.

This table reports the results for pooled panel regressions of Tobin's Q on an index proxy variable for a board's intellectual diversity during the sample period from 2000 to 2017. The main variable of interest, *Bank Value*, was measured contemporaneously, whereas *Board Intellectual Diversity*, *Lawyer-Director*, *MBA Director*, *MS Director*, *Doctorate Director*, and the remaining controls were lagged by one period. Columns (1)-(3) regressed *Bank Value* against the index, together with industry and year (columns (1) and

Hackman, *The Design of Work Teams*, in HANDBOOK OF ORGANIZATIONAL BEHAVIOR 314 (J. Lorsch ed., 1987). Cross-training relates to social interaction that promotes a group's ability to cooperate productively. See Susan G. Cohen & Diane E. Bailey, *What Makes Teams Work: Group Effectiveness Research from the Shop Floor to the Executive Suite*, 23 J. MGMT. 239, 239 (1997) (comparing the variables studied for different types of teams, highlighting the progress that has been made and suggesting what still needs to be done).

160. See Bill Francis et al., *Professors in the Boardroom and Their Impact on Corporate Governance and Firm Performance*, 57 FIN. MGMT. 547, 548–50 (2015) (providing evidence that firms with directors from academia exhibit increased performance); Bing Jiang & Patrick J. Murphy, *Do Business School Professors Make Good Executive Managers?*, 21 ACAD. MGMT. PERSPS. 29, 30 (2007) (highlighting that academic directors are trained to be independent and critical thinkers).

161. We did so by exploring the heterogeneous effect on *Bank Value* of having a *Lawyer-Director* plus one or more directors with diverse educational backgrounds. In particular, we focused on directors who hold an MBA degree (*MBA Director*), directors with scientific expertise who hold a Master of Science degree (*MS Director*), and directors with a doctoral degree (*Doctorate Directors*). We then created a *Board Intellectual Diversity* index variable, built as follows. First, if the bank did not have a *Lawyer-Director*, it received a value of zero. Second, for banks with at least one *Lawyer-Director*, we set the *Board Intellectual Diversity Index* at one. Third, for firm-year observations with a *Lawyer-Director* and at least one director with an *MBA*, *MS*, or *Doctorate* degree, we set the index value at two. Fourth, if the bank's board had a *Lawyer-Director* and directors with at least two of the *MBA*, *MS*, or *Doctorate* degrees (which could be held by the *Lawyer-Director* or one or more other directors), we set the index value at three. Lastly, for banks with a *Lawyer-Director* and directors with at least one each of an *MBA*, *MS*, and *Doctorate* degree, we set the *Board Intellectual Diversity Index* at four.

162. In Tbls. 6 and 7, we explored interactions that require a large number of observations, and so we used pooled panel regressions rather than matched samples.

(2)) or industry \times year (column (3)) fixed effects. Industry fixed effects are defined using three-digit SIC code industry definitions.

Dep. Variable: <i>Bank Value</i> _t				
2000 - 2017				
Variables	(1)	(2)	(3)	(4)
<i>Board Intellectual Diversity</i> _{t-1}	0.010* (1.78)	0.016*** (3.01)	0.015*** (2.96)	
<i>Lawyer Director</i> _{t-1}				0.029** (2.33)
<i>MBA Director</i> _{t-1}				0.006 (0.52)
<i>MS Director</i> _{t-1}				0.025 (1.44)
<i>Doctorate Director</i> _{t-1}				0.023* (1.93)
Control Variables	No	Yes	Yes	Yes
Industry and Year Fixed Effects	Yes	Yes	No	No
Industry \times Year Fixed Effects	No	No	Yes	Yes
# of Unique Firms	1,411	1,411	1,411	1,411
N	11,486	11,486	11,486	11,486
Adjusted R ²	0.338	0.449	0.483	0.460

Table 6 shows a positive and significant association between *Bank Value* and *Board Intellectual Diversity*, confirming that a bank's value is more likely to be greater when it has directors with a diverse set of educational and professional skills.¹⁶³ Table 6, however, tells us something more. In column (4), where we divided *Board Intellectual Diversity* into four different educational backgrounds, we found evidence that most of the positive value associated with *Board Intellectual Diversity* was tied to the effect of lawyer-directors on *Bank Value*. Specifically, the magnitude of the *Lawyer-Director* coefficient was 0.029, statistically significant at the 5% level (t -stat=2.33). In contrast, neither an *MBA* nor *MS Director* (respectively, a director with an MBA or Master of Science degree) was significantly related to *Bank Value*, and a *Doctorate Director* (a director with a doctoral degree) only marginally contributed (coefficient=0.023; t -stat=1.93) to the value of the banks they served. Thus, while banks benefit from directors other than lawyers, our results indicate they gain the most from having lawyer-directors, consistent with our conjecture that a lawyer's mediation skills enable banks to fully benefit from an intellectually-diverse board.

163. For example, column (2) indicates that a one unit increase in the index translates to a 1.4% increase in *Bank Value* relative to the sample mean. The 1.4% economic significance of the increase in *Bank Value* was calculated by multiplying the coefficient of *Board Intellectual Diversity* in column 2 (=0.016), which included industry and year fixed effects, by a 1-unit increase in the index and then dividing the product by the average *Bank Value* in our pooled sample over the period 2000 to 2017 (=1.133, see App. Tbl. A4).

C. Legal Experts

Of course, some of a lawyer's skills are tied to her substantive knowledge of the law.¹⁶⁴ In particular, lawyer-directors are better positioned than non-lawyers to manage two areas of bank risk that have grown substantially in recent years: litigation and regulatory risks.¹⁶⁵ Due to their expertise, lawyer-directors are more likely to accurately weigh whether litigation will fail or succeed or regulation will be interpreted in a particular way, and then determine a strategy to manage the risks. As Peggy Heeg, a lawyer-director at several energy companies, observed: “[A] lot of people on boards don’t have that [regulatory] background and don’t know how to analyze those type of issues, . . . having that regulatory experience has been invaluable.”¹⁶⁶

If our intuition is correct that part of a lawyer-director's value comes from her ability to manage litigation and regulatory risks, we should find that bank value increases in banks with a lawyer-director and higher levels of litigation compared to banks without a lawyer-director or with lower levels of litigation. Table 7 shows the results of our analyses. In this test, we added four additional litigation measures to *Financial Litigation* (which we used as a proxy for overall bank litigation, including regulatory litigation): *Class Action Litigation*, *Securities Litigation*, *Consumer Credit Litigation*, and *Derivative Litigation*, where each proxy was designed to capture only the indicated type of litigation.¹⁶⁷

164. That benefit extends beyond lawyers as directors. A recent study found that, when a firm has a CEO with legal education, it also has less corporate litigation and a lower proportion of lost and settled litigation. See M. Todd Henderson et al., *Lawyer CEOs* 4 (Feb. 21, 2017) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2923136 [<https://perma.cc/9AS5-SDDN>] (examining the value of CEOs with law degrees and their effect on corporate litigation). The study also found that hiring a CEO with legal expertise is likely to be value enhancing, although there is a trade-off between the benefits of reducing litigation and excessively conservative investment policies. *Id.* at 5.

165. See *supra* notes 42–46 and accompanying text.

166. See *Lawyer-Director*, *supra* note 138 (interview with Peggy Heeg).

167. We only show the results for these four litigation measures, since they are what the data indicated mattered most in terms of *Bank Value* and having a *Lawyer-Director*. Interactions with other measures of litigation, such as financial reporting, financial fraud, and insurance litigation, were insignificantly associated with *Bank Value*.

TABLE 7. LAWYER-DIRECTOR, LITIGATION, AND BANK VALUE.

This table reports results from pooled panel regressions of Tobin's Q on lawyer-director and litigation interactions during the sample period from 2000 and 2017. *Bank Value* was measured contemporaneously, whereas *Lawyer-Director* \times *Litigation*, *Lawyer-Director*, *Financial Litigation*, and the controls were lagged by one period.

Dep. Variable: <i>Bank Value</i> _{<i>t</i>}	2000 – 2017				
Variables	(1)	(2)	(3)	(4)	(5)
<i>Lawyer Director</i> _{<i>t</i>-1} \times <i>Financial Litigation</i> _{<i>t</i>-1}	0.045** (2.08)				
<i>Lawyer Director</i> _{<i>t</i>-1} \times <i>Class Action Litigation</i> _{<i>t</i>-1}		0.042* (1.79)			
<i>Lawyer Director</i> _{<i>t</i>-1} \times <i>Securities Litigation</i> _{<i>t</i>-1}			0.072** (2.12)		
<i>Lawyer Director</i> _{<i>t</i>-1} \times <i>Consumer Credit Litigation</i> _{<i>t</i>-1}				0.286* (1.71)	
<i>Lawyer Director</i> _{<i>t</i>-1} \times <i>Derivatives Litigation</i> _{<i>t</i>-1}					0.052* (1.88)
<i>Lawyer Director</i> _{<i>t</i>-1}	0.024* (1.86)	0.025* (1.92)	0.024* (1.82)	0.029** (2.28)	0.027** (2.18)
<i>Financial Litigation</i> _{<i>t</i>-1}	-0.016 (-0.54)				
<i>Class Action Litigation</i> _{<i>t</i>-1}		-0.026 (-1.35)			
<i>Securities Litigation</i> _{<i>t</i>-1}			-0.066* (-1.77)		
<i>Consumer Credit Litigation</i> _{<i>t</i>-1}				-0.154 (-0.97)	
<i>Derivatives Litigation</i> _{<i>t</i>-1}					-0.012 (-0.39)
Significance of Joint Effect:					
[<i>Law Director</i> _{<i>t</i>-1} \times <i>Litigation</i> _{<i>t</i>-1}] + [<i>Law Director</i> _{<i>t</i>-1}]	0.070*** (2.94)	0.067*** (2.62)	0.096*** (2.78)	0.315* (1.89)	0.079*** (2.67)
Control Variables	Yes	Yes	Yes	Yes	Yes
Industry and Year Fixed Effects	Yes	Yes	Yes	Yes	Yes
# of Unique Firms	1,530	1,530	1,530	1,530	1,530
N	12,343	12,343	12,343	12,343	12,343
Adjusted R ²	0.438	0.438	0.438	0.438	0.438

Table 7 confirms our intuition that the risk management benefits of a lawyer-director increased in banks with higher levels of litigation, regardless of the type of litigation. Our most significant results are shown in column (3) of Table 6, where we found on average that banks with lawyer-directors and higher levels of securities litigation had greater *Bank Value* than banks without a lawyer-director. In terms of economic magnitude, the differential gain in *Bank Value* for this subset of banks was 6.4%¹⁶⁸ relative to the sample

168. The 6.4% economic significance of the total incremental increase in *Bank Value* was calculated by

mean of banks without a lawyer-director.¹⁶⁹ Meanwhile, as one would expect, the impact of *Securities Litigation* on *Bank Value* was negative (coefficient = -0.066) and statistically significant (t -stat = -1.77). We found qualitatively similar results using the four other litigation proxies,¹⁷⁰ confirming our conjecture that a lawyer's expertise in managing litigation and regulatory risk is a primary channel through which lawyer-directors add value to banks.

* * *

In Parts III and IV, we showed that lawyer-directors increase bank value through effective risk management. In particular, we found that when a lawyer-director is on a bank's board, the bank is more likely to optimize risk-taking—by mitigating “bad” risks when the chances of loss are greater, and pursuing “good” risks when they are more likely to benefit the bank.¹⁷¹ We also found that lawyer-directors facilitate sound decision-making based on a combination of the training, experience, and practice that lawyers gain throughout their careers.¹⁷² A lawyer's skills are valuable in the boardroom, assisting lawyer-directors—and the board as a whole—to identify, assess, and manage risk.

In the next Part, we consider the implications of those findings, not only for banks but for boards of directors generally. Our tentative proposal relies on market feedback to assess the value of directors whose skills support more efficient risk management. The proposal is intended to reinforce those aspects of board composition that are more likely to enhance the decision-making process.

V. RETHINKING BOARDS

A lawyer has been described as “a counselor, planner, drafter, negotiator, investigator, lobbyist, scapegoat, champion, and, most strikingly, even as a friend.”¹⁷³ This Article adds to that list a lawyer's expertise as a “risk manager.” The value of that expertise, as shown in Parts III and IV, comes from the distinctive combination of skills and “thinking like a lawyer” that a lawyer-director brings to the boardroom.

This Part considers several implications of our analyses for banks and corporate governance. First, as we have shown, regulating risk management, whether through higher

dividing the coefficient of $Lawyer\ Director_{t-1} \times Securities\ Litigation_{t-1}$ (=0.072) by the average *Bank Value* in our pooled sample during the period 2000 to 2017 (=1.133, see App. Tbl. A4).

169. Additionally, when we verified the significance of the joint effect of (i) having a *Lawyer-Director* and (ii) having a *Lawyer-Director* and above-average sample-year levels of *Securities Litigation*, we find that the total effect for this group of banks was an 8.5% increase in *Bank Value* (significant at the 1% level). The 8.5% economic significance of the total incremental increase in *Bank Value* was calculated by dividing the coefficient of *Significance of Joint Effect for Securities Litigation* (=0.096) by the average *Bank Value* in our pooled sample during the period 2000 to 2017 the sample (=1.133, see App. Tbl. A4).

170. For instance, in column (2) of Tbl.7 (showing the interaction of *Lawyer-Director* with *Class Action Litigation*), we found evidence that banks with a lawyer-director and above-average sample-year levels of class-action litigation had a differential increase in *Bank Value* of 3.7% and a total value increase of 5.9% (in each case relative to the sample mean of *Bank Value* and where economic significance was calculated analogously to *Securities Litigation* supra note 169).

171. See supra Tbl. 3 (presenting results on the impact of lawyer-directors on bank risk) and Tbl. 4 (presenting results on the impact of lawyer-directors on bank value).

172. See supra text accompanying notes 137–141.

173. Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 242 (1984).

capital requirements or governance rules, is incomplete.¹⁷⁴ Instead, we must begin to take a more holistic approach to bank governance, one that reflects what goes on inside the board and how that affects the directors' decision-making process, including with respect to risk.

Second, and relatedly, we raise questions about the current regulatory approach to bank boards, requiring both independence and financial expertise.¹⁷⁵ As formulated today, those requirements suffer from a compliance-focused, one-size-fits-all approach to managing banks, which is unlikely to provide the flexibility needed for efficient risk management.

Third, we argue it is time to reconsider the standard black-box framing of the board and corporate governance, under which companies are monolithic entities and the board is simply another box within a box. Our findings on lawyer-directors begin to penetrate the black box of boards, emphasizing the importance of board composition and an individual director's features in making boards more effective. More is needed—in assessing governance in banks, as well as in public companies generally—but our analyses provide a good first step.

To that end, we outline a tentative proposal to promote more effective bank directorship. Our proposal is not intended as a substitute for current regulation but complements existing rules that fail to focus properly on the value of board composition in enhancing the directors' decision-making process.

A. Beyond Compliance

Managing risk requires more than complying with regulation. To be effective, a bank's managers must assess the risks to which the bank is exposed and then determine the optimal risk-and-reward balance. They must do so continuously in light of the dynamic nature of risk and changes in the environment in which each bank operates.¹⁷⁶ That is, there is value to "thinking like a lawyer," even if the director is *not* a lawyer. Doing so is likely to promote informed and flexible decision-making that is essential for risk management.

As a normative matter, this means that bank regulation must begin to more closely reflect a bank's internal features and how those features affect the decision-making process. Existing capital requirements are ill-suited to the task, since they tend to be rigid, backward-looking, and largely indifferent to a particular bank's internal processes.¹⁷⁷ In fact, as we have described, raising a bank's capital levels may have the unintended consequence of increasing its credit risk as the bank's managers seek higher returns on the loans they make.¹⁷⁸ The new rules on bank governance are also misguided.¹⁷⁹ They focus on a specific characteristic of a bank's directors—for example, their independence, largely as a means to address potential conflicts of interest.¹⁸⁰ Beyond this, the rules say little about how a board should agree on a risk management strategy. In that respect, the current emphasis on independence is both too broad and too narrow. It is too broad because it

174. *See supra* Part II.C.

175. *See supra* text accompanying notes 66–71.

176. *See supra* Part II.C.

177. *See supra* text accompanying notes 57–65.

178. *See supra* text accompanying notes 57–62.

179. *See supra* text accompanying notes 66–72.

180. *See supra* notes 66–67 and accompanying text.

makes it more difficult for directors with industry-relevant expertise to join a bank's board. It is too narrow in that it focuses on independence and not on the particular skills a prospective director can bring to the board's decision-making process. In fact, by narrowing the pool from whom bank directors are selected, independence requirements may inadvertently promote more similarity in thinking and, therefore, a less-informed decision-making process.¹⁸¹

The response to the above criticism has included proposals for new regulation that obligates a bank's directors to meet certain minimum expertise requirements. Those proposals, however, have focused primarily on one kind of expertise—financial skills.¹⁸² Our analysis of lawyer-directors shows that this focus is also too narrow. Other expertise may be as relevant as financial expertise for today's banks. In fact, legal expertise may be more relevant in light of the legal challenges some banks have needed to navigate in recent times.¹⁸³ Furthermore, our analyses of lawyer-directors indicate that a greater breadth of skills is needed. For example, the association of lawyer-directors with efficient risk management is tied, in part, to their ability to facilitate communication among directors.¹⁸⁴ Being able to enhance a board's decision-making process goes beyond technical expertise. It reflects a combination of experience and practice that lawyers gain throughout their careers. Through clients and their risks, lawyers also gain a perspective on how businesses operate and the likelihood that particular risks—beyond litigation and regulation—will occur, as well as ways to manage those risks. When these skills are properly reflected in the board, the result has been a rise in bank value. Nevertheless, the importance of non-technical expertise to a bank's directors has received only passing attention.¹⁸⁵

Our evidence raises questions about the kinds of expertise that *really* matter in bank boards. In that respect, financial expertise requirements suffer from the same one-size-fits-all approach that limits the effectiveness of independence standards. The scope of what is considered valuable for a bank's board must be broadened. To do so, as we explain next, the first step is to go beyond the black box model of corporate governance.

B. Beyond the Black Box

This Article demonstrates that what goes on *inside* the board and *who the directors are* is as important for effective risk management, if not more important, than regulatory standards that restrict capital or mandate governance requirements. It also suggests that a one-size-fits-all approach to regulating a bank's internal features will have only limited impact. The upshot is that regulators should no longer view a bank as a black box that makes unitary decisions.¹⁸⁶ Regulation, instead, must focus on the actual process by which boards make decisions, including identifying “ways of thinking” that are likely to be valuable.

Our findings on lawyer-directors begin to penetrate the black box. We demonstrate

181. See *supra* text accompanying 153 (discussing the benefits of heterogeneous sources of information for more informed decision-making).

182. See *supra* notes 70–71 and accompanying text.

183. See *supra* notes 45–46 and accompanying text.

184. See *supra* Part IV.B.

185. See Macey & O'Hara, *supra* note 26, at 103 (suggesting that experience might count as much as education in acquiring banking expertise).

186. See *supra* note 35 and accompanying text.

that the expertise a bank's directors bring to the board influences its ability to manage risk. First, as advocates, lawyer-directors are likely to minimize unproductive group-thinking among board members.¹⁸⁷ Second, as mediators, lawyer-directors can ensure that information on bank risk is effectively disseminated among the directors.¹⁸⁸ And third, as legal experts, lawyer-directors help the board assess litigation and regulatory risks, including managing a bank's operations in light of increasingly complex bank regulations.¹⁸⁹

Yet, going beyond the black box is more easily said than done. Regulating “ways of thinking” is likely to be vague and confusing to implement.¹⁹⁰ Thus, we tentatively propose a different approach to bank governance. This approach relies on the market discipline that informed a large part of our empirical analyses—namely, changes in bank value that arose in light of changes in the composition of a bank's board. What we propose is to harness the market's disciplining influence as one way to encourage the selection of directors who are more likely to be effective risk managers.¹⁹¹

Under our proposal, the Federal Reserve Board (and other bank regulators) will be directed to issue guidance on the skills a bank's board should possess (the “Guidance”). The listed skills will cover technical skills (such as financial or legal knowledge), as well as more general areas of expertise or “ways of thinking” (such as the ability to facilitate communication among directors). The Guidance, however, will not be mandatory or specific. Banks, instead, can decide how to reflect the Guidance in their boards, although regulators can later choose to consider the presence (or absence) of those skills among a bank's directors in imposing penalties for any failure in risk management.¹⁹² In addition,

187. See *supra* Part IV.A.

188. See *supra* Part IV.B.

189. See *supra* Part IV.C.

190. A recent example of this problem is found in the original Volcker Rule. Section 619 of the Dodd-Frank Act prohibited a commercial bank and its affiliates from engaging in “proprietary trading,” but permitted them to engage in “market-making.” The distinction between both activities rested, in part, on what a bank's trader intended at the time it engaged in the transaction, prompting JP Morgan CEO Jamie Dimon to remark that “you have to have a lawyer and a psychiatrist sitting next to you determining what was your intent every time you did something.” Ben Protess, *Jamie Dimon Shows Some Love for Volcker Rule*, N.Y. TIMES: DEALBOOK (May 21, 2012, 2:19 PM), <https://dealbook.nytimes.com/2012/05/21/jamie-dimon-shows-some-love-for-volcker-rule/> [<https://perma.cc/6RJD-WF8D>]. The problem was that the Volcker Rule failed to draw a clear line between permissible and impermissible activities. See Charles K. Whitehead, *The Volcker Rule and Evolving Financial Markets*, 1 HARV. BUS. L. REV. 39, 47–51 (2011) (arguing that a tailored approach to the Rule's prohibitions is required to account for variance in measures used to detect impermissible activities).

191. The role of the stock markets in influencing corporate governance is well known. See, e.g., Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1469–70 (2007) (suggesting that capital markets efficiently convey shareholder information to independent directors). We are also not the first to consider using the stock market as a way to temper bank risk-taking. See, e.g., Coffee, *supra* note 9, at 798 (proposing a new class of bank instruments under which a bank's debt securities would gradually convert into equity securities upon signs of a crisis). Our proposal differs, in part, because we are focusing particular attention on board characteristics that may promote efficient risk-taking and imposing costs on a bank's existing shareholders as one means to temper their inclination toward greater risk. Note that we are not proposing to scrap existing regulation. Since banks may not bear the full cost of their risk-taking, continued regulation remains important. See *supra* text accompanying notes 48–50 (explaining that, if bank managers are not responsible for the cost of their risky decisions, they may take greater risks). Our goal is to supplement (and, potentially, ease reliance on) existing regulation with an approach to board composition that enhances bank value.

192. The use of potential future penalties, whose magnitude may vary based on changes in corporate

the Securities and Exchange Commission will require each public bank to include in its prospectuses, annual reports, and proxy statements disclosures regarding whether the board complies with the Guidance or, if relevant, why aspects of the Guidance are not applicable. That disclosure will have the benefit of a safe harbor that minimizes the risk of shareholder lawsuits under the securities laws.

The likelihood that compliance with the Guidance will affect bank value should, among other things, temper the natural tendency of a bank's shareholders to promote risk-taking.¹⁹³ A board that fails to incorporate Guidance skills into its decision-making process may be less effective in the short-term. That failure will now also expose the bank (and, derivatively, its shareholders) to penalties in the event of a later risk management failure. Minimizing future penalties will provide one incentive for banks to reflect the Guidance in their boards. Most likely, investment banking equity analysts will consider compliance with the Guidance in their reports to the extent that a failure to comply increases the risk of future losses.

Thus, implementing our proposal helps reinforce expertise that is most valuable to a bank through market-based incentives. First, the Guidance will cause bank boards to more deliberately consider the skills needed to manage the bank and its risks. By giving banks the flexibility to meet the Guidelines, banks themselves can determine how best to manage risk rather than being bound by a one-size-fits-all set of requirements. Second, public disclosure, by itself, will provide banks with incentives to meet the Guidance. Few boards will want to acknowledge they fall short of the Guidance's standards.¹⁹⁴ Third, banks that meet the Guidance are more likely to be rewarded by a rise in share price. The potential effect of board composition on share price will also increase the public's focus on those skills that are most likely to enhance bank value—such as we have shown with lawyer-directors and efficient risk management.

This approach, however, raises an interesting question. In general, one would expect financial instruments, whose value is tied to the creditworthiness of a bank (or group of banks), to fluctuate in value based on changes in a bank's risk-taking. Lenders, in turn, should consider changes in those values when deciding what to charge a bank that is a borrower.¹⁹⁵ Consequently, if adding a lawyer-director—or, more generally, a director with desirable skills—enhances a bank's risk management, one would expect it to also lower the bank's cost of capital. Conversely, a bank without a lawyer-director should incur

behavior, as one way to promote that behavior, is not new. The Federal Sentencing Guidelines, for example, have included similar provisions as a way to encourage corporate compliance procedures. See UNITED STATES SENTENCING COMMISSION, GUIDELINES MANUAL ANNOTATED (2018), <https://www.ussc.gov/sites/default/files/pdf/guidelines-manual/2018/GLMFull.pdf> [<https://perma.cc/9DTV-P6RM>].

193. See *supra* note 47 and accompanying text (discussing the need for stricter regulations to limit the risks that banks are exposed to and why shareholders prefer a riskier investment strategy than customers).

194. The signaling effect of laws and their ability to create new norms is well known. See, e.g., Eric A. Posner, *Symbols, Signals, and Social Norms in Politics and the Law*, 27 J. LEG. STUD. 765, 778–84 (1998) (describing the signaling effect of law on people's behavior and beliefs). The potential effect of public disclosure on corporate behavior is also well-known. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 708 (1984) (“Proponents of disclosure of subjects such as foreign payments and pollution frequently argue that disclosure is beneficial precisely because it leads firms to change what they do.”).

195. See Charles K. Whitehead, *The Evolution of Debt: Covenants, the Credit Market and Corporate Governance*, 34 J. CORP. L. 641, 667–70 (2009) (“[E]quity and debt prices should move in tandem when new information regarding a firm's credit risk is discovered.”).

a higher cost of capital, providing strong market-based incentives to add a lawyer to its board. In other words, the credit market should provide a discipline that rewards (punishes) banks that (fail to) reflect the skills needed to enhance risk management.¹⁹⁶ Value-maximizing banks, therefore, should encourage lawyers to join their boards. This may be one reason why the rise of lawyer-directors has been so significant across bank sectors.

Why, then, the need for Guidance? The most likely answer is that market participants are unaware of the value that lawyer-directors bring to the board or the value of the substantive skills they and other directors can provide. Market participants may not be able to identify how a director's particular skills support stronger risk management. Moreover, factors outside the addition of a lawyer-director may affect bank value, making it more difficult for market participants to assess a particular director's skills.¹⁹⁷ As a result, market feedback may not be precise in awarding or disciplining banks based on changes in board composition. In that respect, the Guidelines may be the most useful by helping to focus market participants on those features of a board that are most likely to influence a bank's value.

C. Beyond Banks

Our focus has been on the role of bank boards, and specifically lawyer-directors, in the efficient management of risk. The key insights of our analysis, however, can be extended more generally to all public companies. In that respect, the prior study by two of us, that shows a similar rise in lawyer-directors at non-financial firms with similar benefits in firm value,¹⁹⁸ suggests that the need to go beyond the conventional black box approach to boards is not limited to banks.

The COVID-19 crisis has brought this need to the forefront. The "new normal" has catalyzed deeper board involvement in basic business decisions as directors rush to find new ways to support overwhelmed CEOs. A number of recommendations have been made to assist directors in this task.¹⁹⁹ They include establishing clear channels for timely board communication (and, more explicitly, recommendations for "1-3 update calls per week between the CEO and the chairman" and "weekly, short written updates to the full board"),²⁰⁰ encouraging directors "to ask the right questions and test management's

196. *Id.*

197. *See supra* note 99 (observing that studies on the value implications of board composition have generally produced mixed results).

198. *See* Litov, Sepe & Whitehead, *supra* note 74, at 413.

199. *See, e.g.,* Chaitra Chandrasekhar & Robert C. Pozen, *A Director's Perspective on Covid-19: An Interview with Robert C. Pozen*, NACD: BOARD TALK (Apr. 29, 2020), <https://blog.nacdonline.org/posts/covid-19-robert-pozen> [<https://perma.cc/V7QL-HZCP>] (setting forth three attributes of a well-functioning crisis-time board); Rusty O'Kelley et al., *Board Leadership and Performance in a Crisis*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (May 13, 2020), <https://corpgov.law.harvard.edu/2020/05/13/board-leadership-and-performance-in-a-crisis/#more-129392> [<https://perma.cc/E92U-FEQM>]; *Stepping In: The Board's Role in the COVID-19 Crisis: Guidance for Boards of Directors*, DELOITTE <https://www2.deloitte.com/global/en/pages/about-deloitte/articles/covid-19/stepping-in--the-board-s-role-in-the-covid-19-crisis---deloitte.html> [<https://perma.cc/9ATS-3MN5>]; Martin Hirt et al., *Boards in the Times of Coronavirus*, MCKINSEY & CO. (Apr. 16, 2020), <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/boards-in-the-time-of-coronavirus> [<https://perma.cc/QG3L-2WWG>].

200. *See* O'Kelley et al., *supra* note 199.

assumptions”²⁰¹ (especially regarding “true worst-case possibilit[ies]”),²⁰² and introducing greater adaptability to external changes that affect the business.²⁰³

At their heart, these recommendations—which address communication, deliberation, and flexibility—look to support effective decision-making. They are precisely the skills we have shown lawyer-directors bring to bank boards.²⁰⁴ The question, then, is less whether these recommendations have merit and more whether they signal a need to change how regulators and academics conceive of corporate boards. In other words, one would expect a well-functioning board to naturally incorporate these points on their own in the ordinary course of business. Changes in value should reward this more efficient approach to risk management.²⁰⁵ What is needed, therefore, is an approach to corporate governance that considers board composition and the skills and experience that directors bring to their roles. How those skills are reflected in board interaction will vary from firm to firm, but this new approach is more likely to optimize decision-making, rather than recommendations that focus on the specific actions a director should or should not take.

VI. CONCLUSION

This Article is the first to analyze—theoretically and empirically—the role of lawyers as bank directors. It shows that lawyer-directors at banks are associated with efficient changes in how banks manage risk, as well as significant increases in bank value. Banks with a lawyer-director assume more risk in ordinary (non-crisis) circumstances and less risk when a crisis arises, in each case in a way that makes banks more valuable. In other words, banks with lawyer-directors do more than simply minimize “bad” risk. They also pursue “good” risk under circumstances that are more likely to result in greater bank value.

We focused on lawyer-directors as a means to penetrate the black box around bank boards. Doing so demonstrates that board composition—and the skills directors bring to their jobs—is important in how banks manage risk. In the case of lawyer-directors, for example, those skills extend beyond assessing litigation and regulatory risks. Lawyer-directors also add value by drawing on advocacy skills to analyze the risks that banks face, as well as by making complex information more accessible to a bank’s board.

201. *Id.*; see also Kucera et al., *COVID-19 and Corporate Governance: Key Issues for Public Company Directors*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Apr. 29, 2020), <https://corpgov.law.harvard.edu/2020/04/29/covid-19-and-corporate-governance-key-issues-for-public-company-directors/> [<https://perma.cc/TH6Y-K4LS>] (suggesting that a board of directors’ response to COVID-19 should include “enhancing the company’s existing reporting and information system . . . enhancing communication with the company’s management, [and] . . . confirming the feasibility of the company’s disaster plan.”).

202. See O’Kelley et al., *supra* note 199; see also Peter Atkins et al., *Thoughts for Boards of Directors in the Covid19 Crisis*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Apr. 7, 2020), <https://corpgov.law.harvard.edu/2020/04/07/thoughts-for-boards-of-directors-in-the-covid19-crisis/> [<https://perma.cc/W58F-N2SQ>] (suggesting questions boards should ask to avoid these possibilities, including, among others, “What are the short- and long-term financial impacts on our business as best we can ascertain at this time? What are the most significant “known unknowns” that affect our forecasts? What is the assessment of our capital resources and liquidity position?”).

203. *Id.*; see also Kristen Sullivan et al., *ESG and Corporate Purpose in a Disrupted World*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Aug. 10, 2020), <https://corpgov.law.harvard.edu/2020/08/10/esg-and-corporate-purpose-in-a-disrupted-world/> [<https://perma.cc/828K-4J9N>] (“Investors have indicated that they will assess a company’s response to the pandemic as a measure of stability, resilience, and adaptability.”).

204. See *supra* Part IV.

205. See *supra* Part III.D; see also Litov, Sepe & Whitehead, *supra* note 74, at 415.

Those skills are difficult to identify. How can one define an “advocacy” skill? Drafting new regulation that tries to capture those skills would be difficult. Instead, the trick is to find a means to encourage board skills that are most likely to be valuable. Drawing on market feedback, as we have proposed, provides one means to encourage banks to elect directors whose skills will improve board service. Most importantly, our proposal should prompt a new approach to understanding what really matters for effective directors, in banks as well as public companies generally.

VII. APPENDIX

FIGURE A1. PERCENTAGE OF FINANCIAL FIRMS WITH A LAWYER-DIRECTOR BY TYPE OF INSTITUTION.

Figure A1 shows the percentage of banks in our sample (SIC code 6000-6999), excluding real estate firms (two-digit SIC code: 65), with a lawyer-director, separated by the type of institution, each year from 1999 to 2017. We separated the sample by Commercial Banks, Investment Banks, Insurance Companies, and Other Financial Institutions.

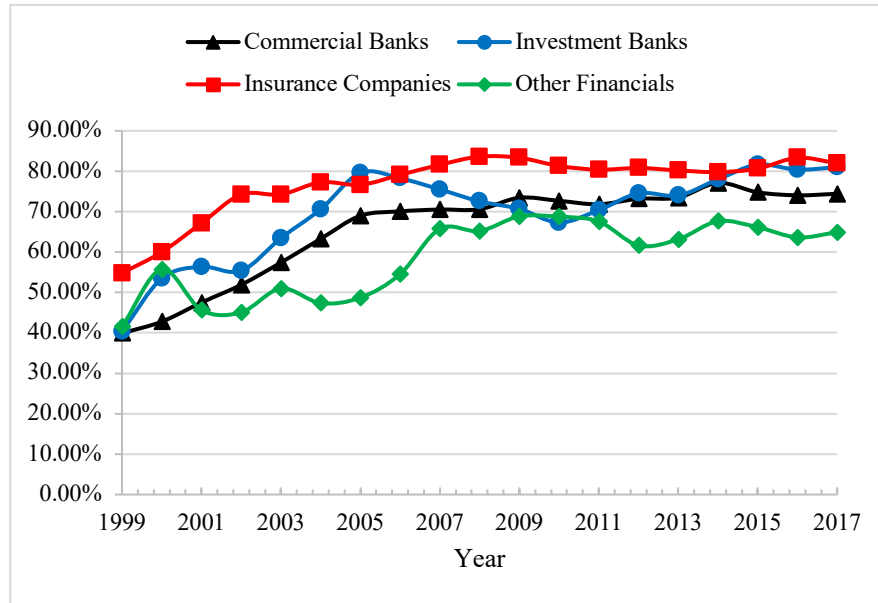


TABLE A1. VARIABLE DESCRIPTIONS.

This table defines the variables used in all of our empirical tests.

Dependent Variables	Description
<i>Bank Value</i>	Tobin's Q: market value of assets (book value of assets – book equity + market equity (prcc_f*csho)) divided by the book value of assets.
<i>Bank Risk</i>	The natural logarithm of Z-score multiplied by negative one (-1). Z-score: the ratio of the sum of return on assets (ROA) and each bank's capital ratio to the standard deviation of each bank's ROA.
Main Explanatory Variables	Description
<i>Lawyer – Director</i>	An indicator variable equal to one (1) if a bank has a lawyer-director, and zero (0) otherwise. We classify board members as lawyer-directors if they have one or more of the following academic qualifications: Juris Doctor, Bachelor of Laws, Master of Laws, Doctor of Jurisprudence, Doctor of Canon Law, Doctor of Civil Law, Doctor of Juridical Science, Doctor of Law, Doctor of Law and Political Science, Legorum Doctor, or Licentiate of Laws.
<i>Board Education Diversity</i>	A count index variable ranging from zero to four (0–4), where greater index values represent a larger collection of educational backgrounds on the board of directors in a given year. The index equals zero if there is no <i>Lawyer-Director</i> ; it equals one if there is a <i>Lawyer-Director</i> but no <i>MBA</i> -, <i>MS</i> -, or <i>Doctorate Directors</i> (respectively, a director with an <u>MBA</u> , <u>Master of Science</u> , or <u>Doctorate degree</u>); it equals two (2) if there is a <i>Lawyer-Director</i> and one of an <i>MBA</i> -, <i>MS</i> -, or <i>Doctorate Director</i> ; it equals three (3) if there is a <i>Lawyer-Director</i> and any two of an <i>MBA</i> -, <i>MS</i> -, or <i>Doctorate Director</i> ; and it equals four (4) if there is a <i>Lawyer-Director</i> and an <i>MBA</i> -, <i>MS</i> -, and <i>Doctorate Director</i> .
Main Interaction Variables	Description
<i>Executive Director</i>	An indicator variable equal to one (1) if a director is also an executive of the bank, and zero (0) otherwise.
<i>CEO Director</i>	An indicator variable equal to one (1) if a director is also the bank's CEO, and zero (0) otherwise. It is also a control variable in the <i>Q</i> and <i>Ln(Z-Score)</i> regressions.
<i>Normal Times</i>	An indicator variable equal to one (1) if the sample year is outside the 2007 through 2009 range, and zero (0) otherwise.
<i>Financial Crisis</i>	An indicator variable equal to one (1) if the sample year is between 2007 and 2009, inclusive, and zero (0) otherwise.

<i>Financial Litigation</i>	An indicator variable equal to one (1) if a bank has a natural logarithm of one plus a financial litigation count value above the sample year mean, and zero (0) otherwise. “Financial litigation” is defined as the sum of bank, consumer credit, derivatives, financial reporting, financial fraud, insurance, and securities litigation. $Ln(\text{Financial Litigation})$ is also included as a control variable in the Q and $Ln(Z\text{-Score})$ regressions, where we take the natural logarithm of one plus the count of financial litigation occurrences.
<i>Class Action Litigation</i>	An indicator variable equal to one (1) if a bank has a natural logarithm of one plus a class action litigation count value above the sample year mean, and zero (0) otherwise. “Class Action Litigation” is defined as <i>is_category_type_1</i> in Audit Analytics.
<i>Securities Litigation</i>	An indicator variable equal to one (1) if a bank has a natural logarithm of one plus a securities litigation count value above the sample year mean, and zero (0) otherwise. “Securities Litigation” is defined as <i>is_category_type_41</i> in Audit Analytics.
<i>Consumer Credit Litigation</i>	An indicator variable equal to one (1) if a bank has a natural logarithm of one plus a consumer credit litigation count value above the sample year mean, and zero (0) otherwise. “Consumer Credit Litigation” is defined as <i>is_category_type_98</i> in Audit Analytics.
<i>Derivatives Litigation</i>	An indicator variable equal to one (1) if a bank has a natural logarithm of one plus a derivatives litigation count value above the sample year mean, and zero (0) otherwise. “Derivatives Litigation” is defined as <i>is_category_type_97</i> in Audit Analytics.
Control Variables	Description
<i>Size</i>	The natural logarithm of the value of the bank’s total book assets in millions of dollars.
<i>Firm Age</i>	The natural logarithm of one plus the number of firm-year observations since the bank’s first appearance in Compustat.
<i>Revenue Growth</i>	The natural logarithm of the value of revenue in millions of dollars in year t divided by the value of revenue in millions of dollars in year $t-1$.
<i>Loss</i>	An indicator variable equal to one (1) if a bank has negative net income during a fiscal year, and zero (0) otherwise.
<i>Debt-to-Equity</i>	A bank’s long-term debt divided by its book equity.
<i>CAPX/Assets</i>	A bank’s capital expenditures divided by the value of its total book assets.

<i>Inst. Ownership</i>	The percentage ownership of a bank by its institutional shareholders, as measured by their equity ownership reported in their Form 13F reports appearing in Thomson Reuters, weighted by the firm's market capitalization.
<i>Outside Director</i>	The number of directors who are outsiders. For these purposes, an "outside director" is a director who was never employed by the bank, is not related to a key employee of the firm, and never worked for a major stakeholder of the firm.
<i>Director Gender</i>	The ratio of (1+ male) to (1+ female) directors that sit on a financial bank's board.
Law Director Characteristic Variables	Description
<i>Lawyer Director Age</i>	The average age of all lawyer-directors who sit on a bank's board.
<i>Lawyer- Executive</i>	The percentage of lawyer-directors on a bank's board who are also executives of the firm.
<i>Lawyer- CEO</i>	The percentage of lawyer-directors on a bank's board who are also the firm's CEO.
<i>Lawyer Male Director</i>	The percentage of lawyer-directors on a bank's board who are male.
<i>Lawyer MBA Director</i>	The percentage of lawyer-directors on a bank's board who also have an MBA degree.

TABLE A2. MATCHED SAMPLE SUMMARY STATISTICS.

This table reports summary statistics for a propensity score matched sample. *Treated Lawyer* firms are defined as financial firms that have a lawyer-director, whereas *Control* firms do not have a lawyer-director during at least the five-year period following the first

year its matched counterpart becomes treated (when a lawyer-director joins its board). We use propensity score matching with replacement in year $t-1$ to create a sample matched on *Bank Value*, *Size*, *Inst. Ownership*, and *Bank Risk*, and two-digit SIC codes. Panel A presents the summary statistics for the year prior to lawyer-director treatment. The column “Difference” provides the difference between the *Treated Lawyer* and *Control* sample mean (test statistic in parentheses). The row “N (by group)” provides the number of unique firms for each group. Panel B shows summary statistics for the full matched panel.

Panel A: Pre-Treatment Lawyer-Director Year ($t-1$)			
Matched Variables:	Treated Lawyer	Control	Difference
<i>Bank Value_t</i>	1.234 (0.764)	1.192 (0.676)	0.041 (0.86)
<i>Size_t</i>	7.083 (1.690)	7.180 (1.809)	-0.097 (-0.83)
<i>Inst. Ownership_t</i>	0.233 (0.272)	0.252 (0.275)	-0.020 (-1.08)
<i>Bank Risk_t</i>	-4.302 (1.140)	-4.285 (1.107)	-0.017 (-0.22)
Other Independent Variables:			
<i>Age_t</i>	2.309 (0.693)	2.419 (0.661)	-0.110** (-2.43)
<i>Revenue Growth_t</i>	0.103 (0.226)	0.077 (0.219)	0.026* (1.70)
<i>Loss_t</i>	0.131 (0.338)	0.160 (0.367)	-0.029 (-1.23)
<i>Debt- to- Equity_t</i>	0.787 (1.007)	0.863 (1.094)	-0.075 (-1.07)
<i>CAPX/Assets_t</i>	0.006 (0.018)	0.007 (0.023)	-0.001 (-0.58)
<i>Ln(Financial Litigation)_t</i>	0.126 (0.492)	0.139 (0.454)	-0.013 (-0.40)
<i>CEO Director_t</i>	0.245 (0.431)	0.235 (0.424)	0.011 (0.38)
<i>Outside Director_t</i>	2.030 (2.727)	1.913 (3.548)	0.116 (0.54)
<i>Director Gender_t</i>	6.110 (6.275)	6.335 (8.990)	-0.235 (-0.43)
<i>Normal Times_t</i>	0.887 (0.317)	0.887 (0.317)	0.000 (0.00)
<i>Financial Crisis_t</i>	0.113 (0.317)	0.113 (0.317)	0.000 (0.00)
N (by group)	450	450	

TABLE A2 (CONTINUED)

Panel B: Summary statistics for ($t-5$) to ($t+5$)				
Matched Variables:	Mean	St. Dev.	Median	Obs.
<i>Bank Value_t</i>	1.148	0.522	1.047	6,041

<i>Size_t</i>	7.514	1.656	7.344	6,041
<i>Inst. Ownership_t</i>	0.276	0.279	0.185	6,041
<i>Bank Risk_t</i>	-4.431	1.101	-4.496	6,041

Other Control Variables:	Mean	St. Dev.	Median	Obs.
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<i>Age_t</i>	2.588	0.576	2.565	6,041
<i>Revenue Growth_t</i>	0.070	0.197	0.058	6,041
<i>Loss_t</i>	0.130	0.337	0	6,041
<i>Debt- to- Equity_t</i>	0.872	1.071	0.507	6,041
<i>CAPX/Assets_t</i>	0.004	0.013	0.001	6,041
<i>Ln(Financial Litigation)_t</i>	0.161	0.528	0	6,041
<i>CEO Director_t</i>	0.258	0.438	0	6,041
<i>Outside Director_t</i>	2.225	3.387	1	6,041
<i>Director Gender_t</i>	7.454	8.363	5.500	6,041

Interaction Variables:	Mean	St. Dev.	Median	Obs.
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<i>Normal Times_t</i>	0.838	0.368	1	6,041
<i>Financial Crisis_t</i>	0.162	0.368	0	6,041

TABLE A3. LAWYER-DIRECTORS AND BANK RISK (POOLED PANEL).

This table reports the results for pooled panel regressions of the natural logarithm of Z-score (multiplied by negative one (-1)) on a *Lawyer-Director* indicator variable from 2000 to 2017. The main variable of interest, *Bank Risk*, is measured contemporaneously, whereas *Lawyer-Director* and the remaining controls are lagged by one period.

Variables	2000 – 2017				
	(1)	(2)	(3)	(4)	(5)
Dep. Variable: <i>Bank Risk</i> _t					
<i>Lawyer Director</i> _{t-1}	-0.073* (-1.80)	-0.062* (-1.69)	-0.062* (-1.67)	-0.077* (-1.65)	-0.079* (-1.67)
<i>Lawyer Director</i> × <i>Executive Director</i> _{t-1}				0.007 (0.13)	0.002 (0.46)
<i>Lawyer Director</i> × <i>CEO Director</i> _{t-1}					0.030 (0.46)
<i>Executive Director</i> _{t-1}				-0.002 (-0.03)	0.009 (0.17)
<i>CEO Director</i> _{t-1}		-0.006 (-0.14)	-0.019 (-0.44)	-0.005 (-0.11)	-0.043 (-0.71)
<i>Firm Value</i> _{t-1}		0.299*** (5.00)	0.240** (3.67)	0.287*** (4.57)	0.287*** (4.51)
<i>Size</i> _{t-1}		-0.025 (-1.63)	-0.023 (-1.46)	-0.028* (-1.80)	-0.025 (-1.64)
<i>Age</i> _{t-1}		-0.329*** (-7.93)	-0.342*** (-7.89)	-0.353*** (-8.10)	-0.355*** (-8.12)
<i>Revenue Growth</i> _{t-1}		-0.020 (-0.26)	0.046 (0.58)	-0.029 (-0.38)	-0.029 (-0.39)
<i>Loss</i> _{t-1}		0.988*** (22.32)	0.976*** (21.54)	0.965*** (22.35)	0.962*** (22.27)
<i>Debt-to-Equity</i> _{t-1}		0.177*** (10.26)	0.178*** (10.24)	0.186*** (10.54)	0.185*** (10.52)
<i>CAPX/Assets</i> _{t-1}		-1.398 (-0.63)	-0.620 (-0.27)	-0.844 (-0.74)	-0.732 (-0.33)
<i>Inst. Ownership</i> _{t-1}		-0.052 (-0.66)	-0.051 (-0.63)	-0.015 (-0.19)	-0.043 (-0.59)
<i>Ln(Financial Litigation)</i> _{t-1}		0.187*** (5.59)	0.167*** (5.05)	0.183*** (5.58)	0.182*** (5.53)
<i>Outside Director</i> _{t-1}		0.004 (0.56)	0.005 (0.67)	0.004 (0.53)	0.004 (0.60)
<i>Director Gender</i> _{t-1}		0.003 (1.11)	0.003 (1.06)	0.003 (1.24)	0.003 (1.15)
Industry and Year Fixed Effects	Yes	Yes	No	Yes	Yes
Industry×Year Fixed Effects	No	No	Yes	No	No
# of Unique Firms	1,466	1,466	1,466	1,466	1,466
N	11,533	11,533	11,533	11,533	11,533
Adjusted R ²	0.158	0.296	0.308	0.302	0.302

TABLE A4. POOLED PANEL SUMMARY STATISTICS.

This table reports full sample summary statistics for the dependent and explanatory variables used in the pooled panel regressions.

	2000 – 2017					
Main Dependent Variables:	Mean	St. Dev.	P25	Median	P75	Obs.
<i>Bank Value_t</i>	1.133	0.373	0.992	1.033	1.099	12,343
<i>Bank Risk_t</i>	-4.501	1.065	-3.801	-4.581	-5.263	11,537
Main Independent Variables:	Mean	St. Dev.	P25	Median	P75	Obs.
<i>Lawyer Director_t</i>	0.671	0.470	0	1	1	12,343
<i>Board Education Diversity_t</i>	1.478	1.397	0	1	3	12,343
<i>Size_t</i>	7.510	1.817	6.322	7.238	8.571	12,343
<i>Age_t</i>	2.616	0.552	2.197	2.565	2.996	12,343
<i>Revenue Growth_t</i>	0.056	0.170	-0.042	0.044	0.140	12,343
<i>Loss_t</i>	0.136	0.342	0	0	0	12,343
<i>Debt- to- Equity_t</i>	0.886	1.056	0.190	0.504	1.162	12,343
<i>CAPX/Assets_t</i>	0.004	0.009	0	0.001	0.003	12,343
<i>Inst. Ownership_t</i>	0.293	0.285	0.014	0.207	0.523	12,343
<i>Ln(Financial Litigation)_t</i>	0.179	0.535	0	0	0	12,343
<i>CEO Director_t</i>	0.195	0.396	0	0	0	12,343
<i>Outside Director_t</i>	1.765	2.750	0	1	3	12,343
<i>Director Gender_t</i>	7.586	7.028	3	6	10	12,343
Main Interacted Variables:	Mean	St. Dev.	P25	Median	P75	Obs.
<i>Executive Director_t</i>	0.777	0.416	1	1	1	12,343
<i>Financial Litigation_t</i>	0.139	0.345	0	0	0	12,343
<i>Class Action Litigation_t</i>	0.142	0.349	0	0	0	12,343
<i>Securities Litigation_t</i>	0.102	0.303	0	0	0	12,343
<i>Consumer Credit Litigation_t</i>	0.003	0.058	0	0	0	12,343
<i>Derivatives Litigation_t</i>	0.026	0.158	0	0	0	12,343
<i>Financial Crisis_t</i>	0.180	0.384	0	0	0	12,343

TABLE A5. LAWYER-DIRECTORS AND BANK VALUE (POOLED PANEL).

This table reports the results for pooled panel regressions of *Bank Value* on a *Lawyer-Director* indicator variable during the sample period 2000 to 2017. The main variable of interest, *Bank Value*, was measured contemporaneously, whereas *Lawyer-Director* and the remaining controls were lagged by one period.

Dep. Variable: <i>Bank Value_t</i>	2000 – 2017				
Variables	(1)	(2)	(3)	(4)	(5)
<i>Lawyer Director_{t-1}</i>	0.025*	0.030**	0.030**	-0.004	0.003
	(1.71)	(2.35)	(2.39)	(-0.27)	(0.15)
<i>Lawyer Director</i> \times <i>Executive Director_{t-1}</i>				0.035**	0.014
				(2.20)	(0.55)
<i>Lawyer Director</i> \times <i>CEO Director_{t-1}</i>					0.057*
					(1.94)
<i>Executive Director_{t-1}</i>				0.016	0.027
				(1.03)	(1.42)
<i>CEO Director_{t-1}</i>		0.010	0.008	-0.001	-0.036*
		(0.61)	(0.51)	(-0.04)	(-1.66)
<i>Size_{t-1}</i>		-0.033***	-0.028***	-0.035***	-0.033***
		(-4.46)	(-3.86)	(-4.78)	(-4.54)
<i>Age_{t-1}</i>		0.043***	0.040**	0.044***	0.043***
		(2.67)	(2.55)	(2.75)	(2.66)
<i>Revenue Growth_{t-1}</i>		0.083***	0.102***	0.152***	0.083***
		(2.85)	(3.31)	(5.45)	(2.82)
<i>Loss_{t-1}</i>		-0.060***	-0.065***	-0.055***	-0.060***
		(-3.51)	(-3.77)	(-3.38)	(-3.49)
<i>Debt-to-Equity_{t-1}</i>		-0.022***	-0.022***	-0.021***	-0.022***
		(-4.51)	(-4.40)	(-4.28)	(-4.49)
<i>CAPX/Assets_{t-1}</i>		10.92***	11.16***	10.71***	10.84***
		(6.22)	(6.10)	(6.15)	(6.22)
<i>Inst. Ownership_{t-1}</i>		0.150***	0.141***	0.160***	0.147***
		(4.38)	(4.20)	(4.72)	(4.32)
<i>Ln(Financial Litigation)_{t-1}</i>		-0.022	-0.032**	-0.020	-0.022
		(-1.59)	(-2.19)	(-1.45)	(-1.56)
<i>Outside Director_{t-1}</i>		-0.002	-0.002	-0.002	-0.002
		(-1.03)	(-1.14)	(-0.89)	(-1.06)
<i>Director Gender_{t-1}</i>		0.003***	0.003***	0.002***	0.003***
		(3.68)	(3.58)	(3.21)	(3.22)
Industry and Year Fixed Effects	Yes	Yes	No	Yes	Yes
Industry \times Year Fixed Effects	No	No	Yes	No	No
# of Unique Firms	1,530	1,530	1,530	1,530	1,530
N	12,343	12,343	12,343	12,343	12,343
Adjusted R ²	0.337	0.438	0.473	0.441	0.439