(2017) 5 NIBLeJ 5

Book Review

Rebecca PARRY*

Rethinking Corporate Governance in Financial Institutions

Demetra Arsalidou

(Routledge 2016) ISBN 978-0-415-53546-5

The global financial crisis of 2008 led to significant amounts of anger as to regulatory failings and it has raised deep and complex questions regarding corporate governance in financial institutions. This important new book offers a well-researched and reflective study of key themes in this area. It is written by an author with a considerable track record of scholarship in this area. This book offers an insightful analysis of three ways in which the governance of financial institutions can be addressed, namely: personal accountability for bankers; executive remuneration incentives as a means of encouraging higher standards of performance; and improving levels of shareholder engagement and activism. By way of comparison, a concluding chapter looks at the position in the United States; other comparative insights are offered throughout the book.

In considering the ways in which the conduct of bankers may be understood the book draws upon behavioural economics, noting particular insights that this field of scholarship may offer, for example in relation to duties of loyalty, but noting also that more work needs to be done from a behavioural economics perspective in relation to the

* Rebecca Parry is Professor of Insolvency Law and the Director of the Centre for Business and Insolvency Law at Nottingham Law School, Nottingham Trent University, UK.

behaviour of bankers. Case studies are used to illustrate a problem of failures by directors to appreciate risks, observing that these problems arose in the Lehman and Northern Rock cases, while the point is made that the sort of conduct that was the subject of criticism is already familiar from director disqualification case law. Problems arising from limited liability are considered. Here the book, in common with lots of other literature, refers to limited liability as offering protection to directors, although this is somewhat of a shorthand term, as limited liability is fundamentally there for the protection of shareholders and this aspect might perhaps have been more clearly brought out. The book considers how personal liability can counter the problems of moral hazard that may have emerged due to the bank bailouts. It evaluates weaknesses of the director disqualification system, possible criminal liabilities, and wrongful trading type liabilities, while noting a role also for tort law. Finally, education is also considered as a possible way to encourage bankers to act ethically and responsibly. A blend of legal, regulatory and educational mechanisms is recommended as the best approach.

The book acknowledges the complexities of the issue of executive remuneration, tracing the controversies that arose in this context in the Royal Bank of Scotland case and the public interest aspects of this topic, while avoiding naïve criticisms of executive pay and noting that "well-designed pay arrangements, share options and other long-term incentives can benefit corporations greatly" (p 69). In a good review of both hard and soft laws in this area and relevant literature it discusses efforts to regulate executive pay in corporate governance codes in the UK, considers efforts at EU level and also commends the approach in Australia. A nuanced blend of hard and voluntary *ex ante* mechanisms and hard law *ex post* responses to failure is advocated for all widely held companies and some good suggestions are made in these regards.

The problem of shareholder engagement is also considered and the efforts to foster stewardship by institutional investors discussed, while the author notes that genuine implementation of the UK Stewardship Code's principles will be a significant challenge. Factors that may limit shareholder engagement are well brought out and the book again draws on behavioural economics, as well as behavioural psychology, in this regard. Accordingly, it is argued that before institutional investors are asked to become stewards, the area needs to be rethought and a number of suggestions are made in this regard.

Chapter 4 reflects on the experience in the United States, discussing corporate governance problems that arose in the Enron and Lehman cases and highlighting efforts to regulate executive pay. The Epilogue then focuses on the cyclical nature of major financial crises and urges that efforts be made to change corporate culture.

This book reflects a good deal of research and insight and is commendable for its efforts to offer balanced solutions to governance failings that have had very serious impacts. It is a well-written book that will be of interest to researchers and students of corporate law and financial law, as well as business studies students.