TWO-TIER BOARDS FOR THE GOVERNANCE OF BANKS

Marina Brogi
Department of Banking, Insurance and Capital Markets
"La Sapienza" University - Via Castro Laurenziano 9, 00161 Rome, Italy
E-mail: marina.brogi@uniroma1.it

ABSTRACT

For financial intermediaries governance is particularly important due to their special role within the economy in the aggregation and transfer of financial resources. Recent measures aimed at supporting the economy and banks have attached particular importance to governance practices, as also suggested by the Financial Stability Forum, which includes corporate governance in the Compendium of 12 key principles for sound financial systems.

Though coordinated measures at European level have often been suggested, corporate governance systems in Europe are actually quite different. There are three different possible board structures: the one-tier board system, typical of the UK, Spain and many other countries, the vertical two-tier system, typical of Germany and of the Netherlands in the case of large companies and countries in which companies may choose between different models, such as France and Italy.

Many large financial groups in Europe, including a number of Italian large banks, have adopted the two-tier board governance structure. While some highlight its advantages, others emphasize the risks of the possible overlapping of functions and roles across different governance layers and of the plethoric multiplication of seats on the boards. This paper pursues a twofold objective of investigating i) the peculiarities of the corporate governance of financial intermediaries as concerns the size of the board and performance and ii) on the basis of international evidence, identifying elements which may be introduced to improve the legislative and self-regulatory framework with a particular focus on the implications of the adoption of the vertical two-tier model by banks and insurance companies.

The structure of the paper is as follows; the first section is dedicated to a brief overview of the principles of corporate governance issued by various supranational entities, with particular attention paid to principles specifically devised for financial intermediaries. The second section summarises relevant corporate governance literature. The third section is dedicated to an empirical analysis which considers two different international samples of companies, the first is made up of the largest European companies of the Eurotop 100 index and the second is made of the top forty European financial intermediaries by market cap. Qualitative and quantitative elements on the governance of the companies in the two samples were drawn and their impact on performance assessed. Among other things, international applications of the vertical two-tier system confirm that financial intermediaries and companies with two-tier boards have more board members but this does not seem to impact negatively on performance. Conversely non-financial companies tend to have smaller boards and board size seems to negatively affect performance. Section 4 concludes with certain policy suggestions also in light of a new vision of control which emerges from the analysis.

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INTRODUCTION

Corporate governance has become an increasingly-critical issue after the corporate scandals which occurred all over the world. Moreover, its specific role in the stability of financial intermediaries was highlighted by the severe crisis which hit financial markets from the summer of 2007. In fact, for financial intermediaries the governance system is all the more important not only because intermediaries are basically in the business of risk acceptance but also due to their special role within the economy in the aggregation and transfer of financial resources.
Recent measures aimed at supporting the economy and banks have attached particular importance to governance practices[1], as also suggested by the Financial Stability Forum, which includes corporate governance in the Compendium of 12 key principles for sound financial systems[2].

In Europe there are three different possible board structures: the one-tier board system, typical of the UK, Spain and many other countries, the vertical two-tier system, typical of Germany and of the Netherlands in the case of large companies and countries in which companies may choose between different models, such as France and Italy. The vertical two-tier system, was introduced in Italy with the company law reform in 2003. In the last two years it was chosen in three of the most recent bank mergers in Italy (Intesa-Sanpaolo IMI, Banca Popolare di Verona e Novara-Banca Popolare Italiana, Banche Popolari Unite-Banca Lombarda) and also by Italy's largest investment bank Mediobanca, which switched back to the traditional Italian horizontal two-tier model after little over a year.
Institutional investors also suggested the vertical two-tier model for Assicurazioni Generali. This re-fuelled the debate concerning corporate governance in Italy.

The adoption of the vertical two-tier system was appreciated by observers who pointed out the potential of the two-tier system in relation to the innovative role of the Supervisory Board and, especially, to its function as filter between ownership and management and in the definition of the risk appetite of financial intermediaries. Others alleged that there are no substantially innovative elements in its application compared to the traditional Italian horizontal two-tier system and underlined the risks of duplication of powers and responsibilities and the plethoric multiplication of seats on the boards, thus leading to larger (and less effective) boards.

This paper pursues a twofold objective of investigating i) the peculiarities of the corporate governance of financial intermediaries as concerns the size of the board and performance and ii) on the basis of international evidence, identifying elements which may be introduced to improve the legislative and self-regulatory framework with a particular focus on the implications of the adoption of this model by banks and insurance companies.

The structure of the paper is as follows; the first section is dedicated to a brief overview of the principles of corporate governance issued by various supranational entities, with particular attention paid to principles specifically devised for financial intermediaries. The second section summarises relevant corporate governance literature. The third section is dedicated to an empirical analysis which considers two different international samples of companies, the first is made up of the largest European companies of the Eurotop 100 index and the second is made of the top forty European financial

[1] For example in Italy, Legislative Decree 185/2008 converted into Law with Law 2/2008 requires that, banks to access measures must satisfy certain corporate governance requirements. The Decree of the Minister of the Economy directly refers to Bank of Italy Regulations of 4 March 2008.
[2] See "12 Key Standards for Sound Financial Systems", http://www.fsforum.org/cos/index.htm.

intermediaries by market cap. Qualitative and quantitative elements on the governance of the companies in the two samples were drawn and their impact on performance assessed. Among other things, international applications of the vertical two-tier system confirm that financial intermediaries and two-tier companies have larger boards but this does not seem to impact negatively on performance. Conversely non-financial companies tend to have smaller boards and board size seems to negatively affect performance. Section 4 concludes with certain policy suggestions also in light of a new vision of control which emerges from the analysis.

1. INTERNATIONAL CORPORATE GOVERNANCE PRINCIPLES

Though regulations vary worldwide general principles concerning corporate governance have been issued by various international agencies, such as OECD (Table 1), by the European Commission (Table 2) and specifically for banks by the Basel Committee (Table 3). The Financial Stability Forum specifically refers to the OECD principles in its Compendium of Standards which lists the various economic and financial standards that are internationally accepted as important for sound, stable and well functioning financial systems, specifying that the international community attaches much importance to the adoption and implementation of these standards because of their beneficial effects on the stability of financial systems both inside countries and globally.

Table 1 – OECD Principles of corporate governance

1999	2004*
	I. Ensuring the Basis for an Effective Corporate Governance Framework The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.
I. The rights of shareholders The corporate governance framework should protect shareholders' rights.	**II. The Rights of Shareholders and Key Ownership Functions** The corporate governance framework should protect and facilitate the exercise of shareholders' rights.
II. The equitable treatment of shareholders The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.	**III. The Equitable Treatment of Shareholders** The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

III. The role of stakeholders in corporate governance The corporate governance framework should recognise the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.	**IV. The role of stakeholders in corporate governance** The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
IV. Disclosure and transparency The corporate governance framework should ensure 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.	**V. Disclosure and Transparency** The corporate governance framework should ensure 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.
V. The responsibilities of the board The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.	**VI. The Responsibilities of the Board** The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.
Note: * New parts with respect to the 1999 version are highlighted.	

Table 2 – Commission Recommendation 2005/162/EC

Preamble	*18 considerations on the prior relevant discipline, on the importance of behaviour to promote trust in markets suggested in the Recommendation.*
Section I	*Scope and definitions*
Section II	*Presence and role of non-executive or supervisory directors on (supervisory) boards*
Section III	*Profile of non-executive or supervisory directors*
Annex I	*Committees of the (supervisory) board* • *Common features* • *The nomination committee* • *The remuneration committee* • *The audit committee*

Annex II	*Profile of independent non-executive or supervisory directors*

Table 3 – Principles of corporate governance for banks

Principle 1	*Board members should be qualified for their positions, have a clear understanding of their role in corporate governance and be able to exercise sound judgment about the affairs of the bank.*
Principle 2	*The board of directors should approve and oversee the bank's strategic objectives and corporate values that are communicated throughout the banking organisation.*
Principle 3	*The board of directors should set and enforce clear lines of responsibility and accountability throughout the organisation.*
Principle 4	*The board should ensure that there is appropriate oversight by senior management consistent with board policy.*
Principle 5	*The board and senior management should effectively utilise the work conducted by the internal audit function, external auditors, and internal control functions.*
Principle 6	*The board should ensure that compensation policies and practices are consistent with the bank's corporate culture, long-term objectives and strategy, and control environment.*
Principle 7	*The bank should be governed in a transparent manner.*
Principle 8	*The board and senior management should understand the bank's operational structure, including where the bank operates in jurisdictions, or through structures, that impede transparency (i.e. "know-your-structure").*

2. RELEVANT CORPORATE GOVERNANCE LITERATURE

Regulatory interventions on corporate governance stem from the fact that the market for corporate control often proves to be ineffective in ensuring that companies are run by the best managers in the interests of shareholders. Often companies, even listed companies, are not contestable (due majority shareholders, shareholders' agreements, and so on) and as such they are not subject to the disciplining effect of a possible hostile takeover bid.

There is extensive corporate governance literature, it focuses on internal governance mechanisms (structure of management bodies and ownership structure) and external mechanisms (market for corporate control and regulatory system). However, it often does not address the impact of such elements on performance. Studies often refer to a single country or provide international surveys on single governance aspects (board organisation, management compensation, ownership concentration).

Of this vast body of literature two areas are particularly relevant for the present paper: studies which address the relation between board size and composition and performance in general and studies which address the governance of financial intermediaries, which normally focus on banks. Previous research tends to focus either on non-financial companies or on banks on the assumption that banks are different.

The first set of studies which are relevant to the present analysis investigate the relation between board size (number of directors) and characteristics (independent vs. insider) and performance. From this viewpoint there are two opposite views: on the one hand, studies which address board size and composition considering **agency theory** and on the other hand studies that adopt a **resource-based view**.

Agency theory applied to the relation between **board size** and **performance** predicts that a smaller board should be more effective since it is more capable of reducing decision-making time and agency problems within the board. Empirical studies should find a negative correlation between board size and performance. Moreover, this approach emphasises the role of independent directors.
Instead, the second approach predicts that a larger board could favour better decisions, based on diversified competences and experiences and therefore suggests a positive correlation between board size and performance. This approach postulates the importance not only of independent directors but also of directors with information on the company (insiders or executives) or with managerial experience in other companies.

There does not seem to be consistent evidence to support that board size or composition affect performance. Certain studies report negative correlation between board size and performance: studies quoted by Hermalin B., Weisbach M. (2003), and as concerns other countries for a review of the literature see Denis D., McConnell J. (2003). More recently, de Andres P., Azofra V. e Lopez F. (2005), report no relation between independent directors and performance, and the negative correlation between board size and value of the company using a sample of international companies excluding financial institutions and the same effects are reported on a sample of Norwegian companies by Bøhren Ø, Strøm R. (2007). Other studies find that better performance seems associated to larger boards and in this case confirm the resource-based view, especially in the case of financial intermediaries as indicated below.

Another important issue concerns the relation between the board **composition** and performance: in theory, a wide number or a majority of **outside directors** could be associated with a better performance since it should reduce agency problems between shareholders and management. As concerns the presence of **executive directors** in the board two opposite effects have been identified. On the one hand, executive directors could positively affect performance since they provide a more in-depth understanding of the company and greater and better information on which the board may base its decisions. According to this approach, **more executive directors** may positively affect the quality of information which reaches the board, see Adams R., Ferreira D. (2007). On the other hand, the presence of executives may limit the board's effectiveness in controlling and disciplining top management.

Again empirical investigations of the relationship between board composition and performance do not lead to conclusive results: certain studies find that the presence of independent directors is positively associated with performance, Barnhart S. W., Rosenstein S. (1998), while others that report that a higher presence of external directors is not associated to better performance. Bhagat S., Black B. (2001), and the studies quoted in the surveys by Hermalin and Weisbach (2003), and Denis D., McConnell J. (2003), and more recently by de Andres P., Azofra V., Lopez F. (2005).

Studies on financial intermediaries tend to focus on banks. These studies are considered relevant for the purposes of the present study since banks and insurance companies are: i) active in the risk acceptance business, ii) strongly regulated and capital constrained and iii) over products which may be substitutes. There are Numberus studies which support the idea that **banks** should be subject to particular governance provisions due to their greater regulation compared to other sectors Levine R. (2003), Caprio G., Levine R. (2002), Busta I. (2007), or their operating characteristics, namely the deposit guarantee fund, deposit insurance and the systemic risks deriving from the management of payment systems and the transmission of monetary policy, Macey J., O' Hara M. (2003). Studies which in general show that governance is affected by industry also indirectly support the idea that intermediaries are different, Black B., Jang H., Kim W. (2006), Gillian S., Hartzell J., Starks L. (2003).
Analyses which investigate the board characteristics for banks show that bank boards are larger and have a higher number of independent members, Adams R., Mehran H. (2003), that compare a sample of bank holding companies with a sample of US manufacturing companies and Schwizer P., Farina V., Carretta A. (2006) who find similar results for Italian companies and intermediaries which make up the S&P MIB 40 index. See also Gillian S.L., Hartzell J.C., Starks L.T. (2003), Adams R. , Mehran H. (2003, 2005) and Hayes R., Mehran H., Schaefer S. (2006).
Again there is mixed evidence on the relation of these elements with performance. There are studies on the US which do not find any significant relation between board size and composition and performance, Belkhir M. (2006). Other studies report that board size is positively correlated with performance (measured by Tobin's Q) and, even though the presence of independent members does not show a significant relation with performance, companies with boards dominated by outsiders show a better performance , Adams R., Mehran H. (2005).
Studies on a sample of European banks register a negative correlation between the size of the board and performance, while the percentage of independent directors seems to be positively correlated with performance measured by Tobin's Q, Staikouras C. K., Staikouras P. K., Agoraki M. K. (2006). Other research conducted on European banks identify a positive correlation between the presence of non-executives and performance in Continental Europe (France, Germany, Italy and Spain) and a negative correlation in the UK, Busta I. (2007).
The results of these analyses on banks confirm the difficulty of reaching univocal conclusions.

The lack of supporting evidence on "ideal" board size and composition could stem from the fact that there is no "one size fits all" in the field of governance. On the contrary, it seems likely that both outside and inside directors are necessary because of their complementary skills. Outside and independent directors which contribute to the Board their insight from the outside and insiders with their in-depth information on the company on which to base decisions.

Even though empirical research does not lead to conclusive results, policy makers, supervisory authorities and institutional investors tend to consider governance important. In particular, institutional investors tend to prefer smaller boards.
Morevoer, relevant literature in explaining possible reasons for the lack of conclusive evidence, provides interesting interpretations which permit a better understanding of the elements to be considered in board functioning mechanisms: the role of information and the board's two main duties control (explained effectively by agency theory) and the support of strategy (outlined more effectively with the resource-based view which highlights the contribution and importance of varied competencies within the board) Szego B., De Vincenzo A., Marano G. (2008).

3. CORPORATE GOVERNANCE CHARACTERISTICS AND PERFORMANCE

Regulation defines the corporate governance systems which may be adopted by companies and therefore indirectly the way in which risk acceptance and risk control are attributed. This section provides an original survey of the governance of the largest listed European companies which make up the Eurotop 100 index and the top 40 listed European financial intermediaries. Companies considered come from 16 different countries (12 in the case of the Eurotop index and 14 for financial intermediaries) and are therefore subject to different regulatory and self-discipline codes.

This section analyses governance systems, board characteristics and their relation with performance, with a particular focus on financial intermediaries, since as pointed out by Denis D., McConnell L. (2003), p. 8 , "Until recently there have been few published papers that study the effectiveness of European Boards of Directors. Despite this lack of evidence and despite the fact that the US evidence is somewhat open-ended regarding the effect of board characteristics on firm value, various European commissions have embraced the idea that appropriate board composition is important to good corporate governance".

The analysis was conducted on two different data sets extracted in January 2007 (market cap in Tables 4 and 5 also refers to 3 January 2007):

- companies in the Eurotop 100 index, representative of the largest European listed companies (Table 4);
- 40 European listed banks and insurance companies (30 of which are also part of the Eurotop 100 index), made up of the largest listed European financial intermediaries (Table 5).

The companies which are part of the Eurotop 100 index are all of significant size and complexity as well as a significant liquidity. Therefore, even though they are different in terms of industry, nationality and currency, companies considered are large and liquid and present significant similarities as concerns competition on capital markets. This means that leading listed companies should be stimulated by the market to adopt the best governance system.

The size of the boards in the various governance systems (one-tier, vertical two-tier and horizontal two-tier, typical of Italian companies) are assessed and compared with three performance measures deemed to be suitable for data sets which present companies from different industries (Tobin's Q, P/E, ROA).

The data base comprises financial data drawn from Bloomberg and company data collected from the official documentation present on the companies' websites (Articles of Association, Corporate Governance codes, Annual reports and other official documentation).

Table 4. Eurotop 100

Country	Company	Market cap (Mln €)	P/E Ratio 2007	Governance system
Switzerland	**ABB**	29,758.9	20.7	One-tier
Netherlands	**ABN AMRO Holding**	46,011.3	41.0	Two-tier
Netherlands	**Aegon**	23,808.3	8.2	Two-tier
France	**Air Liquide**	22,032.0	21.7	One-tier
Germany	**Allianz**	68,020.4	8.2	Two-tier
UK	**Anglo American**	54,486.6	15.1	One-tier
Denmark	**AP Moller - Maersk**	31,253.0	12.2	Two-tier
France	**Arcelor Mittal**	43,899.5	10.4	One-tier
Italy	**Assicurazioni Generali**	43,214.0	14.7	Italian horizontal two-tier
UK	**AstraZeneca**	63,269.8	11.5	One-tier
France	**Axa**	66,422.6	10.8	Two-tier
UK	**Aviva**	32,069.8	13.7	One-tier
Spain	**BBVA**	67,238.8	9.8	One-tier
Spain	**Banco Santander**	90,687.3	11.4	One-tier
UK	**Barclays**	73,651.5	7.3	One-tier
Germany	**BASF**	37,380.5	12.2	Two-tier
Germany	**Bayer**	31,689.6	20.7	Two-tier
Germany	**Bayerische Hypo-und Vereinsbank**	24,863.2	16.7	Two-tier
Germany	**Bayerische Motoren Werke**	28,736.8	8.9	Two-tier
UK	**BG Group**	35,114.3	22.3	One-tier
UK	**BHP Billiton**	33,773.8	12.2	One-tier
France	**BNP Paribas**	79,508.4	8.7	One-tier
UK	**BP**	164,615.1	11.2	One-tier
UK	**British American Tobacco**	45,099.5	18.7	One-tier
UK	**BT Group**	38,189.9	8.8	One-tier

Country	Company	Market cap (Mln €)	P/E Ratio 2007	Governance system
France	**Carrefour**	32,778.0	20.0	Two-tier
France	**Cie de Saint-Gobain**	23,719.8	15.9	One-tier
France	**Crédit Agricole**	48,692.9	9.2	One-tier
Switzerland	**Credit Suisse Group**	64,878.9	9.2	One-tier
Germany	**DaimlerChrysler**	48,535.9	14.2	Two-tier
Denmark	**Danske Bank**	21,751.2	9.2	Two-tier
Germany	**Deutsche Bank**	53,665.8	6.6	Two-tier
Germany	**Deutsche Post**	27,754.5	20.3	Two-tier
Germany	**Deutsche Telekom**	61,893.9	115.6	Two-tier
Belgium	**Dexia**	24,881.3	7.9	One-tier
UK	**Diageo**	41,585.9	20.7	One-tier
Germany	**E.ON**	71,725.8	13.8	Two-tier
France	**EADS**	21,289.5	-	One-tier
France	**Electricité de France**	98,943.9	26.5	One-tier
Spain	**Endesa**	37,479.8	18.3	One-tier
Italy	**Enel**	48,636.2	13.1	Italian horizontal two-tier
Italy	**ENI**	102,056.5	9.2	Italian horizontal two-tier
Sweden	**Ericsson**	51,174.5	11.1	One-tier
Netherlands	**Fortis**	43,342.2	10.5	One-tier
France	**France Telecom**	55,653.4	10.2	One-tier
France	**Gaz de France**	34,317.5	15.9	One-tier
UK	**GlaxoSmithKline**	118,391.1	13.6	One-tier
France	**Groupe Danone**	30,495.1	33.0	One-tier
UK	**HBOS**	63,874.8	6.9	One-tier
Sweden	**Hennes & Mauritz**	31,436.8	24.3	One-tier
UK	**HSBC Holdings**	163,429.8	10.1	One-tier

Country	Company	Market cap (Mln €)	P/E Ratio 2007	Governance system
Spain	**Iberdrola**	29,913.4	19.8	One-tier
Belgium	**InBev**	30,275.9	15.8	One-tier
Spain	**Inditex**	25,444.3	27.0	One-tier
Netherlands	**ING Groep**	75,147.2	6.5	Two-tier
Italy	**Intesa Sanpaolo**	74,788.6	21.1	Two-tier
Belgium	**KBC Groep**	34,802.9	10.2	One-tier
UK	**Lloyds TSB Group**	49,561.1	8.1	One-tier
France	**L'Oreal**	49,214.8	22.2	One-tier
France	**LVMH Moet Hennessy Louis Vuitton**	38,901.0	19.4	One-tier
Germany	**Munich Reinsurance**	30,201.3	7.4	Two-tier
UK	**National Grid**	29,993.4	16.6	One-tier
Switzerland	**Nestle**	107,881.8	18.7	One-tier
Finland	**Nokia**	64,776.6	14.3	One-tier
Sweden	**Nordea Bank**	32,041.8	9.5	One-tier
Norway	**Norsk Hydro**	29,373.9	10.8	Two-tier
Switzerland	**Novartis**	120,601.4	19.6	One-tier
Netherlands	**Philips Electronics**	35,453.0	7.0	Two-tier
UK	**Prudential**	26,243.3	22.3	One-tier
UK	**Reckitt Benckiser**	25,545.3	22.2	One-tier
France	**Renault**	26,385.2	9.4	One-tier
Spain	**Repsol YPF**	32,413.9	9.3	One-tier
UK	**Rio Tinto**	40,222.0	18.5	One-tier
Switzerland	**Roche Holding**	121,743.1	17.2	One-tier
UK	**Royal Bank of Scotland Group**	96,902.4	5.7	One-tier
UK	**Royal Dutch Shell**	173,290.1	8.4	One-tier
Netherlands	**Royal KPN**	21,040.5	8.8	Two-tier

Country	Company	Market cap (Mln €)	PE Ratio 2007	Governance system
Germany	**RWE**	47,615.4	18.5	Two-tier
UK	**SABMiller**	26,546.0	19.9	One-tier
France	**Sanofi-Aventis**	95,508.1	16.1	One-tier
Germany	**SAP**	51,550.7	22.2	Two-tier
Germany	**Siemens**	67,205.8	23.3	Two-tier
France	**Société Générale**	60,625.3	50.0	One-tier
UK	**Standard Chartered**	30,903.9	18.0	One-tier
Norway	**Statoil**	42,764.4	12.3	Two-tier
France	**Suez**	50,614.0	15.1	One-tier
Switzerland	**Swiss Reinsurance**	24,152.8	6.7	One-tier
Italy	**Telecom Italia**	42,739.9	17.0	Italian horizontal two-tier
Spain	**Telefonica**	81,051.0	11.9	One-tier
Sweden	**TeliaSonera**	29,902.8	15.4	One-tier
UK	**Tesco**	48,265.0	18.9	One-tier
France	**Total**	132,277.9	9.7	One-tier
Switzerland	**UBS**	98,822.4	-	One-tier
Italy	**UniCredito Italiano**	71,915.2	10.6	Italian horizontal two-tier
Netherlands	**Unilever**	35,957.8	19.1	One-tier
France	**Vivendi**	34,798.6	13.9	Two-tier
UK	**Vodafone Group**	113,582.1	-	One-tier
Sweden	**Volvo**	22,430.9	14.7	One-tier
UK	**Xstrata**	33,781.7	12.3	One-tier
Switzerland	**Zurich Financial Services**	29,720.5	7.5	One-tier
	Average	**53,935**		
	Standard deviation	**33,217**		
	Standard deviation (%)	**61.6%**		

Source: Bloomberg. Market cap as at 3 January 2007. P/E Ratio 2007 is the last price for 2007 divided by the moving average of EPS in the prior twelve months.
Where P/E is not indicated, it means that the companies recorded losses for 2007.

Table 5. Top 40 financial intermediaries

Country	Company	Market cap (Mln €)	P/E Ratio 2007	Governance system
Netherlands	**ABN AMRO Holding**	46,011.3	41.0	Two-tier
Netherlands	**Aegon**	23,808.3	8.2	Two-tier
Germany	**Allianz**	68,020.4	8.2	Two-tier
Italy	**Assicurazioni Generali**	43,214.0	14.7	Italian horizontal two-tier
France	**Axa**	66,422.6	10.8	Two-tier
Spain	**BBVA**	67,238.8	9.8	One-tier
Spain	**Banco Santander**	90,687.3	11.4	One-tier
UK	**Barclays**	73,651.5	7.3	One-tier
Germany	**Bayerische Hypo-und Vereinsbank**	24,863.2	16.7	Two-tier
France	**BNP Paribas**	79,508.4	8.7	One-tier
France	**Crédit Agricole**	48,692.9	9.2	One-tier
Switzerland	**Credit Suisse Group**	64,878.9	9.2	One-tier
Denmark	**Danske Bank**	21,751.2	9.2	Two-tier
Germany	**Deutsche Bank**	53,665.8	6.6	Two-tier
Germany	**Deutsche Post**	27,754.5	20.3	Two-tier
Belgium	**Dexia**	24,881.3	7.9	One-tier
Netherlands	**Fortis**	43,342.2	10.5	One-tier
UK	**HBOS**	63,874.8	6.9	One-tier
UK	**HSBC Holdings**	163,429.8	10.1	One-tier
Netherlands	**ING Groep**	75,147.2	6.5	Two-tier
Italy	**Intesa Sanpaolo**	74,788.6	21.1	Two-tier
Belgium	**KBC Groep**	34,802.9	10.2	One-tier
Germany	**Munich Reinsurance**	30,201.3	7.4	Two-tier
Sweden	**Nordea Bank**	32,041.8	9.5	One-tier
UK	**Prudential**	26,243.3	22.3	One-tier

UK	**Royal Bank of Scotland Group**	96,902.4	5.7	One-tier
France	**Société Générale**	60,625.3	50.0	One-tier
UK	**Standard Chartered**	30,903.9	18.0	One-tier
Switzerland	**UBS**	98,822.4	-	One-tier
Italy	**UniCredito Italiano**	71,915.2	10.6	Italian horizontal two-tier
Ireland	**Allied Irish Banks**	20,241.6	7.2	One-tier
Ireland	**Anglo Irish Bank**	11,199.4	9.9	One-tier
Portugal	**Banco Comercial Portugues**	10,147.8	18.7	Two-tier
Spain	**Banco Popular Espanol**	17,198.4	11.3	One-tier
Spain	**Banco Sabadell**	10,716.2	11.6	One-tier
Ireland	**Bank of Ireland**	16,803.0	9.4	One-tier
Italy	**Capitalia**	18,752.0	-	Italian horizontal two-tier
Germany	**Commerzbank**	19,627.6	9.0	Two-tier
Austria	**Erste Bank der Oesterreichischen Sparkas**	18,830.8	12.9	Two-tier
Greece	**National Bank of Greece**	17,241.7	14.5	One-tier
	Average	47,221.25		
	Standard deviation	32,127.00		
	Standard deviation (%)	68.0%		

Source: Bloomberg. Market cap as at 3 January 2007. P/E Ratio 2007 is the last price for 2007 divided by the moving average of EPS in the prior twelve months.
Where P/E is not indicated, it means that the companies recorded losses for 2007.

The one-tier system is the most widespread governance system (68%) in the Eurotop 100 index (adopted as the only model in Switzerland, UK, Spain, Belgium, Sweden and Finland). The horizontal two-tier system (in which both the Board of Directors and the Board of Statutory Auditors, in charge of control, are appointed by the Shareholders' Meeting) is adopted exclusively in Italy, while the two-tier model is the only one adopted in Denmark, Germany, Norway. In the Netherlands the two-tier system is mandatory for large companies

Corporate governance choices of the companies in the Eurotop index are strongly affected by the reference regulatory context: in only two countries two different models are simultaneously present (France, one-tier and two-tier, Italy, horizontal two-tier and two-tier). The analysis confirms that the leading European companies have adopted different governance systems.
Little over a quarter of companies in the Eurotop 100 index adopted the two-tier model, Dutch, Danish, French, German, Norwegian and one Italian (Intesa Sanpaolo).
The two-tier model confirms larger boards (Table 6).

Table 6. Board structures in Eurotop 100 companies

Eurotop 100	**Total members ***		**Management body**		**Control body**	
	Average	*S.d.*	*Average*	*S.d.*	*Average*	*S.d.*
Eurotop 100	16.81	5.91	12.28	4.38	7.48	5.87
One-tier (68)	14.07	3.13	14.07	3.13	4.30	1.06
Two-tier (27)	23.30	6.09	7.22	2.50	16.07	4.64
Italian horizontal two-tier (5)	19.00	6.60	15.20	5.72	3.80	1.10

* In the one-tier system the total members is the same as for the Management body (which appoints the control body among its members)

Table 7. Board structures in 40 European financial intermediaries

Financial intermediaries	**Total members ***		**Management body**		**Control body**	
	Average	*S.d.*	*Average*	*S.d.*	*Average*	*S.d.*
Banks and insurance companies	19.00	5.90	13.10	5.20	8.50	6.20
One-tier (23)	15.57	3.50	15.57	3.50	4.48	1.16
Two-tier (14)	23.86	5.74	7.64	2.65	16.21	4.06
Italian horizontal two-tier (3)	23.00	2.00	19.33	1.15	3.67	1.15

* In the one-tier system the total members is the same as for the Management body (which appoints the control body among its members)

Almost half of the companies in this second data set has adopted the two-tier model, namely Dutch, French, German, Portuguese, Austrian and one Italian (Intesa Sanpaolo). Again the two-tier model shows larger boards.

Furthermore, the comparison between the figures in Tables 6 and 7 confirm that financial intermediaries have larger boards and this is occurs irrespective of the corporate governance model adopted: for financial intermediaries with a one-tier board 15.57 (compared to 14.07), with a two-tier board 23.86 (compared to 23.19) and for the Italian horizontal two-tier model 23 (compared to19).

The relation with performance is investigated considering the correlation between the size of corporate boards and performance (summarised with the three performance indicators) in 2005, 2006 and 2007 and the average for the three years

As concerns the **Eurotop index**, in 2005 and 2006 the relation between the **overall size of corporate bodies and performance**, showed a **negative correlation**, more marked for ROA and Tobin's Q and less marked for the P/E ratio. In 2007 correlation with P/E was positive, even though very low (0.073). Using the average over the three years for the performance measures basically confirm the negative correlation. Therefore, for companies in the Eurotop index smaller boards lead to an improved performance.

In the case of **European financial intermediaries** diverging results emerge: in 2006 and 2007 **correlation between overall board members and ROA and P/E is positive**, whereas it is **negative** for **Tobin's Q**. In 2005 correlation was negative for all three indicators. Larger boards lead to better performance in terms of P/E and ROA. Using average figures a very low or positive correlation emerges. Therefore for financial intermediaries larger boards may lead to better performance.

The application of the three governance models is greatly affected by the regulatory framework of the home country of the company, in some countries, such as Italy and France it is possible to choose between different models, while in others there is only one model. In any case, the analysis has led to identify that the one-tier model is the most widespread and, that actually the two-tier model is applied quite differently by the companies which make up the two samples.

The companies organised according to the two-tier model show on average larger corporate bodies with respect to the other two models. Financial intermediaries, irrespective of the governance model chosen always present larger boards (presumably due to the wider competencies which are required in the board to operate in the business of risk acceptance which are typical of financial intermediaries).

Certain first indications have emerged from the empirical analysis, which require further research. For companies in the Eurotop index smaller and one-tier boards are associated to a better performance (perhaps as a result of the shorter decision-making chain) whereas the same does not occur for financial intermediaries in the second data set, for which the size of corporate bodies seems to have at most an uncertain effect. Even though this second result also suggests further research, considering it together with the fact that normally financial intermediaries have larger boards irrespective of the adopted governance model confirms, on the basis of an empirical survey that financial intermediaries are different.

This empirical analysis conducted on large listed companies permits to conclude that the two-tier model may show some potential for banks and insurance companies despite the fact that it is associated to larger boards. Moreover, the differences which emerge from the analysis of the articles of association of companies in the data set which have a two-tier board structure permit to identify different applications of the model present in Europe, which suggest that the model is well suited to mix the checks and balances which are at the basis of an effective governance. In short it is a model which shows an interesting potential provided that roles and competencies are clearly identified, especially as concerns risk acceptance and risk control. For this reason it is interesting to analyse the role of committees which are an important expression of self-governance of listed companies, even though as indicated in section 1 certain committees have been strongly recommended.

4. CONCLUSION

Regulation may impact on financial risk taking by financial intermediaries by way of the decision-making process envisaged in the various possible legal structures set forth by the law.

Even though policy makers and institutional investors tend to attribute great importance to corporate governance there seems to be mixed evidence on the relation between board size and composition and performance. Financial intermediaries tend to have larger boards compared to other companies and size of the board does not seem to negatively affect performance.

The lack of conclusive empirical evidence on the relation between board size and performance probably means that there is no “one size fits all model” and that the two alternative views on board functioning (agency theory and resource-based theory) are complementary. From a purely theoretical viewpoint this seems the case if we consider the different duties which are attributed to boards. The first refers to the **control function** aimed at monitoring management, for which a lower number of (mostly independent) directors is probably best. The second approach better explains the board's **strategic function**, that is its advisory role in helping management in defining strategy and risk appetite policies, and in this case a mix of outside and inside directors with diverse background is best. In general it is important that the key functions and processes of the board are clearly defined also as concerns the support which may be provided by board committees.

The two-tier model, which has been recently introduced in Italy, even though it leads to a higher number of board members, may in any case prove to be effective especially for financial intermediaries where board size may actually prove to be an advantage if complementary expertise and backgrounds are present on the board.
Moreover, because of the difficulties in identifying a superior governance system the recent decision by the Bank of Italy to issue Regulations concerning bank's organization and corporate governance[3] and prepare a "Corporate governance plan" explaining their decisions on organizational matters and governance could probably prove to be an effective measure in improving accountability for the sound and prudent management of banks.

[3] See Bank of Italy, Regulations concerning bank's organization and corporate governance, press release of 4 March 2008.

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