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Has the application of the "fit and proper" regime improved governance structures in the Banking Union?

Banking Union Scrutiny

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Abstract

This paper examines trends in the size and composition of the boards of significant institutions during the 2011-2018 period, comprising several years before and after the ECB started conducting fit and proper assessments in 2014. Throughout this period, there have been trends towards directors who are more qualified, hold fewer other board positions, and are more likely to be female and a foreign national. Unlike in the pre-SSM period, however, more recently the average age of directors has increased, bank boards have become larger, and the share of independent directors has risen. The appointment of additional independent directors in recent years is potentially harmful to financial stability, as especially independent directors could favour riskier bank strategies with a view to increasing shareholder value.

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LIST OF ABBREVIATIONS

CEO	Chief Executive Officer
EBA	European Banking Authority
ECB	European Central Bank
ESMA	European Securities and Markets Authority
EU	European Union
NPL	Nonperforming Loans
ROA	Return on Assets
ROE	Return on Equity
SSM	Single Supervisory Mechanism

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EXECUTIVE SUMMARY

The European Central Bank (ECB) has the exclusive responsibility to conduct fit and proper assessments for significant institutions. These tests are applied to executive as well as nonexecutive directors. There are five fit and proper criteria relating to i) experience, ii) reputation, iii) conflicts of interest and independence of mind, iv) time commitment, and v) the board's collective suitability. This paper examines trends in the size and composition of the boards of significant institutions over the 2011-2018 period, comprising several years before as well as after the ECB started conducting fit and proper tests in November 2014. In practice, only data that shed some light on the application of the experience, time commitment, and collective suitability criteria are available.

The average number of qualifications at undergraduate level and above of board members rose during the period 2011-2018, including the SSM period 2014-2018. Conversely, the average cumulative number of board positions that board members have occupied, as a measure of practical experience, declined during 2014-2018.

To inform on time availability, we consider the average number of current board positions in any organization. This measure declined throughout the 2011-2018 period, suggesting a greater time availability of SSM bank directors. As an additional index of time availability, we consider the average network size of board members, defined as the number of connections with other directors and senior managers through employment, education and other activities. Average network size increased before as well as after the SSM took effect in 2014, with possibly negative implications for time availability. Larger networks, however, could yield the benefit of additional access to people that can provide useful information relevant for the SSM bank directorship.

Two main variables pertinent to collective board suitability are board size and the share of directors that are independent of management. The average board size dropped before the ECB started conducting fit and proper assessments, and slightly increased afterwards. The implications of these changes in the average board size for bank performance are uncertain, as it is difficult to determine at which side of the 'optimal board size' SSM banks actually are. The share of independent directors rose from 76.6% in 2014 to 78.3% in 2018, reversing an earlier trend towards a lower share of independent directors in the pre-SSM period. The increase in the share of independent directors is potentially worrying, as prior research has documented a positive association between the share of independent directors and bank risk, reflecting that especially independent directors could favour risky bank strategies with a view to increasing shareholder value.

As additional variables related to collective board suitability, we consider a board's age diversity, gender diversity, and diversity of nationality. Age diversity declined, while the shares of female directors and of directors with a foreign nationality both rose. Prior evidence suggests that the decline in age diversity was beneficial for bank performance, while the increases in the shares of female and foreign directors potentially had positive and negative effects on bank performance.

1. INTRODUCTION

The European Central Bank (ECB) has the exclusive responsibility to conduct fit and proper assessments for significant institutions according to the Single Supervisory Mechanism (SSM) Regulation (Article 4,1,e).[1] These tests are to be applied to the overall management body, including the management function (executive directors) and the supervisory function (non-executive directors). In line with the Capital Requirements Directive (CRD) IV (European Council and European Parliament, 2013), the ECB applies five criteria to assess the fitness and propriety of members of the management body. These relate to: i) experience, ii) reputation, iii) conflicts of interest and independence of mind, iv) time commitment, and v) the board's collective suitability. Together, the application of these criteria should ensure that board members individually and collectively can perform the board's main tasks of monitoring and advising management.

This paper examines trends in the size and composition of the boards of significant institutions over the 2011-2018 period, comprising several years before as well as after the ECB started conducting fit and proper tests in November 2014. In carrying out fit and proper assessments, the ECB faces two main constraints. First, fit and proper tests can only be applied to board candidates that are proposed by the banks. Second, the ECB is bound by the legal framework underlying fit and proper assessments in the European Union (EU), including the at times unequal transposition of the CRD IV into national law, which could give rise to uneven fit and proper assessment outcomes across countries. The trends in board size and composition described in this paper jointly reflect the ECB's application of fit and proper tests and the constraints that it faces.

Our main data source is BoardEx that collects information on company boards mainly from annual reports. The sample consists of 51 significant institutions, for which we have enough observations over time to help identify any trends in the data.[2] In practice, no systematic information is available to assess any trends related to the fit and proper criteria of reputation, and conflicts of interest and independence of mind (see box 1), leaving us to consider variables pertinent to the criteria of experience, time commitment, and collective board suitability.[3]

Box 1: Non-observable criteria

This study analyses only publicly observable and systematically available criteria. As set out in subsection 2.2, the ECB applies five criteria to assess whether candidates are suitable for board positions, some of which are concepts that are not easily observable, such as a candidate's "conflicts of interest and independence of mind".

From a scrutiny perspective, it would be relevant to know how those concepts are operationalised to make them consistently applicable in practice, and what sources of information the supervisor can avail of. If there were no clear guidance on how to operationalise the relevant concept or if there were no reliable sources of information available, there would be a risk that a criterion is either not applied at all or applied inconsistently.

Related to the experience criterion, we find that the average number of qualifications at undergraduate level and above of board members rose during the period 2011-2018, including the SSM period 2014-

[1] See European Council (2013).

[2] We started from the list of SSM banks as of January 2019. This list includes 117 significant supervised entities, 3 of which are branches.

[3] There is potentially a link between the application of the reputation criterion by the ECB and the occurrence of misconduct, for instance, in the form of money laundering at significant institutions, but no systematic data exist to assess any such link.

2018. Conversely, we find that the average cumulative number of board positions that board members have occupied, as a measure of practical experience, declined during 2014-2018.

To gauge whether board members can commit sufficient time to their director positions, we consider the average number of current board positions in any organization. This measure declined throughout the 2011-2018 period, suggesting a greater time availability of SSM bank directors. As an additional index of time availability, we consider the average network size of board members, defined as the number of connections with other directors and senior managers through employment, education and other activities.[4] Average network size increased before as well as after the SSM took effect in 2014, with possibly negative implications for time availability. Larger networks, however, could yield the benefit of additional access to people that can provide useful information relevant for the SSM bank directorship.

Two main variables pertinent to collective board suitability are board size and the share of directors that are independent of management. The average board size dropped before the ECB started conducting fit and proper assessments, and slightly increased afterwards. The implications of these changes in the average board size for bank performance are uncertain, as it is difficult to determine at which side of the 'optimal board size' SSM banks actually are. The share of independent directors rose from 76.6% in 2014 to 78.3% in 2018, reversing an earlier trend towards a lower share of independent directors in the pre-SSM period. This recent increase in the share of independent directors is potentially worrying, as research by Erkens, Hung and Matos (2012) and Anginer, Demirgüç-Kunt, Huizinga and Ma (2018) document a positive association between the share of independent directors and bank risk, reflecting that especially independent directors could favour risky bank strategies with a view to increasing shareholder value. Post-crisis reforms, in the form of higher capital requirements and a substitution of bail-in for bailout, were implemented to reduce the probability of generous bank bailouts. Consequently, the current contribution of supplementary independent directors to bank riskiness could be less substantial than before.

As additional variables related to collective board suitability, we consider a board's age diversity, gender diversity, and diversity of nationality. We find a decline in age diversity, while the average director age decreased from 2011 to 2015 followed by an increase in more recent years. The literature suggests that a lower age dispersion is beneficial for bank performance (Wang and Hsu, 2013, and Talavera, Yin, and Zhang, 2018). Furthermore, the share of female directors rose from 19.1% in 2014 to 26.7% in 2018, which the literature suggests could be beneficial for bank performance (Pathan and Faff, 2013, Garcia-Meca, Garcia-Sanchez, and Martinez-Ferrero, 2015, and Owen and Temesvary, 2018). Finally, the share of directors with a foreign nationality increased, which is potentially detrimental to performance (Garcia-Meca, Garcia-Sanchez, and Martinez-Ferrero, 2015). In the remainder, section 2 describes the legal framework underlying fit and proper assessments in the EU, and it provides some information on the application of the five fit and proper criteria. Section 3 describes the observed trends in the size and composition of the boards of significant institutions. Section 4 concludes.

[4] Board members presumably want to maintain the relationship capital stemming from their professional networks, which will take some of their time.

2. FIT AND PROPER ASSESSMENTS OF SSM BANKS

The ECB has the exclusive responsibility to conduct fit and proper assessments for significant institutions according to the SSM Regulation. Subsection 2.1 succinctly sets out the common legal framework for fit and proper assessments in the EU. Subsection 2.2 describes the five assessment criteria that are applied in fit and proper assessments.

2.1. The legal framework for fit and proper assessments

The substance of fit and proper assessments is described summarily in Article 91 of the CRD IV (European Council and European Parliament, 2013). These assessments apply to the overall management body, both in their management function (executive directors) and supervisory function (non-executive directors). When carrying out fit and proper tests, the ECB has to apply national law implementing this directive (according to Article 4(3) of the SSM Regulation). In practice, the 19 euro area countries have transposed Article 91 of the CRD IV in different ways. For instance, there is variation in whether fit and proper tests are to be conducted before or after a director assumes his responsibility. The current lack of a truly common legal basis for fit and proper assessments in the euro area potentially contributes to uneven fit and proper test outcomes in otherwise similar cases.[5] In this paper, we examine SSM-wide trends in the size and composition of the boards of SSM banks, without attempting to evaluate any independent effect of the current variation in fit and proper legislation across countries.

The ECB also is required to comply with the joint European Securities and Markets Authority (ESMA) and European Banking Authority (EBA) Guidelines on suitability (2017). These guidelines aim to improve and harmonize fit and proper assessments in the EU by providing common ways to interpret the fit and proper assessment criteria in the CRD IV, and by recommending common supervisory practices regarding suitability (see Busch and Teubner, 2019, p. 7). The ECB has indicated that it intends to comply with these guidelines within the limit of, and without prejudice to, national provisions transposing CRD IV.[6]

2.2. The fit and proper criteria and the ECB guidelines on their application

In line with CRD IV and the ESMA and EBA guidelines, the ECB applies five criteria to assess the fitness and propriety of members of the management body. These relate to: i) experience, ii) reputation, iii) conflicts of interest and independence of mind, iv) time commitment, and v) collective board suitability. The ECB's Guide to fit and proper assessments (2018) provides some details on how it aims to implement these criteria. This subsection briefly lays out the five criteria and their intended implementation.

Experience

The ECB assesses whether members of the management body have sufficient knowledge, skills and experience to fulfil their functions. Both theoretical knowledge gained through education and training and practical experience gained in previous occupations are taken into account.

Reputation

Members of the management body should at all times have a good reputation. An appointee will be considered to have a good reputation if there is no evidence to the contrary and no reasonable doubt

[5] By the same token, reforms that would further harmonize fit and proper assessments in the EU can be expected to lead to more even fit and proper assessment outcomes. Recently the European Commission (2019) has published a consultation document on implementing the final Basel III reforms in the EU outlining, among other things, possible changes in the CRD regarding fit and proper assessments.

[6] See ESMA and EBA (2018).

about this. Doubts about reputation could result, for instance, from criminal or administrative proceedings.

Conflicts of interest and independence of mind

Members of the management body should be able to make their own, sound, and independent decisions. Independence of mind could be hampered by conflicts of interest between the member of the management body and the supervised entity. A conflict of interest will impede an appointment if it poses a material risk and it is not possible to mitigate the conflict of interest.

Time commitment

Appointees must be able to commit sufficient time to carry out their functions in the institution. The ability to commit time to a membership of the management body is taken to be negatively influenced by other directorships. Precise criteria are provided for the number of directorships a member of the management body of a significant institution is allowed to hold. In particular, an appointee is limited to one executive directorship with two non-executive directorships, or alternatively to four non-executive directorships. Two exceptions to this rule apply:

i) Directorships in organizations that do not pursue predominantly commercial objectives do not count.

ii) Certain multiple directorships count as a single directorship, for instance directorships held within the same group.

Beyond the quantitative limits on the number of directorships, there is a qualitative assessment of the potential time commitment.

Collective suitability

The management body should be collectively suitable. While the ECB guidelines indicate that it will be considered how an appointee will fit into the collective suitability, no further substantive information is provided on how this criterion is assessed.

Following a fit and proper test, a candidate can be rejected or accepted with or without a qualification, which can take the form of a condition, an obligation, or a recommendation. The ECB does not reveal how frequently candidates are rejected. However, ECB (2019) provides some summary information on the percentages of positive decisions that come with a qualification, broken down by the five fit and proper criteria that the qualification can address. Relatively many positive decisions come with a qualification pertinent to the experience and time commitment criteria. Specifically, in 2018 17% of positive decisions for a non-executive appointment came with a qualification related to the experience criterion, as opposed to 5% of positive decisions for an executive appointment. Furthermore, 19% of non-executive appointees were confronted with a condition, obligation, or recommendation related to the time commitment criterion, compared to 12% of executive appointees.

3. TRENDS IN THE SIZE AND COMPOSITION OF THE BOARDS OF SSM BANKS

In this section, we consider the outcomes of the ECB's fit and proper assessments as reflected in the size and composition of the boards of SSM banks. We obtain data on bank boards from BoardEx that collects this information mainly from banks' annual reports. Our sample consists of 51 SSM banks for the years 2011-2018. This sample period comprises several years before as well as after the ECB started doing fit and proper assessments for SSM banks in November 2014.[7] In practice, we can only show trends of variables related to the experience, time commitment and collective suitability criteria, as systematic data pertinent to the reputation, and conflicts of interest and independence of mind criteria are not available.

A sizeable empirical literature has addressed the implications of board size and composition for the performance and stability of financial institution (see De Haan and Vlahu, 2016, and Srivastas and Hagendorff, 2016, for recent surveys). This literature provides some indication of which board characteristics can be taken to be conducive to good banking sector outcomes. In this section, we discuss trends in board characteristics in tandem with pertinent empirical studies, if available. Specifically, section 3.1 discusses trends and prior studies related to the experience criterion, while sections 3.2 and 3.3. discuss trends and prior empirical evidence related to the time commitment and collective suitability criteria, respectively.

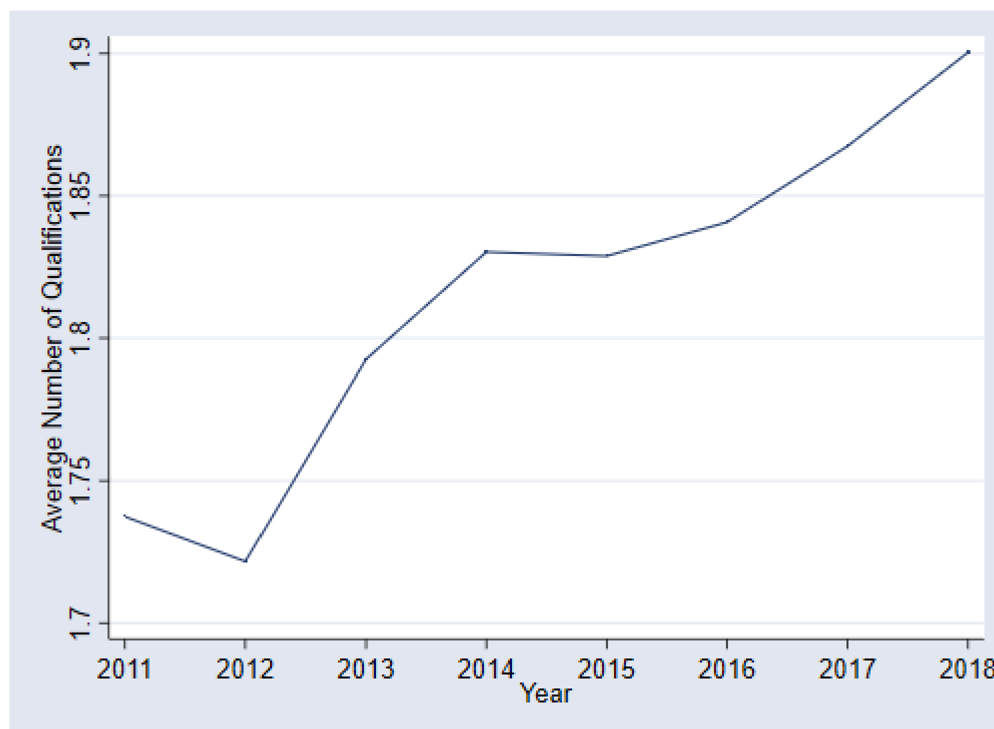
3.1. Variables related to expertise

Directors should have sufficient expertise, especially related to banking. There is empirical evidence, however, that financial expertise on the part of directors can be harmful, as more financially expert directors are also more aware of the potential benefits to shareholders of pursuing riskier bank strategies. Specifically, Minton, Taillard, and Williamson (2014) find that a higher percentage of independent directors with financial expertise is associated with lower bank capitalization and higher bank stock price variability before the crisis, indicating higher pre-crisis risk, for a sample of US banks during 2003-2008.

From BoardEx, we retrieve information on the total number of qualifications at undergraduate level and above of the directors of SSM banks obtained in all disciplines. Figure 1 shows that the average number of qualifications of SSM bank direct rose secularly during the 2011-2018 period, including the SSM period since 2014. Thus, the effect of ECB fit and proper assessments on the average number of qualifications of directors, if any, was not to alter the prior trend towards more qualified directors.

[7] To construct our sample of banks, we start with the 117 banks that were significant institutions as of January 2019. From BoardEx we are able to retrieve information for 65 of these banks. We further restrict the sample to banks with data for at least 3 years before 2015 or after 2014. This reduces the sample to 51 banks (see the Appendix for a list of included banks).

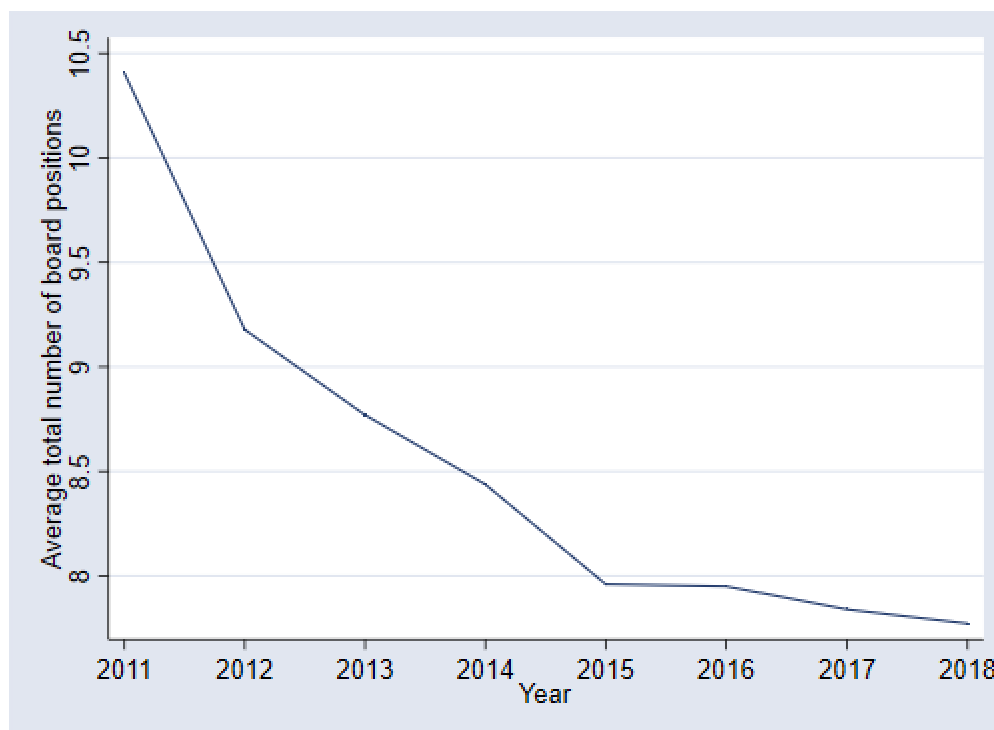
Figure 1. Average number of qualifications of directors



This figure displays the average of the bank-level mean number of qualifications at undergraduate level and above of directors.

Experience also includes relevant prior work experience and, in the case of directors, prior experience as a director in other organizations. Figure 2 displays the average number of board positions that directors have held in any organization, including for-profit and not-for-profit organizations and also counting current board positions. The average total number of board positions of SSM bank directors declined throughout the 2011-2018 period, from 10.4 in 2011 to 7.8 in 2018. Taken together, Figures 1 and 2 show that during the SSM period directors of SSM banks have become more qualified, and the decline in directors' experience as measured by total directorships held was reduced after 2014.

Figure 2. Average total number of board positions of directors



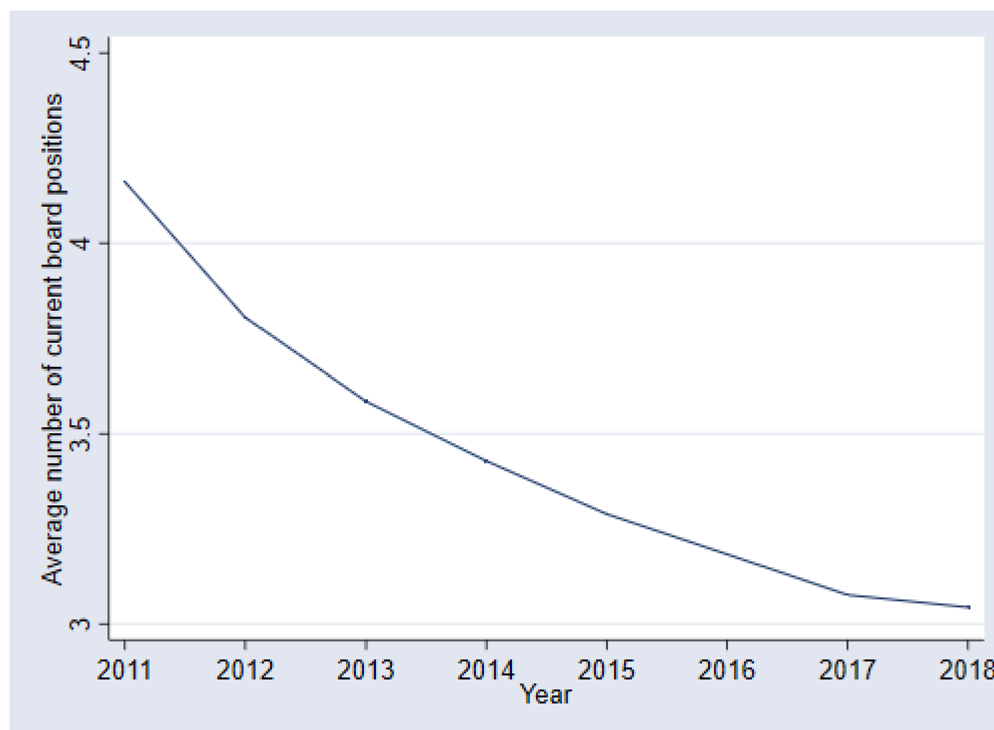
This figure displays the average of the bank-level mean total number of board positions that directors have held.

3.2. Variables related to time commitment

The ECB ascertains whether an appointee can spend sufficient time on his SSM bank directorship. As discussed in section 2.2, the time commitment criterion implies a quantitative limit on the number of directorships that a director of an SSM bank can hold, reflecting the notion that too many other directorships prevent the director of an SSM bank to spend sufficient time on his SSM bank directorship. However, there is empirical evidence that having other directorships can be beneficial in providing bank directors with useful information to prevent misconduct at a bank. Specifically, Nguyen, Hagendorff and Eshraghi (2016) estimate a negative relation between the size of a bank director's network and the occurrence of misconduct, based on a sample of US banks during 2000-2013. In their paper, misconduct is proxied by the occurrence of regulatory enforcement actions against a bank, and the size of a director's network is measured as the number of co-directors that a director has access to by being a director at other firms.

Figure 3 shows that the average number of current board positions in all organizations declined throughout the 2011-2018 period, including the SSM period. These data imply that the ECB has approved new board members with increasingly lower numbers of current board positions. While this may have led to a greater time availability of SSM bank directors, it also carries the risk that these directors have less access to useful information from co-directors in other organizations.

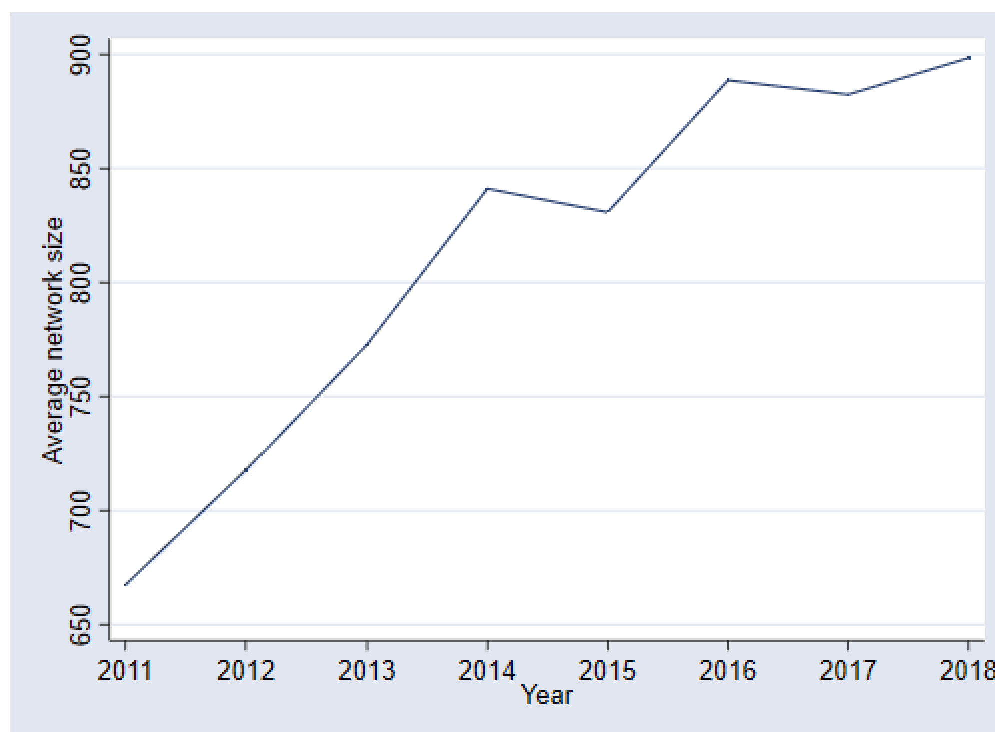
Figure 3. Average number of current board positions of directors



This figure displays the average of the bank-level mean number of current board positions of directors.

From BoardEx we obtain a variable that alternatively defines the size of a director's network as the number of connections with other professionals from firms covered by the BoardEx database through employment, education and other activities. Large numbers of connections constitute possible relationship capital of board members that also can be beneficial for the banks. Figure 4 shows that the average network size of directors according to this definition increased after the SSM took effect in 2014, continuing the earlier upward trend. As suggested by Nguyen, Hagendorff and Eshraghi (2016), a trend towards a large network size potentially generates the benefit of a lower probability of misconduct at the bank.

Figure 4. Average network size of directors



This figure displays the average of the bank-level mean network size of directors.

3.3. Variables related to collective suitability

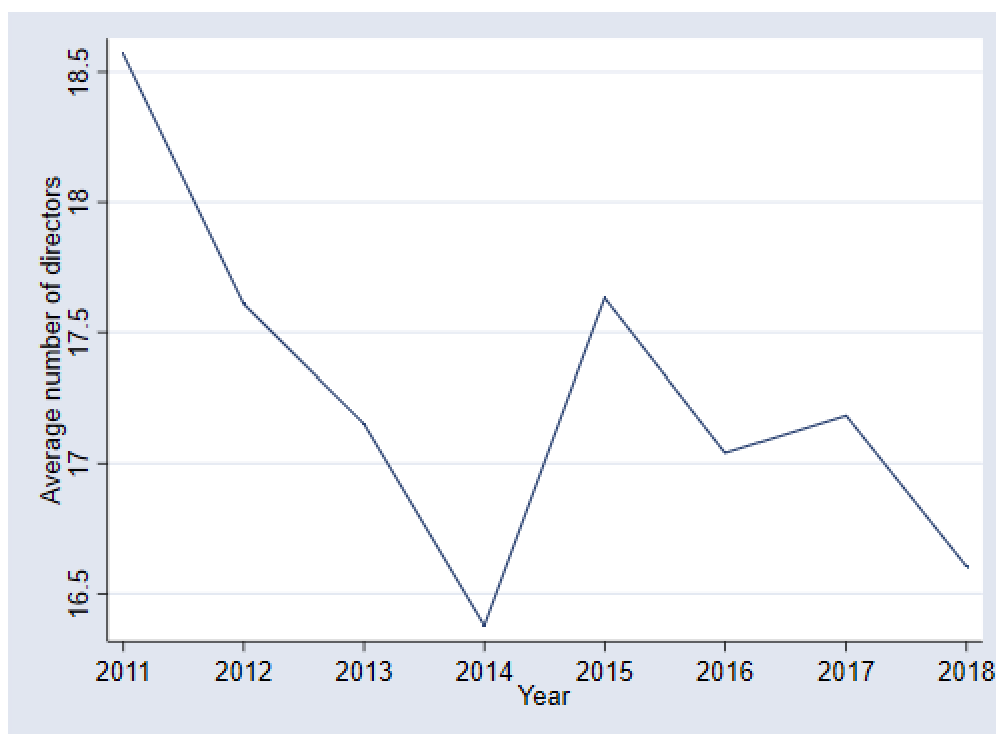
In this subsection, we examine trends in several board characteristics that are indicative of a board's collective suitability. These are board size, the share of independent directors, age diversity, gender diversity, and the share of directors with a foreign nationality.

Board size and the share of independent directors

Andres and Vallelado (2008) find an inverted U-shaped relation between bank size and bank performance as measured by the market-to-book value ratio of the bank for a sample of 69 commercial banks from six member countries of the Organization for Economic Cooperation and Development during the period 1995-2005. Specifically, the estimation implies an 'optimal board size' of around 19 directors. This finding suggests that very small boards lack the capacity and knowledge to perform well, while very large boards could be subject to free rider and communication problems that hinder performance. In a related paper, Pathan and Faff (2013) find a negative relation between bank performance, measured as pre-tax operating income divided by total assets, and board size for a sample of 212 US bank holding companies during the period 1997-2011. Taken together, these two studies guard against bank boards that are too large, as very large board size could hamper bank performance.

The average board size declined before the start of SSM in 2014, but it subsequently increased between 2014 and 2018 (see Figure 5). By 2018, the average board size was 16.6, which is fairly close to the number of 19 that was estimated to be optimal by Pathan and Fall (2013). Beyond that, it is difficult to say whether at present the average board size of SSM banks is too large or too small.

Figure 5. Board size



This figure displays the average number of directors of banks.

Pathan and Faff (2013) also find that bank performance decreases with the share of independent directors. To explain this result, they note that independent directors could be chosen primarily for conforming to regulatory requirements or that the market for high-performing independent directors is limited. Recently, several studies have addressed the implications of the share of independent directors for bank risk. Anginer, Demirgüç-Kunt, Huizinga and Ma (2018) show that US banks that were forced to increase their share of independent directors following the Sarbanes-Oxley Act of 2002 became riskier, perhaps reflecting that independent directors favour shareholder interests that generally are served by risky bank strategies (see box 2). In line with this, Erkens, Hung and Matos (2012) find that firms with a higher share of independent directors experienced worse stock returns during the financial crisis of 2007-2008, based on a sample of 296 financial firms from 30 countries.

Box 2: The concept of „independence"

In the context of this study, independent directors are board members not affiliated with the firm.

The concept of non-affiliation must not be confused with that of an independent mind set, nor with freedom from external pressure (applied by shareholders).

To measure how many board members have no affiliation with the firm (hence are non-executive directors, or independent external directors) makes in particular sense in countries that have one-tier governance structures, in which a unified board performs both management and supervisory functions. Under the two-tier system, there is a clear separation between the executive board of directors and the supervisory board, the latter typically comprising only or a majority of independent directors. In the EU, some countries have established one-tier systems, others two-tier systems.

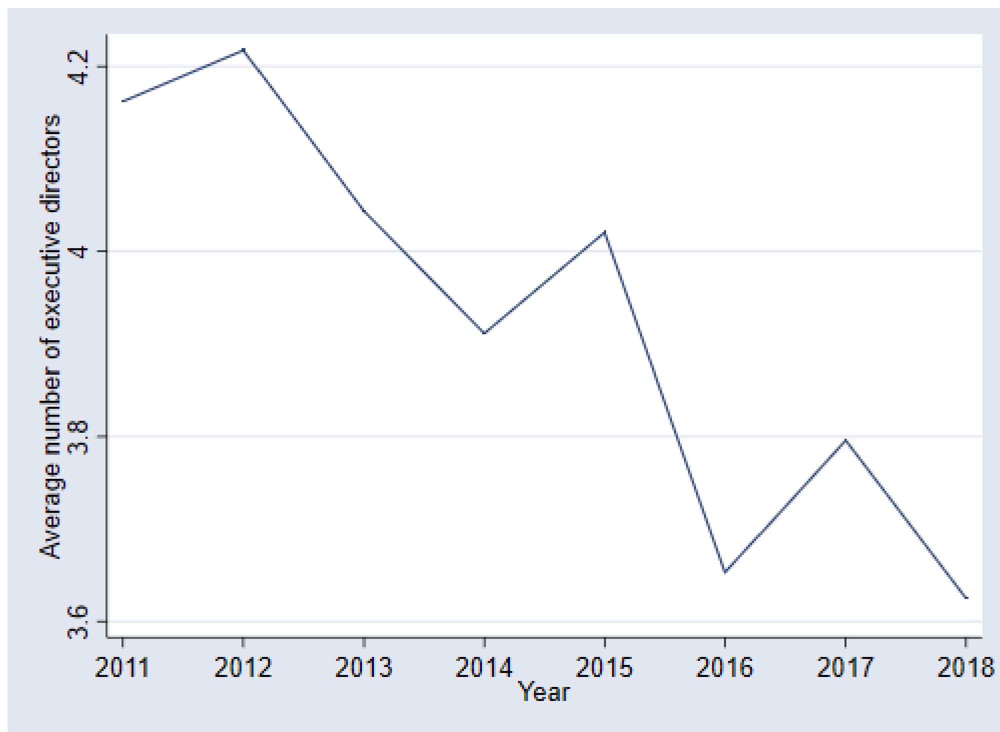
Non-affiliation with the firm does in any case not mean that independent directors are free from external pressure. In fact, shareholders, especially institutional shareholders, in a number of jurisdictions frequently communicate with the company and exert influence on the appointment of "independent" (external) board positions (in some cases, even leading to the right of appointing a certain number of board members). Under those circumstances, more independent directors on the board may therefore simply translate into a higher degree of shareholder influence.

Nguyen, Hagendorff and Eshraghi (2016), however, find that the probability of misconduct at banks is negatively related to the share of independent directors that were appointed before the current Chief Executive Officer (CEO), and hence can be taken to be truly independent of the current management. Misconduct surely is not in the interest of shareholders, and truly independent directors apparently have a useful role to play in reducing misconduct risk. Nevertheless, this is a very specific type of risk, and hence the research by Nguyen, Hagendorff and Eshraghi (2016) is not inconsistent with a positive association between the share of independent directors and bank risk strategies that do serve the interests of shareholders.

Figures 6 and 7 plot the average numbers of executive and non-executive directors, respectively, with non-executive directors being directors that are independent of management.[8] These figures show that by 2018, the average number of executive (non-executive) directors was lower (higher) than in 2014, at the time of the start of SSM.

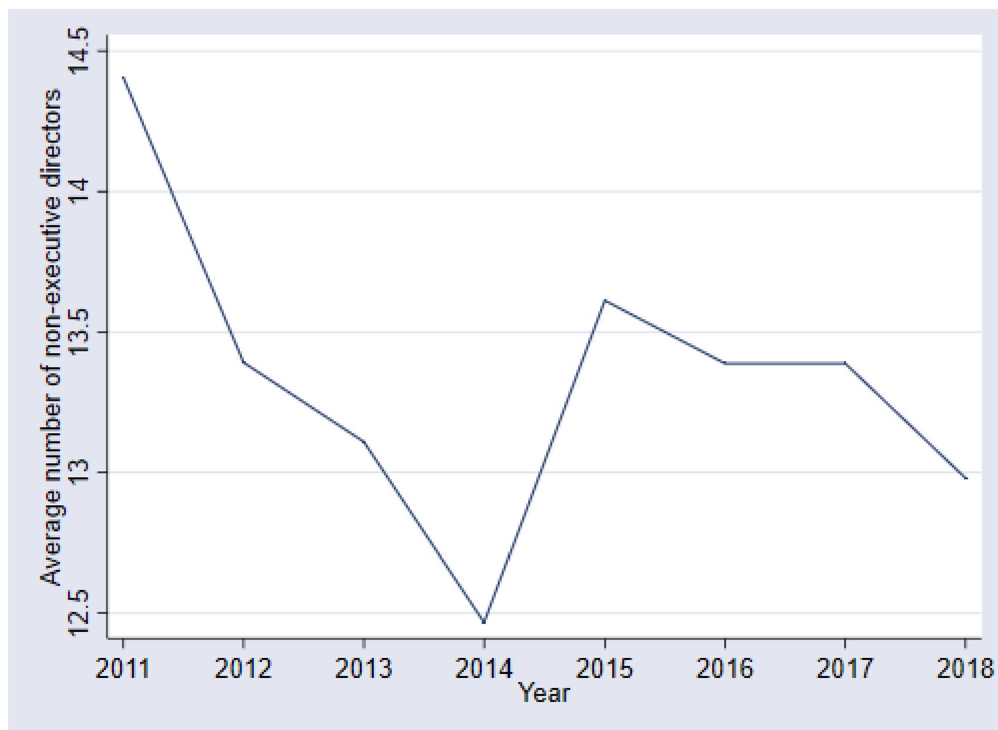
[8] We use the distinction between executive and non-executive directors made by BoardEx. Non-executive directors can be taken to be independent of management, but not necessarily of the firm, as these could include employee representatives. We also follow BoardEx in its determination of who is a director. Directors as provided by BoardEx may not always include all the top managers who are part of the management function as meant in the CRD IV and hence should be and in some instances probably are subject to fit and proper assessments by the ECB.

Figure 6. Number of executive directors



This figure displays the average number of executive directors of banks.

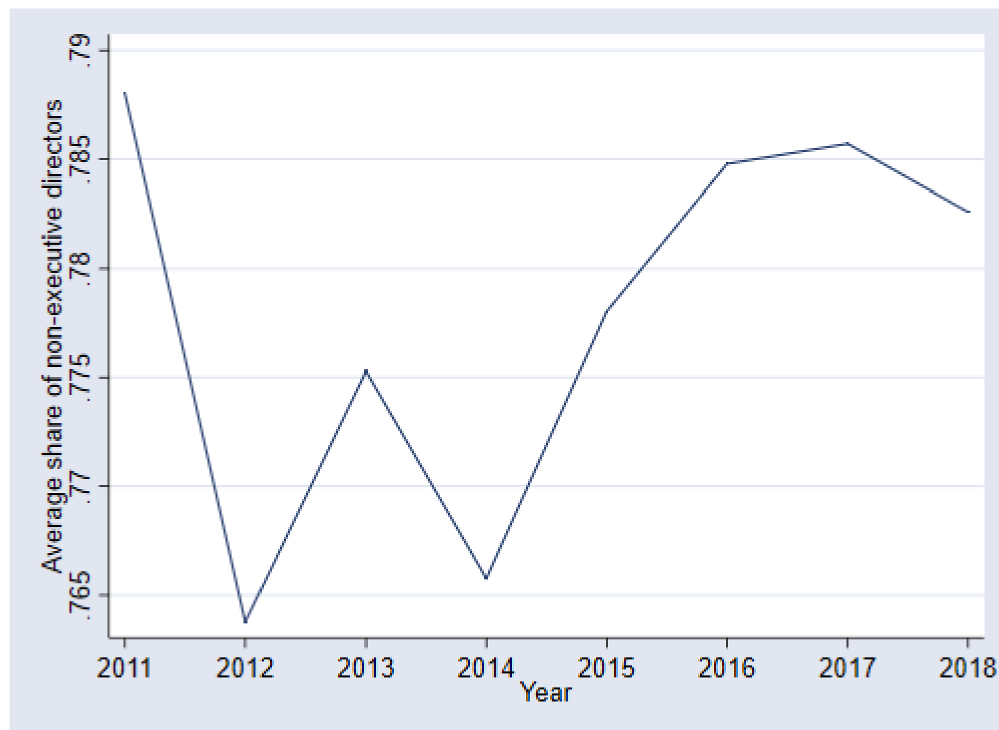
Figure 7. Number of non-executive directors



This figure displays the average number of non-executive directors of banks.

As a corollary, the share of non-executive directors rose after 2014 (see Figure 8). As suggested by prior empirical evidence, the increase in the share of non-executive directors during the SSM period potentially led to additional bank risk taking. Post-crisis regulatory reforms, however, have probably reduced the probability of bank bailouts in recent years. Thus, it is uncertain whether at present independent directors still support risky bank strategies with a view to increasing shareholder value. In the absence of empirical evidence on this, it is advisable that the ECB refrains from using fit and proper assessments to bring about a higher average share of independent directors in the years to come.

Figure 8. Share of non-executive directors



This figure displays the average share of non-executive directors of banks.

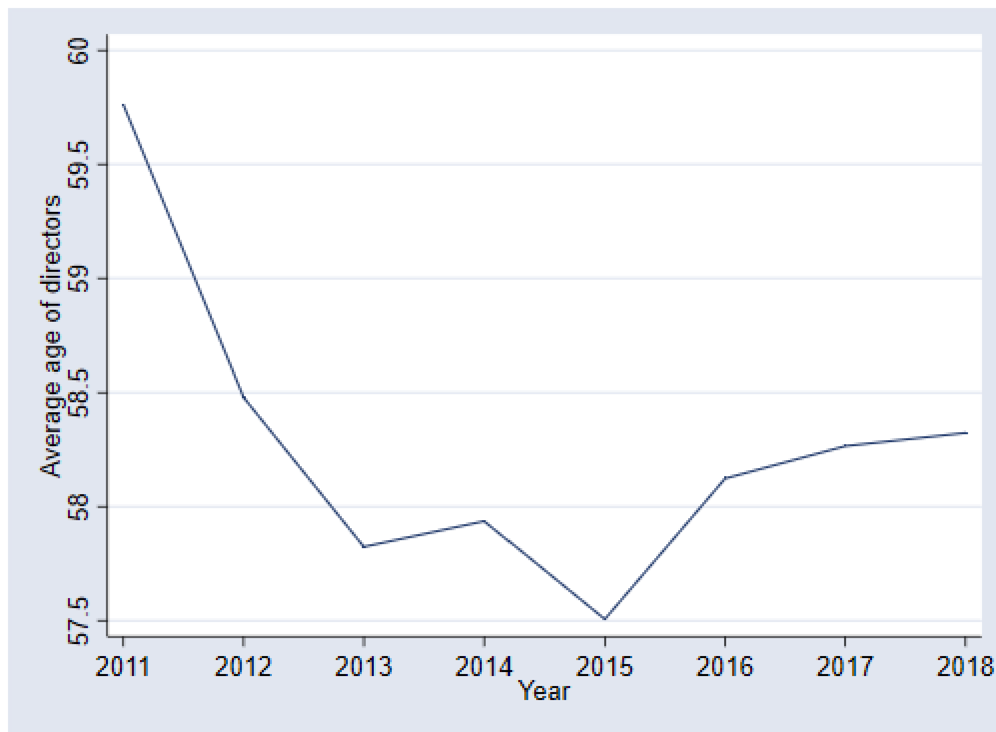
Age diversity

A director's ability to contribute to the board's tasks of monitoring and advising management is likely to change with age. Experience can only increase with age, but older directors may have less physical energy and up-to-date knowledge. A board's 'optimal average age' may vary over time, depending on the relative importance of, say, prior experience and knowledge about recent advances in technology. Beyond the average age of directors, bank performance can be affected by age diversity as well. Greater age diversity, in particular, could imply that board members bring different relevant experiences and knowledge to the board, but it could also harm board performance if age diversity becomes an obstacle to effective communication within the board. Two empirical studies suggest that age diversity has a negative impact on board performance. First, Wang and Hsu (2013) show that the probability of operational risk events is positively related to age diversity for a sample of financial institutions in the US between 1996 and 2010. Second, Talavera, Yin, and Zhang (2018) demonstrate that bank performance, as measured by ROA and Return on Equity (ROE), is negatively related to age diversity, while risk measures (the Z-score and the Nonperforming Loans (NPL) ratio) are not significantly affected by age diversity, for a sample of 97 Chinese banks over the period 2009-2013.

The average age of directors of banks in the SSM sample declined from 2011 to 2015, followed by an increase in more recent years. This development of the average director age over time could reflect

changing trade-offs between experience and up-to-date knowledge made by the banks themselves and by the ECB.

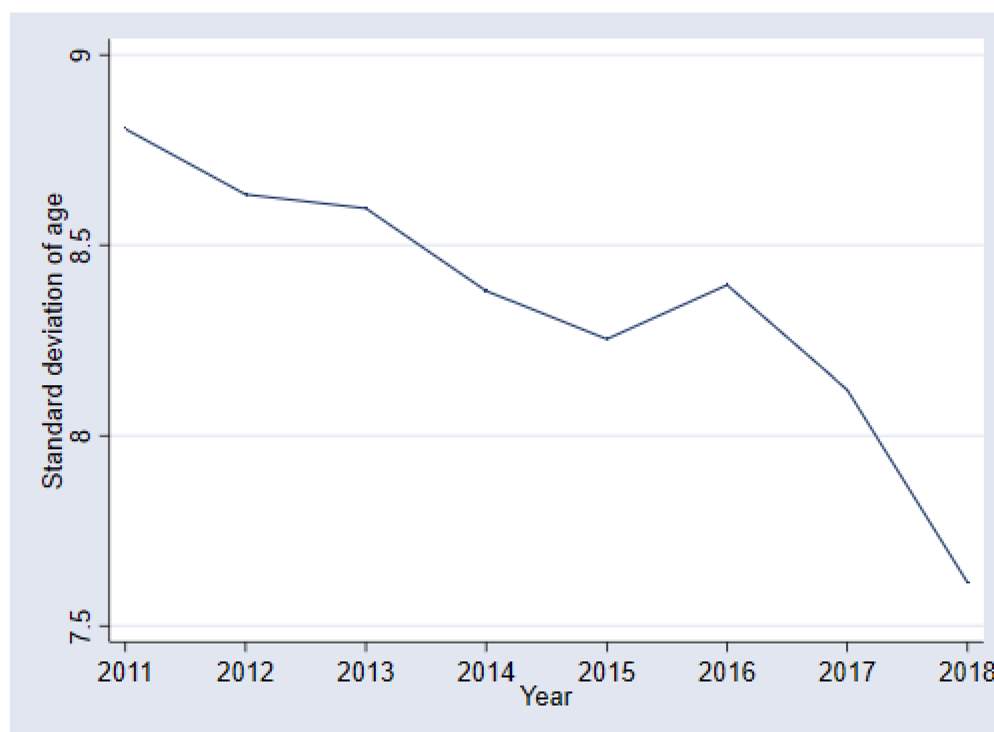
Figure 9. Average age of directors



This figure displays the average of the bank-level mean current age of directors.

Average age diversity, measured as the average standard deviation of director age across banks, declined in each of the years 2011-2018 apart from 2016 (see Figure 10). The above mentioned empirical evidence suggests that the decline in age diversity in recent years has been beneficial.

Figure 10. Standard deviation of the age of directors



This figure displays the average of the bank-level standard deviation of the current age of directors.

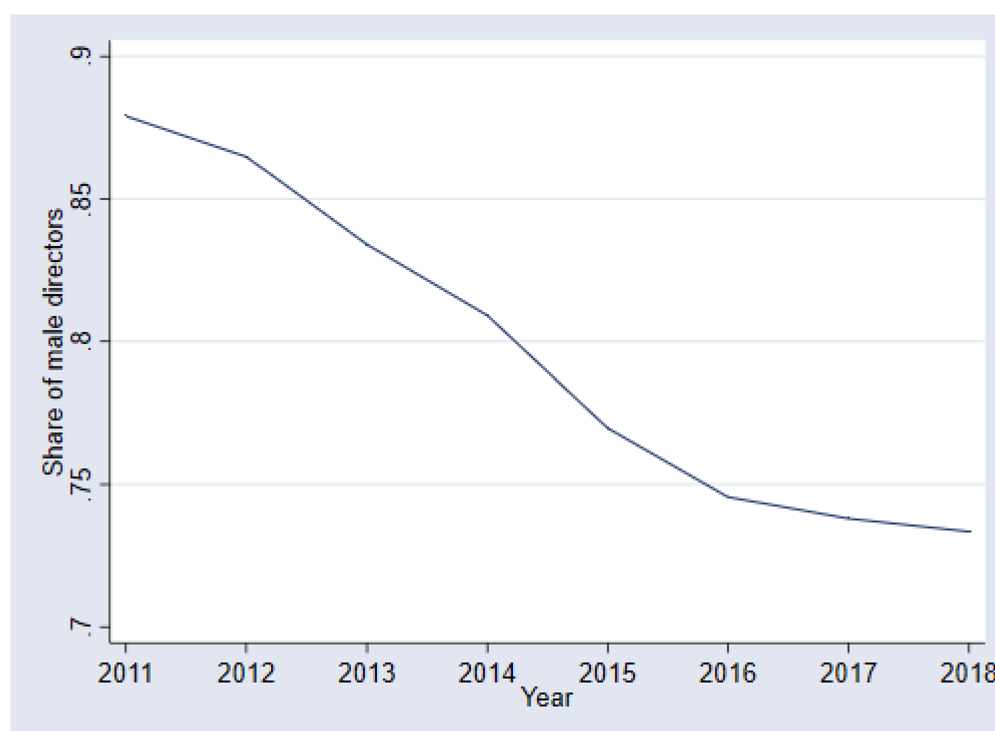
Gender diversity:

Gender diversity in the board could improve board performance through greater information availability, but it conceivably could lead to slower and more conflicted decision marking. Several recent studies suggest that gender diversity contributes positively to bank performance. Among these, Garcia-Meca, Garcia-Sanchez, and Martinez-Ferrero (2015) find that bank performance, proxied by the market-to-book value ratio and ROA, is positively related to the share of female directors for a sample of 159 banks in nine countries during the period 2004-2010. Similarly, Pathan and Faff (2013) estimate a positive association between bank performance, measured as pre-tax operating income divided by assets, and the share of female board members. Furthermore, Owen and Temesvary (2018) find that ROA is positively related to gender diversity, beyond a threshold value of gender diversity and in the case of better capitalized banks, for a sample of 90 US bank holding companies during 1999-2015. There is also evidence that gender matters for bank risk taking. In particular, Palvia, Vähämaa, and Vähämaa (2015) find that US commercial banks with female CEOs hold more conservative capital levels after controlling for the bank's asset risk, and that smaller banks with female CEOs and board chairs were less likely to fail during the financial crisis.[9]

Figure 11 shows that the share of male directors of banks in the SSM sample has declined throughout the 2011-2018 period, with potentially positive implications for bank performance. In 2018, the average share of male directors stood at 73.3%.

[9] Barber and Odean (2001) show that men trade stocks more excessively than women consistent with men being overconfident investors, reducing men's net returns relative to those achieved by women.

Figure 11. Share of male directors



This figure displays the average share of male directors of banks.

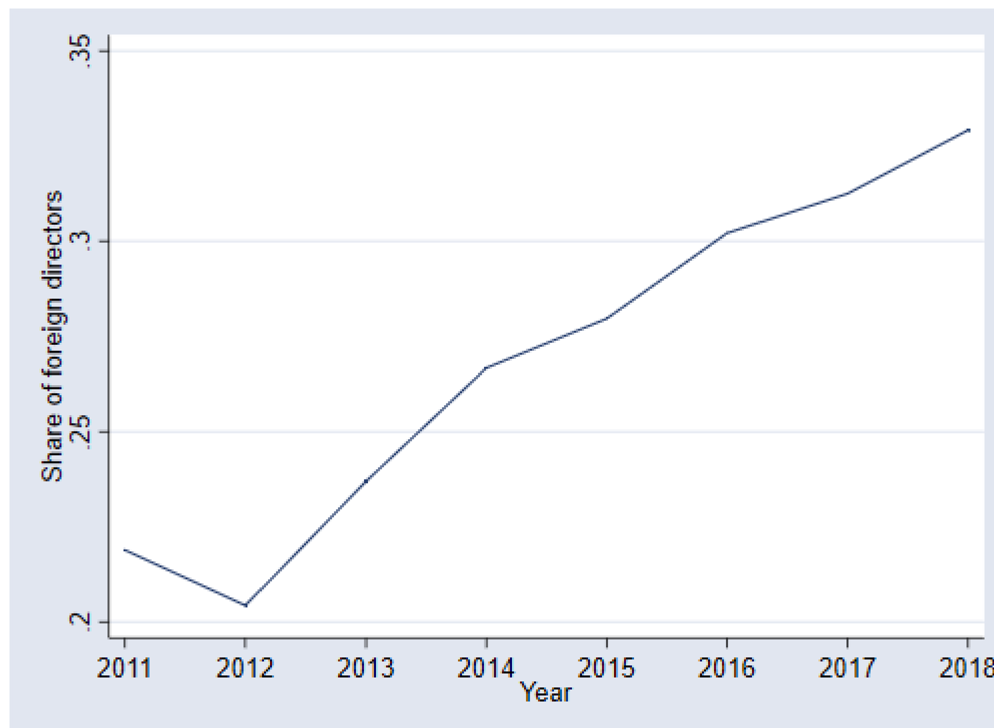
Foreign directors

Similarly, to gender diversity, more directors with a foreign nationality could bring additional relevant information to the board, but it could also potentially be a barrier to effective communication. The study by Garcia-Meca, Garcia-Sanchez, and Martinez-Ferrero (2015) mentioned above finds that bank performance, as measured by the market-to-book value of the bank and ROA, is negatively related to the share of directors with a foreign nationality.

As a related matter, Masulis, Wang and Xie (2012) examine the effects of the share of foreign independent directors, in the sense that they are based abroad, on the performance of US financial and nonfinancial firms over the 1998-2006 (the sample contains firms that are included in the S&P 1500 index). These authors report that the share of foreign-based independent directors is negatively related to firm performance as indicated by ROA. In addition, firms with more foreign independent directors have a greater likelihood of intentional financial misreporting, and a lower sensitivity of CEO turnover to performance. However, firms with more foreign independent directors are shown to make better cross-border acquisitions when the targets are from the home regions of these foreign directors.

Figure 12 shows a generally upward trend in the share of directors with a foreign nationality before and after the ECB started conducting fit and proper assessments in 2014. The available empirical evidence suggests that this trend towards more foreign directors could have been detrimental to bank performance.

Figure 12. Share of foreign directors



This figure displays the average share of directors with a foreign nationality of banks.

4. CONCLUSION

This paper documents trends in board characteristics of SSM banks during the period 2011-2018. This sample period enables us to ascertain whether board composition has developed differently during the SSM period compared to the pre-SSM period.

For some board characteristics, we observe that trends that already were in place before the SSM took effect continued afterwards. In particular, there have been trends towards a higher average number of qualifications of board members, and reductions in average current as well as cumulative board memberships throughout the 2011-2018 period. Furthermore, there have trends towards a lower age diversity of directors, and greater average shares of female directors and directors with a foreign nationality during the 2011-2018 period.[10]

Several board characteristics, however, show trends that are different after the inception of the SSM, possibly reflecting an influence of the ECB's fit and proper assessments. To start, the average age of directors of banks in the SSM sample declined from 2011 to 2015 followed by a small increase in more recent years. This variation in the average director age possibly reflects changing trade-offs between director experience and up-to-date knowledge made by the banks themselves and by the ECB.

Similarly, the average board size dropped before the ECB started conducting fit and proper assessments, and slightly increased afterwards. The implications of relatively small board size changes for bank performance are uncertain, as it is difficult to determine at which side of the 'optimal board size' SSM banks actually are.

Finally, the share of independent directors declined prior to SSM, but it increased subsequently. As suggested by prior empirical evidence, this increase in the share of independent directors during the SSM period potentially generated additional bank risk taking. Post-crisis regulatory reforms have probably reduced the probability of generous bank bailouts. Thus, it is uncertain whether at present independent directors still support riskier bank strategies with a view to increasing shareholder value. In the absence of empirical evidence on this, it is advisable that the ECB refrains from steering banks towards boards with a higher share of independent directors in the years to come.

[10] The mentioned empirical work by Palvia, Vähämaa, and Vähämaa (2015) finds that female board chairs assess bank risks more conservatively, which suggests that appointing additional female directors could have the benefit of reducing bank failure risks at the current time of economic crisis caused by the coronavirus.

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ANNEX A. LIST OF BANKS

Bank name	Country
AAREAL BANK AG	Germany
ABN AMRO Group NV (Listed 11/2015)	Netherlands
AIB GROUP PLC (Allied Irish Banks PLC prior to 12/2017)	Ireland
ALPHA BANK A E	Greece
BANCA MPS (Banca Monte Dei Paschi di Siena SpA prior to 08/2001)	Italy
BANCA POPOLARE DI SONDRIO SCARL	Italy
BANCO COMERCIAL PORTUGUES SA	Portugal
BANCO ESPIRITO SANTO SA (De-listed 02/2016)	Portugal
BANCO SABADELL SA	Spain
BANCO SANTANDER SA (Banco Santander Central Hispano SA prior to 08/2007)	Spain
BANK OF CYPRUS HOLDINGS PLC (Bank of Cyprus Public Company Ltd prior to 01/2017)	Cyprus
BANK OF IRELAND GROUP PLC	Ireland
BANK OF PIRAEUS SA	Greece
BANK OF VALLETTA PLC	Malta
BANKINTER SA	Spain
BBVA - BANCO BILBAO VIZCAYA ARGENTARIA SA	Spain
BNP PARIBAS SA	France
BPER BANCA SPA (Banca Popolare dell'Emilia Romagna Scarl prior to 12/2016)	Italy
Bank Degroof Petercam SA/NV (Bank Degroof SA/NV prior to 10/2015)	Belgium
Bank fur Arbeit und Wirtschaft und Osterreichische Postsparkasse AG (BAWAG PSK AG)	Austria
BayernLB AG (Bayerische Landesbank)	Germany
CAIXABANK SA (Criteria CaixaCorp SA prior to 07/2011)	Spain
COMMERZBANK AG	Germany
CREDEM - CREDITO EMILIANO SPA	Italy
CREDIT AGRICOLE SA	France
Caixa Geral de Depositos SA	Portugal
DEUTSCHE BANK AG	Germany
DEUTSCHE PFANDBRIEFBANK AG	Germany
DEXIA SA (De-listed 12/2019)	Belgium
ERSTE GROUP BANK AG (Erste Bank Der Oesterreichischen Sparkassen AG prior to 08/2008)	Austria
EUROBANK ERGASIAS SA (EFG Eurobank Ergasias SA prior to 08/2012)	Greece
GRUPPO BANCA CARIGE SPA	Italy
Groupe BPCE SA	France
HELLENIC BANK PUBLIC COMPANY LTD	Cyprus
HSBC France SA (Credit Commercial de France SA prior to 11/2005)	France
Hamburg Commercial Bank AG (HSH Nordbank AG prior to 02/2019)	Germany
Helaba Landesbank Hessen-Thuringen	Germany
ING GROEP NV	Netherlands
INTESA SANPAOLO SPA (Banca Intesa SpA prior to 01/2007)	Italy
KBC GROUP NV (KBC Bankverzekeringsholding prior to 03/2005)	Belgium
LIBERBANK SA	Spain
Landesbank Baden-Wurttemberg AG (LBBW)	Germany
NATIONAL BANK OF GREECE SA	Greece

NORDEA BANK ABP (Nordea Bank AB prior to 10/2018)	Finland
Nederlandse Waterschapsbank NV	Netherlands
Norddeutsche Landesbank Girozentrale	Germany
OP Financial Group (OP Osuuskunta) (OP-Pohjola Group prior to 01/2015)	Finland
RAIFFEISEN BANK INTERNATIONAL AG (Raiffeisen International Bank Holding AG prior to 10/2010)	Austria
SOCIETE GENERALE SA	France
UNICREDIT SPA (Unicredito Italiano SpA prior to 01/2008)	Italy
UNIONE DI BANCHE ITALIANE SPA (UBI BANCA) (Unione di Banche Italiane ScpA prior to 11/2015)	Italy

This paper examines trends in the size and composition of the boards of significant institutions during the 2011-2018 period, comprising several years before and after the ECB started conducting fit and proper assessments in 2014. Throughout this period, there have been trends towards directors who are more qualified, hold fewer other board positions, and are more likely to be female and a foreign national. Unlike in the pre-SSM period, however, more recently the average age of directors has increased, bank boards have become larger, and the share of independent directors has risen. The appointment of additional independent directors in recent years is potentially harmful to financial stability, as especially independent directors could favour riskier bank strategies with a view to increasing shareholder value.

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