

Corporate governance of financial institutions
Speech in Copenhagen on 9th June, 2010

A little more than 20 years ago, the Iron Curtain fell and totalitarian rule in Eastern Europe and the Soviet empire came to an end, a sequence of developments of massive global significance. The particular relevance of all this for corporate governance is that, as a result of the transition to greater democracy in the world alongside the globalisation of production, trade and capital markets activity, the boards of many major corporations now exercise power second only to that of elected governments and, indeed, in excess of that available to the governments of many smaller countries.

In Europe, the United States and elsewhere in the developed world, the original purpose of the board was to protect and advance the interests of all shareholders. Subsequently, and particularly recently, new accountabilities have been added by statute and regulation in areas as diverse as health and safety, employment and pension rights, the form and detail of financial accounts, environmental impact, competition and anti-trust..... and there are many others, specific to particular business sectors. In banking, insurance and other financial institutions the social externalities associated with serious problems or failure are internalised through financial regulation, and major initiatives, national and international, are currently in train both to intensify and to extend its reach. This reflects an understandable and rational political reaction to the massive damage inflicted on society above all through lost output and growth but, also, the burden on taxpayers, who have found themselves saddled with unlimited liability in situations in which the liability of owners of failed entities was limited to the loss of their equity stakes.

The political, Main Street and media mood still retains a strongly retributive flavour. And there is schizophrenia in the twin political aims of ample, cheap credit and safe banks – which are unlikely to be simultaneously achievable. What is clearly important is that new policy prescriptions are based on objective, authoritative and coherent diagnosis so that what is put in place yields sustainable improvement at the critical interface between public policy and private enterprise. If policy measures are not properly thought through and if appropriate balance is not achieved, the unintended consequences could in the event be seriously negative, for example in diverting disproportionate entrepreneurial energy into regulatory and tax arbitrage; and in making major financial institutions materially less attractive to investors and thus less able to play their critical role in the provision of credit and other financial services on which all other business relies.

There are in any event specific constraints on what legislation and regulation can achieve. Legislation created legal personality and limited liability for shareholders and lays specific accountabilities on boards of directors. But

