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

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May 2017

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Abstract

There is a growing literature about the question of who should regulate the regulators. This paper is interested in the question of how to regulate the regulators. More specifically, it explores how far it may be feasible to apply rules and principles of good corporate governance to the governance of financial regulators and financial regulatory institutions. For this purpose, the paper discusses the literature on the differences between private and public sector firms and their application to financial regulatory institutions, followed by an assessment of conceptual similarities between the governance of financial regulatory institutions and corporate governance. Subsequently, it turns to the core of the analysis, namely the question how far standards of good corporate governance should be applied to the governance of financial regulatory institutions.

Keywords: Financial regulatory institutions, corporate governance, principal-agent problem, independence of regulators, organisational design

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Hadar Jabotinsky[*] and Mathias Siems[**]

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Abstract

There is a growing literature about the question of *who* should regulate the regulators. This paper is interested in the question of *how* to regulate the regulators. More specifically, it explores how far it may be feasible to apply rules and principles of good corporate governance to the governance of financial regulators and financial regulatory institutions. For this purpose, the paper discusses the literature on the differences between private and public sector firms and their application to financial regulatory institutions, followed by an assessment of conceptual similarities between the governance of financial regulatory institutions and corporate governance. Subsequently, it turns to the core of the analysis, namely the question how far standards of good corporate governance should be applied to the governance of financial regulatory institutions.

Keywords: financial regulatory institutions, corporate governance, principal-agent problem, independence of regulators, organisational design

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1. Introduction

Financial regulatory institutions are at the centre of intensive debates in international commercial law. Many of these debates are concerned with the regulatory tools to supervise financial firms and markets, but there is also a growing literature that focuses on the financial regulatory institutions themselves. Here, following Juvenal's famous phrase "quis custodiet ipsos custodes?", the literature has mainly been concerned with the question of "*who* should regulate the regulators".[1] The main idea of this paper is that we should extend the debate and ask *how* we can regulate them.

The question of how to regulate organisations is not unique to financial regulatory institutions. Thus, it is worth exploring whether there are general principles that can apply to organisations in different fields. This paper contributes to this debate. Yet, it is also clear that such general principles could only be phrased at a high degree of abstraction. More specifically, the following will therefore draw on lessons learned from corporate governance as a possible analogy, being a field where governance questions have been discussed and tested in depth.[2] Even though private sector companies differ from financial regulatory institutions, this paper will show that some analogies can be made. It is also important to note that the history of companies is closely linked to the public sector since the East India Companies and other colonial joint-stock companies were conveyed public-law rights of sovereignty.[3] Moreover, today, it is sometimes argued that company law is indeed a hybrid of private and public law as its interventionist elements aim at changing behavioural patterns of corporate participants in line with society.[4]

On the regulatory institutions' side, there can be forms of public-private structural hybrids of financial regulatory institutions, namely if they are established as limited companies, such as the Prudential Regulatory Authority and the Financial Conduct Authority in the UK. This paper chooses to focus on the more common status of financial

[1] See, e.g., Susan E. Dudley, "Improving Regulatory Accountability: Lessons from the Past and Prospects for the Future" (2014) 65 *Case Western Reserve Law Review* 1027. Others refer to the oversight or supervision of regulators, see, e.g., John Armour, Dan Awrey, Paul Davies, Luca Enriques, Colin Mayer and Jennifer Payne, *Principles of Financial Regulation* 568-70 (Oxford: Oxford University Press 2016); Kurt Bayer, "Quis Custodiet Ipsos Custodes? – Who Supervises the Supervisors?" (2010) 7 *European Journal of Economics and Economic Policies: Intervention* 50.

[2] See also Section 3, below.

[3] Jennifer Hill, "Public Beginnings, Private Ends – Should Corporate Law Privilege the Interest of Shareholders", in Fiona Macmillan (ed.), *International Corporate Law*, Volume 1, 17 (Oxford: Hart 2000).

[4] Marc T. Moore, *Corporate Governance in the Shadow of the State* 4 (Oxford: Hart Publishing 2013). See also Marc T. Moore, "Private Ordering and Public Policy: The Paradoxical Foundations of Corporate Contractarianism" (2014) 34 *Oxford Journal of Legal Studies* 693.

regulatory institutions as independent bodies of public law with own legal personality, such as the Securities Exchange Commission in the US, BaFin in Germany, Consob in Italy and CNMV in Spain.[5] Another special attribute of financial regulatory institutions is that their supervisory tasks may be organised in a consolidated or a fragmented (e.g., split between the supervision of banking, insurance and securities markets) structure. In this respect, we include any of these structures: the main aim is to address questions of governance at the general level, but we will also consider possible problems of multiple authorities operating within one jurisdiction.[6]

This paper is structured as follows: Section 2 discusses the literature on differences between private and public sector firms and their application to financial regulatory institutions, while Section 3 addresses conceptual similarities between the governance of financial regulatory institutions and corporate governance. Based on these general considerations, Section 4 turns to the core of the analysis, namely the question how far standards of good corporate governance should be applied to the governance of financial regulatory institutions. Section 5 concludes.

2. The literature on differences between private and public sector firms and their application to financial regulatory institutions

The distinction between the private and public sector has often been discussed in the academic literature on public administration.[7] Most studies in this field, however, address public utilities whereas only some articles discuss other public sector institutions, such as regulators or ministries.[8] Financial regulatory institutions are subsumed under the latter;

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[5] This is also to be distinguished from scenarios where the regulatory institution is a unit of the government with some independence but without a separate legal personality, e.g. the pensions' supervisor DGSFP in Spain, see Pablo Iglesias-Rodriguez, *The Accountability of Financial Regulators. A European and International Perspective* 43 (Alphen aan den Rijn: Kluwer Law International 2014).

[6] E.g., see the discussion about the situation in France in Section 4 B, below.

[7] See Rhys Andrews, George A. Boyne and Richard M. Walker, "Dimensions of Publicness and Organizational Performance: A Review of the Evidence" (2011) 21(suppl 3) *Journal of Public Administration Research and Theory* i301; Soonhee Kim and Hyangsoo Lee, "The Impact of Organizational Context and Information Technology on Employee Knowledge-Sharing Capabilities" (2006) 66 *Public Administration Review* 370; George A. Boyne, "Public and Private Management: What's the Difference?" (2002) 39 *Journal of Management Studies* 97.

[8] Articles addressing institutional issues relating to non-public utilities companies include: Andrew Rudalevige, "The Structure of Leadership: Presidents, Hierarchies, and Information Flow" (2005) 35 *Pres-*

they are service-granting public institutions which do not provide society with public utility services.

Considering the scarcity of studies relating to differences between private sector firms and regulatory institutions, some insights can be deduced from the literature comparing private sector firms to firms providing public utilities. In this section, these insights will be adjusted, where needed, to fit financial regulatory institutions and enable a better assessment of the existing financial supervisory models. Unless stated otherwise, the differences between public institutions and private sector firms highlighted in the following parts are also applicable to financial regulatory institutions.

A. General differences between public institutions and private sector firms

The main difference between public institutions and private sector firms is that public sector institutions are held by the government while private sector firms are held by natural persons or other companies as their shareholders.[9] This difference yields two immediate results – the way the firms are financed, and the way in which the firms are controlled.[10] Private sector firms are financed through revenues paid by their consumers, by credit which they borrow from banks, and by securities issued on the stock market whereas public institutions are funded mainly from tax payers' money.[11] The second factor, the control, refers to the fact that private sector firms are controlled by market forces, i.e. supply and demand, as opposed to public institutions which are controlled by political powers and pressures.[12] This is especially true when the public institutions are not financially independent from government, i.e. when their budgets depend on government decisions, which is the case for many financial regulatory bodies around the world.[13] In such

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idential Studies Quarterly 333 at 335-336 and Matthew C. Stephenson, "Information Acquisition and Institutional Design" (2011) 124 *Harvard Law Review* 1422 at 1432.

[9] Hal G. Rainey, Robert W. Backoff, and Charles H. Levine, "Comparing Public and Private Organizations" (1976) 36 *Public Administration Review* 233 at 233-244. Note that we focus on private sector firms incorporated as companies, not other legal forms (partnerships, cooperatives etc.).

[10] See Boyne, above note 7, p. 98; Andrews et al., above note 7, pp. i301-i319.

[11] As early as: Gary L. Walmsley and Mayer N. Zald, *The Political Economy of Public Organization* (Lexington Books, Lexington, Massachusetts 1973), followed also by Andrews et al., above note 7, p. i302 and Boyne, above note 7, p. 98.

[12] Boyne, above note 7, p. 98 followed by Andrews et al., above note 7, p. i302.

[13] Information on how different regulators are funded in different countries may be found in the following report: The Group of 30, *The Structure of Financial Supervision: Approaches and Challenges in a Global Marketplace* (Washington: Group of 30 2008).

cases, the public institutions may be subject to political pressure which might undermine their professional judgment and lead to suboptimal decision-making.

These three main differences, i.e. the identity of the controller, the way in which the legal entity is financed, and the way in which it is controlled, have an effect on the organisational behaviour of the entity.[14] This goes back to the theory of the firm and to incentives to monitor. Dispersed ownership in the context of public institutions means being owned by the state, which, theoretically should lead to lower efficiency in the public sector.[15] The reason behind this phenomenon is an incentive problem: in contrast to private sector firms which are supposed to maximise their shareholders' profits,[16] in the public sector no individual voter will directly gain from a more efficient organisational design for public institutions. This causes a difference in the amount of monitoring in each type of entity: in a private sector firm the shareholders are incentivised to monitor the managers and provide them with incentive schemes which will increase shareholders' profits. This in turn provides a drive for innovation and efficiency as the manager's salary is often tied to the company's performance either through shares or through remuneration programs and bonuses. In contrast, when it comes to public institutions, managers do not usually get an increase in their salary if they opt for a better organisational design.[17] As monitoring, or lack of, does not directly influence any particular individual, it becomes a "public good" – very few people are induced to take part in the monitoring of a public agency as their efforts will very likely exceed their gains.[18]

Although financial regulators do not produce tangible products, monitoring them may create several problems. First, monitoring financial products is a complicated task requiring expertise.[19] As a result, the monitoring of financial regulators requires expertise and competence in appreciating the problems and solutions applied by the regulator. Clearly, there are only a handful of people who might have the requisite expertise and

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[14] Boyne, above note 7, p. 98, Kim and Lee, above note 7, pp. 370-385; Barry Bozeman, *All Organizations are Public* (Jossey-Bass, London 1987).

[15] See already Kenneth Clarkson, "Some Implications of Property Rights in Hospital Management" (1972) 15 *Journal of Law and Economics* 363 at 363-384 followed also by Andrews et al., above note 7, pp. i301-i319 and Koldo Zabalza and Jesus Matey, "Strategic Management Development from the State-owned Company to the Private Company" (2011) 7 *Journal of Modern Accounting and Auditing* 48.

[16] At least in most Anglo-Saxon countries, see Section 3 A, below.

[17] Boyne, above note 7, p. 99.

[18] Ibid.

[19] David Llewellyn, "The Economic Rationale for Financial Regulation" (1999) *FSA Occasional Papers in Financial Regulation* 1 at 23-25.

knowledge to assess the regulatory work. Second, very much in line with consumers serviced by a public utility firm, the individual consumer of financial regulatory services will not directly benefit from a more efficacious design of financial regulatory institutions, and so does not have the right incentives to promote a more efficiently designed regulatory authority.

The above-mentioned concerns with the monitoring of public sector institutions might also escalate the problem of a captured agent. In the absence of monitoring it is easier for the public servant to bring into account his own utility function and be lured into lucrative opportunities from the industry in exchange for favouritism in the area of which he is in charge. The actions of a captured public agent will accord with the benefit of the capturing group, rather than the good of the general public.[20] Such actions might include withholding information and disseminating partial information so as to tilt the final decision in directions beneficial to the regulated firms.

Another problem which is related to political as opposed to economic control is that of multiple sources of authority.[21] Multiple sources of authority become a problem when those who have the authority contradict each other. It is very likely that in order to mitigate this problem, public institutions will develop complex bureaucratic mechanisms to make sure that all those who have the authority are satisfied. Take for example the structure of financial regulatory institutions in France. France has many interconnected regulatory bodies, sometimes with overlapping responsibilities. The interconnectivity of the French regulatory bodies, which is reflected by the fact that the heads of a regulatory body can and do sit on the board of other regulatory bodies, might be partially explained by the need to satisfy all those who have the authority and political power.[22]

According to Boyne, the three distinctions between public institutions and private sector firms are not just conceptual but also empirical. The empirical evidence on this issue suggests that they are not perfect proxies for each other. This implies that all three differences – ownership, funding, and control – should be taken into account when eval-

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[20] George J. Stigler, "The Economic Theory of Regulation" (1971) 2 *The Bell Journal of Economics and Management Science* 3; Sam Peltzman, "Toward A More General Theory of Regulation" (1976) 19 *Journal of Law and Economics* 211.

[21] Bozeman, above note 14; Kim and Lee, above note 7, p. 327.

[22] See Group of 30, above note 13, pp. 96–103.

uating the effects of being a public institution.[23] As financial regulatory institutions are indeed public institutions these differences are relevant for our discussion as well.

B. The impacts of being a public institution

Beyond the impact of being a public institution in general, this section goes further into the details and highlights the theoretical effects of belonging to the public sector. The literature on differences between public sector and private sector managers identifies four main theoretical effects of being a public sector institution: the connection between being a public sector institution and organisational environments, organisational goals, organisational structures, and the values of managers.[24]

(i) Differences in organisational environments

There are several aspects in which public sector institutions differ from private sector firms. The organisational differences have been summed up by the literature as follows:[25]

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

Intrusion: Public institutions are easily influenced by external pressures and events.[26] This is especially true when the budget of the public institution depends on government decisions

Instability: Due to external political pressure, public institutions tend to change their strategies more frequently than private sector firms. This can be viewed in the fre-

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[23] Boyne, above note 7, p. 98.

[24] Boyne, above note 7, p. 99.

[25] See Boyne, above note 7, p. 100; Kim and Lee, above note 7, p. 372; Andrews et al., above note 7, pp. i304-i307.

[26] See also Richard A. Posner, "Theories of Economics Regulation" (1974) 5 *Bell Journal of Economics* 335 and Stigler, above note 20, pp. 3-21. Regulation is supplied in response to pressure from political interest groups.

quent changes to the financial regulatory structures undertaken by countries across the world.[27]

Lack of competition: public institutions *usually* do not compete with other public institutions in order to provide their services. It is usually the case that the state will want to minimise the public resources invested in the public institutions and so, in the name of efficiency, will try not to form two public institutions which have overlapping responsibilities. If the state succeeds in doing so, it means that consumers have no choice other than to engage with one specific public institution, no matter how bad its services are. In addition, as public institutions do not receive their revenues from the people to whom their service is granted, their willingness to be responsive to consumers' demands drops. The consumers cannot influence the quality of the service they receive.[28] Another relevant point relates to the market for corporate control. In private sector firms admitted to stock markets, managers are incentivised to prove themselves in order to avoid a situation where they are dismissed following a takeover of the company. This is not the case for public sector firms where managers are appointed for long terms, sometimes even for life.

It follows that it is difficult to create incentives for increasing efficiency in public institutions. Moreover, there are differences in the nature, purpose, and scope of structural reform. In the private sector viable organisational reforms are selected by the markets. We therefore assume that such organisational reforms are efficient, or else they would not occur. A public institution reform, on the other hand, does not occur as a result of market power and competition but rather as a result of the political atmosphere of the time. It is therefore much harder to detect the reason behind such reform and evaluate whether it is efficient or not. This is one of the reasons why some scholars suggest that regulatory competition between different regulatory bodies might be beneficial. Others disagree as they claim that such competition undermines the goals behind the regulation that these entities are supposed to produce, and encourages unwanted behaviour by the

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[27] As has been identified by Donato Masciandaro and Marc Quintyn, "Regulating the Regulators: The Changing Face of Financial Supervision Architectures Before and After the Crisis" (2009) 6 *European Company Law* 187.

[28] See as early as: William A. Niskanen, *Bureaucracy and Representative Government* (Aldine-Atherton, Chicago 1971); but also Andrews et al., above note 7, p. i304.

regulated firms, such as forum shopping.[29] The answer is not conclusive and this question is still open for debate.[30]

Different agency problems: Although both financial regulatory institutions and private sector firms suffer from agency problems, the types of agency problems are somewhat different. In private sector firms a distinction can be made between three types of agency problems: an agency problem between minority and controlling shareholders, an agency problem between creditors and shareholders and an agency problem between management/board of directors and shareholders. In public sector firms (financial regulatory institutions included) the agency problems usually exist between the public and the bureaucrats and between bureaucrats and politicians. This may create problems relating to a captured agent or other inefficiencies but these problems are different than those created in private sector firms. In addition, due to the fact that a public institution cannot go bankrupt (since it is backed up by the state), the agency problem between creditors and shareholders is non-existent. However, this also causes the incentives of creditors to monitor the public sector institution to disappear.

(ii) Differences in goals

While private sector firms typically have one major goal, which is to maximise profits, public institutions often have many different goals, such as pleasing the different stakeholders, and promoting values such as justice, equality, and fairness.[31] Even though financial regulatory authorities are mainly concerned with efficiency considerations, they too have many other goals such as consumer protection, promoting competition, and promoting values of justice and fairness. Take for example the consolidated Swiss financial supervisory authority, FINMA, whose goals are defined in Article 5 of the Financial Market Supervisory Act (FINMASA) 2007 as follows:

> *"In accordance with the financial market acts, financial market supervision has the objectives of protecting creditors, investors, and policy holders as well as ensuring the smooth functioning of the financial mar-*

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[29] Daniel B. Schwarcz, "Regulation Insurance Sales or Selling Insurance Regulation: Against Regulatory Competition in Insurance" (2010) 94 *Minnesota Law Review* 1707 at 1710-1712.

[30] Wolfgang Kerber, "The Theory of Regulatory Competition and Competition Law", in Adelheid Puttler, Marc Bungenberg and Karl M. Meessen (eds.), *Economic Law as an Economic Good, Its Rule Function in the Competition of Systems* (Sellier, Munich 2009). See also Armour et al, above note 1, pp. 565-6.

[31] Boyne, above note 7, pp. 98-122.

kets. It thus contributes to sustaining the reputation and competitiveness of Switzerland's financial centre."[32]

Another example containing a whole spectrum of goals is Section 2 of the American Securities Exchange Act of 1934. It defines the goals of the Securities Exchange Commission as follows:

> *"For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are effected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports, to remove impediments to and perfect the mechanisms of a national market system for securities and a national system for the clearance and settlement of securities transactions and the safeguarding of securities and funds related thereto, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions…"*[33]

This difference between public institutions and private sector firms results in a different type of managerial regime: managers of public institutions must be aware of the different, sometimes contradicting goals they are asked to achieve, and must navigate a golden line between them. According to Boyne,[34] public institutions, as opposed to private sector firms, are also vaguer with regards to their goals, since their organisational policies are dictated by politicians rather than by professional managers. This is especially true when the independence of the financial regulatory authority is weaker, such as the case where its budget is dependent on a political decision. This creates a difference in the need for clarity: in order to get policies adopted politicians need to gain a wide support

[32] Federal Act on the Swiss Financial Market Supervisory Authority (Financial Market Supervision Act, FINMASA) of 22 June 2007, Article 5.

[33] Securities Exchange Act of 1934, (15 USC § 78a - Short title).

[34] For the following see Boyne, above note 7, p. 101.

for the change from many diverse groups. In these surroundings lack of clarity is an asset as it is more difficult to object to a less clear change. These political pressures hamper the work of public institutions, as performance targets and measurements are inherently unclear, and management according to objectives is discouraged.

(iii) Differences in organisational structures

The organisational structures of public institutions and private sector firms reflect some of the same arguments as the differences in goals. As a result of having many sources of authority and the consequent need for political compromise, public institutions tend to be more bureaucratic. The complex and bureaucratic structure of public institutions is also caused, in part, by demands set by monitoring bodies which are abundant in the public sector, and by requirements of accountability.[35] As a result of the bureaucracy in public sector organisations, stagnation and formalisation cause delays and inefficiencies which are referred to as red tape in the literature.[36]

Managers of public institutions typically also have less autonomy than their colleagues in private sector firms, especially when it comes to firing, hiring and promoting employees. This is due to the rigid rules of government employment contracts and due to the fact that they are in the public eye, and are thus subject to criticism by the public.[37] This of course makes it harder for managers in public sector institutions to control their employees, as there are no substantial "reward or punishment" tools. Moreover, and with regards to the need for information-sharing, public institutions have ambiguous performance measurements which make it hard to convince employees that sharing knowledge will be worth their while.[38] As public sector institutions financial regulatory authorities also suffer from these drawbacks making them less efficient and more prone to stagnation and, doing so, hurting their ability to regulate the rapidly evolving industry.

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[35] Boyne, above note 7, pp. 109-112.

[36] Barry Bozeman, Pamela N. Reed and Patrick Scott, "Red Tape and Task Delays in Public and Private Organizations" (1992) 24 *Administration and Society* 290.

[37] See Boyne, above note 7, pp. 101-102 and Kim and Lee, above note 7, pp. 370-385.

[38] Kim and Lee, ibid.

(iv) Differences in employees' commitment and values

The last difference between public and private sector entities has been identified in the literature as a difference in the values of employees and managers.[39] However, the literature seems to disagree on the direction in which these differences go.[40] While part of the literature considers managers in public institutions as manipulative agents who try to abuse the system in order to escape accountability and get around the monitoring systems put in place to control their actions,[41] a different stream of the literature views these managers as less materialistic agents concerned with serving the public and promoting the public good with which they are entrusted.[42] The truth lies somewhere in the middle. In their research, Mayer et al. analysed the ethical behaviour patterns of 904 employees and 195 managers in 195 departments. Their findings back up findings from the social learning and social exchange theories and suggest that ethical behaviour is transmitted top down from one managerial layer to the one beneath it.[43] These findings suggest that managers of public institutions will behave, on average, in accordance with the ethics and norms dictated to them from the top.[44]

Putting this debate aside, scholars tend to agree that the differences in pay, remuneration, and goals of public institutions attract employees of a different type to the ones who choose to work for private sector firms.[45] As public institutions, financial regulatory authorities are entrusted with promoting a public good, and they tend to have missions of broader scope and greater impact than those of private sector firms.[46] Thus, employees who choose to work for the public sector are thought to be more altruistic and less concerned with financial remuneration in comparison with their colleagues in the private sector.[47] This has been found to be true in a number of empirical studies which tested the

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[39] See Boyne, above note 7, p. 102 and Bradley E. Wright, "Public Service and Motivation: Does Mission Matter?" (2007) 67 *Public Administration Review* 54.

[40] Dorit Rubinstein Reiss, "Account me in: Agencies in Quest of Accountability" (2009) 19 *Journal of Law and Policy* 611 at 614.

[41] Reiss, ibid, p. 642.

[42] See Reiss, ibid, p. 642 and Boyne, above note 7, p. 102.

[43] David M Mayer, Maribeth Kuenzi, Rebecca Greenbaum, Mary Bardes and Rommel Bombie Salvador, "How Low does Ethical Leadership Flow? Test of a Trickle-Down Model" (2009) 108 *Organizational Behavior and Human Decision Processes* 1.

[44] Mayer et al., ibid, p.11.

[45] Wright, above note 39, pp. 54-55.

[46] Ibid.

[47] Wright, above note 39, pp. 54-64.

value employees attach to helping others as opposed to the value or utility they derive from financial rewards.[48]

These differences between public and private sector entities dictate a need for a different type of management in public versus private sector entities. It also has implications for the organisational structure. The differences, to the extent that they exist, between public and private sector entities call for a slightly different evaluation of problems relating to organisational design and structure. For example: knowledge-sharing is important both in the public and the private sector. Researchers have found that organisations which transfer knowledge efficiently are more productive than ones which do not.[49] For private sector firms, information-flow is essential in order to meet consumer demands and remain competitive. Even though public institutions are not subject to competitive market forces, knowledge-sharing is important for them as well. In the public sector there is a growing focus on result-oriented services and performance. These require greater information and knowledge-sharing capabilities.[50] Employee turnover makes it essential to collect, preserve, and share knowledge within the organisation. Moreover, as the world becomes more complex, cooperation between different government institutions is needed. In order to do so, government institutions need to share their knowledge with one another.[51] It is important to identify the optimal environment for enhancing employee knowledge-sharing capabilities. Capabilities of knowledge-sharing with other institutions are also significant as they are often essential for the work of the institutions. Financial regulatory institutions are no exception, information sharing within and between them is important both in order to perform the day-to-day supervisory tasks, but also in order to stop or mitigate a financial crisis once it has begun.[52]

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[48] Bradley E. Wright, "Public Sector Work Motivation: Review of Current Literature and a Revised Conceptual Model" (2001) 11 *Journal of Public Administration Research and Theory* 559 and Boyne, above note 7, p. 102.

[49] Kim and Lee, above note 7, pp. 370-385.

[50] Ibid.

[51] Organization for Economic Co-operation and Development (OECD), "The Learning Government: Introduction and Draft Results of the Survey of Knowledge Management Practices in Ministries/Departments/Agencies of Central Government" (2003) paper presented to the 27th Section of Public Management Committee, Paris.

[52] Hadar Y. Jabotinsky, "The Federal Structure of Financial Supervision: A Story of Information-Flow" (2017) 22 *Stanford Journal of Law, Business and Finance*, forthcoming.

3. Conceptual similarities between the governance of financial regulatory institutions and corporate governance

The previous section has shown that there are some profound differences between private sector firms (such as companies) and public sector firms (such as financial regulatory institutions). By contrast, this section will explain why, in some respects, there are also conceptual similarities between the corporate governance of companies and the governance needed for financial regulatory institutions. Corporate governance is mostly discussed for firms which are fully privately owned. In addition, there is a growing interest in the corporate governance of state-owned enterprises (SOEs).[53] Since financial regulatory institutions too are controlled by the state, there are likely to be additional similarities between them and the corporate governance of SOEs. The following therefore distinguishes between the similarities of financial regulatory institutions to the corporate governance of all firms on the one hand and that of SOEs on the other.

A. Similarities to corporate governance of all firms

For companies (and company law), a core topic is the relationship between the shareholders (initially the founders) and the directors and managers of the company, for example, the way the shareholders can appoint and dismiss the directors. This relationship is often phrased as the principal-agent problem of corporate governance,[54] with some scholars identifying the shareholders as the "owners" of the company.[55] A related view to justify the position of shareholders is the democratic or political model of the company. In this respect, the shareholders are sometimes seen as the "citizens" of the company,[56]

[53] E.g., Curtis J. Milhaupt and Mariana Pargendler, "Governance Challenges of Listed State-Owned Enterprises Around the World: National Experiences and a Framework for Reform" (2017) 50 *Cornell International Law Journal*, forthcoming; Christopher Chen, "Solving the Puzzle of Corporate Governance of State-Owned Enterprises: The Path of the Temasek Model in Singapore and Lessons for China" (2016) 36 *Northwestern Journal of International Law & Business* 303; Giuseppe Grossi, Ulf Papenfuß and Marie-Soleil Tremblay, "Corporate Governance and Accountability of State-Owned Enterprises: Relevance for Science and Society and Interdisciplinary Research Perspectives" (2015) 28 *International Journal of Public Sector Management* 274; Samuel Nana Yaw Simpson, "Boards and Governance of State-Owned Enterprises" (2014) 14 *Corporate Governance* 238.

[54] This is the "vertical agency", see Reinier Kraakman et al., *The Anatomy of Corporate Law: A Comparative and Functional Approach* 29-32 (Oxford: Oxford University Press, 3rd edn 2017), as distinguished from the "horizontal agency" (the relationship between majority and minority shareholders).

[55] For the debate see, e.g., David C. Donald, "Shareholder Voice and its Opponents" (2005) 5 *Journal of Corporate Law Studies* 305; Paddy Ireland, "Company Law and the Myth of Shareholder Ownership" (1999) 62 *Modern Law Review* 32.

[56] Donald, ibid, at 308.

while others regard them as akin to the company's "parliamentarians", so that the general meeting is to be regarded as the parliament of the company and thus as its "highest body".[57] Furthermore, it is frequently stressed, that the notion that the company is a political entity implies separation and limitation of powers.[58]

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

In the corporate governance debate, a recent trend is that the position of shareholders is not only discussed under the perspective of shareholder rights, but it is also argued that there is the need for shareholders' duties.[59] A particular focus is directed to the position of institutional investors, for example, how far they have an obligation towards their own investors to be active and vigilant, and not mere passive financial investors.[60] The parallel to financial regulatory institutions is that the government, acting on behalf of the state, may need to consult with the parliament and follow the interest of the general public in matters related to the monitoring of the regulatory authority. In addi-

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[57] See Mathias Siems, *Convergence in Shareholder Law* 150-168 (Cambridge: Cambridge University Press 2008).

[58] See, e.g., Jennifer Hill, 'Visions and Revisions of the Shareholder' (2000) 48 *American Journal of Comparative Law* 39 at 52-3.

[59] E.g., Hanne Birkmose (ed.) *Shareholders' Duties* (London: Kluwer 2017).

[60] E.g., Iris H-Y Chiu, *The Foundations and Anatomy of Shareholder Activism* (Oxford: Hart Publishing 2010).

tion, here too, the issue can arise whether the state may face liability if the entity, i.e. here the regulator, causes damage to the organisation or third parties due to breach of duties.[61]

This leads to another topic at the core of company law: directors' duties. The discussion usually concerns directors' duties of care and loyalty. Specifically, conflicts of interests raise issues regarding directors' duties, including questions about a continuing duty of loyalty of past directors. Another frequent topic deals with the ultimate target of directors' duties: is it to benefit shareholders, the company as a whole, all relevant stakeholders, or the general public?[62] As financial regulatory institutions also enjoy a degree of autonomy, for them too, the question arises what kind of duties they have and how instances of conflict of interest should be addressed. Another relevant issue is whether their actions should strictly be aligned to those of the current government or whether they should enjoy a greater degree of freedom to consider wider public interests.

In company law, the directors form part of the board of directors (or, in a two-tier system, either the management board or the supervisory board).[63] In the corporate governance literature many structural questions are related to the company's board. For example: should directors be independent? Should the CEO also be the chairman of the board? Should there be committees for special topics (appointment, remuneration, auditing etc)? How big should boards be? How often should they meet? And should there be gender quotas or other personal requirements, for example, for board members sitting on the audit committee? For financial regulatory institutions such topics are also relevant as far as they act in the form of collective bodies. In addition, these points of discussion can be linked to the general scholarship of organisational design given that most organisations include both forms of cooperation and checks and balances.[64]

The final parallel to mention is that for larger companies in particular there are often special requirements of accountability, for example, disclosure requirements towards the shareholders and the public, as well as the need for internal and external audit-

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[61] See the book by Iglesias-Rodriguez, above note 5.

[62] For all of these topics see, e.g., Andreas Fleckner and Klaus Hopt (eds.), *Comparative Corporate Governance: A Functional and International Analysis* (Cambridge: Cambridge University Press 2013).

[63] For an overview see www.oecd.org/daf/ca/corporate-governance-factbook.htm.

[64] See, e.g., Lauren B. Edelman, "The Legal Lives of Private Organizations", in Austin Sarat (ed.), *The Blackwell Companion to Law and Society* 231 (Malden, MA: Blackwell 2004); W. Richard Scott, "Reflections on a Half-Century of Organizational Sociology" (2004) 30 *Annual Review of Sociology* 1; Milton Harris and Artur Raviv, "Organization Design" (2002) 48 *Management Science* 852.

ing.[65] Financial regulatory institutions too need to be accountable: so they may need to produce information about their operations and may face internal and/or external audits. For them too it is relevant to ask whether any disclosure is mainly done for the benefit of the current government or whether they also owe some accountability to the general public.[66] Likewise, both companies and regulatory bodies may, in some circumstances, not disclose certain information due to legitimate reasons of privacy and professional secrecy.

B. Similarities to corporate governance of SOEs

For companies which are SOEs further similarities to financial regulatory institutions can be identified. To start with, it can be expected that, due to the state ownership, such companies are expected to a have a higher degree of social responsibility. Thus, in this respect, SOEs are akin to non-profit organisations and social enterprises.[67] Financial regulatory institutions can be said to resemble SOEs as both have aims related to public policy: while, naturally, it can be expected that they do not waste financial resources, their prime aim is not to make profit but to act in the public's interest in pursuing their given objectives.

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

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[65] This provides a connection to topics of securities regulation, for instance, for the EU see http://ec.europa.eu/finance/securities/index_en.htm.

[66] This is one of the main suggestions by Luca Enriques and Gerard Hertig, "Improving the Governance of Financial Supervisors" (2011) 12 *European Business Organization Law Review* 357.

[67] But note that there is also some variation: for example, it is possible to distinguish between SOEs which pursue economic activities and those which pursue public policy objectives. See Section III of the OECD Guidelines on Corporate Governance of State-Owned Enterprises 2015, discussed in Section 4, below.

In addition, both financial regulatory institutions and SOEs face less market pressure than private companies.[68] While this may make it harder to monitor them, it can also be suggested that the reduced dependence on market forces could make SOEs and financial regulatory institutions act in a way that is more accountable to public interests. Thus, overall, the dynamics of state influence may either be positive or negative, depending on the institutional quality of the state in question (lack of corruption, respect for the rule of law etc).

Furthermore, it is possible that the public dimension of SOEs and financial regulatory institutions impacts on further elements of the governance structure. For example, while some countries require the appointment of employee representatives as board members for SOEs but not for other companies.[69] For such organisations, it is also more plausible than for privately owned companies to argue that further persons are needed on the board, such as public representatives from consumer groups, NGOs etc. After the global financial crisis of 2008 and the subsequent nationalisation of some financial institutions, the remuneration of executives of SOEs has become a point of discussion and concern given that public resources are at stake.[70] With respect to the remuneration of executives of financial regulatory authorities, questions regarding their pay and how to incentivise them through pay have also been raised following the crisis.[71]

Overall, the conceptual comparison of financial regulatory institutions with both the corporate governance of all firms and SOEs in particular shows that there are sufficient similarities to contemplate whether tools of good corporate governance can be suitable for financial regulatory institutions. Thus, on this basis, the subsequent section will explore how far, practically speaking, such form of transplantation is commendable.

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[68] See also Section 2 B (i) above for the difference between private and public sector firms.

[69] For an overview of the situation in the EU Member States see www.worker-participation.eu/National-Industrial-Relations/Across-Europe/Board-level-Representation2.

[70] See, e.g., Elisa Henderson, “Quasi-Nationalisation in the UK Banking Crisis: A Problematic Policy Option” (2015) 31 *Financial Accountability & Management* 463.

[71] See, e.g., Armour et al, above note 1, pp 571-3; Eddy Wymeersch, “The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors” (2007) 8 *European Business Organization Law Review* 237 at 275.

4. Good corporate governance and the governance of financial regulatory institutions

For good corporate governance this section will mainly focus on the G20/OECD Corporate Governance Principles 2015 and the OECD Guidelines on Corporate Governance of State-Owned Enterprises 2015 (in the following: "OECD Principles" and "OECD SOE Guidelines").[72] For issues not fully covered in the OECD Principles or OECD SOE Guidelines some references will be made to selected domestic company laws.

We choose the OECD Principles for the following reasons: in the Preamble, the OECD Principles explain that "there is no single model of good corporate governance", but that they aim to build on their "common elements".[73] This search for commonalities is also reflected in the Principles' coverage of the mainstream topics of corporate governance, such as the rights of shareholders and the responsibilities of the board. Indeed, it can be said that the laws of most developed countries – which also tend to be OECD members – widely correspond to the Principles.[74] Furthermore, they have a global appeal: in the first instance, the Principles are soft law aimed at law makers in less developed economies. At the level of companies, they may simply have to apply domestic laws based on the Principles. In addition, as far as those laws leave options for companies, the Principles function as guidance for good practice, in particular for larger companies.[75]

The OECD SOE Guidelines refer to the OECD Principles suggesting that the "state should strive toward full implementation of the OECD Principles of Corporate Governance when it is not the sole owner of SOEs, and of all relevant sections when it is the sole owner of SOEs".[76] The rationale for considering both the OECD Principles and the OECD SOE Guidelines is that, on the one hand, the OECD Principles are helpful as they are a relatively pure version of the main themes of corporate governance. On the other hand, the OECD SOE Guidelines already adjust for the state ownership; thus, they

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[72] Available at www.oecd.org/daf/ca/principles-corporate-governance.htm and www.oecd.org/corporate/guidelines-corporate-governance-soes.htm.

[73] G20/OECD Principles of Corporate Governance 2015, p 10.

[74] References in Siems, above note 57, at 227.

[75] For a more detailed analysis see Mathias M Siems and Oscar Alvarez-Macotela, "The G20/OECD Principles of Corporate Governance 2015: A Critical Assessment of their Operation and Impact" (2017) *Journal of Business Law* 310.

[76] OECD SOE Guidelines, IV. A.

are bound to be more similar to the issues concerning financial regulatory institutions, but less "pure" in how they identify themes of corporate governance.

Each of the following sub-sections will start with an outline of selected core issues of corporate governance. As regards to financial regulatory institutions, we will then address two questions: how far *does* the governance of these regulatory institutions correspond with standards of good corporate governance? And, as far as this is not the case, *should* their governance be aligned with the corporate governance standards?

A. Appointment to the board

In company law, the appointment and possible dismissal of board members raises a number of legal questions. The OECD Principles for good corporate governance are, however, not very specific on that matter. They mention in general terms that it is one of the rights of shareholders to elect and remove members of the board.[77] In most domestic company laws there are more details: in Germany, for example, appointment is fixed for five years with dismissal only for good reasons, while in other countries the situation is more flexible, often with appointments of one to three years and no specific requirements for a dismissal resolution (yet, often also with the need to pay compensation).[78]

Appointment and dismissal of financial regulators and of the boards of their institutions is related to questions regarding the independence of the regulatory authority. In order to be able to supervise the markets effectively, financial regulators need to be as independent as possible from government. Therefore, some jurisdictions (but not all) appoint their regulators and/or the board members of the regulatory authority for a given amount of time, during which they cannot be dismissed.[79] Members of the Board of Governors of the American Federal Reserve System, for example, are appointed by the president with approval of the Senate for a set term of fourteen years.[80] This raises other concerns linked to accountability – if the regulators and/or the board members of the

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[77] OECD Principles II A 5.

[78] For a comparative overview of dismissal rights see variable 6 of CBR Extended Shareholder Protection Index 1990-2013 (30 Countries), available at www.cbr.cam.ac.uk/datasets/.

[79] The Group of 30, above note 13; Willian Howard Taft, "Boundaries Between the Executive, the Legislative and the Judicial Branches of the Government" (1916) 25 *Yale Law Journal* 599 at 608; Lisa Schultz Bressman and Robert B. Thompson, "The Future of Agency Independence" (2010) 63 *Vanderbilt Law Review* 599 at 600; Aziz Z. Huq, "Removal as a Political Question" (2013) 65 *Stanford Law Review* 1 at 3-5; Peter Conti-Brown, "The Institutions of Federal Reserve Independence" (2015) 32 *Yale Journal on Regulation* 257 at 258-261.

[80] 12 U.S. Code § 241.

regulatory authority cannot be dismissed, what other mechanisms can be applied in order to keep them accountable and make sure that they promote the public's welfare? Part of the solution relates to the composition of the supervisory board and the executive personnel inside the financial regulatory authority. In other words, the type of people appointed to sit on the board of the financial regulatory institution and their positions in life has an effect on questions relating to accountability.

As regards the question who can be appointed, the general starting point of domestic company law, as well as the OECD Principles, is that there are no restrictions or particular personal requirements. By contrast, the OECD SOE Guidelines include the general statement that all board members "should be nominated based on qualifications and have equivalent legal responsibilities".[81] Exceptions of this general starting point exist for disqualified persons, typically someone who had been responsible for a criminal bankruptcy.[82] There can also be specific requirements for specific industries, for example, there are often special appointment rules for boards of banks and other financial firms in financial regulation.[83] In company law, it is not seen as a problem to appoint someone as a director who, later on, may have a conflict of interest for some of the board resolutions: indeed, it is fairly common that directors sit on the boards of multiple companies.˙ Rather, the intervention takes place once a conflict of interest arises. According to the provision of the OECD Principles on related-party transactions, for example, "members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation".[84]

The situation for regulators or for the people sitting on the board of the regulatory institutions is quite similar, as some countries do allow directors to sit on more than one board as long as they have the general needed qualifications (and sometimes not even that). In fact, in some countries the situation is so intertwined that from an econom-

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[81] OECD SOE Guidelines VII C s. 2.

[82] This is usually discussed within the wider context of creditor protection, see, e.g., Kraakman et al., above note 54, p. 130.

[83] See, e.g., Article 91 of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, also restricting the number of directorships a director may hold.

[84] OECD Principles II F 1. There are also conflict of interest provisions for shareholders, see OECD Principles III C. ("Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments").

ic point of view, the structure of the financial regulatory authorities is questionable as it removes their independence and makes them more vulnerable to political interference due to the fact that politicians sit on the board of directors of most supervisory authorities.

France is a good example for an intertwined system as it has many regulatory institutions and the members of their boards usually sit on more than one board: the Director General of the Treasury, which is part of the Ministry of Economy, Finance and Industry (MINEFI), the French body responsible for the issuance and approval of new financial regulation, is also a member of the governing boards of the prudential supervisor (the CB), the authority which is entrusted with licensing banks and insurance companies (CECEI), and the insurance supervisory authority (CEA). A commissioner is also provided by the government in order to sit on the boards of the insurance systemic supervisory authority (the ACAM) and the authority which supervises and regulates the public's savings (AMF). The governing board of the prudential supervisory authority, the Banking Commission (CB), comprises the head of the central bank, the finance minister, the head of the ACAM, and four members who are appointed by the treasury. The governing board of the committee of Credit Institutions and Investment firms (CECEI), which is responsible for licensing credit providers, comprises the head of the central bank, a Ministry of Finance commissioner, the head of the securities authority (AMF), the head of the deposit guarantee authority (FGD), and eight other members appointed by the Treasury. The commissioner of the central bank (BDF) also sits on the board of the Insurance and Mutual Societies Supervisory Authority (ACAM) which is the main French insurance supervisor. Coordination between the authorities is maintained mainly through the Board of Financial Sector Authorities (CACESF) which is basically a committee of supervisors consisting of the heads of the Bank of France (BDF), the Financial Markets Authority (AMF), and the Insurance and Mutual Societies Supervisory Authority (ACAM).[85] This situation weakens the independence of the financial regulatory institutions and increases the political influence over them.

What follows from these similarities and differences between corporate governance and financial regulatory institutions for the normative question of whether the latter can draw on models of the former? We have seen that, at least in some jurisdictions, it is

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[85] The Group of Thirty, above note 13, pp. 98-100.

relatively straight-forward to dismiss member of the board of directors; yet, given the need to protect the independence of financial regulators, we would not suggest such rules for their dismissal.

As a point of similarity, we have seen that, in general, in neither of the two fields there are restrictions for the person to be appointed and the number of positions any individual can hold. However, there are some restrictions according to the specific corporate governance rules for financial firms, in particular as regards the personal characteristics of board members and the number of directorships per person. These rules should inspire the appointment rules of financial regulators: for instance, given the problems outlined above (e.g., in France), we would recommend reducing the number of financial regulatory institutions in one jurisdiction and free their boards from political intervention, for example by prohibiting the nomination of politicians to the boards of the financial regulatory institutions.

Another issue which relates to the regulatory work is how to incentivise regulators to regulate in times where regulating may come at a personal cost to them. If we take the financial crisis of 2007 as an example, we find that regulators hesitated to intervene when the market was burgeoning.[86] This is due to the fact that in such a situation it is extremely difficult for the regulator to regulate against the industry as he/she will be presented as a regulator which destroys business. In some cases, especially where the regulator's term is not set in advance, he/she may even lose his job and be scrutinised by the politicians and the public. It is understandable that under these circumstances the regulator might be reluctant to step in and regulate. In fact, what the public good demands from the regulator in such cases is to take on personal risks.

Here an important lesson can be learned from corporate governance. It has been argued in the corporate literature that compensation arrangements granted to managers can be used in order to mitigate agency problems by encouraging risk-taking behaviours and providing incentives to optimise the long-term performance of the firm.[87] An analogy can be drawn to financial regulators as, in the aforementioned scenario, we would like to incentivise the regulator to take on more risk and regulate according to the pub-

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[86] Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States xviii* (US Gov. Printing Office, 2011).

[87] Samuel R. Gray and Albert A. Cannella, "The Role of Risk in Executive Compensation" (1997) 23 *Journal of Management* 517 at 517-8. See also Section 3, above.

lic's general welfare and against the industry.[88] This could also consider giving regulators the option to leave the regulatory institution for compensation, for instance, to install some sort of voluntary early retirement mechanisms for regulators who take on the risk and regulate against the public and political opinion of the time.[89] Adopting such mechanism might be helpful in reducing regulatory capture as it decreases the regulator's dependency on the regulated firms.

B. General board composition

Another organisational question is whether there are rules about the ideal general composition of the board of directors. In company law, three themes are frequently discussed. First, in some two-tier countries,[90] some members of the supervisory board are appointed by the company's employees. Details are very diverse, for example as regards the percentage of employee representatives on this board,[91] and the OECD Principles only refer to such participation at a general level.[92] There are also suggestions for other models. The UK government currently considers introducing forms of employee and stakeholder involvement without imposing mandatory board participation.[93] There is also the interesting proposal of wider stakeholder representation through "stakeholder councils" with representatives from employees, consumers, suppliers and the general public.[94]

Secondly, today, it is widely suggested that public companies should have a good number of independent non-executive directors on the board, possibly even a majority. In most, though not all, legal systems independence is defined in a way that these direc-

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[88] To be sure, one has to be aware of the fact that this solution might increase moral hazard problems, cf. Bengt Holmstrom, "Moral Hazard and Observability" (1979) 10 *Bell Journal of Economics* 74; therefore, some external observability mechanism is needed to make sure that the right regulatory decisions are accepted, see our suggestions in sub-section C, below.

[89] An analogy in corporate governance are "golden parachutes"; yet, it is controversial how they affect shareholder value, see e.g. Lucian Bebchuk, Alma Cohena, and Charles C.Y. Wang, "Golden Parachutes and the Wealth of Shareholders" (2014) 25 *Journal of Corporate Finance* 140.

[90] See Section 3 A, above.

[91] For an overview see www.worker-participation.eu/National-Industrial-Relations/Across-Europe/Board-level-Representation2.

[92] OECD Principles IV C 2 ("Mechanisms for employee participation should be permitted to develop").

[93] For the 2016 Green Paper of the proposed reform see www.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf

[94] Shann Turnbull, "A Sustainable Future for Corporate Governance Theory and Practice" (March 2012), available at https://ssrn.com/abstract=1987305.

tors should neither be executives of the company nor have any linkages to the company's shareholders.[95] Independent directors play a crucial role for cases where conflicts of interests arise. The OECD Principles therefore state that "boards should consider assigning a sufficient number of nonexecutive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest."[96] A related point is whether the CEO can also be the chairman of the board. While some companies (and countries) favour such a system with a strong leader,[97] most corporate governance codes recommend a split, as do the OECD SOE Guidelines suggesting that "good practice calls for the Chair to be separate from the CEO".[98]

Thirdly, there is also the trend to encourage (or possibly to regulate) greater board diversity, for example, in terms of gender diversity. In the OECD Principles we only have the cautious statement that "boards should regularly carry out evaluations to appraise their performance and assess whether they possess the right mix of background and competences".[99] In the OECD SOE Guidelines there are also two general references to board diversity.[100] Some domestic company laws and corporate governance codes provide more details, for example, with some suggesting a certain minimum ratio of female board members (such as 1/3 or 1/2).[101]

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

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[95] For a recent comparison see Harald Baum, Souichirou Kozuka, Luke R. Nottage, and Dan W. Puchniak, (eds.), *Independent Directors in Asia: A Historical, Contextual and Comparative Approach* (Cambridge: Cambridge University Press 2017).

[96] OECD Principles VI E 1. Then referring to examples of "ensuring the integrity of financial and non-financial reporting, the review of related party transactions, nomination of board members and key executives, and board remuneration."

[97] Notably, this has traditionally been the case in France, see e.g. B Mojuyé, "French Corporate Governance in the New Millennium: Who Watches the Board in Corporate France" (2000) 6 *Columbia Journal of European Law* 73.

[98] OECD SOE Guidelines VII F, second sentence.

[99] OECD Principles VI E 4.

[100] OECD SOE Guidelines II F 2 and VI A 5

[101] See e.g. Siri Terjesen, Ruth V. Aguilera and Ruth Lorenz, "Legislating a Woman's Seat on the Board: Institutional Factors Driving Gender Quotas for Boards of Directors" (2015) 128 *Journal of Business Ethics* 233.

“...In selecting the members of the Board, not more than one of whom shall be selected from any one Federal Reserve district, the President shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country. In selecting members of the Board, the President shall appoint at least 1 member with demonstrated primary experience working in or supervising community banks having less than $10,000,000,000 in total assets...”[102]

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

With regards to the independence of directors and executive personnel of financial regulatory institutions, the main concern is the relationship to the government. If the government influences their appointment, their independence might be questionable, and in accordance also their ability to take decisions which are favourable to the public’s general welfare but go against the government’s wishes.[103] Thus, in these circumstances, the decision about appointment is not primarily about delegating power but entrusting someone who is even more committed to the task of the institution than the principal.[104] Consequentially, the question of who decides on the budget of the organisation is of particular importance because if the regulatory institution depends on the government for budgetary approval, its independence is damaged; separating the budget of the regulatory institution from government is therefore highly recommended.[105]

Another topic related to the appointment of senior executives refers to restrictions on appointments of personnel inside the financial regulatory institutions. Many jurisdictions have post-employment restrictions on employees of financial regulatory institutions, usually in the form of cooling-off periods which restrict them from working

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[102] 12 U.S. Code § 241.

[103] Neal Devins and David E. Lewis, “Not-So Independent Agencies: Party Polarization and the Limits of Institutional Design” (2008) 88 *Boston University Law Review* 459 at 469–77; Peter L. Strauss, “The Place of Agencies in Government: Separation of Powers and the Fourth Branch” (1984) 84 *Columbia Law Review* 573 at 587–91. See also Chris Hanretty and Christel Koop, “Shall the Law Set Them Free? The Formal and Actual Independence of Regulatory Agencies” (2013) 7 *Regulation & Governance* 195.

[104] For this distinction see Giandomenico Majone, “Two Logics of Delegation: Agency and Fiduciary Relations in EU Governance” (2001) 2 *European Union Politics* 103.

[105] For further details on this point see D, below.

for the supervised industry after leaving office (discussed in the next section). Some jurisdictions also have cooling-off periods for people entering the regulatory institution from the private sector. The US under the Obama administration for example set a two year cooling-off period under which all employees entering the public sector are not allowed to work on anything related to their previous positions in the private sector.[106]

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

Yet, as we have seen, a somehow parallel situation is the enhanced role of independent directors in cases where some of the other directors cannot vote due to a conflict of interest. Beyond this specific point, we suggest that the role of independent directors is a topic where financial regulatory institutions can learn from corporate governance. The involvement of independent directors has the purpose to strengthen the checks and balances within the organisation – an insight that can also be applied to financial regulatory authorities. Likewise, the recommendation in most corporate governance standards is that the CEO and the chairman of the board should be two different persons, suggests that, here too, the top personal needs to be embedded in a system of checks and balances.

There are also lessons to be learned from the general trends to ensure board diversity in corporate governance. We suggest that for financial regulatory institutions it should also be considered to have rules which institutionalise inclusive governance, for example, through forms of employee participation. The specific idea of including societal actors as part of the board of government institutions has already been raised in the general academic literature about public services.[107] As mentioned previously, the core element that assures the well functioning of governmental institutions (financial regula-

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[106] See, e.g., the instructions that president Obama issued on January 21, 2009, when he came into office - Executive Order 13490 - Ethics Commitments By Executive Branch Personnel: https://obamawhitehouse.archives.gov/the-press-office/ethics-commitments-executive-branch-personnel.

[107] Samuel Paul, "Accountability in Public Services: Exit, Voice and Control" (1992) 20 *World Development* 1047 at 1048; John Ackerman, "Co-Governance for Accountability: Beyond 'Exit' and 'Voice'" (2004) 32 *World Development* 447.

tory institutions included) is the accountability of the bureaucrats working in those institutions.[108] Such accountability can be reached by direct societal participation. In case of financial regulatory authorities, having public representatives from a wide range of stakeholders (not only employees but, depending on the institution, also customers of financial products, legal experts, traders, etc) sit on the governing board might help increase the accountability of the other directors. In addition, it is highly recommended that a public committee appoints the regulators. The composition of the committee is also important and should include experts as well as public representatives.

C. Other relevant persons and bodies

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

To start with, in public companies it is nowadays relatively common that there are at least some board committees. The rationales behind these committees are that they can enable a system of checks and balances and that the members of these committees may have special expertise for the tasks of the respective committee. A large diversity of committees are prevalent in practice and discussed in the literature, such as, audit, nomination, remuneration (compensation), executive, planning (strategy), internal control (corporate governance; appeals), corporate social responsibility (CSR; ethics; environmental), finance (investment), and compliance committees.[109]

The OECD Principles also suggest that boards should set up committees, in particular with respect to audit, risk management and remuneration, whereby "their mandate, composition and working procedures should be well defined and disclosed by the board".[110] Considering specific laws, for example, in the EU, audit committees are required for listed companies, remuneration committees are recommended on a "comply-

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[108] Ackerman, ibid, p. 448.

[109] See, e.g., Philip Stiles, "Board Committees", in Mike Wright, Donald S. Siegel, Kevin Keasey, and Igor Filatotchev (eds.), *The Oxford Handbook of Corporate Governance* 177 (Oxford: Oxford University Press 2013). Heidrick & Struggles, Towards Dynamic Governance 2014: European Corporate Governance Report, available at www.heidrick.com/~/media/Publications%20and%20Reports/European-Corporate-Governance-Report-2014-Towards-Dynamic-Governance.pdf, includes some data on committees in practice (ibid pp. 18-22).

[110] OECD Principles VI 2. Similar OECD SOE Guidelines VII H.

or-explain" basis, while the establishment and operation of other committees (say, for CSR) are left to the companies.[111]

Financial regulatory institutions have some committees, but there is no uniformity for all institutions as not all regulatory institutions are created equal. For example, the American Federal Reserve has the following committees: Committee on Board Affairs, Committee on Consumer and Community Affairs, Committee on Economic and Financial Monitoring and Research, Committee on Financial Stability, Committee on Federal Reserve Bank Affairs, Committee on Bank Supervision, Subcommittee on Smaller Regional and Community Banking, and a Committee on Payments, Clearing, and Settlement,[112] while other financial regulatory institutions do not have committees at all.[113] Note that none of the committees of the Federal Reserve deals with the Fed itself. Rather most existing committees are coordinating committees which are established in order to increase coordination and cooperation between a few different regulatory authorities. Such committees may deal with systemic risk in the local market and regulated institutions which are too big to fail[114] or with data transmission between the authorities.[115]

In company law, apart from audit committees, law makers have turned their attention to the auditing of companies more generally. The main focus is on external auditing with a tendency to provide detailed rules following recent scandals concerning both companies and the audit profession.[116] The OECD Principles also address external auditors, stating that they "exercise due professional care in the conduct of the audit", and that the annual audit by "an independent, competent and qualified, auditor" should as-

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[111] Article 39 of Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts; Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board.

[112] The official webpage of the Federal Reserve, www.federalreserve.gov/aboutthefed/bios/board/default.htm.

[113] The Group of Thirty, above note 13.

[114] For example, the Financial Stability Committee in Mexico which is formulated when a financial institution is "too big to fail". It comprises representatives from the CNBV, IPAB, the Bank of Mexico and SHCP. This mechanism exists although it has never been tested in reality (The Group of 30, above note 13, p. 81).

[115] The Italian Financial Stability Committee (FSC) for example, whose main task is to enable the smooth transfer of information between the authorities in order to prevent and mitigate a future financial crisis. Each of the authorities established a unit which is tasked with supporting the work of the FSC if and when required (The Group of 30, above note 13, p. 111).

[116] For details see, e.g., Hatice Kubra Kandemir, *Understanding External Auditing and its Regulation in the EU and in Turkey: A Way to Convergence?* (Durham PhD thesis 2014), available at http://etheses.dur.ac.uk/10900/1/THESIS.pdf?DDD19+

sure that "the financial statements fairly represent the financial position and performance of the company in all material respects".[117] The OECD SOE Guidelines provide a similar statement but also mention internal audit procedures monitored by the board and the audit committee.[118]

Finally, for listed companies in particular, further persons and bodies play a role in matters of the company. In this respect, the OECD Principles recommend that persons such as proxy advisors, analysts, brokers, and rating agencies should "disclose and minimise conflicts of interest that might compromise the integrity of their analysis or advice."[119] Regulatory details go beyond questions of corporate governance and can often be found in rules of securities regulation, for example, as regards duties of financial analysts and rating agencies.[120]

As already mentioned,[121] one of the biggest questions for financial regulatory institutions is who shall regulate the regulators. This goes back to problems of monitoring and accountability. In practice, auditing of financial regulatory institutions is usually done incidentally while reviewing the country for preparation of country reports by international organisations such as the International Monetary Fund, the World Bank, and the OECD.[122] Thus, there is the risk of a lack of regular and consistent monitoring as regards the structure of financial regulatory institutions and of the conduct of the financial regulators themselves.

This leads us again to the possible lessons that can be learned from corporate governance for financial regulatory institutions. To start with, we recommend introducing an audit committee to the financial regulatory authority as a tool to help monitor its work. In addition, and as far as our recommendation to detach the regulatory institution's budget from the state's and make it financially independent is accepted, it is also recommended to introduce a remuneration (compensation) committee which will decide

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[117] OECD Principles V D and C.

[118] OECD SOE Guidelines VII. See also ibid VI B (for external auditing).

[119] OECD Principles D.

[120] See, e.g., Niamh Moloney, *EU Securities and Financial Markets Regulation* 634-98 (Oxford: Oxford University Press, 2nd edn. 2014).

[121] See Section 1, above.

[122] See, e.g., the Reports on the Observance of Standards and Codes (ROSCs), available at www.imf.org/external/NP/rosc/rosc.aspx.

on the remuneration scheme for the top bureaucrats inside the financial regulatory institutions.

Trends in corporate governance exemplify the need for the external auditing of organisations. With respect to financial regulatory authorities, it would be difficult to implement a system that delegated this task to commercial auditors, such as the big four accounting firms, not least since some of these firms are themselves subject to supervision by financial regulatory institutions. In our view, a model of peer review is a possible option. It could be implemented in a way that the government asks similar sector regulators from other countries to conduct such a peer review. Moreover, here too, an analogy to companies is possible as, in an increasingly interconnected world, many large multi-national corporations are subject to scrutiny by foreign supervisory authorities.

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

It is for this reason that some jurisdictions impose restrictions on former regulators with regards to their post employment.[123] Such rules can also be supported by an analogy to the situation in corporate governance and the corresponding rules of securities regulation. It was mentioned that it is increasingly recognised that a sound legal framework not only requires good rules for the core bodies of the company (board, shareholders etc.) but also other relevant persons in the wider sphere of the corporations, such as analysts and advisors. In many company laws, there are also rules on "de facto

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[123] E.g., in Canada, both scenarios are addressed in Conflict of Interest Act, SC. 2006, C.9, S.2, art. 34(1) and (2) (Can.).

directors”,[124] thus confirming the need to consider persons who may not be officially part of the organisation.

D. Powers and responsibility of boards

The starting point of most company laws is that the board of directors has a wide range of powers. For example, the OECD Principles provide that the board should fulfil certain key functions listing a number of non-exhaustive items.[125] In the OECD SOE Guidelines the powers are phrased in a general way that boards “should be assigned a clear mandate and ultimate responsibility for the enterprise’s performance” and that details should be defined in legislation.[126]

A limitation of the power of boards is the need for shareholder approval in a restricted number of circumstances. For example, the OECD Principles refer to “fundamental corporate changes” such as amendments to the company’s articles of association.[127] As far as shareholders are competent, shareholders can, generally speaking, use their voting power without any restrictions, but there is also a growing debate about the acceptance of shareholders’ duties.[128] For SOEs in particular, the OECD SOE Guidelines go further in stating that “the state should act as an informed and active owner” and that it should also ensure transparency and accountability.[129]

For financial regulatory institutions the situation is again more complicated. The powers of the regulatory authority are usually dictated by law. However, with regards to their functions and guidelines the abundance of regulatory authorities in different jurisdictions creates a wide range of standards. This is evident for example in setting the goals for the institution. For some financial regulatory institutions the organisational goals of the authority are clearly dictated by law, while for others the law is silent and goals are provided in the strategic plans or annual working programs.[130]

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[124] See, e.g., the case study in Mathias Siems and David Cabrelli, *Comparative Company Law: A Case Based Approach* 165-90 (Oxford: Hart Publishing 2013).

[125] OECD Principles D.

[126] OECD SOE Guidelines VIII A.

[127] OECD Principles II B.

[128] See Section 3 A above and D below for requirements of transparency.

[129] OECD SOE Guidelines II.

[130] Jabotinsky, above note 52.

As far as the board of directors is competent, most company laws do not allow the shareholders of public companies to intervene in the decision making of the directors.[131] The independence of the directors in the day to day running of the company is often also seen one of the advantages of the company as a legal form.[132] The OECD Principles therefore state that "the board should be able to exercise objective independent judgement on corporate affairs".[133] The OECD SOE Guidelines are explicit that independence is also related to independence from the state as a shareholder: "the government should allow SOEs full operational autonomy to achieve their defined objectives and refrain from intervening in SOE management" and "the state should let SOE boards exercise their responsibilities and should respect their independence".[134] In some domestic company laws, a codified law of groups of companies addresses the similar point that the parent company needs to respect the autonomy of the subsidiary.[135]

For public bodies in general, a distinction should be made between two cases: in some cases, there can be delegation of power where the agent simply has to comply with all of the principal's instructions; while in other cases the rationale of the delegation is to appoint an independent agent which is detached from the principal.[136] The latter situation applies to financial regulatory institutions. As explained in the previous sections, their independence is essential in order to allow regulators to make professional decisions that serve the public's interest, without any political concerns. In particular, dependence on politicians for budgetary approval or any other need, might interfere with the regulators' strategic, long-term thinking, and force them to calculate their moves based on short-term political constraints.

Another important question of corporate governance is how directors should use their discretion. The OECD Principles state, on the one hand, that "board members

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[131] See, Siems, above note 57, pp. 152-5 (also for the exceptional position of Chinese company law).

[132] E.g., Stephen Bainbridge, "Preserving Director Primacy by Managing Shareholder Interventions", in Jennifer G. Hill and Randall S. Thomas (eds.) *Research Handbook on Shareholder Power* 231 (Cheltenham: Edward Elgar Publishing, 2015). It can also be related to the separation of ownership and control as famously identified by Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (New York: Legal Classics Library, 1993, original from 1932).

[133] OECD Principles VI E.

[134] OECD SOE Guidelines II. B. and C.

[135] E.g., in Germany. For a comparison see Klaus J. Hopt, "Groups of Companies: A Comparative Study of the Economics, Law, and Regulation of Corporate Groups" in Jeffrey Gordon and Wolf-Georg Ringe (eds.), *The Oxford Handbook of Corporate Law and Governance* (Oxford: Oxford University Press 2017, forthcoming).

[136] See Majone, above note 104, and B, above.

should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders", while on the other hand the board should also "take into account the interests of stakeholders".[137] These statements reflect a widespread position of many company laws. To start with, there are general duties of directors, often phrased as fiduciary duties.[138] The interests of shareholder play a role but there is no pure notion of "shareholder primacy" which directors have to follow. Rather, they have to consider the interests of the company as a whole, also with the possibility of taking into account the interests of employees and other stakeholders.[139]

The OECD SOE Guidelines go further in emphasising the wide responsibility of SOEs and their boards. They make it clear that the "state exercises the ownership of SOEs in the interest of the general public" and that the ultimate purpose of these companies "should be to maximise value for society".[140] Correspondingly, it is said that boards of directors of SOEs should "effectively carry out their functions of setting strategy and supervising management, based on broad mandates and objectives set by the government".[141] This means that the directors should implement the public purpose for which the SOE was established. As far as SOEs undertake economic activities, they should ensure that there is fair competition and a level playing field in the marketplace.[142]

With regards to financial regulatory institutions, this touches on one of the interesting points regarding their roles – should sector regulatory institutions, in our case financial regulatory authorities, take into account other considerations such as promoting or maintaining competition in the markets, consider environmental consequences of their regulatory instructions, narrowing social gaps and so on?[143] The answer to this question

[137] OECD Principles VI A and C.

[138] In particular in the common law world but there are equivalent duties in civil law countries, see e.g. Study on Directors' Duties and Liability - European Commission (2013), available at http://ec.europa.eu/internal_market/company/docs/board/2013-study-analysis_en.pdf

[139] For the debate see, e.g., Jonathan Mukwiri, "Myth of Shareholder Primacy in English Law" (2013) 24 *European Business Law Review* 217. The role of stakeholders in corporate governance is also addressed in OECD Principles IV and OECD SOE Guidelines, V.

[140] OECD SOE Guidelines I and I A.

[141] OECD SOE Guidelines VII B.

[142] OECD SOE Guidelines III.

[143] Maher M. Dabbah, "The Relationship Between Competition Authorities and Sector Regulators" (2011) 70 *Cambridge Law Journal* 113 at 117.

is not clear. In some cases, the law specifically demands that the regulators take into account other objectives, while in other cases the law is silent on this point.[144]

So, what normative lessons can be drawn from corporate governance for financial regulatory institutions with regards to these topics of powers and responsibilities? We have seen that in corporate governance, there are precise rules that determine the powers of the board of directors and the shareholders. With regards to financial regulatory institutions, it is clear that the government should respect their independence. Apart from this general position, there is however lack of clarity about the precise details of this relationship. Thus, we suggest that analogous rules as in corporate governance would be helpful: so, for example, this would state that regulators act independently while also clarifying the limits of their powers in relation to the government.

With respect to the specific topic of the budget of the institution, it is highly recommended to keep the budget of the authority separate from the state budget and instead fund its activities from fees levied on the regulated industry. Here the best parallel in corporate governance is the situation of groups of companies. In codifications of the law of groups of companies (or else, in case law dealing with such scenarios), it is made clear that despite the group structure the parent company and the subsidiary are separate legal entities. This means that their finances need to be kept strictly separate and transfer payments are only possible under restricted circumstances: such rules could be well transferred to the relationship between the government and financial regulatory institutions.

Finally, this section addressed the topic of directors' duties in company law. Here too, analogies are possible for financial regulators, for example, as they can said to be subject to duties of care and loyalty. As in corporate governance, there can also be cases where it becomes relevant how far passivity, say a lack of monitoring by the top personal of the regulatory institution, can lead to corresponding breaches of duty. Moreover, as the direction of directors' duties is increasingly understood to include considerations of the public interest and stakeholders, it is clear that financial regulatory institutions also serve the public interest (as often explicitly stated for SOEs). This precept does not allow the financial regulatory institution to circumvent their main obligations,

[144] The Bank of Israel Law, 5770-2010 (IL) for example mentions that the objectives of the Israeli Central Bank include "to support other objectives of the Government's economic policy, especially growth, employment and reducing social gaps".

for example, to impose a fine in case of misconduct. However, in the practice of any complex organisation, be it a large company or a financial regulatory institution, many decisions cannot only be based on simple bright-line rules: thus, as there are degrees of discretion,[145] there is also the corresponding need of the law to provide guidance.

E. Transparency of objectives and operations

The objectives of a company are usually specified in the articles of the association and therefore transparent to the public through commercial registers. The OECD Principles also state that disclosure should include material information on the company's objectives.[146] However, in practice, company laws and registers often allow wide objectives in order to facilitate the operation of companies in changing economic conditions.[147] Stricter standards may be necessary for SOEs. According to the OECD SOE Guidelines, an ownership policy has to include information about, for example, the rationales for state ownership and the responsible persons implementing this policy.[148] Correspondingly, it is then also said that the "government as a shareholder should avoid redefining SOE objectives in a non-transparent manner".[149]

Turning to further transparency obligations, there are some circumstances where shareholders can obtain specific pieces of information: in the run-up to the general meeting through the agenda and the accompanying documents, and in many countries at the general meeting through the opportunity to ask questions to the directors.[150] In return, as a more recent development, there may be some disclosure obligations for shareholders, specifically for institutional investors. For example, according to the OECD Principles, "institutional investors acting in a fiduciary capacity should disclose their corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights".[151]

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[145] Similar Armour et al., above note 1, pp. 570-1 ("constraining discretion").

[146] OECD Principles V A 2.

[147] There is also some variation between countries, see, e.g., Andreas Cahn and David C. Donald, *Comparative Company Law* 131-7 (Cambridge: Cambridge University Press 2010).

[148] OECD SOE Guidelines I B.

[149] OECD SOE Guidelines B s. 2

[150] E.g. see OECD Principles II A 3, II C 3.

[151] OECD Principles III A. See also Section 3 A, above.

Public transparency obligations of companies listed on a stock exchange are usually based on rules of securities law, following the rationale that effective disclosure fosters capital market's pricing mechanism and allocation of capital. Most of these obligations are about regular disclosure, for example, through annual reports. In addition, most securities laws require companies to provide "ad-hoc" disclosure of major events. Typically, today, all of this information is available online, for example, on the website of the stock exchange, the supervisory authority and/or the company.[152]

Despite their focus on company (not securities) law, the OECD Principles include some statements that refer to public transparency obligations. For example, it is said that it should be ensured that "timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company", and that "channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users".[153] According to the OECD SOE Guidelines too, SOEs "should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies".[154] Furthermore, there is often a disclosure obligation of listed companies to "comply or explain" with the relevant domestic standards of corporate governance. In the OECD Principles too it is indicated that they should be transparent about the content and the implementation process of any governance code.[155]

As far as financial regulatory authorities are concerned, their disclosure requirements are, at present, much narrower. Some financial regulatory institutions conduct audits on the regulated firms and those remain confidential. Information about the work of a financial regulatory institution might be found partly on the authority's website, which will usually include the regulations it publishes, or in country reports conducted by international organisations. Other parts of the regulatory work might be exposed during

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[152] See, e.g., Christof Beuselinck, Marc Deloof, and Sophie Manigart, "Financial Reporting, Disclosure, and Corporate Governance", in Mike Wright, Donald S. Siegel, Kevin Keasey, and Igor Filatotchev (eds.), *The Oxford Handbook of Corporate Governance* (Oxford: Oxford University Press 2013).

[153] OECD Principles V (with further details in subsequent sections) and ibid E.

[154] OECD SOE Guidelines, VI.

[155] OECD Principles V A 9.

court procedures against the authority. But most of its work remains far from the public's eye.[156]

From a normative perspective, we suggest that rules of corporate governance and, to a lesser extent, securities law can be a model for the transparency obligations of financial regulatory authorities. To start with, it is recommended to set the goals of financial regulatory institutions clearly by law. The goals of the authority are highly relevant to its work, for example with regards to collection of information. If the goals are clearly defined in the founding laws, then the amount of relevant information which is collected by the employees of the financial regulatory authority is higher.[157]

Beyond this specific point, more formalised and extensive public disclosure is well over due for financial regulatory institutions. Exposing parts of the regulatory work to the public is crucial in terms of the regulatory authority's accountability. For example it is recommended to publish the protocols of the board meetings of the committees of the regulatory authority. Another important public disclosure relates to the CVs and conflict of interest agreements signed with employees which enter the regulatory institutions. Such specific recommendations should then also consider whether and how such transparency is implemented for corresponding topics in company and securities law, notwithstanding evident differences.[158]

Furthermore, it is suggested that it would be worth developing a set of international governance rules that financial regulatory institutions should follow on a "comply or explain" basis. The corporate governance standards operating on such a basis are widely seen as a successful model in company and securities law. A similar approach is also used elsewhere for quasi-public bodies already, namely the "Santiago Principles" designed to promote good governance, accountability, and transparency for the sovereign wealth funds.[159]

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[156] See for example the request from UK bank regulators to disclose more information about lenders in order to avoid another financial crisis which was raised by Andrew Tyrie, the head of the Treasury select committee. (Caroline Binham, "Watchdog Urged to Disclose more Information about Banks", *Financial Times*, 7 June 2016). See also Enriques and Hertig, above note 66, p. 360; Armour et al, above note 1, pp. 567-8.

[157] Ibid.

[158] In particular that some of the disclosure obligations of listed companies are due to the fact that they have publicly traded shares. See Sections 2 and 3, above.

[159] See www.ifswf.org/santiago-principles.

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

5. Conclusion

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

The main interest of this article was to examine the feasibility of applying rules of corporate governance to the governance of financial regulatory institutions. It has done so in three steps: first, discussing at a general level how far private and public sector institutions differ; second, presenting theoretical arguments why there are also some similarities; and third, showing which standards of good corporate governance should also be applied to financial regulatory institutions.

Our main normative suggestions can be summarised as follows: (i) we recommend to reduce the number of financial regulatory institutions in one jurisdiction and free their boards from political intervention, for example, by prohibiting the nomination of politicians to the boards of the financial regulatory institutions; (ii) the budget of the authority should be completely independent from government both in the way it is fund-

ed and in the way it is decided upon; (iii) in order to incentivise regulators to regulate in times of crisis, early retirement mechanises for regulators should be adopted; (iv) we recommend diversifying the board of directors of the regulatory institutions by having public representatives and experts sit on the governing board. Furthermore, we contend that both the directors of the regulatory institution and the regulators themselves should be subject to duties of care and loyalty; (v) we recommend audit and remuneration committees; in addition, peer review by similar sector regulators from other countries should be introduced; (vi) employment of former employees of the financial regulatory institution should be restricted in order to avoid capture and unwanted conflict of interests; (vii) the goals of the financial regulatory authority should be clearly set by law, and more formalised and extensive public disclosure of the regulatory work is well over due.

In principle, these suggestions apply to any financial regulatory institution established as an independent body with its own legal personality.[160] This is not to deny that, from a normative perspective, any implementation of these suggestions would also need to consider the precise national and institutional context of the regulatory institution in question. In addition, it is clear that, from a positive perspective, the implementation of our suggestions may be more or less challenging depending on the national and institutional context: for example, as the composition of agencies in France is due to its strong conception of the state, resistance to some of the suggestions may be more pronounced.

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

[160] See Section 1, above.

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