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Bank Governance: Lessons Still Not Learned

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Abstract

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Keywords: bank governance, risk shifting, agency cost of debt, executive compensation, financial regulation, Credit Suisse

JEL Classification: G21, G28, G34, G38, K22, L51

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Policymakers learned the wrong lessons about bank governance from the 2008 financial crisis, and the collapse of Credit Suisse shows that the misconceptions persist. The central problem in banking is not the conflict between shareholders and management but the agency cost of debt: shareholders, boards and management together shift risk onto depositors, deposit insurers and taxpayers. Post-crisis reforms strengthened shareholder control and thereby amplified the problem, while supervision remains reactive, intervening only after losses have materialised. We propose preventive governance: restructuring incentives inside the bank before risk shifting can operate. Its most practical form gives the deposit insurer, the natural representative of dispersed creditors, the right to nominate professional directors to bank boards. The deposit insurer's own balance sheet bears the cost of failure, so its incentives are aligned with stability rather than returns; nomination of qualified professionals, rather than appointment of officials, avoids the failures of politically appointed boards; and the mechanism strengthens governance even where the state itself is the controlling shareholder, where experience shows that shareholder thinking otherwise persists, and conflicts of interest are rife.

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1. Introduction

The central thesis of this paper is that the primary governance issue in banks is the agency cost of debt, the conflict of interest between creditors and shareholders, rather than the agency cost arising from conflicts between shareholders and management. The fundamental importance of the agency cost of debt, first identified by Jensen and Meckling, has been largely overlooked by banking policymakers and practitioners who continue to focus on shareholder-manager conflicts while ignoring the more critical creditor-shareholder tensions inherent in highly leveraged banking institutions.[1]

Post-2008 corporate governance reforms are fundamentally misaligned with both theoretical prescriptions based on the agency cost of debt and empirical findings. Rather than addressing the core problem of risk shifting from shareholders to creditors and taxpayers, many reforms have reinforced the very incentive structures that exacerbate the agency costs of debt that contributed to the financial crisis. Say-on-pay provisions, deferred equity compensation, and enhanced shareholder engagement do not reduce risk-taking: they amplify it by strengthening shareholder control and tightening the alignment between managers and equity holders, thereby amplifying rather than mitigating the agency cost of debt.

The dominant view on bank governance treats banks like non-financial institutions that should maximise shareholder value subject to complying with regulations in place. On this view, bank regulation exists to ensure that shareholders' interests remain paramount in executive decision-making, whilst other constituencies (depositors, taxpayers, borrowers, and society at large) are protected by the legal, institutional, and regulatory context. This framing relies critically on the assumption that an optimal regulatory regime can be put in place. But as Maurice Clark (1916) aptly observed long ago, that is likely an unattainable ideal.[2] Regulatory reform is slow, path-dependent, incomplete, and often perplexing, inevitably lagging behind innovation: Clark's "twilight zone" describes the period during which regulators have not yet updated imperfect regulations or grasped the significance of industry developments that participants already understand. Regulatory capture compounds this problem. If government policy is necessarily imperfect, banking executives should answer to a more broadly defined notion of the common good, and bank governance should not rest on shareholder primacy alone.

Admati, Hellwig, and Portes, analysing the US failures at Silicon Valley Bank (SVB) and First Republic Bank, reach a similar diagnosis: banks took excessive risks, regulators failed to intervene, and losses that should have fallen on shareholders were instead socialised.[3] Their proposed remedy, however, relies on non-governance policy responses, such as dramatically higher capital requirements and tightened supervision. While higher capital would reduce risk shifting incentives, this approach places substantial weight on regulators' capacity to set appropriate levels, resist lobbying, and intervene promptly, precisely the capacities that repeated crises have shown to be absent. It also assumes that substantially higher capital requirements would come at little or no cost to the economy, a proposition that remains contested. This paper asks whether redesigning governance structures to empower creditors and deposit insurers might prove equally or more effective at considerably lower cost.

[1] Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305–60.

[2] J Maurice Clark, 'The Changing Basis of Economic Responsibility' (1916) 24 Journal of Political Economy 209–29.

[3] Anat Admati, Martin Hellwig and Richard Portes, 'When Will They Ever Learn? The US Banking Crisis of 2023' (CEPR 2023).

Credit Suisse serves as a stark warning about the inadequacy of current governance approaches. The bank followed post-crisis governance prescriptions to the letter: say-on-pay mechanisms, deferred compensation, clawback provisions, and capital ratios exceeding regulatory requirements. Despite this apparent compliance, Credit Suisse collapsed in 2023. The failure was not a case of insufficient shareholder oversight but of excessive shareholder influence. Facing mounting losses, a board oriented towards shareholder value responded by pursuing ever riskier strategies, the "gambling for resurrection" dynamic that theory predicts when equity holders have little left to lose. Credit Suisse demonstrates that current bank governance frameworks are not merely insufficient but potentially counterproductive.

Regulatory responses to Credit Suisse's demise and the subsequent turmoil show some promise in areas such as enhanced supervisory powers and international coordination, but they continue to ignore the fundamental lessons that theory and evidence have highlighted for decades. The regulatory response to SVB and First Republic Bank was muted and calls to implement portions of the Dodd-Frank Act designed to realign the risk-taking incentives in executive compensation went unheeded. On the contrary, the Trump administration is set on a path of deregulation that will give banks a freer hand. Not surprisingly, the international response was similarly inadequate. The focus remains on strengthening existing frameworks rather than reconceptualising the governance model itself.

Effective and relatively low-cost reforms do exist but implementing them requires acknowledging that banks are not ordinary corporations. Executive compensation could be restructured to align managerial incentives with creditors' interests rather than shareholders'. More fundamentally, banks could adopt corporate structures that grant creditors and deposit insurers governance powers, including board representation, commensurate with their risk exposure. Such reforms would represent a paradigm shift away from the shareholder-centric model that dominates current thinking: a shift from reactive supervision, which attempts to constrain risk shifting after problems materialise, to preventive governance structures that prevent risk shifting from occurring in the first place. Until policymakers recognise that empowering shareholders creates more risk than regulators can contain, bank failures will repeat the same destructive pattern.

2. Why Bank Governance is Different

The business model of banks presents unique governance challenges that distinguish them fundamentally from non-financial corporations, so much so that the mainstream shareholder corporate governance model may not only prove ineffective but be actively harmful.[4]

Three distinct layers of agency conflict characterise bank governance. The first is the traditional agency cost of equity between shareholders, boards, and management, arising from the need to delegate authority when shareholders are too numerous or dispersed to participate directly in corporate affairs. The second layer involves the conflict between debt and equity holders, which is dramatically amplified in banking by extraordinarily high leverage, by deposit insurance, and the implicit state guarantees that eliminate creditors' incentives to monitor. The third and most distinctive layer pits banks against society at large: when firm

[4] Anat Admati and Martin Hellwig, *The Bankers' New Clothes* (new and expanded ed., Princeton University Press 2024); Marco Becht, Patrick Bolton and Ailsa Röell, 'Why Bank Governance Is Different' (2011) 27 Oxford Review of Economic Policy 437–63; Hamid Mehran, Alan D Morrison, and Joel D Shapiro, 'Corporate Governance and Banks: What Have We Learned from the Financial Crisis?', in Mathias Dewatripont and Xavier Freixas (eds.), *The Crisis Aftermath: New Regulatory Paradigms* (CEPR 2012); Kose John, Sara De Masi and Andrea Paci, 'Corporate Governance in Banks' (2016) 24 Corporate Governance: An International Review 303–21.

value maximisation induces shareholders and creditors to take on risks whose costs fall disproportionately on deposit insurance funds, taxpayers, and the broader economy.

This paper makes three contributions. First, drawing on a jurisdiction-by-jurisdiction survey assembled in Appendix A, we document that the corporate governance reforms adopted after 2008 in the European Union, the United Kingdom and the United States strengthened shareholder control over banks, notwithstanding a supervisory doctrine that has long proclaimed the primacy of depositor and public interests. The reforms thus contradicted, rather than implemented, the diagnosis on which they were ostensibly based. Second, we treat the collapse of Credit Suisse in 2023 as a test of the post-crisis governance agenda. Credit Suisse adopted the complete reform toolkit; its shareholders made active use of their enhanced powers, as our reconstruction of fifteen years of say-on-pay and governance votes shows (Appendix B); and the bank nonetheless failed through risk shifting. Third, we develop the concept of preventive governance and derive from it a set of practically ranked reforms, culminating in board nomination and appointment rights for deposit insurers, that would place creditor-aligned decision-makers inside bank governance rather than leaving creditor protection to after-the-fact supervision.

The proposition that bank governance differs from the governance of ordinary corporations is not new. Among economists, it underpins the "representation hypothesis" of Dewatripont and Tirole, who justify prudential regulation precisely on the grounds that dispersed depositors cannot exercise the monitoring and control that concentrated creditors impose on ordinary firms,[5] and it runs through a substantial empirical and survey literature.[6] Among lawyers, the specialness of bank governance is a staple of the literature on banking supervision, particularly in the German tradition.[7] And it is stated at the very outset of the Basel Committee's own governance principles: "The primary objective of corporate governance should be safeguarding stakeholders' interests in conformity with public interest on a sustainable basis. Among stakeholders, particularly with respect to retail banks, shareholders' interests would be secondary to depositors' interests."[8]

Yet a different view has dominated reform practice. The post-crisis policy reports diagnosed the governance failures of 2007-2009 as failures of shareholder control: disengaged owners, insufficiently independent boards, and pay insufficiently aligned with shareholder value.[9] The operative reforms accordingly empowered shareholders (Appendix A). They did so despite the awkward finding of the empirical literature that banks with more shareholder-friendly boards and better-aligned chief executives fared worse, not better, in the crisis.[10] Our claim of neglect is accordingly directed at reform practice and mainstream governance advice, not at the academic or supervisory literature: the gap between what

[5] Mathias Dewatripont and Jean Tirole, *The Prudential Regulation of Banks* (MIT Press 1994).

[6] Renée B Adams and Hamid Mehran, 'Is Corporate Governance Different for Bank Holding Companies?' (2003) 9 FRBNY Economic Policy Review 123; Ross Levine, 'The Corporate Governance of Banks: A Concise Discussion of Concepts and Evidence' (World Bank Policy Research Working Paper 3404, 2004); Laeven (n 19); de Haan and Vlahu (n 21).

[7] Klaus J Hopt, 'Corporate Governance of Banks and Other Financial Institutions after the Financial Crisis' (2013) 13 Journal of Corporate Law Studies 219-53; Klaus J Hopt, 'Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy' (2021) 22 European Business Organization Law Review 13-37; Peter O Mülbert, 'Corporate Governance of Banks' (2009) 10 European Business Organization Law Review 411-36; John Armour, Dan Awrey, Paul Davies, Luca Enriques, Jeffrey N. Gordon, Colin Mayer, and Jennifer Payne, *Principles of Financial Regulation* (OUP 2016) ch 17.

[8] Basel Committee on Banking Supervision, Guidelines: Corporate Governance Principles for Banks (July 2015) 3, Introduction para 2; restated in Fernando Restoy, 'Overseeing banks' governance: can we do it better?' (FSI speech, Manila, 25 May 2026).

[9] Grant Kirkpatrick, 'The Corporate Governance Lessons from the Financial Crisis' (2009) OECD Journal: Financial Market Trends 61; David Walker, A Review of Corporate Governance in UK Banks and Other Financial Industry Entities: Final Recommendations (2009); European Commission, Green Paper: Corporate Governance in Financial Institutions and Remuneration Policies, COM(2010) 284 (2010).

[10] Andrea Beltratti and René M Stulz, 'The Credit Crisis Around the Globe: Why Did Some Banks Perform Better?' (2012) 105 Journal of Financial Economics 1; Rüdiger Fahlenbrach and René M Stulz, 'Bank CEO Incentives and the Credit Crisis' (2011) 99 Journal of Financial Economics 11.

supervisory doctrine has long proclaimed and what post-crisis reform actually implemented is precisely the subject of this paper.

The following sections examine these conflicts in detail. Section 2.1 analyses risk shifting between equity and debt holders, drawing on the theoretical foundations established by Jensen and Meckling, and Myers.[11] Section 2.2 addresses the bank-society conflict and its implications for governance design. Section 2.3 reviews the empirical evidence on bank governance and risk-taking.

2.1 Risk Shifting

The theoretical foundation for understanding bank governance problems lies in the seminal work of Jensen and Meckling, whose insights about agency costs have been selectively applied in ways that miss the most critical issues for banking institutions.[12] While the agency cost of equity, that is, the conflicts between managers and shareholders, is well recognised among practitioners and policymakers, the agency cost of debt remains poorly understood or simply neglected in bank governance reforms.

The agency cost of equity arises when owner-managers sell equity claims and subsequently bear only a fraction of the costs of any personal non-pecuniary benefits they extract. This problem has received extensive attention in corporate governance literature and practice, leading to sophisticated mechanisms for aligning managerial and shareholder interests through equity-based compensation, monitoring, and control mechanisms.

However, Jensen and Meckling also identified the agency cost of debt.[13] They observed that potential creditors would not lend substantial sums to a firm in which the entrepreneur has only a minimal investment. With such a financial structure, the owner-manager has a strong incentive to engage in activities that promise very high payoffs if successful, even if the probability of success is low. If these investments turn out well, the owner captures most of the gains; if they turn out badly, the creditors bear most of the costs. This reasoning explains why large firms financed almost entirely with debt-type claims are rarely observed in most industries.

Yet banks are precisely such institutions: large firms financed almost entirely with debt-type claims from depositors and other creditors. The typical leverage ratio of a bank is approximately 10:1, far higher than that of most non-financial firms.[14] The agency cost of debt problem is present in both widely held banks and in those controlled by large blockholders, making it a universal feature of banking rather than a problem limited to specific ownership structures.

Risk shifting is particularly acute when the going-concern value of a bank is low, and management is tempted to "gamble for resurrection." To illustrate, consider a bank with assets worth \$30 and obligations to creditors of \$30. If the bank adopts a risky project costing \$10 that has a 10 per cent chance of generating \$80 and a 90 per cent chance of complete failure, shareholders benefit in expectation: they gain \$7 on average (if the project succeeds, the firm will be worth \$100, namely \$80 plus what is left of the pre-existing assets; the creditors then receive \$30 and the shareholders keep \$70) while creditors lose \$9 on average (if the project

[11] Jensen and Meckling, 'Theory of the Firm'; Stewart C Myers, 'Determinants of Corporate Borrowing' (1977) 5 Journal of Financial Economics 147–75.

[12] Jensen and Meckling, 'Theory of the Firm'.

[13] ibid.

[14] Admati and Hellwig, The Bankers' New Clothes (n 4).

fails, their claim for $30 cannot be satisfied in full, as $10 was wasted on the project).[15] Management acting on behalf of shareholders will undertake such value-destroying projects because the gains accrue to equity while the losses fall on debt. This dynamic intensifies as the bank approaches insolvency.

One important manifestation of risk shifting is the reluctance to issue new equity, the debt overhang problem first identified by Myers.[16] This problem arises when equity holders are unwilling or unable to supply fresh capital, even when doing so would enhance the overall value of the bank to all claimholders, because some or all of the value created would go towards making creditor claims safer. Then the state may have to step in to force an infusion of capital, or to provide fresh capital itself. At Lehman Brothers, CEO Dick Fuld had ample opportunity to raise additional equity in the year before its demise but delayed until June 2008, raising too little capital too late.[17] Conversely, companies close to insolvency have an incentive to make excessive payouts to shareholders in the form of dividends or share repurchases, thereby again transferring risk from shareholders to creditors.

In banking, the risk-shifting problem is compounded by deposit insurance and implicit state guarantees for systemically important financial institutions. Normally, short-term funding curtails risk shifting because funding quickly dries up when a financial institution approaches insolvency. But with government deposit insurance, this disciplinary mechanism is absent and must be replaced by regulatory monitoring and intervention, a hard-won lesson from the savings and loan crisis of the late 1980s, when troubled institutions gambled heavily on newly permitted risky assets, including junk bonds, hugely increasing the ultimate cost to taxpayers.[18]

Government guarantees affect creditor behaviour in two reinforcing ways. First, insured depositors are protected against losses and therefore have no incentive to monitor bank behaviour or demand compensation for risk-taking.[19] Second, uninsured creditors who anticipate government bailouts of systemically important institutions similarly reduce their monitoring efforts. The result is that creditors are willing to invest in highly leveraged institutions despite what would otherwise constitute an unacceptably high agency cost of debt. This makes debt a cheap source of funds, biasing banks further towards leverage.[20]

The speed at which banks can accumulate risk further distinguishes them from most other industries. Unlike manufacturing companies that typically must build physical capacity to increase risk exposure, banks can rapidly expand their risk profile through trading activities, lending decisions, or off-balance-sheet commitments.[21] Their portfolios are often illiquid and hard to value, their positions shift rapidly, and their assets and liabilities can be extraordinarily complex. This capability for rapid risk transformation means that governance mechanisms must be particularly robust, timely, and forward-looking rather than reactive.

Large long-term universal owners such as pension funds and life insurance companies might theoretically help internalise externalities, and their portfolios often include substantial debt holdings that could align their interests with addressing risk shifting. However, these institutional investors have been given no special

[15] This illustrative numerical example follows the structure of Jensen and Meckling's theoretical framework.

[16] Myers, 'Determinants of Corporate Borrowing'.

[17] Anton R Valukas, *Lehman Brothers Holdings Inc. Chapter 11 Proceedings Examiner Report* (2010).

[18] See David H Pyle, 'The US Savings and Loan Crisis' in Robert A Jarrow, Vojislav Maksimovic and William T Ziemba (eds), Finance (Handbooks in Operations Research and Management Science vol 9, Elsevier 1995) 1105–25.

[19] See generally Luc Laeven, 'Corporate Governance: What's Special About Banks?' (2013) 5 Annual Review of Financial Economics 63–92.

[20] ibid.

[21] Jakob de Haan and Razvan Vlahu, 'Corporate Governance of Banks: A Survey' (2016) 30 Journal of Economic Surveys 228–77.

role in bank governance, and they face their own double agency problems: asset managers' incentives are not fully aligned with asset owners, limiting their effectiveness in addressing the fundamental governance challenges in banking.

Jensen and Meckling's creditors protect themselves: they demand covenants, collateral, information rights and higher yields, or they refuse to lend. Bank creditors, by contrast, impose no such contractual discipline, and it is worth being explicit about why. First, deposit insurance removes the incentive of insured depositors to monitor at all. Second, the protection extends far beyond the formal guarantee: in none of the three major failures of 2023 did any depositor, insured or uninsured, lose money. The FDIC invoked the systemic risk exception to protect all deposits at Silicon Valley Bank and Signature Bank; Credit Suisse's depositors were protected through the state-orchestrated acquisition by UBS, supported by central-bank liquidity assistance and a CHF 9 billion federal loss guarantee.[22] Anticipation of such protection acts as de facto insurance for uninsured claims. Third, even absent protection, bank creditors are dispersed depositors facing prohibitive collective-action and information costs; this is Dewatripont and Tirole's representation hypothesis: prudential regulation exists because depositors cannot do what concentrated lenders do. Fourth, demandable debt gives each depositor an individual remedy cheaper than voice: exit. The run disciplines ex post and destructively, not ex ante through contract. Fifth, short-term bondholders of systemic banks have come to understand that public protection effectively extends to them as well, removing any incentive to negotiate covenants or to monitor. Regulation has in part substituted for the missing covenants themselves: the minimum capital conservation requirements introduced after the global financial crisis stand in for the interest-coverage covenants that bond contracts would otherwise contain. The disappearance of contractual creditor discipline is thus not a market failure to be lamented but a direct consequence of the public safety net, and it implies that the institutions providing that safety net have become the creditors' residual representatives. The governance question is whether they hold governance rights commensurate with that role. We return to this in Section 6.

2.2 The Social Externality

That bank failure imposes costs on parties who never contracted with the bank has underpinned banking regulation since the 1930s: deposit insurance, entry restrictions, examination and prudential supervision all rest on it, and the Basel Committee states flatly that "effective corporate governance is critical to the proper functioning of the banking sector and the economy as a whole".[23] What post-crisis governance reform did not do is internalise this externality in the governance of the bank itself.

The third and most distinctive layer of agency conflict in banking pits banks against society at large. This conflict arises because bank owners do not internalise the risks that their institution's failure poses to the rest of the financial system, even though such systemic risk can pose significant threats to the broader economy. Unlike the agency costs between shareholders and managers or between debt and equity holders, the bank-society conflict cannot be resolved through private contracting; it represents a fundamental externality that market mechanisms alone cannot address.

The costs externalised to society take multiple forms. Bank failures impose direct costs on deposit insurance funds, which must compensate insured depositors when institutions become insolvent. During

[22] Swiss Federal Council, Report on Banking Stability (April 2024) 43-44; FINMA, Lessons Learned from the CS Crisis 37.

[23] Basel Committee on Banking Supervision (BCBS), *Corporate Governance Principles for Banks* (July 2015) 3.

the 2007–2010 financial crisis, the cost to the US deposit insurance fund from 325 bank failures amounted to $79.3 billion.[24] Beyond deposit insurance, governments frequently intervene to rescue systemically important institutions through capital injections, guarantees on bank liabilities, impaired asset relief, and funding support. In the United States, the Troubled Asset Relief Program (TARP) deployed $204.9 billion in capital purchases to 707 banks, and the Congressional Oversight Panel's final tally of total federal support, spanning TARP, FDIC guarantees and Federal Reserve liquidity facilities, reached $476.2 billion for Citigroup and $336.1 billion for Bank of America alone.[25]

Paradoxically, the systemic importance of large banks creates incentives for them to take even more risk. Banks that are perceived as "too big to fail" receive a de facto government guarantee, which is reflected in their riskiness as perceived by creditors.[26] This implicit guarantee reduces funding costs for large institutions, a subsidy that encourages further growth and risk-taking, while ensuring that the ultimate costs of failure are borne by taxpayers rather than by the institution's owners and creditors.

The conflict between banks and society arises even when the combined value of equity and debt is maximised for the individual institution. Shareholders and creditors may share a joint interest in pursuing high-risk strategies whose expected private returns exceed their expected private costs, even when the expected social costs, including the losses from systemic disruption, exceed the social benefits. This divergence between private and social optimality is the defining characteristic of the bank-society conflict.

What this means for corporate governance is that not only shareholders but also depositors, other creditors, transaction counterparties, and taxpayers are at risk from banks' activities. It follows that governance mechanisms should protect not merely the interests of shareholders, the primary focus of shareholder value based corporate governance, but also the interests of these other constituencies. Proposals to address these concerns include enhanced capital adequacy regulations, intervention powers for deposit insurers, limitations on proprietary trading by deposit-insured institutions, and measures to reduce the size and complexity of institutions deemed too big to fail. Whether these regulatory interventions can substitute effectively for governance mechanisms that would internalise externalities within the firm remains an open question.

2.3 The Evidence

Evidence of risk-shifting behaviour in banking is substantial, spanning the savings and loan crisis of the 1980s, the 2007–2009 financial crisis, and the COVID-19 pandemic.

One of the most detailed case studies comes from Landier, Sraer, and Thesmar, who analysed New Century Financial Corporation's portfolio data during the subprime mortgage crisis.[27] Following the Federal Reserve's monetary tightening in 2004, which created an adverse shock to the company's $13 billion loan portfolio financed by variable-rate bonds, New Century did not reduce risk but instead shifted massively to

[24] Federal Deposit Insurance Corporation, *Annual Report 2010*.

[25] Congressional Oversight Panel, Final Report (March 2011); Eamon Javers, 'Citigroup Tops List of Banks Who Received Federal Aid' CNBC (16 March 2011).

[26] "Too big to fail" is not unique to banking: governments have rescued carmakers, airlines and utilities on similar reasoning. What is special in banking is that demandable debt, deposit insurance and standing central bank facilities make support systematic rather than episodic, so the expectation of rescue is priced into bank funding ex ante and the incentive to shift risk onto the safety net operates continuously, not only in crisis.

[27] Augustin Landier, David Sraer, and David Thesmar, 'The Risk-Shifting Hypothesis: Evidence from Subprime Originations' (working paper, 2015; originally circulated 2010 as 'Going for Broke: New Century Financial Corporation, 2004-2006').

interest-only loans with higher real estate price sensitivity, effectively doubling down on real estate exposure when the existing portfolio was already under stress. The company also concentrated risk geographically, originating more loans in regions correlated with existing asset performance. Most tellingly, New Century increased its payout ratio from 5 per cent to 90 per cent in 2004, extracting value from the firm precisely when prudent risk management would have suggested retaining capital. This behaviour exemplifies the theoretical prediction that shareholders facing potential bankruptcy prefer high-risk strategies, since they have little to lose and everything to gain.

The patterns observed at New Century were not idiosyncratic. Research on the 2007–2009 financial crisis documents that many banks maintained or increased dividends until late 2008, cutting them significantly only in 2009.[28] These dividend policies have been interpreted as attempts to signal financial strength, but they are also consistent with wealth transfers from creditors to shareholders at precisely the moment when capital conservation should have been the priority.

The debt overhang problem identified by Myers also finds clear empirical support.[29] UniCredit's January 2012 equity issuance illustrates why banks resist recapitalisation even when regulators demand it. To meet new European Banking Authority capital targets, UniCredit announced a €7.5 billion discounted rights issue: a two-for-one offering at a subscription price of €1.943 against an opening share price of €4.1362 on the pricing date.[30] By January 9, the share price had fallen to €2.286; accounting for the value of the rights, existing shareholders suffered a return of approximately −28 per cent over just five trading days. This outcome viscerally demonstrates why equity holders resist dilutive capital raises: the benefits of strengthened capital buffers flow disproportionately to creditors, while existing shareholders bear the immediate costs. UniCredit's experience exemplified why other European banks avoided voluntary recapitalisation: with the EBA's December 2011 capital exercise identifying an initial €115 billion shortfall across 37 banks,[31] most chose to meet capital targets by shrinking balance sheets, cutting dividends, or selling assets rather than face similar shareholder dilution.[32]

More recent evidence from the COVID-19 pandemic reinforces these findings. Fringuellotti and Kroen exploit the imposition and subsequent relaxation of payout restrictions on large US bank holding companies in 2020 as a natural experiment.[33] Using high-frequency data and difference-in-differences analysis, they find that when payout restrictions were imposed, equity values fell while debt values rose, consistent with a reduction in risk shifting. When restrictions were relaxed, the pattern reversed: equity values increased and credit default swap spreads widened, indicating that creditors perceived higher default risk. The study also finds evidence that banks subject to binding restrictions reduced lending to riskier borrowers, suggesting that payout policy and risk-taking decisions are complements.

The importance of ownership structure in determining risk-taking behaviour is demonstrated by

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[28] See Viral V Acharya, Irvind Gujral, Nirupama Kulkarni, and Hyun Song Shin, 'Dividends and Bank Capital in the Global Financial Crisis of 2007–2009' (2022) 4(2) Journal of Financial Crises 1–39.

[29] Myers, 'Determinants of Corporate Borrowing'.

[30] UniCredit SpA, 'The BoD Approved the Terms and Conditions and the Timetable of the Offer of Ordinary Shares to the Existing Shareholders', price-sensitive press release (4 January 2012); Rights Offering Prospectus (Documento di Registrazione, 15 December 2011; Nota Informativa and Nota di Sintesi, 4 January 2012).

[31] European Banking Authority, *Final Report on the Recapitalisation of European Banks* (October 2012) 3. Of the 71 banks examined, 37 showed an initial shortfall of €115 billion.

[32] European Banking Authority, 'EU-wide Stress Test Results' (2011).

[33] Fulvia Fringuellotti and Thomas Kroen, 'Payout Restrictions and Bank Risk-Shifting' (Federal Reserve Bank of New York Staff Report No 1123, 2024).

research on the savings and loan crisis. Hermalin and Wallace first documented that mutual thrifts, which have no shareholders, took significantly less risk than their stock-owned counterparts, a finding subsequently confirmed by Fraser and Zardkoohi, and Esty.[34] This body of evidence provides direct support for the proposition that the presence of shareholders with limited liability fundamentally affects risk-taking incentives.

Not all banking systems exhibit identical patterns, though the interpretation of countervailing evidence requires care. Peydró, Polo, Sette and Vanasco found that fragile Italian banks reduced risk during crises rather than increasing it.[35] However, it is not clear whether their study captures risk shifting in the precise sense of Jensen and Meckling, that is, the substitution of higher-variance projects that transfer value from creditors to shareholders, or simply changes in overall risk exposure or leverage. More generally a bank might reduce measured risk while still engaging in risk shifting if the composition of its portfolio shifts towards assets with more favourable payoff distributions for equity holders. Conversely, increased risk-taking need not constitute risk shifting if creditors are adequately compensated.

Taken together, this body of evidence strongly supports the theoretical predictions derived from Jensen and Meckling, and Myers: high leverage combined with limited liability creates powerful incentives for risk shifting and resistance to recapitalisation, and these incentives are amplified by deposit insurance and implicit government guarantees that insulate creditors from the consequences of excessive risk-taking.[36]

3. The Role of the Board

The link between board competence and bank risk-taking is more subtle than simple narratives of incompetent directors blindly acquiescing to excessive risk-taking. Evidence from different countries indicates that the problem may not just be a lack of expertise, but also how that expertise is directed given prevailing governance incentives.

Indeed, Minton, Taillard, and Williamson found that financial expertise among independent directors in the United States was positively associated with both balance-sheet and market-based measures of risk in the run-up to the 2007–2008 financial crisis.[37] This counterintuitive finding challenges the assumption that board incompetence caused excessive risk-taking. Two interpretations are possible: financially sophisticated directors, operating within a shareholder-centric governance framework, may have actively encouraged rather than restrained risk-taking; alternatively, banks intending to pursue riskier strategies may have recruited sophisticated directors precisely to execute those strategies. Either interpretation suggests that expertise serves the governance mandate under which directors operate.

Evidence from Germany reinforces this conclusion from a different angle. Hau and Thum found that state-owned *Landesbanken*, whose supervisory boards included political appointees with limited financial

[34] Benjamin E Hermalin and Nancy E Wallace, 'The Determinants of Efficiency and Solvency in Savings and Loans' (1994) 25 RAND Journal of Economics 361–81; Donald R. Fraser and Asghar Zardkoohi, 'Ownership structure, deregulation, and risk in the savings and loan industry' (1996) 37 Journal of Business Research 63-69; Benjamin C. Esty, 'Organizational form and risk taking in the savings and loan industry' (1997) 44 Journal of Financial Economics 25-55.

[35] José-Luis Peydró, Andrea Polo, Enrico Sette and Victoria Vanasco, 'Risk Mitigating versus Risk Shifting: Evidence from Banks' Security Trading in Crises' (ECGI Finance Working Paper 713/2020; CEPR Discussion Paper 15473).

[36] See generally de Haan and Vlahu, 'Corporate Governance of Banks'.

[37] Bernadette A Minton, Jérôme P Taillard, and Rohan Williamson, 'Financial Expertise of the Board, Risk Taking, and Performance: Evidence from Bank Holding Companies' (2014) 49 Journal of Financial and Quantitative Analysis 351–80.

expertise, suffered losses three times larger than private banks during 2007–2008.[38] The critical difference was not the presence or absence of a shareholder-value orientation but the capacity to understand the risks being taken. Incompetent boards approved strategies they did not fully understand; competent boards in shareholder-focused institutions understood the risks but pursued them anyway because the governance framework rewarded doing so.

The finding that more independent boards were associated with larger losses during the crisis by Erkens, Hung, and Matos further complicates conventional governance prescriptions.[39] Independence from management, long regarded as a hallmark of good governance, appears to have provided no protection against excessive risk-taking, and may have facilitated it by ensuring that boards were more responsive to shareholder pressure for higher returns.

Research on risk management systems within banks provides more encouraging evidence about the potential for internal governance mechanisms to constrain risk-taking. Ellul and Yerramilli constructed a Risk Management Index (RMI) for the 72 largest US bank holding companies, computed as the first principal component of six variables: whether the bank has a designated Chief Risk Officer with enterprise-wide remit; whether the CRO holds executive rank; whether the CRO is among the five highest-paid executives; the ratio of CRO to CEO compensation (termed "CRO Centrality"); whether independent directors on the board's risk committee have banking and finance experience; and whether the risk committee meets more frequently than average.[40] The descriptive statistics reveal striking variation: while 80 per cent of bank holding companies had a designated CRO, only 40 per cent gave the CRO executive rank, and only 20 per cent placed the CRO among the five highest-paid executives. On average, CRO compensation was just 31 per cent of CEO compensation. In Ellul and Yerramilli's index, CRO Centrality, the relative compensation measure, carries substantial weight, and crisis-period outcomes were driven above all by the overall quality of risk oversight, suggesting that the risk function's organisational standing matters more than the mere presence of a CRO. Banks with higher pre-crisis RMI scores experienced lower tail risk, fewer non-performing loans, and better overall performance during the crisis. Notably, the relationship between risk management quality and outcomes was pronounced during stressed conditions but showed little effect during normal periods, suggesting that robust internal risk controls become especially valuable precisely when they are most needed.

Case study evidence reinforces these findings. The Valukas report on the Lehman bankruptcy documented that senior management routinely overrode risk limits and disregarded risk managers' concerns.[41] In 2007, Lehman removed its CRO and the head of its fixed income division reportedly because of their opposition to management's accumulation of risky and illiquid investments. In the United Kingdom, a parliamentary investigation into the failure of HBOS alleged that its risk officer was made redundant for raising questions about the level and types of risk the bank was assuming.[42] These cases illustrate what

[38] Harald Hau and Marcel Thum, 'Subprime Crisis and Board (In-)Competence: Private versus Public Banks in Germany' (2009) 24 Economic Policy 701–52.

[39] David H Erkens, Mingyi Hung, and Pedro Matos, 'Corporate Governance in the 2007–2008 Financial Crisis: Evidence from Financial Institutions Worldwide' (2012) 18 Journal of Corporate Finance 389–411.

[40] Andrew Ellul and Vijay Yerramilli, 'Stronger Risk Controls, Lower Risk: Evidence from US Bank Holding Companies' (2013) 68 Journal of Finance 1757–803.

[41] Valukas, *Lehman Brothers Examiner Report*.

[42] House of Commons Treasury Committee, Banking Crisis: Dealing with the Failure of the UK Banks (Seventh Report of Session 2008-09, HC 416, 2009) (evidence of Paul Moore); see also House of Commons Treasury Committee, Banking Crisis: Reforming Corporate Governance and Pay in the City (Ninth Report of Session 2008-09, HC 519, 2009).

happens when risk management lacks organisational power: even when risk officers identify problems, they cannot prevent value-destroying strategies if they lack the standing to challenge executive decisions.

These findings highlight a crucial distinction between expertise applied within current governance frameworks and expertise applied within structures that properly align incentives. Sophisticated directors operating under shareholder-centric mandates may rationally encourage risk-taking that benefits equity holders at the expense of creditors and taxpayers: this is the agency cost of debt manifesting at the board level. The same expertise applied within governance structures that incorporated creditor interests might yield more prudent outcomes. The problem is not that banks lack competent directors but that competent directors are given the wrong objectives.

4. Post-Crisis Reforms

The assessment of post-crisis governance reforms reveals a fundamental misdiagnosis: policymakers framed the crisis as a problem of agency cost of equity, conflicts between shareholders and managers, when the fundamental issue in banking is the agency cost of debt: conflicts between shareholders and creditors. This misdiagnosis led to reforms on both sides of the Atlantic that strengthened shareholder control and tightened manager-shareholder alignment, precisely the opposite of what theory prescribes for highly leveraged institutions where shareholders benefit from risk shifting.

The reform agenda treated the crisis as resulting from managerial short-termism, inadequate shareholder engagement, and insufficient alignment between executives and long-term shareholder value. The de Larosière Report in 2009 set the conceptual framework by identifying that financial institutions had acted "in a short-term perspective" and that "the long-term, 'through the cycle' perspective has been neglected." (p.30)[43] This temporal framing, short-term versus long-term, became the foundation for subsequent reforms. Yet as Section 2 demonstrates, the problem is structural, not temporal: shareholders of highly leveraged institutions benefit from volatility regardless of time horizon. A manager with five-year deferred equity compensation still benefits from increased asset volatility; the payoff structure is unchanged, only the timing of realisation differs.

The Walker Review (2009) in the United Kingdom and the European Commission's Green Paper (2010) developed this temporal framing into an explicit diagnosis of agency cost of equity.[44] Walker attributed bank failures to inadequate board oversight and insufficient shareholder engagement, adding "groupthink" as an explanation for why boards failed to challenge management. The prescribed solutions (strengthening shareholder engagement, enhancing say-on-pay, improving remuneration alignment with "long-term shareholder value") all assume that shareholders want prudent management but cannot achieve it. This assumption inverts the actual problem: the evidence reviewed in Section 3 suggests that shareholders were not victims of managerial excess but beneficiaries of risk-shifting strategies they actively encouraged.

The Liikanen Report published in 2012 came closest to the correct diagnosis. It explicitly recognised that "Shareholders and their bank manager agents are effectively holding a call option on the bank's assets, which, given their limited liability, implies that they benefit from the bank's assets becoming increasingly

[43] The High-Level Group on Financial Supervision in the EU (chaired by Jacques de Larosière), Report (Brussels, 25 February 2009).

[44] Walker, Review of Corporate Governance (n 9); European Commission, Green Paper (n 9).

volatile." 51)[45] Yet the report drew no governance conclusions from this insight. Instead, it recommended reforms in the Capital Requirements Directive (CRD) mould: remuneration aligned with "long-term" interests through equity-based compensation, governance focused on shareholder monitoring, and fit-and-proper requirements ensuring directors serve shareholder interests effectively. Having diagnosed the agency cost of debt, the report prescribed solutions designed to address the agency cost of equity.

In the United States, the Dodd-Frank Act passed in 2010 followed the same pattern. John Coffee observed that Dodd-Frank's corporate governance provisions "may work at cross-purposes to the general intent of Dodd-Frank to control systemic risk."[46] The Act empowered shareholders through proxy access (Section 971), say-on-pay mandates (Section 951), and enhanced disclosure requirements, while simultaneously acknowledging in Section 956 that incentive compensation at financial institutions could "encourage inappropriate risks" and "lead to material financial loss." Coffee identified the fundamental contradiction: "because the quickest, simplest way for a financial institution to increase its profitability is to increase its leverage, an enduring tension will exist between regulators and systemically significant financial institutions over the issues of risk and leverage." He noted that "growing evidence suggests that shareholders favored [compensation] formulas to induce managers to accept higher risk and leverage. Shareholder pressure, then, is a factor that could cause the failure of a systemically significant financial institution."

Section 956 of Dodd-Frank, which required regulators to prohibit incentive arrangements that encourage inappropriate risk-taking, represented the one provision that might have addressed the agency cost of debt. Yet fourteen years after enactment, Section 956 remains unimplemented. The Federal Reserve, FDIC, OCC, and other agencies proposed rules in 2011 and again in 2016, but interagency disagreement has prevented finalisation.

The persistence of shareholder-centric thinking is equally evident in European regulation. The Capital Requirements Directive IV (CRD IV) adopted in 2013 and subsequent ECB guidance mandated risk committees, required fit-and-proper assessments for directors and senior managers, and promoted board independence.[47] These reforms address legitimate concerns about board competence but do not alter the fundamental governance problem. Fit-and-proper requirements ensure that directors are qualified to serve shareholder interests; they do not change the interests directors are mandated to serve. The Liikanen Report noted concerns that existing 'fit and proper' tests were inadequate. A director who is fit and proper for maximising shareholder value may be entirely unsuitable for protecting creditors and financial stability.

The ECB's draft Guide on Governance and Risk Culture, published for consultation in July 2024 after Credit Suisse's failure, showed no fundamental reconceptualisation of bank governance. The draft was never finalised; in June 2026 the ECB announced that it would be replaced by a report on good practices.[48] The EBA's remuneration guidelines acknowledge that variable compensation can create a "heads I win, tails I still win" approach that "encourages more risk taking than would likely be preferred by the institution's

[45] Erkki Liikanen, *Liikanen Report* (European Commission 2012).

[46] John C Coffee, 'The Litigation and Corporate Governance Impact of the Dodd-Frank Act' (presentation, Brussels, 25 October 2010); see also John Coffee, 'Systemic Risk after Dodd-Frank: Contingent Capital and the Need for Regulatory Strategies beyond Oversight' (2011) 111 Columbia Law Review 795.

[47] Directive 2013/36/EU (CRD IV); European Central Bank, *Guide to Fit and Proper Assessments* (2021).

[48] European Central Bank, *Draft Guide on Governance and Risk Culture* (July 2024); ECB, 'ECB Streamlines Supervisory Guidance to Improve Clarity and Transparency' (press release, 26 June 2026): 'The Draft guide on governance and risk culture will be replaced by a report focused exclusively on good practices. This publication is planned for the first quarter of 2027, after the revised EBA Guidelines on internal governance have been finalised.'

shareholders or creditors."[49] Yet the prescribed solutions (deferral, equity-based pay, malus and clawback) all operate through temporal mechanisms and serve only shareholder alignment. The guidelines do not explain how aligning management with shareholders will serve creditors whose interests systematically diverge from shareholders in highly leveraged institutions.

The following section examines whether these reforms succeeded in practice despite their conceptual shortcomings. Credit Suisse offers the ideal test case: a globally systemically important bank that adopted every prescribed governance mechanism, whose shareholders actively exercised their enhanced powers, and which maintained capital ratios above regulatory requirements throughout.

5. Credit Suisse: A Case Study in Governance Failure

The collapse of Credit Suisse in March 2023 revealed the consequences of the misdirected reform agenda analysed in Section 4. As FINMA's own post-mortem report acknowledged, the crisis offers "lessons learned", though, as this section demonstrates, the lessons had in fact been identified years earlier but never acted upon.[50] Credit Suisse did not fail for want of governance reforms; the risk of failure was exacerbated by misguided reforms. The bank's shareholder-aligned board pursued precisely the risk-shifting strategies that theory predicts, and that the reforms, by strengthening shareholder control, had made more likely.

This section examines Credit Suisse not as a chronological narrative (that account appears in Appendix B) but as a case study in four interconnected governance failures: the paradox of shareholder alignment, the compensation problem, the board's shareholder orientation, and the limits of reactive supervision. Each failure corresponds to a reform proposed in Section 6.

[49] European Banking Authority, *Guidelines on Sound Remuneration Policies under Directive 2013/36/EU* (2021). Some supervisors argue that post-crisis remuneration reforms, while imperfect, provided useful tools for intervention in specific cases. Independent Chairs of Remuneration Committees have in some instances designed balanced scorecards incorporating risk indicators alongside profitability metrics, resisting shareholder pressure with supervisory encouragement. The question remains whether such successes depend on the particular individuals and circumstances involved rather than on the structural design of the reforms themselves.

[50] Swiss Financial Market Supervisory Authority FINMA, *FINMA Report: Lessons Learned from the CS Crisis* (2023).

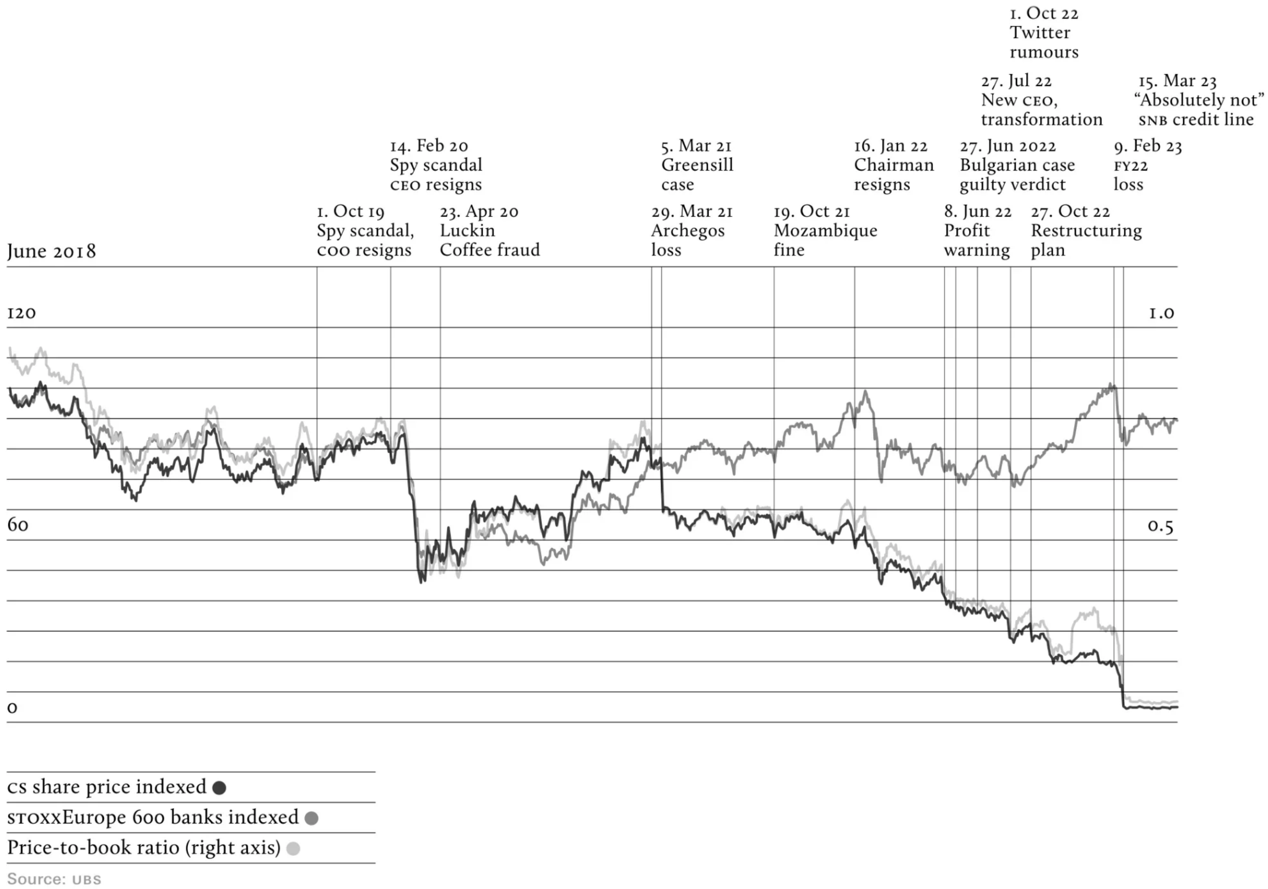

Figure 1. The Demise of Credit Suisse — Credit Suisse share price and price-to-book ratio versus European banking sector, June 2018–March 2023. Source: UBS.

Figure 1 shows the market's evolving assessment of Credit Suisse over the five years preceding its collapse. The pattern is striking. For most of the period, Credit Suisse's share price tracked the European banking sector despite a succession of scandals and governance failures: the spy scandal that cost the chief operating officer and, ultimately, the chief executive their positions, the Luckin Coffee fraud, the Greensill collapse, the $5 billion Archegos loss, and the Mozambique fine. Markets appeared to treat these as isolated incidents rather than symptoms of systemic governance dysfunction. The price-to-book ratio, while declining, remained above 0.5 until late 2022. Only when deposit outflows accelerated following the October 2022 Twitter rumours did markets abruptly reprice the stock, abandoning any expectation that higher risk-taking would generate compensating returns. By March 2023, the share price had collapsed to near zero, a belated recognition that governance failures had destroyed, not created, shareholder value.

5.1 The Shareholder Alignment Paradox

Credit Suisse satisfied the established formal governance requirements imposed by post-crisis reforms. Switzerland's 2013 "Minder initiative" referendum had imposed binding say-on-pay requirements more stringent than those in most jurisdictions, giving shareholders direct control over executive compensation rather than merely advisory input.[51] Credit Suisse shareholders used this power extensively. When the bank posted losses in 2015-2016 during its strategic restructuring, opposition to the remuneration report rose

[51] Alexander F Wagner and Christoph Wenk, 'Binding Say-on-Pay and Shareholder Value' (2026) 15 Review of Corporate Finance Studies 123-57.

sharply, reaching 40% in 2017. The board responded by overhauling its compensation framework to align more closely with "long-term shareholder value," introducing profitability metrics, increased shareholding requirements, and enhanced clawback provisions.

The 2017 reforms exemplify the post-crisis prescription: faced with shareholder dissatisfaction, the board restructured compensation to strengthen alignment with shareholder interests. Return on Tangible Shareholders' Equity and Tangible Book Value Per Share replaced capital adequacy metrics as performance measures. The CEO's minimum shareholding requirement rose from 350,000 to 500,000 shares. Deferral periods were extended. Shareholders approved these reforms, and opposition to compensation votes declined to below 20% in 2018 and 2019.

From a shareholder-centric governance perspective, this was the system working as designed: shareholders expressed dissatisfaction, the board responded, and alignment was strengthened. Yet this "success" contained the seeds of the bank's destruction. The removal of capital adequacy metrics like CET1 ratios from the incentive structure shifted compensation alignment away from the interests of creditors and deposit insurers, who rely on strong capital buffers as protection against bank failure. The reforms made management more responsive to shareholders, precisely the constituency whose interests diverge most sharply from financial stability in highly leveraged institutions.

The consequences of shareholder-aligned governance became apparent in 2021 when Credit Suisse suffered catastrophic losses from two client failures in quick succession. The collapse of Archegos Capital Management in March 2021 resulted in a $5 billion loss for Credit Suisse, the largest among all involved banks. Almost simultaneously, the bank was forced to close four supply chain finance funds linked to Greensill Capital, freezing $10 billion in client assets.

These were not random misfortunes but the predictable consequences of risk-shifting incentives. Credit Suisse's prime brokerage unit had extended concentrated exposure to Archegos far beyond prudent limits, accepting inadequate margin and ignoring warning signals that other banks had heeded. In concluding its enforcement proceedings on the Greensill funds in February 2023, FINMA found that the bank had seriously breached its supervisory obligations “with regard to risk management and appropriate organisational structures”; warnings raised by control functions had gone unheeded. This pattern of aggressive risk-taking enabled by weak risk controls is precisely what theory predicts when management is aligned with shareholders who benefit from volatility.

The shareholder response to these disasters was instructive. At the 2021 annual general meeting, held five weeks after the Archegos default, the board withdrew its proposals on short- and long-term variable compensation and postponed the vote on discharge; the chairman of the risk committee resigned hours before the meeting after major shareholders indicated they would vote against his re-election. The updated 2020 compensation report (re-issued with executive bonuses cancelled) then passed with 82.45 per cent approval. The chairmanship of the board also changed hands at the same meeting. These actions demonstrated that shareholders could and would exercise their governance powers when dissatisfied.

The pattern extends beyond compensation votes: shareholders went on to refuse discharge for the 2020 financial year at the 2022 AGM and re-elected the final board in 2023 on barely more than half the votes represented, with the binding vote on Executive Board fixed compensation rejected outright (see Tables 1 and 3 in Appendix B).

Yet shareholder activism addressed the wrong problem. Shareholders were angry that management had generated losses rather than profits: risk-taking had failed rather than succeeded. Their response was to demand better execution of high-risk strategies, not to question whether such strategies were appropriate. The new chairman launched initiatives to strengthen risk management and corporate culture, but within the same shareholder-value-maximising framework. The bank continued to pay substantial variable remuneration (some CHF 2 billion for 2021 despite the losses) and, defending the reduced CHF 1 billion pool for 2022, the board argued that variable pay remained necessary to retain talent and "protect the business franchise".

5.2 The Compensation Problem

The Credit Suisse case illuminates a fundamental paradox in post-crisis remuneration regulation. FINMA's report documents that Credit Suisse paid out over CHF 33 billion in variable remuneration over ten financial years during which it generated a cumulative net loss of CHF 2.1 billion. The regulator observed that "the development of variable remuneration at CS primarily followed the developments in the market, with business performance only playing a secondary role." Variable pay had become effectively fixed, a guaranteed cost regardless of performance.

This outcome was not the result of shareholder inattention. Credit Suisse shareholders approved each compensation report at the Annual General Meeting. They did so because, from a shareholder perspective, the remuneration structure was rational. Competitive compensation was necessary to attract and retain the traders and bankers who could generate outsized returns. The asymmetric payoff structure, in which management shares in gains but is protected from catastrophic losses by limited liability and the too-big-to-fail backstop, was a feature, not a bug, from the shareholder perspective. It encouraged precisely the risk-taking that shareholders wanted.

FINMA acknowledged its limited ability to intervene. The Swiss remuneration circular permits institutions to deviate from its principles on a "comply or explain" basis, and Credit Suisse consistently provided explanations that FINMA felt unable to reject absent a "sufficiently robust legal basis." The regulator could express concern and apply pressure, but ultimate authority over remuneration rested with shareholders, the constituency least aligned with financial stability.

5.3 The Board's Shareholder Orientation

The Credit Suisse board was not failing shareholders. It was serving them, all too effectively.

FINMA's 2023 report identifies governance failures as central to Credit Suisse's collapse. The report documents that the bank's governing bodies "were unable to remedy the repeatedly identified shortcomings in a sustainable way", and records numerous unplanned changes in the Board of Directors and Executive Board: the Chairman and CEO roles each changed hands twice between 2020 and 2022. The regulator raised concerns about the "tone from the top", risk culture, and inadequate risk management processes.

Yet FINMA's proposed remedies do not address the fundamental governance problem. The regulator recommends introduction of a Senior Managers Regime to ensure clearer allocation of responsibilities and facilitate individual accountability. The attribution of individual responsibilities may strengthen accountability incentives: a major failure in one's area of responsibility affects fitness and propriety assessments, potentially preventing the individual from maintaining or assuming board positions in the future. However, this mechanism still operates reactively: consequences follow only after problems have materialised and been attributed to specific individuals. A Senior Managers Regime would not have altered Credit Suisse's trajectory; the issue was not that no one was accountable for risk-taking, but that the board and management were accountable to shareholders who benefited from risk-taking.

Most tellingly, FINMA explicitly disclaims authority over the governance decisions that mattered most. On strategy, the report states that "the approval and periodic revision of the business strategy and risk policy are among the non-transferable tasks of the Board of Directors" and that Swiss financial market legislation "does not envisage any direct influence by FINMA on the strategy." On corporate governance, FINMA clarifies that "it is not the supervisory authority's role to get actively involved in" the selection of corporate leadership. The regulator acknowledges that "the governing bodies of CS were unable to remedy the repeatedly identified shortcomings" but proposes no change to the governance structure that produced those governing bodies.

This deference reflects the same shareholder-centric assumption that pervades post-crisis regulation: that boards appointed by and accountable to shareholders will serve the interests of financial stability if given appropriate tools and incentives. The Credit Suisse case demonstrates that this assumption is false. The board fulfilled its mandate to shareholders with considerable effectiveness, pursuing strategies that maximised expected shareholder value while transferring risk to creditors, depositors, and Swiss taxpayers.

5.4 The Limits of Reactive Supervision

The slow-burn unravelling of Credit Suisse over a multi-year period exposes the fundamental limitations of the current supervisory approach to bank governance. FINMA's own post-mortem acknowledges that it operated within constraints that effectively ceded agenda-setting power to the bank's board.[52] The supervisor explicitly refused to intercede in strategic decisions: under FINMA's mandate, the board sets business directions, and FINMA responds only after decisions have been taken and problems have materialised. As for board composition, FINMA made clear that "[t]he selection of the Executive Board and submission of proposals for the election of members of the Board of Directors by the Annual General Meeting are among the non-transferable duties of the Board of Directors" and that "[i]t is not the supervisory authority's role to get actively involved in this selection process."[53] FINMA is involved, if at all, only in a second step, during the authorisation process for changes to governing bodies, where it has authority to assess whether proposed candidates meet "fit and proper" requirements. Regarding compensation, FINMA's reactive approach is equally evident: clawback provisions attempt to recover pay after risk shifting has occurred and losses have materialised, but retrieving money already paid is legally difficult, time-consuming, and often unsuccessful.

This reactive approach gives bank shareholders and management structural advantages that supervision cannot surmount. Banks possess vastly greater resources than their supervisors: Credit Suisse deployed hundreds of lawyers, compliance officers, and risk professionals against FINMA's team of approximately forty full-time equivalents, assigned to both Swiss global systemically important banks combined.[54] Bank

[52] These constraints were not merely self-imposed deference but reflected legal limitations under Swiss banking law. Under the *Bankgesetz* and *Finmagesetz*, FINMA could not impose limits on business strategies and business risks until after a declaration of non-viability, despite Basel Pillar 2 contemplating supervisory behaviour control. FINMA explicitly acknowledged that Swiss financial market legislation "does not envisage any direct influence by FINMA on the strategy, or even approval of the strategy." FINMA, *Lessons Learned from the CS Crisis*, 43. This legal framework exemplifies the reactive approach: supervisors gain intervention powers only when it is already too late.

[53] FINMA, *Lessons Learned from the CS Crisis*, 46.

[54] FINMA, *Lessons Learned from the CS Crisis*, 10.

executives face powerful monetary incentives to maximise shareholder value through strategies that may involve risk shifting; supervisors face no comparable countervailing incentives. The information asymmetry is equally stark: banks understand their own businesses, instruments, and daily, rapidly evolving, risk exposures far better than any external supervisor can hope to.[55] Under these conditions, a strategy that relies on supervisors catching up to reverse decisions already taken by well-resourced, highly motivated bank management is unlikely to succeed. The alternative, developed in Section 6, is to move from reactive supervision to preventive governance: restructuring the governance environment itself so that risk-shifting incentives are addressed at their source rather than constrained after the fact.

This characterisation of supervision as uniformly reactive may invite the objection that we focus selectively on failures while ignoring successes. Supervisors at the ECB, Federal Reserve, and Bank of England have in specific cases achieved meaningful governance changes: independent Remuneration Committee Chairs have designed balanced scorecards incorporating risk indicators alongside profitability metrics, sometimes with supervisory encouragement; supervisors have intervened on bonus pools despite management pushback; fit and proper assessments have blocked unsuitable candidates. Some supervisors argue that post-crisis remuneration reforms, while imperfect, have proven to be useful tools for intervention in specific cases. Independent Chairs of Remuneration Committees have of course definitely achieved these rare successes, but they depend on the particular individuals and circumstances involved rather than on the structural design of the reforms themselves, and it is not clear that they can be extended to the whole banking sector. Preventive governance mechanisms, by contrast, operate through incentive alignment: if executives hold bail-in-able debt, they bear the consequences of excessive risk-taking regardless of whether supervisors happen to intervene. The question is not whether reactive supervision ever works, but whether it can reliably prevent risk shifting given structural information asymmetries, resource constraints, and the variability inherent in discretionary intervention.

Credit Suisse's collapse also illustrates the limits of capital requirements as a risk moderation mechanism. The bank did not fail because it was insolvent or lacked equity capital. It was adequately capitalised to the very end. It failed because depositors and clients had lost confidence in Credit Suisse following a succession of governance failures and Credit Suisse's management's seeming inability to steady the ship. The crisis was distinct from a traditional bank run driven by concerns about balance-sheet insolvency. Throughout 2022 and into 2023, the bank was gradually eroding the confidence in management competence, giving rise to what might be termed a "competence run" rather than a solvency run. The Archegos and Greensill episodes had revealed continual risk management failures; the spy scandal had raised questions about management judgment; the succession of CEOs and chairs suggested a board unable to find stable leadership. Depositors and clients concluded that Credit Suisse was simply too risky to deal with, not because its balance sheet was weak, but because its governance was inexorably unfolding, without any effective intervention by supervisors, in an increasingly risky direction. Astonishingly, by all regulatory standards, Credit Suisse was a well-governed bank. Capital requirements, however high, cannot address this form of institutional decay. Preventive governance, placing competent, creditor-aligned decision-makers in positions of authority, offers a more targeted response to governance failures that capital buffers alone cannot prevent.

[55] Even when supervisors do act, banks can delay compliance for years through litigation. The Postfinance case illustrates this dynamic: FINMA required Postfinance to hold additional capital against interest rate risk. Postfinance challenged the ruling in court. Three years were consumed by procedural challenges alone: three rounds of litigation culminating in a Federal Supreme Court decision that FINMA's initial ruling had been issued by the wrong internal body. When FINMA complied with the procedural requirements and reissued the ruling, Postfinance contested again on substance. The Federal Administrative Court finally ruled in FINMA's favour in 2023, approximately six years after the initial supervisory request. Throughout this period, the risks FINMA had identified remained unaddressed.

5.5 A Systemic Pattern

Credit Suisse was not an isolated case. In March 2023, in the days immediately preceding Credit Suisse's rescue, Silicon Valley Bank and Signature Bank failed in the United States - at the time the second and third largest US bank failures in history respectively.[56] The governance deficiencies were strikingly similar. The Board of Governors of the Federal Reserve System found that SVB's "senior leadership failed to manage basic interest rate and liquidity risk" and its "board of directors failed to oversee senior leadership and hold them accountable". SVB operated without a Chief Risk Officer for eight months during 2022, a period when interest rate risk was accumulating rapidly.[57] None of the seven members of SVB's board risk committee had ever held a senior risk management position.[58] Executive compensation emphasised growth and profitability with no effective link to risk outcomes; bonuses were paid to staff hours before the FDIC seized the bank, and executives sold millions of dollars of company stock in the weeks preceding collapse.[59] Signature Bank exhibited comparable weaknesses: the FDIC found that management "did not prioritise good corporate governance practices," key decisions were made by small informal groups of executives without following prescribed processes, and supervisory recommendations went unheeded for years.[60] As at Credit Suisse, shareholders raised no objection: in 2022, SVB's shareholders approved executive pay packages with 89 percent support, and Signature Bank shareholders with 94 percent.[61] In all three cases, boards and management pursued rapid growth without commensurate investment in risk management, precisely the pattern predicted by the agency cost of debt framework when shareholders control governance.

The US regulatory response to SVB and Signature Bank mirrored FINMA's approach to Credit Suisse. The Federal Reserve's Office of Inspector General found that "when interest rates started to rise, SVB did not heed the early signs of market risk, removed its hedges, and had significant unrealized losses on its held-to-maturity investment securities"; the report went on to recommend more assertive supervision.[62] The FDIC attributed Signature Bank's failure to SBNY management prioritizing "aggressive growth over the implementation of sound risk management practices needed to counterbalance the liquidity risk associated with concentrations in uninsured deposits" and proposed new corporate governance guidelines in October 2023.[63] Yet these guidelines follow the familiar post-2008 template: board composition requirements, risk committee structures, Chief Risk Officer reporting lines, and three-lines-of-defence frameworks.

Section 956 of Dodd-Frank, which requires regulators to prohibit incentive arrangements that encourage inappropriate risk-taking, remains unimplemented fourteen years after enactment. When asked in March 2024 whether the Federal Reserve would commit to finalising Section 956, Chairman Jerome Powell responded: "I would like to understand the problem we're solving."[64] This statement, made one year after three major bank failures demonstrated precisely the problem Section 956 was designed to address, illustrates the persistence of regulatory blindness to the fundamental governance challenge in banking.

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[56] Federal Deposit Insurance Corporation, *FDIC's Supervision of Signature Bank* (2023); Board of Governors of the Federal Reserve System Office of Inspector General, *Material Loss Review of Silicon Valley Bank* (2023).

[57] Prarthana Prakash, 'Silicon Valley Bank Had No Official Chief Risk Officer for 8 Months' Fortune (10 March 2023).

[58] Clifford Rossi, 'Silicon Valley Bank: A Failure in Risk Management' GARP Risk Intelligence (14 March 2023).

[59] Congressional Research Service, *Silicon Valley Bank's Failure and Potential Director/Officer Liability* (LSB10946, 2023).

[60] FDIC, *FDIC's Supervision of Signature Bank*, 2.

[61] US Government Accountability Office, *Bank Regulation: Agencies Should Finalize Rulemaking on Incentive Compensation* (GAO-25-107032, 2025).

[62] Board of Governors of the Federal Reserve System Office of Inspector General, *Material Loss Review of Silicon Valley Bank* (2023), 3–4.

[63] Office of Inspector General FDIC, *Material Loss Review of Signature Bank of New York* (2023); FDIC, 'Proposed Guidelines Establishing Standards for Corporate Governance', (2023) 88 Federal Register 70391.

[64] Testimony of Jerome H Powell before the Committee on Financial Services, US House of Representatives (6 March 2024).

The international response has been no different. The Basel Committee's October 2023 report on the "banking turmoil" identified shortcomings in "basic risk management" and supervisory delays in escalating concerns, but proposed no changes to governance standards.[65] The Financial Stability Board's review focused on resolution planning, liquidity backstops, and whether loss-absorbing capacity requirements should extend to non-G-SIBs.[66] The European Commission's Crisis Management and Deposit Insurance reform, while prompted in part by the 2023 failures, addresses resolution mechanics and deposit guarantee fund deployment rather than governance structure.[67] The ECB's 2024 Guide on Governance and Risk Culture similarly refines existing supervisory tools without questioning the shareholder-primacy model at their foundation.[68] The Guide emphasises that governance arrangements should be "commensurate with the bank's size, complexity and risk profile" (10) and that banks should have "a strong management body in its supervisory function which challenges decision-making" (5).[69] These are sensible objectives, but the Guide does not question whose interests the management body should serve. Across all these responses, the assumption remains that better supervision of existing governance arrangements will suffice. The possibility that shareholder-controlled governance is itself the source of excessive risk-taking, the central lesson of both 2008 and 2023, continues to go unacknowledged at the international standard-setting level.

Credit Suisse, SVB, and Signature Bank thus demonstrate both the failure of post-crisis reforms and the failure to learn from that failure. Credit Suisse implemented every governance reform prescribed by regulators. Its shareholders actively exercised their enhanced powers. Its board responded to shareholder concerns by strengthening alignment with shareholder interests. The result was a bank that pursued increasingly risky strategies to generate returns for shareholders, paid substantial compensation regardless of performance, and ultimately collapsed, imposing losses on AT1 bondholders who lost $17 billion, on Swiss taxpayers who provided emergency liquidity, and on the financial system that absorbed the shock of a global systemically important bank's failure. SVB and Signature Bank followed the same pattern on a smaller scale, with the same outcome.

The lesson is clear: shareholder-centric governance does not produce financial stability. Until regulators recognise that the primary governance problem in banking is the agency cost of debt, the conflict between shareholders and creditors, rather than the agency cost of equity, their reforms will continue to miss the target.

6. Practical Reform Solutions

The preceding sections have demonstrated that post-crisis governance reforms were inadequate and incomplete, and that they were largely based on a misdiagnosis of the fundamental agency problem in banking. Policymakers treated the crisis as originating from an agency failure of shareholder-manager alignment, when the evidence points to another agency problem, the shareholder-creditor conflict and the governance challenge in controlling excess risk taking.

The question is therefore how bank governance should be restructured to address risk-shifting incentives

[65] Basel Committee on Banking Supervision, Report on the 2023 Banking Turmoil (October 2023), executive summary.

[66] Financial Stability Board, *2023 Bank Failures: Preliminary Lessons Learnt for Resolution* (2023).

[67] European Commission, *Reform of Bank Crisis Management and Deposit Insurance Framework* (2023).

[68] ECB, Draft Guide on Governance and Risk Culture (July 2024).

[69] ibid 5, 10.

directly. We term the approach developed in this section to address these incentives directly as "preventive governance" to distinguish it from the reactive supervisory model that has dominated post-crisis reform. What we call preventive governance is, in the strict sense used in constitutional adjudication, prophylactic governance: it restructures the environment in which risk shifting might occur rather than policing risky behaviour after the fact.[70]

Banking supervision has, of course, always been forward-looking in aim: capital requirements, fit-and-proper testing, and early-intervention regimes all aspire to prevent failure rather than resolve crises, and capital requirements in particular are meant to create what Hellwig calls "room for intervention" before the bank becomes insolvent.[71] Our distinction is not between different objectives but rather between different kinds of governance instruments. Supervisory instruments act on observed behaviour: they detect, correct and sanction risk-taking after strategies have been chosen. Their implementation can be delayed for years by a well-advised board post strategy adoption, as the Postfinance litigation and the Credit Suisse record in Section 5 illustrate. Preventive instruments, by contrast, shape the environment in which decisions are taken, so that potential risk-taking is adequately assessed and weighed before it is pursued.

Applied to banking, preventive governance means embedding decision-makers with creditor-aligned incentives directly in the governance structure, rather than relying on external supervision to monitor decisions made by shareholder-aligned boards. The fundamental insight is that governance powers should be allocated to those who bear the costs of bank failure (creditors, deposit insurers, and ultimately taxpayers) rather than concentrated in the hands of shareholders who benefit from risk shifting.

We examine four mechanisms that could implement preventive governance: compensation reform using existing debt-like instruments; board nomination and appointment powers for creditor representatives; capital structure reforms that match liability with control; and state equity ownership with enhanced governance rights. These mechanisms are not mutually exclusive; indeed, they can be complementary. The overall recommendation emerging from our analysis is that governance powers should be placed in the hands of deposit insurers (to the extent that these are separate agencies) and whose incentives are most closely aligned with preventing bank failure.

These are not novel or untested concepts. Corporate governance scholarship has long recognised that governance structures must be tailored to the specific agency problems that financial institutions face. The case for more active supervisory involvement in bank strategy was made three decades ago by Hellwig, who argued that "[i]f one looks at prudential supervision of banks as a substitute for monitoring by creditors, one ought to think about monitoring strategies that go more directly to the heart of the matter. This would require supervisory authorities to take a more active part in banks' strategy choices."[72] The mechanisms discussed in this section have been applied and tested in other contexts, including strategic sectors such as defense, aerospace, or nuclear energy, where the state bears significant risk exposure, and could readily be extended to banking. This section examines the four approaches in order of practicality.

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[70] On prophylactic rules in constitutional adjudication, see David A Strauss, 'The Ubiquity of Prophylactic Rules' (1988) 55 University of Chicago Law Review 190-209. The medical usage of prophylaxis carries the same structural sense.

[71] "[A] capital requirement provides the supervisor with room for intervention before the bank becomes insolvent", creating breathing space between the point at which supervisors have a right to intervene and the onset of insolvency. Martin Hellwig, 'Capital Regulation after the Crisis: Business as Usual?' (2010) 8 CESifo DICE Report 40-46.

[72] Martin Hellwig, 'Systemic Aspects of Risk Management in Banking and Finance' (1995) 131 Swiss Journal of Economics and Statistics 723–37, 735. Hellwig noted that "[a]s presently constituted, supervisory authorities are not in a position to do so. They have neither the resources nor the incentives to do more than implement a few simple bureaucratic rules."

6.1 Compensation Reform: Credit Risk-Adjusted Pay

An easily implementable reform involves compensating bank executives with Contingent Convertible bonds (CoCos) or other debt-like instruments in addition to equity-based compensation. The Credit Suisse collapse provides a perfect illustration of why this approach would be effective: AT1 bondholders lost $17 billion (100 per cent loss) when the bank failed, while equity shareholders received some value in the UBS acquisition,[73] and senior management largely retained their accumulated compensation from previous years: the Swiss Federal Department of Finance suspended certain outstanding variable-pay components, but the Federal Council concluded that clawing back bonuses already paid would be unlikely to succeed under current law, and former executives have been able to keep them.[74] Had management been compensated with AT1 instruments, executives would have lost their deferred compensation alongside losses to other AT1 holders, creating alignment between executive wealth and bank stability.

This approach eliminates the "heads I win, tails you lose" incentive structure that characterises equity-based compensation in highly leveraged institutions. This proposed reform would use existing market instruments without requiring new regulations and would represent a simple adjustment of existing compensation structures. It would also help banks meet their regulatory capital requirements since executive compensation would contribute to regulatory capital rather than representing a drain on it. Implementation could begin immediately at individual institutions or be mandated by regulators as part of their compensation oversight.

The relevant regulatory authority already exists in the US. Section 956 of Dodd-Frank requires regulators to prohibit incentive arrangements that encourage inappropriate risk-taking; yet fourteen years after enactment, the provision remains unimplemented. The Liikanen Report similarly recommended that "a share of variable remuneration should be in the form of bail-in bonds." These are not radical proposals requiring new legislation; they are already settled reforms awaiting implementation.

6.2 Board Nomination, Director Elections and Removal

A more fundamental reform would address not merely the incentives of existing decision-makers but also the process by which decision-makers are selected. The current approach relies on shareholders nominating and appointing directors, with supervisory discretion limited to ex post "fit and proper" assessments. Directors understand whom they serve: they are nominated by shareholders, appointed by shareholders, and removable by shareholders. Their loyalty goes to their masters. The existing fit and proper framework, however sophisticated, cannot overcome this structural bias. A fit and proper test is a regulatory requirement that is meant to ensure that directors in key roles have the necessary background in terms of a proven record of honesty, integrity, reputation, competence, capability, and financial expertise. The fit and proper assessment by the ECB, FCA, or national supervisors involves meeting a check list of requirements based on the candidate's background, qualifications, and track record.[75] At best, the presumption is that regulators

[73] The Credit Suisse resolution controversially wrote down AT1 instruments while preserving some value for equity holders, inverting the standard hierarchy of claims. Had management been compensated with AT1 instruments, they would have implicitly been aligned as junior creditors in the UBS takeover.

[74] Swiss Federal Council, Report on Banking Stability (April 2024); 'Former Credit Suisse Executives Can Keep Bonuses' swissinfo.ch (14 April 2024).

[75] The legal framework for fit and proper assessments varies considerably across jurisdictions. Some countries require ex ante supervisory approval before candidates may assume their positions, while others grant supervisors only ex post intervention powers. The ECB has called for harmonisation of the timing of assessments and, in practice, requests advance notification of appointments even in jurisdictions with ex post regimes, enabling

can identify individuals who will exercise independent judgment and resist shareholder pressure towards excessive risk-taking: directors who will behave, in effect, as Maurice Clark's (1916) idealised fiduciaries serving the broader social interest.

This appears promising, but the fit and proper assessment can only go so far. How can regulators determine whether elected directors will resist pressure from those who appointed them? The Credit Suisse directors presumably all passed the fit and proper test. They had all the relevant experience, adequate qualifications, and unblemished reputations. Yet they approved the strategies and compensation structures that led to the bank's collapse. The problem was not that they lacked competence to serve shareholder interests; the problem was that they served shareholder interests all too effectively.

The fit and proper test was no match for the power shareholders had over directors through their nomination, appointment, compensation, and director removal rights. Shareholder nomination and appointment powers fundamentally shape the power dynamics between supervisors and shareholders. If directors were to be nominated or appointed by creditor representatives, they would clearly understand whose interests they represent. They would understand that the continuation of their appointment would depend on serving depositor and financial stability interests. They would bring to the boardroom a perspective that shareholder-nominated directors, however personally virtuous, could not credibly provide. The power to nominate, and more powerfully to appoint and remove directors, is worth more than any number of personality assessments.

How would creditor nomination or appointment rights interact with the shareholder franchise of company law? Three routes exist, in ascending order of legal intrusiveness. The least intrusive is contractual: banks could adopt charters or articles with provisions granting the deposit insurer the right to propose one or more candidates for election to the board by the general meeting of shareholders, a commitment supervisors could encourage under Pillar 2, or attach as a condition to the banking license or to access to public liquidity facilities. The intermediate route is banking law: banking legislation already deviates from general company law in matters of owner suitability, board composition and remuneration;[76] a statutory nomination right for the deposit insurer, with election to the board remaining a requirement, is an incremental extension of an established practice, a *lex specialis* for banks, and requires no reform of general company law. The strongest route is direct appointment to the board along the lines of the French model discussed below, which does require statutory intervention. Our near-term recommendation is the intermediate form: nomination rights, minority representation, shareholder election.

The nearest analogue in the co-determination family is the German experience and it illustrates the feasibility but also the limitations of the concept. On the one hand, half a century of *Mitbestimmung* demonstrates that the appointment of constituency directors is a workable governance model at scale and that who controls the nomination process shapes how appointed directors subsequently behave.[77] On the other hand, the German corporate governance literature documents real costs (board fragmentation, confidentiality frictions), that could be partially avoided through minority rather than parity representation for creditor nominees.[78]

informal engagement before candidates take office. See European Central Bank, *Guide to Fit and Proper Assessments* (December 2021).

[76] For example, the qualifying-holding and fit-and-proper regimes under Directive 2013/36/EU.

[77] Gary Gorton and Frank A Schmid, 'Capital, Labor, and the Firm: A Study of German Codetermination' (2004) 2 Journal of the European Economic Association 863-905.

[78] Hopt, 'Corporate Governance of Banks and Financial Institutions' (n 7) with further references.

Nomination rights do not require the deposit insurer to nominate its own supervisors or employees. The insurer can use the services of executive search firms or maintain a roster of qualified director candidates. A market for such directors is likely to develop, and training can be made available: business schools can be expected to offer courses, and the deposit insurer, perhaps in cooperation with the supervisor, can develop its own. In Germany, the Hans-Böckler-Stiftung already runs courses and produces materials for employee representatives on supervisory boards, a precedent that shows such an infrastructure can be built.[79]

Interestingly, in strategic sectors where the state bears significant risk exposure, governance structures are designed differently and often grant director nomination and appointment powers to other stakeholders than shareholders. Corporate governance at Safran SA, the French aerospace and defense company, illustrates how an alternative nomination model could work.[80]

Under French law, the state may exercise governance powers in companies of strategic importance that exceed its proportional economic ownership.[81] Crucially, the law distinguishes between two types of board representation: directors *appointed* by the state, and directors *nominated* by the state but elected by shareholders at the general meeting. The distinction matters. Appointed directors hold their position by virtue of the state's designation alone; they can be removed by the state without shareholder involvement. A nominated director, by contrast, must secure shareholder election and can be removed by shareholders; the state's power is limited to proposing candidates. The appointed director's loyalty flows unambiguously to the appointing authority; the nominated director occupies a more ambiguous position, formally elected by shareholders but proposed by the state. These powers exist because the state bears risks related to its defense capability, technological sovereignty, and strategic autonomy that exceed its economic stake.[82]

A parallel between defense and banking can evidently be drawn. Deposit insurers and central banks bear risks from bank failures that vastly exceed any economic stake they hold. When Credit Suisse collapsed, Swiss taxpayers were exposed to potential losses of hundreds of billions of francs; the shareholders whose appointed directors had been responsible for the collapse faced losses limited to their equity investment. If the Safran model grants the French state governance powers commensurate with its risk exposure in aerospace, the same logic supports granting deposit insurers, central banks and supervisors governance powers commensurate with their broader risk exposure in banking.

These alternative governance mechanisms are well understood and legally well tested. The stronger form (appointment power) would allow supervisors to place directors on the board whose position depends entirely on the appointing authority, ensuring unambiguous accountability to depositor and financial stability interests.[83] The weaker form (nomination power) would give supervisors the right to propose candidates who must then secure shareholder election, introducing creditor perspectives to the boardroom while preserving shareholder involvement in the final selection. Even the weaker form would represent a significant departure from current practice, where shareholders control both nomination and election.

[79] Hans-Böckler-Stiftung, *Mitbestimmungsportal* (training courses and materials for employee representatives on supervisory boards).

[80] Marco Becht, Juan Mejino-López and Guntram B Wolff, 'Who Controls the Defence Industry?' (Bruegel Working Paper 08/2026).

[81] Specifically, Ordonnance n° 2014-948 of 20 August 2014.

[82] The French precedents that are relevant here are the state-shareholder regimes - Ordonnance n° 2014-948 of 20 August 2014 and the Loi de démocratisation du secteur public of 26 July 1983.

[83] Any expansion of supervisory authority over board composition must be designed to prevent political capture. The experience of Italian banks in the 1980s, where political interference distorted appointment processes, illustrates the risks of vesting appointment powers directly in government actors. The proposals advanced here emphasise representation for creditors and deposit insurers, parties with direct financial exposure, rather than discretionary appointment authority for political actors.

These arrangements need not displace the current shareholder-centric board model entirely; even minority creditor representation would introduce perspectives currently absent from bank boardrooms.

A potential concern with the strong form could be that a supervisor that appoints directors could become co-responsible for the risk-taking strategies adopted by the bank that it must later supervise, compromising the independence of its ex post supervisory role. German law illustrates how far current systems can go without crossing this line: BaFin may attend meetings of a credit institution's supervisory board under the KWG, an information right that stops well short of a governance right.[84] This potential conflict of interest is a principal reason why, to the extent that they are separate entities, it would be best to locate nomination rights with the deposit insurer rather than the going-concern supervisor, so that board membership does not in any way compromise the supervisory function. Granting nomination power to the deposit insurer is also consistent with the debtholder representation argument that unpins the contract theory motivation of prudential supervision.[85]

Corporate governance scholarship and practice confirm that who nominates matters. In employee codetermination systems, worker-nominated directors behave differently from shareholder-nominated directors, not because they have different personalities, but because they represent different constituencies. In state-influenced companies like Safran, state-appointed and state-nominated directors bring perspectives that purely commercially oriented boards would lack. The same imperative would apply to directors appointed or nominated by supervisors on bank boards.

Could creditor-nominated directors raise banks' cost of equity? The value of bank equity includes the value of shareholders' option to shift risk onto the safety net; governance that curtails this option could reduce equity value, but only insofar as it reflects value shifted from the government (through the abuse of the backstop it offers) to shareholders. The repricing would convert an implicit public subsidy into a visible private cost, exactly as higher capital requirements do,[86] and it should be evaluated the same way: the relevant question is not whether shareholder value falls, but whether socially costly strategies become privately unprofitable. The ex ante effects are in any case less clear-cut, since shareholders themselves may gain from being able to commit in advance not to take excessive risks ex post.

The failure to apply preventive governance to banks is also an institutional failure in asset management. Universal owners, such as the Norwegian Government Pension Fund Global (GPFG) or the Japanese Government Pension Investment Fund (GPIF), hold global equity and bond portfolios that include banks and non-bank companies. The value of their holdings would be greatly diminished by a financial crisis, so they have a direct incentive to treat banks separately and to apply preventive corporate governance as part of their active ownership programs. There is no evidence that they do so. GPFG was one of Credit Suisse's largest shareholders: its year-end equity stake ranged between 4.3 and 5.7 per cent from 2013 to 2019 and stood at 3.4 per cent in 2020. The fund was simultaneously a substantial creditor, holding Credit Suisse debt securities worth between USD 0.5 billion and 1.4 billion at every year-end from 2008 to 2022, including USD 0.9 billion at the end of 2022, months before the bank failed.[87] Yet it never nominated a candidate for the board or filed a shareholder proposal, and its published voting records show support for every substantive

[84] § 44(4) KWG (right to send representatives, with the right to speak, to meetings of an institution's supervisory organs); § 44(7) KWG (right to require such meetings to be convened).

[85] Dewatripont and Tirole (n 5).

[86] Admati and Hellwig (n 4).

[87] Norges Bank Investment Management, annual holdings disclosures, 2008-2022, nbim.no.

management proposal from 2013 until 30 April 2021, weeks after the Greensill and Archegos losses had crystallised, when it opposed the re-election of six directors including the risk committee chair. Even thereafter it voted for every remuneration report through April 2023, and its opposition to the chairman and long-tenured directors came only at the April 2023 AGM, after the rescue by UBS. The fund acted, but from the perspective of a single shareholding and only after losses had materialised: reactively sanctioning the board that had already failed rather than intervening in a preventive way.[88]

6.3 Capital Structure Reform: Extended Liability

Before turning to contemporary proposals, it is worth recalling that the oldest answer to the Jensen-Meckling excess-risk taking problem in banking was to extend shareholder liability. From 1863 until the reforms of the 1930s, shareholders of US national banks, and of most state banks, were subject to double liability: in the event of failure they could be assessed up to the par value of their shares, in addition to losing their investment.[89] British banks went further for much of the nineteenth century, operating with unlimited or reserve liability.[90] The evidence is that extended liability worked as theory predicts: banks in double-liability regimes took less risk, and New England banks whose managers bore greater personal liability were run conservatively.[91]

Why, then, was extended liability abandoned, and what does its demise teach us? Three sources of problems recur in the historical record, and each constrains any modern revival of this solution. The first is that extended liability is only worth what shareholders can actually pay: assessments proved hardest to collect precisely in systemic crises, when they were most needed; the 1878 failure of the City of Glasgow Bank, which bankrupted the vast majority of its unlimited-liability shareholders, remains the canonical illustration.[92] The second is that, as bank shares diffused to investors of modest means, liability came to rest on "widows and orphans" who neither controlled nor understood bank risk. The third is that wealthy investors can interpose limited-liability vehicles between themselves and the liability. All three of these considerations meant that unlimited-liability banks needed to restrict share transfers and vet new owners. These issues bind even more tightly today, when bank equity is held overwhelmingly through mutual funds, index funds and pension vehicles: blanket double liability would ultimately be borne by diversified households, while leaving the executives and activist blockholders who actually drive risk decisions underexposed. Extended liability is, moreover, not a costless corrective: it is ultimately incompatible with the anonymous public trading of shares in liquid secondary markets, and litigation over shareholder assessments raises the same enforceability concerns as litigation over officer liability or clawback arrangements. The historical record and the development of modern capital markets have tilted the balance

[88] Norges Bank Investment Management, voting records, nbim.no; Stephen Morris, Owen Walker and Tabby Kinder, 'Credit Suisse Shareholders Seek Removal of Risk Chief after Twin Scandals' *Financial Times* (25 April 2021); Patrick Winters, 'Credit Suisse Top Holders Seek to Oust Directors Over Archegos' *Bloomberg* (26 April 2021).

[89] Jonathan R Macey and Geoffrey P Miller, 'Double Liability of Bank Shareholders: History and Implications' (1992) 27 Wake Forest Law Review 31; Richard S Grossman, 'Fear and Greed: The Evolution of Double Liability in American Banking, 1865-1930' (2007) 44 Explorations in Economic History 59-80.

[90] John D Turner, Banking in Crisis: The Rise and Fall of British Banking Stability, 1800 to the Present (CUP 2014); Charles R Hickson and John D Turner, 'The Trading of Unlimited Liability Bank Shares in Nineteenth-Century Ireland: The Bagehot Hypothesis' (2003) 63 Journal of Economic History 931-58.

[91] Richard S Grossman, 'Double Liability and Bank Risk Taking' (2001) 33 Journal of Money, Credit and Banking 143; Benjamin C Esty, 'The Impact of Contingent Liability on Commercial Bank Risk Taking' (1998) 47 Journal of Financial Economics 189-218; Peter Koudijs, Laura Salisbury and Gurpal Sran, 'For Richer, for Poorer: Bankers' Liability and Bank Risk in New England, 1867 to 1880' (2021) 76 Journal of Finance 1541-99. See also Felipe Aldunate, Dirk Jenter, Arthur Korteweg and Peter Koudijs, 'Shareholder Liability and Bank Failure' (working paper).

[92] Graeme G Acheson and John D Turner, 'The Death Blow to Unlimited Liability in Victorian Britain: The City of Glasgow Failure' (2008) 45 Explorations in Economic History 235.

towards the liquidity and capital-raising benefits of freely traded bank shares.

A complementary approach operates through the capital structure itself. Goodhart and Lastra propose a system with two classes of equity holders: "insiders" with information about and power to influence managerial decisions, and "outsiders" without such powers.[93] The key innovation they propose is that insiders (including senior executives, board members, activist shareholders with board representation, and potentially auditors and advisers) would face enhanced personal liability for losses in the event of bank failure.

Their proposal addresses a fundamental unfairness in the current system. When a financial crisis occurs, workers, trade creditors, depositors, and small investors may face substantial losses, while senior managers often "walk away relatively unscathed."[94] The Credit Suisse collapse exemplifies this asymmetric outcome: executives largely retained accumulated compensation, since clawbacks proved legally unenforceable, while AT1 bondholders lost everything. A two-tier system would align liability with power, ensuring that those with decision-making authority and privileged information bear personal financial consequences commensurate with their influence on bank risk shifting.

This two-tier shareholder/director structure has advantages over incremental reforms such as clawback provisions or deferred compensation. Claw-backs apply only to a proportion of pay for a small number of senior managers. Moreover, they are difficult to implement; two-tier equity could extend to anyone with material influence over bank decisions, including activist shareholders who exert pressure to increase leverage, dividend payouts, and risk shifting.

Goodhart and Lastra acknowledge that their proposal is "more complex and far reaching" than incremental alternatives, but argue that it is "capable of inducing major changes to the structure and perception of capitalism, if that was what a democratic society wanted."[95] The question is whether the recurring pattern of banking crises, taxpayer bailouts, and wealth transfers from creditors to shareholders has generated sufficient political demand for fundamental reform.

Seen against this history, two-tier equity is best understood not as an alternative to double liability but as its modified modern form. By confining extended liability to insiders, meaning those with information about, and power over, managerial decisions, it concentrates liability where it can be enforced, on parties who can bear it, and on those whose decisions are the source of the risk, remedying in one stroke the three failures that killed the historical regimes: liability that could not be collected in a crisis, liability that fell on those who could neither bear nor control the risk, and liability that sophisticated investors could structure around. The compensation proposal in Section 6.1 is the same idea applied to managers: pay in the form of AT1 instruments imposes on executives the extended liability that double liability tried, and failed, to impose through the share register. Compensation reform would be much easier to implement.

6.4 State Equity Ownership with Enhanced Governance Rights

The most direct approach to implementing the preventive bank governance approach would have the state take equity positions in systemically important banks, with governance rights exceeding proportional

[93] CAE Goodhart and RM Lastra, 'Equity Finance: Matching Liability to Power' (2020) 6 Journal of Financial Regulation 1.

[94] ibid 12.

[95] ibid.

ownership. This approach has surface appeal: it would give the state, as ultimate guarantor of financial stability, direct voice in the institutions whose failure it is exposed to. However, state ownership and control of banks carry significant risks that the other reform mechanisms avoid.

These risks are illustrated by the numerous German *Landesbanken* failures in the global financial crisis. These state-owned institutions with public-interest mandates have been responsible for spectacular governance and risk-management failures, including heavy exposures to US subprime mortgages.[96] State ownership did not prevent incompetent management or excessive risk-taking; in some cases, political interference in board appointments may even have contributed to poor governance.

The question which agency would manage state ownership stakes further complicates the matter. State holding companies or sovereign wealth funds may lack the specialised competence required to oversee complex banking institutions. They may also face conflicting mandates: post-crisis nationalised banks have often been managed by agencies that have been instructed to maximise shareholder value and prepare the institution for re-privatisation, which creates precisely the wrong incentives. Even large, diversified state pension funds that should theoretically have an interest in preventing risk shifting, since their beneficiaries bear the costs when bank failures damage the broader economy, in practice report returns on equity and face pressure to match private-sector investment performance.

State ownership also creates risks of politicisation that could end up creating more problems than those it aims to solve. Political pressure to direct lending toward favoured constituencies, to maintain employment in particular regions, or to avoid difficult decisions before elections could compromise bank governance as severely as shareholder pressure for short-term returns.

The politicisation risk is not hypothetical; it is one of the more robust findings in the empirical banking literature. State-owned banks lend at lower rates to firms in regions where their political patrons are strong, and their lending expands measurably in election years.[97] The Landesbanken example mentioned above is an instance of a more general pattern, not just a German idiosyncrasy: Spanish savings banks (cajas) chaired by political appointees, or by chairmen without banking experience or postgraduate education, had significantly worse loan performance.[98]

If state equity ownership is nonetheless pursued, for instance in the aftermath of a rescue when the state already holds equity, the design conditions follow from the risks we have just catalogued: the stake should be held by an independent mandate-holder at arm's length from the treasury; its statutory objective should be confined to solvency and financial stability, not returns or industrial policy; nominee directors should meet the same fit-and-proper standards as any other director, with appointments insulated from electoral cycles; and exit should follow a pre-committed, rule-based path.

The British experience after 2008 shows what could happen otherwise. Following the rescues of Royal

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[96] The German experience has led some scholars to express scepticism about supervisory board representation. See Hellwig, 'Systemic Aspects of Risk Management', 735, noting concerns about supervisors' resources and incentives. The lesson is not that supervisory involvement is inherently flawed, but that supervisors exercising governance powers need appropriate skills, seniority, and institutional backing, including the capacity to work closely with the bank's risk management function. Political appointees without relevant expertise, as characterised some *Landesbanken* supervisory boards, see Hau and Thum (n 38), are not what we propose.

[97] Paola Sapienza, 'The Effects of Government Ownership on Bank Lending' (2004) 72 Journal of Financial Economics 357; I Serdar Dinç, 'Politicians and Banks: Political Influences on Government-Owned Banks in Emerging Markets' (2005) 77 Journal of Financial Economics 453.

[98] Vicente Cuñat and Luis Garicano, 'Did Good Cajas Extend Bad Loans? Governance, Human Capital and Loan Portfolios' in Samuel Bentolila, Michele Boldrin, Javier Díaz-Giménez and Juan J Dolado (eds), The Crisis of the Spanish Economy: Economic Analysis of the Great Recession (FEDEA 2010)..

Bank of Scotland and Lloyds, the government ended up as the dominant shareholder, and its stakes were managed by UK Financial Investments under a mandate framed in terms of 'protecting and creating value for the taxpayer as shareholder', with financial stability relegated to a matter of 'due regard'.[99] Inevitably the performance of these banks has been judged in terms of the shareholder returns to "taxpayers". The conflict between shareholders and depositors therefore survived nationalisation: the state as owner stepped into the shareholders' shoes. This is a further argument for placing preventive governance with the deposit insurer rather than with the state as shareholder. Nomination rights for the deposit insurer deliberately pit one arm of government against another, and they give the supervisor an ex-ante ally inside the boardroom. These conditions are demanding, which is why the evaluation below ranks the state ownership option behind board nomination rights for deposit insurers.

6.5 Evaluation

The preceding analysis suggests that among the reform mechanisms examined, board appointment and nomination powers represent the most direct and cost-effective route to improving bank governance. Compensation reform using CoCos addresses management incentives but leaves unchanged the shareholder-centric board that sets strategy and approves risk-taking. Capital structure reforms such as Goodhart and Lastra's two-tier equity would align liability with power but require fundamental changes to corporate law and market practice. State equity ownership introduces risks of politicisation and depends on identifying agencies with appropriate competence and incentives, a condition that historical experience suggests is difficult to satisfy. Board representation, by contrast, addresses the problem at source: it places decision-makers with creditor-aligned incentives directly in the room where strategy is set and risk-taking is approved.

The question then becomes: which agency should exercise these governance powers? Any agency that is granted these powers must satisfy three conditions. First, its incentives must be aligned with preventing bank failure rather than with maximising shareholder returns. Second, it must possess the staff and competence to nominate suitable external candidates who will play the assigned roles in preventive bank governance. Third, it must be sufficiently independent from political pressure to resist demands that could compromise the choice of candidates.

Among the natural existing agencies, the deposit insurance agency (with its supervisory role) emerges as the most suitable. The deposit insurer's incentives are directly aligned with preventing bank failure. Unlike shareholders, who benefit from upside risk while bearing limited downside, the deposit insurer bears the costs when banks fail and gains nothing when risk-taking succeeds. Unlike state holding companies managing ownership stakes, the deposit insurer has no mandate to maximise shareholder returns or prepare banks for privatisation. Unlike pension funds, the deposit insurer does not report returns on equity or face pressure to match private investment performance. The deposit insurer's institutional purpose is to protect depositors and maintain financial stability, precisely the objectives that current governance structures fail to serve.

The deposit insurer also has the relevant expertise. Agencies such as the FDIC in the United States employ staff with expertise in bank supervision, resolution planning, and risk assessment. They understand bank balance sheets, capital structures, and the mechanisms through which risk shifting occurs. This expertise

[99] UK Financial Investments Ltd, *Framework Document* (2016) s 4.1. UKFI managed the government's shareholdings in Royal Bank of Scotland and Lloyds Banking Group from 2008 until its absorption into UK Government Investments in 2018.

would translate directly to choosing and evaluating board nominees and board members.

An objection might be raised that not all jurisdictions have deposit insurance agencies with the institutional capacity of the FDIC. In some countries, deposit guarantee agencies are thinly staffed. The European Union operates a patchwork of national deposit guarantee schemes along with a single supervisory system for the largest banks. How can deposit insurers exercise governance powers if they lack the institutional infrastructure to do so?

This objection, however, identifies a problem requiring solution rather than a reason to abandon the approach. If deposit insurance agencies in some jurisdictions lack the capacity to exercise governance powers over banks, that is an argument for building such capacity, not for leaving governance powers exclusively in shareholder hands. The logic that justifies deposit insurance in the first instance, that depositors cannot effectively monitor bank risk-taking and require institutional protection, equally justifies giving the protecting institution meaningful governance voice. A deposit insurance system that pays out when banks fail but that has no role in preventing bank failure is incomplete. The absence of a capable deposit insurance agency should motivate the creation of such an agency, rather than acceptance of the status quo.

Indeed, the governance role could provide the catalyst for institutional development. An agency tasked merely with administering a guarantee fund has limited need for sophisticated analytical capacity. An agency responsible for supervision and nominating or appointing powers of directors to bank boards, monitoring their performance, and exercising removal powers where necessary requires deeper expertise: expertise that would also enhance the agency's effectiveness in its other functions, including resolution planning and risk-based insurance premium setting.

The reforms proposed in this section are not mutually exclusive. CoCo compensation could be implemented immediately while longer-term governance reforms are developed. Board nomination rights for deposit insurers could complement rather than replace capital structure reforms. The choice is not between perfect solutions but between continuing to pursue approaches that have repeatedly failed and implementing practical reforms that address the structural sources of bank risk-shifting behaviour.

7. Conclusion

The collapse of Credit Suisse confirms what theory has long predicted: governance structures designed to align management with shareholders produce excessive risk-taking in highly leveraged institutions where shareholders benefit from upside gains while creditors, deposit insurers, and taxpayers bear downside losses. Post-crisis reforms failed not because they were poorly implemented but because they were founded on a misdiagnosis. The problem in banking is not the agency cost of equity, the divergence between shareholder and management interests, but the agency cost of debt: the divergence between shareholder interests and those of creditors and society.

Credit Suisse provided a definitive test of the post-crisis governance agenda. The bank adopted the complete reform toolkit: every mechanism that regulators prescribed to prevent excessive risk-taking. Its shareholders actively exercised their enhanced governance powers. Yet the bank collapsed following precisely the risk-shifting pattern that theory predicts and that governance reforms were ostensibly designed to prevent. The reforms strengthened shareholder control; the board decided on a risky strategy to generate high returns for shareholders; when initial projects failed, risk taking became risk shifting; and risk shifting destroyed the bank.

In its post-collapse report, FINMA recited the litany of its own limitations: how boards of directors are structured, boards nominate board members, regulators assess fitness and propriety only after candidates have been proposed. The supervisor's role is to inspect and ratify ex post. This reactive approach failed at Credit Suisse, as it had failed before, and is likely to fail again so long as governance structures leave agenda-setting power in the hands of those whose interests diverge from financial stability.

The path forward requires abandoning the shareholder-centric paradigm that has dominated post-crisis reform in favour of preventive governance: structures that address risk-shifting incentives ex ante rather than attempting to constrain their consequences after the fact. Effective solutions exist and are practically implementable. Compensating executives with contingent convertible bonds rather than equity would align management incentives with bank stability using existing market instruments. Granting deposit insurers the power to nominate or appoint directors would place creditor-accountable decision-makers in the room where strategy is set and risk-taking is approved. These reforms do not require new legislation, fundamental revision of corporate law, or politically impossible changes to banking structure. They require only the recognition that banks are not ordinary corporations and cannot be governed as if they were.

The agency cost of debt has been understood since Jensen and Meckling identified it in 1976. The application to banking has been clear since the financial crisis laid bare the consequences of ignoring it. The question is no longer whether the diagnosis is correct but whether policymakers will act on it, or whether another crisis will be required before the lessons, still not learned, are finally implemented.

Appendix A — Post-Crisis Regulatory Response

This appendix provides a detailed assessment of the governance reforms implemented following the 2008 financial crisis in both Europe and the United States. The analysis demonstrates that policymakers on both sides of the Atlantic made the same fundamental error: diagnosing the crisis as a failure of shareholder-manager alignment when the evidence pointed to shareholder-creditor conflict as the primary governance problem.

A.1 The European Reform Trajectory

A.1.1 The de Larosière Report

The de Larosière Report, published in 2009, was commissioned by the European Commission in October 2008 and the first major post-crisis inquiry to address bank governance.[100] The High-Level Group, chaired by former IMF Managing Director Jacques de Larosière, was tasked with advising on how to strengthen European supervisory arrangements, with a view to protecting citizens and rebuilding trust in the financial system.

The report identified corporate governance as "one of the most important failures of the present crisis." It alleged that management took excessive risk, non-executive directors failed to stand in the way, boards and senior managers neither comprehended complex financial products nor understood their companies' total risk exposure, and shareholders neglected their monitoring role. The diagnosis emphasised temporal rather than structural problems: "the financial system at large did not carry out its tasks with enough consideration for the long-term interest of its stakeholders" and "most of the incentives… encouraged financial institutions to act in a short-term perspective."

The de Larosière Report's Recommendation 11 stated that "compensation incentives must be better aligned with shareholder interests and long-term firm-wide profitability" through three mechanisms: multi-year bonus assessment spreading payments over the cycle, application of the same principles to proprietary traders and asset managers, and ensuring bonuses reflect actual rather than guaranteed performance. The report recommended that supervisors "oversee the adequacy of financial institutions' compensation policies" and use Pillar 2 capital requirements as a sanction for non-compliance.

The de Larosière framing was subtle but consequential. By conceptualising the problem temporally (short-termism versus long-termism) rather than structurally, it set the stage for reforms that would extend time horizons without addressing the fundamental payoff asymmetry between shareholders and creditors. The assumption that "long-term shareholder interests" are compatible with financial stability does not hold for highly leveraged institutions where shareholders benefit from volatility regardless of time horizon.

A.1.2 The Walker Review

The Walker Review was commissioned by the UK government in February 2009 to examine corporate governance in UK banks and other financial institutions.[101] Sir David Walker, a former executive director of the Bank of England, produced 39 recommendations, colloquially known as the "39 Steps", focusing on

[100] High-Level Group Report (n 43).

[101] Walker, Review of Corporate Governance (n 9).

board effectiveness, institutional shareholder engagement, remuneration, and risk governance.

Walker's diagnosis differed from de Larosière in one important respect: it introduced "groupthink" as a central explanation for governance failures. Drawing on concepts promoted by the Tavistock Institute, the review suggested that boards failed to challenge management due to psychological dynamics within the boardroom rather than structural incentive problems. This framing implied that the solution was better board composition and dynamics, not fundamental changes to the governance mandate.

The Walker Review's prescriptions reinforced shareholder primacy. The review called for enhanced engagement between institutional investors and boards, strengthened stewardship codes, improved disclosure of voting records, and more effective communication between shareholders and boards on strategy and risk. The underlying assumption was that shareholders wanted prudent management but were unable to achieve it due to coordination problems and information asymmetries. There was no evidence presented that shareholders had in fact opposed risk-taking; the review simply assumed they would have done so if properly engaged.

A.1.3 The European Commission Green Paper

The European Commission's Green Paper on Corporate Governance in Financial Institutions and Remuneration Policies, published in June 2010, drew explicitly on the de Larosière Report. The Green Paper acknowledged that "confidence in the model of the shareholder-owner who contributes to the company's long-term viability has been severely shaken, to say the least." It noted that shareholders "sometimes seem to show little interest in the long-term governance objectives" of financial institutions and "may be responsible for encouraging excessive risk-taking."

Despite these observations, the Green Paper identified three reform priorities that reinforced shareholder primacy: strengthening board responsibilities in risk oversight, aligning remuneration practices more closely with long-term shareholder value, and enhancing transparency and shareholder engagement. The Green Paper attributed excessive risk-taking to shareholders with "short, or even very short (quarterly or half-yearly) investment horizons," treating this as a problem of insufficient long-term orientation rather than a structural conflict between shareholders and other stakeholders.

The Green Paper did acknowledge the interests of other stakeholders, stating that "in the financial services sector, corporate governance should take account of the interests of other stakeholders (depositors, savers, life insurance policy holders, etc), as well as the stability of the financial system." It even considered "the creation of a specific duty for the board of directors to take account of the interests of depositors and other creditors in their decision-making." However, these considerations remained subordinate to the shareholder-centric framework, and no concrete governance powers were proposed for creditors or deposit insurers.

A.1.4 The Liikanen Report

The High-Level Expert Group on Reforming the Structure of the EU Banking Sector, chaired by Erkki Liikanen, Governor of the Bank of Finland, was established in February 2012 to investigate whether structural reforms of EU banks were needed. The final report, published in October 2012, devoted an entire subsection to ownership and corporate governance.[102]

The Liikanen Report came closest to the correct diagnosis. It explicitly recognised the risk-shifting dynamic: "Shareholders and their bank manager agents are effectively holding a call option on the bank's assets, which, given their limited liability, implies that they benefit from the bank's assets becoming increasingly volatile." The report acknowledged that "even with improved remuneration incentive structures, management and staff face limited downside risk due to limited liability" and that creditors have "limited incentives to monitor the banks, because of the explicit guarantee of deposits as well as the implicit guarantees that seemingly continue to apply to the debt of systemically important banks."

Yet the Liikanen Report drew no governance conclusions from this diagnosis. Having identified shareholders' call option on bank assets, the report nonetheless recommended remuneration aligned with "long-term" interests through equity-based compensation, governance focused on shareholder monitoring, and fit-and-proper requirements. The report did recommend that "a share of variable remuneration should be in the form of bail-in bonds," which would have addressed risk-shifting incentives by aligning management compensation with creditor interests. However, this recommendation was not implemented in subsequent legislation. The disconnect between the report's analytical sophistication and its policy conclusions remains striking.

A.1.5 The Capital Requirements Directives (CRD III, CRD IV, and CRD V)

The Capital Requirements Directives translated the policy conclusions of the post-crisis reports into binding EU law.[103] CRD III (2010) introduced the first comprehensive remuneration requirements, including limits on guaranteed bonuses, requirements for deferral and payment in instruments, and malus and clawback provisions. CRD IV (2013) added the controversial bonus cap (limiting variable remuneration to 100% of fixed pay, or 200% with shareholder approval), strengthened requirements for risk committees and Chief Risk Officers, and enhanced fit-and-proper assessments for directors and senior managers.

CRD V (2019) refined these requirements further, extending deferral periods for senior staff to five years and broadening the application of the requirement, introduced under CRD IV, that at least 50% of variable remuneration be paid in shares, share-linked instruments, or other qualifying instruments. The Directive also introduced specific provisions for institutions identified as global systemically important (G-SIIs).

A.1.6 Board Structure and Fit-and-Proper Requirements

CRD IV introduced substantial requirements for board composition and director qualifications. Significant institutions were required to establish dedicated risk committees composed of non-executive directors with adequate knowledge, skills, and expertise to understand and monitor the bank's risk strategy. The Directive imposed limits on the number of directorships that board members could hold simultaneously, recognising that overboarded directors cannot devote sufficient attention to complex banking institutions.

The fit-and-proper framework, developed through joint EBA and ESMA guidelines and implemented through national supervisory authorities, requires assessment of directors' reputation, experience, independence of mind, and time commitment. The ECB's Guide to Fit and Proper Assessments operationalises these requirements for significant institutions in the Banking Union, establishing detailed

[102] Liikanen Report (n 45).

[103] European Commission, Directive 2010/76/EU (CRD III); Directive 2013/36/EU (CRD IV); Directive (EU) 2019/878 (CRD V).

criteria for evaluating director suitability.[104]

These reforms address legitimate concerns about board competence, but they do not alter the fundamental governance problem. Fit-and-proper requirements ensure that directors are qualified to serve shareholder interests effectively; they do not change the interests directors are mandated to serve. The Liikanen Report noted concerns that existing 'fit and proper' tests were inadequate. A director who passes fit-and-proper assessment for maximising shareholder value may be entirely unsuitable for protecting creditors and financial stability. The requirements assume that competent directors pursuing shareholder value will produce prudent outcomes, an assumption that the theoretical framework in Section 2 demonstrates is false for highly leveraged institutions.

Similarly, requirements for board independence address independence from management, not independence from shareholder interests. Independent directors are expected to challenge executive decisions, but within a framework that takes shareholder primacy as given. The empirical evidence reviewed in Section 3, showing that more independent boards were associated with larger crisis losses, suggests that independence from management may actually facilitate rather than constrain risk-taking when independent directors serve shareholder interests.

Throughout this evolution, the fundamental framework remained unchanged: remuneration was to be aligned with "long-term" shareholder value through equity-based instruments, boards were to be composed of competent directors serving shareholder interests, and governance was to be strengthened through shareholder-centric mechanisms. The EBA Guidelines on Sound Remuneration Policies (2021) acknowledged that variable compensation can create a "heads I win, tails I still win" approach that "encourages more risk taking than would likely be preferred by the institution's shareholders or creditors." Yet the prescribed solutions (deferral, equity-based pay, malus and clawback) all operate through temporal mechanisms and serve only shareholder alignment.

A.1.7 The ECB Guides

The ECB Guide to Fit and Proper Assessments and the Guide on Governance and Risk Culture represent the current state of supervisory thinking in the Banking Union.[105] The 2024 Guide, published after the Credit Suisse collapse, emphasises that governance arrangements should be "commensurate with the bank's size, complexity and risk profile" and that banks should have "a strong management body in its supervisory function which challenges decision-making."

These are sensible objectives, but the Guide does not question whose interests the management body should serve. The implicit assumption throughout is that effective governance means serving shareholder interests effectively, precisely the framework that theory and evidence suggest produces excessive risk-taking in banking. The Guide's discussion of risk culture, while sophisticated, operates entirely within a shareholder-centric paradigm. There is no mention of creditor representation, debtholder governance rights, or structural changes to address the agency cost of debt.

A.2 The United States: Dodd-Frank

[104] ECB, *Guide to Fit and Proper Assessments.*

[105] ECB, Draft Guide on Governance and Risk Culture (July 2024); ECB, *Guide to Fit and Proper Assessments.*

A.2.1 Overview

The Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted in July 2010, represents the most significant revision of US financial regulation since the 1930s. The Act contains 390 rulemaking requirements and addresses systemic risk regulation, consumer protection, derivatives reform, and numerous other topics. Its corporate governance provisions apply to all US public companies, not just financial institutions, but have particular significance for bank governance.

John Coffee, in his analysis of Dodd-Frank's implications for systemic risk, observed that the Act's corporate governance provisions "may work at cross-purposes to the general intent of Dodd-Frank to control systemic risk." The Act simultaneously empowers shareholders through proxy access, say-on-pay, and enhanced disclosure, while acknowledging in Section 956 that incentive compensation at financial institutions can encourage inappropriate risks. This tension reflects the same misdiagnosis evident in European reforms: treating the crisis as a failure of shareholder-manager alignment rather than recognising it as the predictable consequence of shareholder-creditor conflict.

A.2.2 Shareholder Empowerment Provisions

Section 971 of Dodd-Frank authorised the SEC to adopt proxy access rules enabling shareholders to include director nominees in company proxy materials. The SEC responded by adopting Rule 14a-11, which would have allowed shareholders holding at least 3% of voting stock for at least three years to nominate up to 25% of board seats through the company's proxy statement. Although Rule 14a-11 was vacated by the DC Circuit Court in 2011 (*Business Roundtable v. SEC*), the provision signalled Congress's intent to strengthen shareholder control over boards.

Section 951 mandated say-on-pay votes, requiring public companies to provide shareholders with a non-binding vote on executive compensation at least every three years. Section 952 required fully independent compensation committees with authority to retain their own advisers. Section 957 prohibited broker voting on director elections, executive compensation, and other significant matters without express shareholder instructions, a change that strengthened the influence of institutional investors relative to retail shareholders whose brokers had previously voted their shares.

These provisions assume that empowering shareholders will improve corporate governance. As Coffee argued, this assumption is problematic for financial institutions: "because the quickest, simplest way for a financial institution to increase its profitability is to increase its leverage, an enduring tension will exist between regulators and systemically significant financial institutions over the issues of risk and leverage." He presented evidence that "shareholders favored [compensation] formulas to induce managers to accept higher risk and leverage. Shareholder pressure, then, is a factor that could cause the failure of a systemically significant financial institution." Yet Dodd-Frank prescribed more shareholder-friendly governance as the solution.

A.2.3 Remuneration Provisions

Section 954 of Dodd-Frank expanded clawback requirements beyond the Sarbanes-Oxley provisions, requiring recovery of incentive compensation from current or former executive officers in the event of an accounting restatement due to material noncompliance with financial reporting requirements. The provision covers the three-year period preceding the restatement and does not require a finding of misconduct. The SEC adopted final clawback rules in 2022, requiring listed companies to adopt compliant policies.

Section 953 required enhanced disclosure of the relationship between executive compensation and company financial performance, including a comparison of compensation actually paid to stock performance. The provision also mandated disclosure of the ratio between CEO compensation and median employee compensation, a requirement that generated significant compliance costs but provided limited governance benefits.

Section 955 required disclosure of whether executives and directors are permitted to hedge their equity compensation through put options, equity swaps, collars, or prepaid variable forward contracts. While hedging disclosure may improve transparency, it does not address the fundamental incentive problem: even unhedged equity compensation aligns management with shareholders whose interests diverge from creditors.

A.2.4 Section 956: The Unfulfilled Promise

Section 956 of Dodd-Frank stands apart from the Act's other governance provisions. It requires six federal agencies (the Federal Reserve, FDIC, OCC, FHFA, NCUA, and SEC) to jointly prescribe regulations prohibiting incentive compensation arrangements at covered financial institutions that encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss. Unlike the shareholder empowerment provisions, Section 956 recognises that incentive compensation at financial institutions may require constraints beyond those that shareholders would impose.

The provision has never been implemented. The agencies proposed rules in 2011 and again in 2016, but interagency disagreement prevented finalisation. The 2016 proposal would have required deferral of incentive compensation for senior executives and significant risk-takers, subjected awards to forfeiture and clawback, prohibited certain types of incentive arrangements, and established risk management requirements for compensation programs. However, the proposal faced industry opposition and lacked consensus among the regulators.

In May 2024, four agencies (the FDIC, OCC, FHFA, and NCUA) re-proposed the 2016 rules, but the Federal Reserve and SEC declined to join.[106] At a House Financial Services Committee hearing in March 2024, Federal Reserve Chairman Jerome Powell was asked whether the Fed would "commit to helping finalise the Dodd-Frank section of 956 this year." Powell responded: "I would like to understand the problem we're solving and then I would like to see a proposal that addresses that problem."[107]

This statement, made fourteen years after Dodd-Frank's enactment and one year after Credit Suisse's collapse, illustrates how the fundamental governance problem in banking remains unrecognised at the highest levels of financial regulation. Section 956, the one provision that might have addressed the agency cost of debt, remains unimplemented, while the shareholder empowerment provisions have been fully operational for over a decade.

A.2.5 The Contradiction at the Heart of Dodd-Frank

[106] FDIC, OCC, FHFA and NCUA, 'Incentive-Based Compensation Arrangements' (notice of proposed rulemaking, May 2024) (not published in the Federal Register; the 2016 predecessor proposal is at 81 FR 37670).

[107] Testimony of Jerome H Powell, Semiannual Monetary Policy Report, before the House Committee on Financial Services (6 March 2024); also cited at n 64.

Coffee identified the fundamental contradiction in Dodd-Frank's approach: the Act simultaneously strengthens shareholder control and seeks to constrain the risk-taking that shareholders encourage. Say-on-pay votes ensure that remuneration structures serve shareholder interests; proxy access enables activist shareholders to place directors on bank boards; and the elimination of broker voting strengthens institutional investor influence. Meanwhile, Section 956 recognises that these same shareholder interests may produce incentive arrangements that "could lead to material financial loss."

The tension is not merely theoretical. In his analysis of systemic risk after Dodd-Frank, Coffee argued that "growing evidence suggests that shareholders favored [compensation] formulas to induce managers to accept higher risk and leverage. Shareholder pressure, then, is a factor that could cause the failure of a systemically significant financial institution." He proposed contingent capital as a mechanism to create "a class of voting preferred shareholders who would be rationally risk averse and would resist common shareholder pressure for increased leverage and risk taking", recognising that common shareholders themselves were part of the problem.

In a subsequent article on the political economy of Dodd-Frank, Coffee traced the "regulatory sine curve" through which reform legislation is progressively weakened after enactment. He observed that investors are "dispersed, disorganized, and their potential political power is diffused", constituting a classic latent group, that tends to be dominated by smaller, but more cohesive and better funded special interest groups in the competition to shape legislation and influence regulatory policy.[108] This dynamic helps explain why Section 956, the provision that might have constrained shareholder-driven risk-taking, remains unimplemented while the shareholder empowerment provisions have been fully operational for over a decade.

Appendix B — Chronicle of Credit Suisse's Collapse

The collapse of Credit Suisse (CS) in March 2023 was not a sudden event, but the culmination of years of strategic missteps, persistent governance failures, and recurrent scandals that eroded market and client confidence. Chapter 6 of the Swiss Financial Market Supervisory Authority (FINMA) "Lessons Learned from the CS Crisis" report details the bank's trajectory from the 2008 financial crisis to its eventual emergency takeover by UBS. In addition, we conducted our own analysis of original Credit Suisse documents, such as annual reports, invitations to annual general meetings and voting results.

B.1 Post-Financial Crisis and Early Strategic Shifts (2007-2015)

Under its then CEO, Credit Suisse navigated the 2008 global financial crisis without the need for state support, a notable contrast to its domestic rival, UBS. Despite an initial adherence to its integrated business model with a significant investment bank, the firm began to pivot. Responding to the incoming Basel III regulatory framework and a low-interest-rate environment, CS initiated a strategy to downsize the investment bank and reallocate capital towards wealth management. However, this period was also marred by legal troubles, including a $2.6 billion penalty from the US Department of Justice in 2014, under a guilty plea to conspiring to aid US clients in evading taxes. In 2012, FINMA had already found that CS had seriously violated its license requirements in its US cross-border business.

[108] John C Coffee, 'The Political Economy of Dodd-Frank: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated' (2012) 97 Cornell Law Review 1019.

In compliance with post-crisis regulation CS introduced an advisory say-on-pay vote in 2009. In the first-year shareholders were supportive of the remuneration report, but from 2010 to 2012 there was considerable opposition (Table 2). Specifically, opposition rose to 29.16% in 2010, reflecting growing shareholder dissatisfaction. Although there was a slight decrease in opposition to 23.45% in 2011, disapproval surged again in 2012, reaching 31.56%, the highest level recorded during this period. Shareholders voted against Credit Suisse's pay reports in unusually high numbers because they believed executive remuneration was overly rich, poorly justified, and not in shareholders' best interests. Influential investors and proxy advisors (ISS, Glass Lewis, among others) publicly admonished Credit Suisse's board to reform its pay practices, urging lower and capped bonuses, better pay-performance linkage, improved transparency, and a more equitable split of the bank's gains. The controversy ultimately contributed to Switzerland adopting binding say-on-pay rules in 2013 following a political referendum (the "Minder initiative"), empowering shareholders to more directly block executive pay packages going forward.[109]

The CS board responded by pledging more emphasis on closer alignment of executive remuneration with "long term" shareholder value. In 2012 it reformed its compensation approach for the Executive Board by introducing individual targets and caps for compensation determination, restructuring incentive award plans to include an unrestricted cash payment and a short-term incentive (STI) award vesting over three years, and implementing a new separate long-term incentive (LTI) award with five-year vesting periods. The LTI awards were structured as deferred cash-based awards subject to challenging performance vesting conditions linked to Group relative total shareholder return (RTSR) and underlying return on equity (ROE), while STI awards became deferred share-based awards subject to clawback provisions in the event of negative business performance.[110]

B.2 Restructuring, Scandals, and a Turn to Wealth Management (2015-2020)

With the appointment of a new CEO in July 2015, CS embarked on an ambitious new strategy. The focus shifted decisively towards wealth management, particularly in Asia, funded by a significant downsizing of the investment bank. This involved substantial restructuring, including the creation of regionally focused divisions and two capital increases totalling CHF 6 billion.

Despite these efforts, the bank's performance was volatile, posting significant losses in 2015 and 2016. This period was also characterised by a series of damaging incidents that exposed deep-seated issues in the bank's risk management and corporate culture:

- **Anti-Money Laundering Failures:** In 2018, FINMA identified serious deficiencies in the bank's anti-money laundering processes related to the Petrobras, PDVSA, and FIFA corruption scandals.
- **The "Spygate" Scandal (2019):** A bizarre corporate espionage affair involving the surveillance of high-ranking executives severely damaged the credibility of the Board of Directors. FINMA's subsequent investigation revealed serious organisational shortcomings and breaches of regulatory duties.

The losses had a direct impact on the remuneration votes. Opposition to the remuneration report had subsided in 2013 and 2014 following the 2012 shareholder value-oriented reforms but resurfaced in 2015

[109] SWI swissinfo.ch, 'Swiss Firms Face Greater Shareholder Opposition', 22 August 2017; Urs Geiser, 'Fat Cat Salaries: Voters Crack Down on Corporate Pay Packages' SWI swissinfo.ch (3 March 2013); Wagner and Wenk, 'Binding Say-on-Pay'.

[110] Credit Suisse Group AG, *Annual Report 2012*, 187.

following the reported losses in the same year. The consultative vote on the 2014 compensation report saw support drop to 66.76%, with opposition rising to 30%, a sharp reversal from the 81.28% approval rate achieved just the year before (Table 2). This pattern reflected shareholders' growing concern about rewarding executives during a period of strategic uncertainty and financial underperformance.

The introduction of binding remuneration votes in 2015 marked a significant shift in corporate governance, giving shareholders direct control over executive compensation decisions rather than merely advisory input. Initially, these binding votes received strong support, with approval rates above 80% for most components of executive compensation in 2015 and 2016. However, the binding vote structure revealed nuanced shareholder sentiment by disaggregating compensation into distinct components: board compensation, fixed compensation, short-term variable incentives, and long-term variable incentives. This granular approach allowed shareholders to express more targeted dissatisfaction with specific aspects of the remuneration package.

The discontent peaked in 2017, when the consultative vote on the 2016 compensation report received only 57.98% support, the lowest approval rate in the bank's voting history up to that point, as nearly 40% of shareholders voted against the remuneration package (Table 2). The binding votes that year told an even more revealing story: while fixed compensation maintained relatively strong support at 81.69%, short-term variable incentive compensation barely survived with just 59.59% approval, demonstrating shareholders' reluctance to reward management for poor near-term results despite the longer-term strategic repositioning efforts (Table 3). This differential voting pattern suggests that shareholders distinguished between compensation for basic executive duties and performance-based rewards, holding management accountable for the immediate costs of restructuring while acknowledging the necessity of retaining leadership during the strategic transition.

The Credit Suisse board responded by further revising the compensation policy and aligning it even more closely with "long term" shareholder value.[111] The 2017 reforms, implemented for 2018, represented a comprehensive overhaul developed through extensive consultation with shareholders and external stakeholders who had voiced their concerns through the voting process. The changes targeted the specific areas where shareholder opposition had been strongest, particularly around performance measurement and long-term value creation. For short-term incentives, the board introduced a simplified STI award pool structure based on predetermined Group financial metrics (weighted at 67%) and non-financial metrics (weighted at 33%), aiming for greater transparency in performance criteria. More significantly, the long-term incentive framework was fundamentally restructured to better reflect shareholder priorities: capital metrics like CET1 ratios were removed in favour of profitability measures including Return on Tangible Shareholders' Equity and Tangible Book Value Per Share, while the payout levels for target performance were reduced from 80% to 67% of maximum opportunity. The relative total shareholder return component was de-emphasised, with its weighting reduced from 50% to 33% and zero payout introduced for bottom quartile performance. Additionally, shareholding requirements were substantially increased: the CEO's minimum holding rose from 350,000 to 500,000 shares, while other Executive Board members' requirements doubled from 150,000 to 300,000 shares. While these reforms demonstrated the board's responsiveness to shareholder feedback and represented a clear attempt to rebuild trust by ensuring executive compensation would reward long-term value creation, the removal of capital adequacy metrics like CET1 ratios from the

[111] Credit Suisse Group AG, *Annual Report 2017*, 236.

incentive structure arguably shifted compensation alignment away from the interests of creditors and deposit insurers, who rely on strong capital buffers as protection against bank failure.

B.3 The Unravelling (2020-2022)

A new CEO took over in February 2020, just as the COVID-19 pandemic began. The bank continued its strategy of reducing its reliance on the investment bank, but a series of major failures accelerated its decline:

- **Greensill and Archegos (2021):** The collapse of two major clients in quick succession dealt a devastating blow. In March 2021, CS was forced to close four supply chain finance funds linked to Greensill Capital, freezing $10 billion in client assets. Almost simultaneously, the implosion of the hedge fund Archegos Capital Management resulted in a staggering $5 billion loss for CS, the largest among all involved banks.
- **Intensified Regulatory Scrutiny:** These events triggered forceful interventions from FINMA, which imposed immediate measures to reduce risk, mandated a review of the bank's risk appetite, and opened enforcement proceedings. By 2020, FINMA had already elevated CS to its highest supervisory category of "intensive and permanent supervision" due to the accumulation of governance issues and enforcement cases.
- **Erosion of Capital and Confidence:** The losses and reorganisations eroded the bank's capital base. A capital increase of CHF 1.7 billion in April 2021 was insufficient to shore up confidence. Rating agencies began downgrading the bank's debt, increasing its funding costs and making it an outlier among its peers. FINMA repeatedly raised concerns about the low capital base of the parent bank, Credit Suisse AG, which it identified as the "weakest link."

Following the 2017 reform, shareholder opposition through negative compensation votes declined: consultative approval recovered from the 2017 low of 57.98% to 80.80% in 2018 and 82.14% in 2019, and held at 79.21% in 2020 (Table 2). The operational disasters of 2021 nonetheless shattered this fragile trust, but the fury expressed itself outside the consultative vote: the board withdrew its short- and long-term variable compensation proposals, postponed the discharge vote, and lost its risk-committee chair on the morning of the meeting. The consultative vote that did take place was held on the updated 2020 compensation report, re-issued with executive variable compensation cancelled, and passed with 82.45% approval (Table 2). The deferred reckoning came later: in 2022 shareholders refused to discharge the board and management for the 2020 financial year (35.88% in favour), and in 2023 the compensation report passed with just 50.06% (Tables 1 and 2).

The board anticipated the protest and the binding STI and LTI votes in 2021 were not even presented to shareholders, appearing as blanks in the voting records, an extraordinary admission that management expected these proposals to fail outright. The crisis reached its peak when the head of the risk committee, who earned a $1 million annual fee, stepped down just hours before the 2021 annual general meeting after the board became 'alarmed at the level of shareholder dissent' over his role.[112] Major shareholders including Harris Associates (holding 10.25% of the bank), Norway's sovereign wealth fund, and the Ethos Foundation had indicated they would vote against his re-election.[113] Proxy advisor Glass Lewis had recommended voting against him, arguing that as risk committee chairman since 2018 he bore 'ultimate accountability' for the

[112] Morris, Walker and Kinder (n 88).

[113] Winters (n 88).

Greensill and Archegos disasters, while David Herro of Harris Associates bluntly stated: 'Not only should Mr. Gottschling be voted down, but I'm actually surprised in light of current events that he hasn't already resigned'.[114] The chairman of the board, who had overseen the bank through years of crisis, also stepped down that day, at the end of his planned term, amid shareholder and regulatory demands for accountability for the governance failures that had allowed such massive losses to occur under inadequate risk controls.[115]

The board proposed yet another compensation reform, effective 2022, representing the most radical overhaul of executive pay since the introduction of "say-on-pay" in 2009. Faced with the complete breakdown of shareholder trust, the new framework abandoned the traditional distinction between short-term and long-term incentives in favour of a simplified overall incentive pool capped at just 2% of Group income before taxes. This dramatic shift toward share-based compensation mandated that at least 70% of variable awards be granted as share awards, with cash and Contingent Capital Awards limited to a maximum of CHF 2 million per executive, a stark reduction from previous levels. The reforms introduced punitive measures for poor performance: if the bank's Relative Total Shareholder Return fell within the bottom quintile of peers, all variable compensation would be converted to long-term share awards, effectively eliminating any immediate cash rewards for failure. Most significantly, the framework reintroduced capital adequacy concerns that had been removed in 2017 by subjecting share awards to 'underpins' (minimum CET1 ratio and income thresholds), with failure to meet these metrics resulting in forfeiture of outstanding compensation tranches. The shareholding requirements were doubled again, with the CEO now required to hold 1,000,000 shares and other Executive Board members 500,000 shares, while ESG factors were elevated to 30% weighting in performance assessment. These reforms represented a fundamental acknowledgment that previous compensation structures had failed to prevent the risk-taking behaviour that nearly destroyed the bank, attempting to restore creditor and regulator confidence by directly linking executive rewards to both capital strength and long-term survival. Arguably they came too late and still failed to align remuneration sufficiently with creditor, depositor and broader financial stability interests.

Director elections and discharge votes tell the same story with greater force. Under the annual re-election regime introduced by the Ordinance against Excessive Compensation, Credit Suisse's directors were routinely re-elected with more than 90 per cent support. The chairman of the risk committee was re-elected with approval above 97 per cent in every election from 2017 to 2020, even as the Mozambique affair, the spy scandal and mounting supervisory findings accumulated. The accountability instruments were deployed only after catastrophe. In 2021, his candidacy was withdrawn on the morning of the AGM and the discharge vote was withdrawn with it; individual director opposition reached 27 per cent (a non-executive director re-elected with 72.51 per cent). In 2022, shareholders refused to discharge the board and management for the 2020 financial year (35.88 per cent in favour) while granting discharge for 2021. In 2023, the entire board was re-elected on support of between 50.05 and 55.94 per cent (the vice-chairman at 50.05 per cent, the chairman at 55.67 per cent), and the discharge item was again withdrawn. The board chairman's support, never below 89 per cent before 2020, fell to 77.50 per cent in the year of the spying scandal (Table 1). Shareholders thus possessed, and eventually used, every accountability instrument the post-crisis reforms gave them, but only after losses had crystallised, and to punish failed risk-taking rather than to restrain risk-taking itself.

[114] ibid; Morris, Walker and Kinder (n 88).

[115] Credit Suisse Group AG, *Changes to the Board of Directors of Credit Suisse Group*, Press Release (2021).

Table 1 - Board accountability votes at Credit Suisse Group AG AGMs, 2014-2023

Year	Chair election (% for)	Discharge (% for)	Lowest ind. director election (% for)
2014	92.73	90.39	92.73 (Chairman)
2015	96.26	94.28	96.26 (Chairman)
2016	92.19	86.37	92.19 (Chairman)
2017	90.61	88.53	90.61 (Chairman)
2018	89.45	93.35	89.45 (Chairman)
2019	93.15	87.92	93.15 (Chairman)
2020	77.50	79.61	77.50 (Chairman)
2021	96.45	withdrawn	72.51 (director)
2022	95.31	35.88 (FY2020, rejected) / 77.51 (FY2021)	68.66 (director)
2023	55.67	withdrawn	50.05 (Vice-Chair)

Source: Votes represented (%), official Credit Suisse AGM voting-results documents, 2014-2023 (all directors subject to annual re-election from 2014). 2021: the risk-committee chair's candidacy and the discharge item were withdrawn before the vote; the chair figure for 2021 is the incoming chairman's first election. 2023: discharge again withdrawn.

B.4 The Final Collapse (July 2022 – March 2023)

The appointment of a new CEO in July 2022 marked the final chapter. A new strategic review was announced, aimed at a radical transformation of the investment bank. However, the bank was now in a death spiral, driven by a profound crisis of confidence.

In October 2022, social media speculation about the bank's stability triggered a massive wave of withdrawals, with clients pulling CHF 138 billion in the last quarter of the year alone. The bank announced a CHF 4 billion capital increase, with the Saudi National Bank becoming the largest shareholder.

The global banking turmoil in March 2023, sparked by the failures of Silicon Valley Bank and Signature Bank in the US, proved to be the final trigger. On March 15, after the Saudi National Bank ruled out further investment, CS's share price plummeted by 30%, and the cost to insure its debt skyrocketed. This led to a massive acceleration in deposit outflows, reaching CHF 13.2 billion on that day alone.

Despite a joint statement of support from FINMA and the Swiss National Bank (SNB), and the provision of emergency liquidity assistance of CHF 48 billion on 16 March 2023 (total Swiss National Bank facilities ultimately reached up to CHF 168 billion), the bank run continued unabated. With insolvency imminent, the Swiss authorities orchestrated an emergency merger. On March 19, 2023, it was announced that UBS would acquire Credit Suisse, backed by massive state liquidity support and guarantees, bringing an end to the 167-year history of one of Switzerland's most iconic financial institutions.

B.5 Credit Suisse Say-on-Pay Voting Results

This section contains information on the corporate governance of Credit Suisse based on original documents, in particular annual report, remuneration (compensation) reports, invitations to annual meetings and voting results.

Table 2: Consultative Vote on the Remuneration/Compensation Report

Year	Agenda Item	Favour (%)	Against (%)	Abstentions (%)
2007	*No remuneration vote.*			
2008	*No remuneration vote.*			
2009	Consultative vote on the remuneration report	88.60	5.57	5.83
2010	Consultative vote on the 2009 Remuneration report	66.23	29.16	4.61
2011	Consultative vote on the 2010 Remuneration report	74.11	23.45	2.44
2012	Consultative vote on the 2011 Remuneration report	67.63	31.56	0.81
2013	Consultative vote on the 2012 Remuneration report	87.98	10.30	1.72
2014	Consultative vote on the 2013 Compensation Report	81.28	16.59	2.13
2015	Consultative Vote on the 2014 Compensation Report	66.76	30.00	3.24
2016	Consultative Vote on the 2015 Compensation Report	79.39	17.94	2.67
2017	Consultative Vote on the 2016 Compensation Report	57.98	40.02	2.00
2018	Consultative Vote on the 2017 Compensation Report	80.80	13.54	5.66
2019	Consultative Vote on the 2018 Compensation Report	82.14	16.27	1.59
2020	Consultative vote on the 2019 compensation report	79.21	17.45	3.34
2021	Consultative vote on the updated 2020 compensation report	82.45	16.28	1.27
2022	Consultative vote on the 2021 compensation report	80.23	18.76	1.01
2023	Consultative vote on the 2022 Compensation Report	50.06	49.38	0.56

Source: Votes represented (%), official Credit Suisse AGM voting-results documents, 2009-2023. The consultative vote was introduced in 2009. The 2021 vote was held on the updated 2020 compensation report reissued after the Archegos loss.Votes represented (%), official Credit Suisse AGM voting-results documents, 2014-2023 (all directors subject to annual re-election from 2014). 2021: the risk-committee chair's candidacy and the discharge item were withdrawn before the vote; the chair figure for 2021 is the incoming chairman's first election. 2023: discharge again withdrawn.

Table 3: Binding Remuneration Vote Results

Year	Agenda Item	Favour (%)	Against (%)	Abstentions (%)
2015	Approval of BoD Compensation	87.79	11.15	1.06
	Approval of Executive Board Compensation	86.95	11.02	2.03
2016	Approval of BoD Compensation	83.26	16.43	0.31
	STI Compensation	81.48	17.99	0.53
	Fixed Compensation	85.05	14.65	0.30
	LTI Compensation	82.95	15.58	1.47
2017	Approval of BoD Compensation	73.09	24.69	2.22
	STI Compensation	59.59	38.40	2.01
	Fixed Compensation	81.69	15.92	2.39
	LTI Compensation	73.52	24.20	2.28
2018	Approval of BoD Compensation	82.89	11.48	5.63
	STI Compensation	82.83	11.57	5.60
	Fixed Compensation	88.45	5.95	5.60
	LTI Compensation	82.45	11.93	5.62
2019	Approval of BoD Compensation	86.76	13.00	0.24
	STI Compensation	84.86	13.55	1.59
	Fixed Compensation	86.86	11.55	1.59
	LTI Compensation	84.47	13.88	1.65
2020	Approval of BoD Compensation	87.09	11.92	0.99
	STI Compensation	84.56	12.10	3.34
	Fixed Compensation	88.43	10.60	0.97
	LTI Compensation	86.54	12.47	0.99
2021	Approval of BoD Compensation	82.44	16.29	1.27
	STI Compensation		*Not presented*	
	Fixed Compensation	90.55	8.19	1.26
	LTI Compensation		*Not presented*	
2022	Approval of BoD Compensation	86.16	12.69	1.15
	STI Compensation	82.97	15.84	1.19
	Fixed Compensation	93.43	5.40	1.17
	Share-based Replacement Awards	92.80	5.97	1.23
2023	Approval of BoD Compensation	50.42	49.12	0.46
	Fixed Compensation for Executive Board	48.43	48.21	3.36

Source: Votes represented (%), official Credit Suisse AGM voting-results documents, 2015-2023. Binding annual compensation votes were introduced under the Ordinance against Excessive Compensation with effect from the 2015 AGM. Items not shown for 2021 were withdrawn by the board before the vote.Votes represented (%), official Credit Suisse AGM voting-results documents, 2014-2023 (all directors subject to annual re-election from 2014). 2021: the risk-committee chair's candidacy and the discharge item were withdrawn before the vote; the chair figure for 2021 is the incoming chairman's first election. 2023: discharge again withdrawn.

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ECGI is an international non-profit membership organisation that provides a platform for debate and dialogue among academics, policymakers, and business leaders, with a focus on major corporate governance, ESG, and stewardship issues.

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