

SPECIAL COMMENT

Bank Boards in the Aftermath of the Financial Crisis

Board of Director Composition at 20 Large Banks

Table of Contents:

SUMMARY OPINION	1
WHY BOARD COMPOSITION IS AN IMPORTANT CONSIDERATION IN OUR ANALYSIS	3
MANY BANKS HAVE MADE CHANGES THAT WE VIEW POSITIVELY...	4
High degree of board turnover potentially improves oversight quality and independence	4
Turnover has improved outside director financial industry experience	5
...BUT THERE IS STILL ROOM FOR IMPROVEMENT	5
Independent leadership could be improved; former CEOs serving on some boards	5
Independent board leadership	5
Former CEOs on boards	5
Financial industry experience is still weak or absent at some banks	6
Relatively low board independence levels at a minority of banks	6
Boards are generally too large, which could hamper their effectiveness	6
MOODY'S RELATED RESEARCH	7
APPENDIX: SUMMARY DATA TABLE	8

Analyst Contacts:

NEW YORK	1.212.553.1653
Christian Plath	212.553.7182
<i>Vice President</i>	
Christian.Plath@moodys.com	
Mark LaMonte	212.553.0455
<i>Team Managing Director</i>	
Mark.Lamonte@moodys.com	

Summary Opinion

The financial crisis has raised questions about the effectiveness of board oversight at some large banks, including whether or not boards were comprised of a sufficient number of directors with relevant financial industry experience who could ask the right questions and appropriately challenge management in key areas such as risk management and strategy.

There has been a flurry of changes to many bank boards since the beginning of the financial crisis, particularly at banks where governments have or had taken ownership stakes or provided extraordinary support. This report reviews the degree and potential impact of changes to board of director¹ composition at 20 large, global banks in North America and Europe since the beginning of the crisis in July 2007, and it also assesses the potential governance and credit implications.

Among our findings, we discovered that more boards are now in a better position in terms of composition:

- » The high degree of board turnover at many banks has added new ideas and fresh perspectives, potentially helping to improve the quality of board oversight and independence. The bank boards we examined turned over nearly one-third (32%) of their outside (non-executive) directors, on average.
- » The turnover has also improved the level of financial industry experience on bank boards. Roughly half (46%) of the banks' outside directors now have financial backgrounds, as opposed to roughly one-third (32%) pre-crisis, on average.

¹ Or supervisory board, in jurisdictions with a two-tiered board structure.

However, there remains room for improvement:

- » Independent board leadership could be reinforced; former CEOs continue to serve on some boards, often as chairman.
- » Financial industry experience among outside directors remains weak or is just absent at some banks.
- » Board independence levels are relatively low at a minority of banks.
- » Bank boards are generally too large, which could hamper their effectiveness.

The ability of boards of directors to provide effective oversight is an important factor in our overall assessment of corporate governance at major banks. For the banks whose ratings were most affected by the crisis, we will want to gain comfort around improvement to the banks' governance practices, including board composition, risk governance and executive compensation, before significant upgrades begin to take place, and before failure to make changes could contribute to downwards rating pressure.

Why Board Composition Is an Important Consideration in our Analysis

Board composition is an important consideration in our analysis of large banks' corporate governance practices because it affects a host of critical corporate governance issues, including the ability of board to act as an effective check on management, the quality of risk oversight, and ensuring proper culture and "tone at the top". Boards of directors of large, multinational companies have substantial responsibilities, and investors have the right to expect (a) that the boards of these companies will have directors with high levels of business operating experience who have the time and dedication to do a credible job, and (b) that a given board will reflect the strategic needs of the company.

These issues are increasingly important, given bank size and complexity and in order to meet the increased expectations of regulators, institutional investors, the public and others to ensure proper board effectiveness in the wake of the financial crisis. For example, new Securities and Exchange Commission (SEC) disclosure rules – applicable to all U.S. public companies – address director qualifications/experience and rationale for board leadership structure. U.K. regulators are also considering the implementation of new rules and best practice standards following the publication of the final recommendations of the Walker review (See Box).

Heightened Regulatory Focus in U.S. and UK on Board Composition and Leadership

U.S.: Many of the SEC's new proxy disclosure enhancement rules, effective as of Feb. 28, 2010 and applicable to all public companies, focus on director qualifications and board leadership structure.

- **Director qualifications.** The new rules expand on the required information provided about the background and experience of current and nominee directors. Disclosures should include information about the experience, qualifications, and attributes considered in the nomination and reasons why the individual should serve on the company's board.
- **Board leadership structure.** The rules require disclosure of a company's leadership structure and why it has chosen to either combine or separate the positions of chairman and chief executive. The SEC does not take a view about which structure is most appropriate, but it requires companies to explain why it believes the current structure is appropriate. If the roles are combined, the company must disclose whether it has designated a lead independent director and, if so, provide details of the individual's role.

UK: Many of the final recommendations of the Walker Review (published November 2009) on corporate governance in the UK banking industry relate to the roles and competence of key individuals in firms' governance structures. For example, the report recommends that the chairman of a major bank should bring a combination of relevant financial industry experience and a track record of successful leadership capability in a significant board position. The overall time commitment of non-executive directors (NEDs) should be greater than has been normal in the past, and several NEDs should expect to devote a minimum 30-36 days per year to board service.

The Financial Services Authority (FSA) is currently seeking comment on which of the recommendations could be implemented through regulatory action. Additionally, it is expected that many of the recommendations will be incorporated into the revised UK Corporate Governance Code. The Code is currently under review, and the revised code is expected to apply for accounting periods beginning on or after June 29, 2010.

Moody's will closely monitor changes to board of director composition and leadership, particularly at the banks whose ratings were most affected by the crisis. As the environment for the banking sector improves, we will want to gain comfort about the banks' strengthened governance practices, including board composition, risk governance, and executive compensation, before significant upgrades begin to take place, and before failure to make changes could undermine ratings.

Many Banks Have Made Changes That We View Positively...

High degree of board turnover potentially improves oversight quality and independence

Many of the banks in our sample have seen high board turnover levels—in particular those that were hit hardest by the financial crisis. The changes potentially help improve the quality of board oversight and independence by adding directors with new ideas and fresh perspectives (and relevant backgrounds/skills – see below). Our analysis shows the following:

- » On average, boards turned over one-third (33%) of their directors and added four new ones since the onset of the financial crisis.
- » Six banks have turned over half or more of their outside directors: UBS (75%); RBS (67%); Bank of America (67%); Lloyds (56%); and Citigroup and HSBC (50% each).²
- » Generally, banks that became partly government owned or have/had received extraordinary government assistance saw the most board turnover, and most of these were banks that experienced the largest downward Bank Financial Strength Rating (BFSR) migrations.
- » Nominal board independence is unchanged, and roughly 70% of the boards are independent on average according to our standards.³ However, we believe actual independence may have improved, given the removal of many longer-tenured or other directors that may have been “too close” to management.

Board changes may also have helped to enhance a board's regional representation. At Bank of America, for example, in addition to noting potential improvements in board oversight stemming from high level of board changes, we commented⁴ favorably about the broadening of the board's representation to better reflect its wide footprint.

For the banks that made sweeping changes to their boards, we believe this turnover will ultimately be beneficial. Nevertheless, we note that it will take the new directors time to come up to speed on the details of business operations. It may therefore be a number of years before these directors are fully effective. We also point out that changes in and of themselves are insufficient. Boards must be willing and able to hold management to account and to be assertive when necessary.

² As of the date of this report, nine banks (Bank of America, Citigroup, Goldman Sachs, HSBC, Lloyds, RBS, Société Générale, UBS and Wells Fargo) have publicly announced additional board changes that will take place at or before their 2010 shareholder meetings. The data shown in this report is as of the publication date and excludes these planned changes.

³ For the North American banks in our sample, we assessed independence using our criteria for assessment of director independence (See Special Comment: [Criteria for Assessing Director Independence](#), October 2006 (100302)). Outside of North America, we relied primarily on the company's determination of independence under applicable local corporate governance codes.

⁴ See Issuer Comment: [Moody's Comments on Latest Changes to BofA's Board of Directors, Governance](#), September 25, 2009.

Turnover has improved outside director financial industry experience

One of the major criticisms levied at many bank boards is that they lacked a significant contingent of outside directors with extensive and first-hand financial industry experience or that this experience was dominated by insiders or former insiders (i.e. former senior executives of the bank). To a great extent, this reflected a desire to avoid appointing directors who may have potential conflicts of interest associated with competitor financial-service companies. Nonetheless, there is now a much greater focus on ensuring that boards are composed of a sufficient number of outside directors with relevant financial industry experience. Ideally, these individuals can ask the right questions and be better equipped to challenge management in key areas such as risk and strategy.

We find that, on average, roughly half (46%) of the banks' outside directors now have financial backgrounds vs. roughly one-third (32%) of those that did pre-crisis. In general, banks that are/were partly government owned or have/had received extraordinary government assistance added the most financial experience: Bank of America, Citigroup, Lloyds, RBS, and UBS. Barclays also added a significant level of financial experience to its board. Lloyds Banking Group and UBS have made the most significant changes to date. In July 2007, only one of Lloyds' outside directors had this type of background, compared with five presently. At UBS, the figures are one director in July 2007 and seven currently.

...But There Is Still Room for Improvement

Independent leadership could be improved; former CEOs serving on some boards

Independent board leadership

Independent board leadership presents a mixed picture. In July 2007, 13 banks had split the roles of chairman and CEO; and Moody's considered seven of these chairmen to be independent. Currently, 15 banks split the role, and nine chairmen are independent by our standards. The two banks that split the roles that did not previously split them are Bank of America and Citigroup. Four banks that had previously split the roles have new independent chairman: CIBC, Lloyds, RBS, and UBS.

However, nine banks do not have any form of independent board leadership (either via an independent chairman or independent lead director / senior independent director role): BNP Paribas, Credit Suisse, Deutsche Bank, Goldman Sachs, JPMorgan Chase, KBC, Santander Group, Société Générale, and Wells Fargo.

For U.S. boards, we have taken the view that some form of independent board leadership—either an independent chairman or strong independent lead director—bolsters board effectiveness.⁵ We also view this practice favorably in other jurisdictions. Furthermore, we believe independent board leadership is particularly useful in certain situations, including the following: (a) if the board is large (15+ members); (b) if there is low proportion of independent directors; and (c), during a leadership transition period. These situations apply to many of the banks in our sample.

Former CEOs on boards

The bank's previous CEO continues to serve on the board at four banks (three as chairman), down from six banks (four as chairman) pre-crisis. This as an improvement, but in general we view negatively the practice of a former CEO remaining on the board for an indefinite period (typically not

⁵ See Special Comment: [Board Leadership: A Positive View on Non-executive Chairs and Lead Directors](#), August 2006 (98557).

longer than a transition period of 12-18 months) because his or her presence can undermine the new CEO's authority and reduce his or her flexibility to make course corrections or instill cultural change, if needed.⁶

Financial industry experience is still weak or absent at some banks

The BNP Paribas, Deutsche Bank, JPMorgan Chase, KBC, and Wells Fargo boards have the least financial industry experience among outside directors; 20% or fewer of the outside directors possess relevant experience at these banks. JPMorgan Chase currently does not have any outside directors with financial industry experience. Of the two outside directors with relevant financial experience on the BNP Paribas and Deutsche Bank boards, one is the former CEO (BNP Paribas) and one is the supervisory board chairman (Deutsche Bank), who is a former senior executive at the bank. We therefore believe these banks could benefit from the addition of new directors with banking or other relevant financial industry experience.

Relatively low board independence levels at a minority of banks

A minority of banks in our sample could benefit from improved board independence levels, in our view. Currently, the Deutsche Bank (45%), KBC (14%), and Santander Group (48%) boards are all less than 50% independent.⁷

We believe it is reasonable to expect that at least a majority of the directors of large, global banks, be independent. A high standard of director independence is merited by the view that dispassionate, objective debate at the board level is integral to strong oversight of management.

Boards are generally too large, which could hamper their effectiveness

Board size now averages 16 members, or the same as before the crisis, although some banks have reduced board size. RBS, for example, cut the size of its board from 16 to 12 current members to facilitate the bank's restructuring process. Nonetheless, several banks continue to maintain large boards; four of the banks have 20 or more members.

Moody's prefers smaller boards (of approximately nine-12 members) to facilitate quick decision-making (particularly in a crisis); to enable a more detailed review of key issues; and allow for the active participation of all directors. Goldman Sachs (12 members), JPMorgan Chase (11 members), RBS (12 members) and UBS (12 members) are currently the only banks within this range.

⁶ See Special Comment: [Analyzing Credit and Governance Implications of Management Succession Planning](#), May 2008 (108948).

⁷ We note that in some Continental European jurisdictions, company law mandates employee representation on corporate boards/supervisory boards. Board independence levels may be constrained as a result (and board size increased). For example, under Germany's "Co-determination Law", employees elect one-third or one-half of the supervisory board, depending on company size.

Moody's Related Research

Special Comments:

- » [Risk Governance at Large Banks: Current Status and Credit Implications, July 2009 \(118784\)](#)
- » [Corporate Governance in the Credit Crisis: Key Considerations for Investors, November 2008 \(112847\)](#)
- » [Analyzing Credit and Governance Implications of Management Succession Planning, May 2008 \(108948\)](#)
- » [Criteria for Assessing Director Independence, October 2006 \(100302\)](#)
- » [Board Leadership: A Positive View on Non-executive Chairs and Lead Directors, August 2006 \(98557\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Appendix: Summary Data Table

BANK NAME	BOARD SIZE 7/07	CURRENT BOARD SIZE	# NEW NEDs ADDED	% NEW NEDs	# NEDs W/ FIN'L EXPER. ADDED	% NEDs W/ FIN'L EXPER 7/07	CURRENT % NEDs W/ FIN'L EXPER	SPLIT CHAIR-CEO?	CHAIR IS IND?	FORMER CEO SERVES ON BOARD?	% BOARD INDEPEND.	BFSR OR RATING 7/07	CURRENT BFSR OR RATING	CURRENT OUTLOOK
Bank of America	17	15	8	67%	5	15%	42%	Y	Y	N	80%	A	C-	Stable
Barclays	16	13	3	28%	3	46%	80%	Y	Y	N	77%	B+	C	Stable(m)
BNP Paribas	15	14	1	9%	0	17%	19%	Y	N	Y (as chairman)	72%	B	B-	Stable
CIBC	17	16	5	34%	2	24%	40%	Y	Y (new chair)	N	88%	B-	B-	Neg
Citigroup	13	17	8	50%	7	17%	44%	Y	Y	N	95%	A	C-	Stable(m)
Credit Suisse	13	14	3	16%	2	62%	72%	Y	N (new chair)	N	79%	B	B	Neg
Danske Bank	15	15	1	10%	0	30%	30%	Y	Y	N	67%	B	C	Stable(m)
Deutsche Bank	20	20	3	33%	1	10%	20%	Y	N	N	45%	B	C+	Stable
Goldman Sachs	12	12	2	19%	1	45%	40%	N	N/A	N	67%	Aa3	A1	Neg
HSBC	18	21	7	50%	4	22%	36%	Y	N	Y (as chairman)	72%	B	C+	Neg
JP Morgan Chase	12	11	0	0%	0	9%	0%	N	N/A	N	91%	B+	B	Neg
KBC	26	22	7	37%	1	N/A	16%	Y	N	N	14%	B-	C+	Neg(m)
Lloyds Banking Group	14	14	5	56%	5	13%	78%	Y	Y (new chair)	N	65%	B+	C-	Stable(m)
Morgan Stanley	12	14	2	17%	2	64%	75%	Y	N (new chair)	Y (as chairman)	70%	Aa3	A2	Neg
RBS	16	12	7	67%	5	55%	89%	Y	Y (new chair)	N	67%	B+	C-	Stable(m)
Santander Group	19	19	0	0%	0	62%	62%	Y	N	Y	48%	B	B-	Neg
Société Générale	15	13	3	30%	1	46%	50%	N	N/A	N	70%	B	C+	Neg
UBS	11	12	9	75%	7	12%	59%	Y	Y (new chair)	N	100%	A-	C	Neg
UniCredit Group	23	23	5	32%	4	N/A	37%	Y	Y	N	70%	B+	C	Stable(m)
Wells Fargo	16	17	4	25%	1	27%	19%	N	N	N	94%	A	C	Stable(m)
Averages	16.0	15.7	4.2	33%	2.6	32%	46%				72%			

Source: Corporate proxy statements, annual reports and company websites.

Notes: "NED's" refers to non-executive (outside) directors. The data is current as of the date of this report and does not reflect planned board changes that will occur at banks' 2010 annual shareholder meetings.

Report Number: 123831

Author(s)
Christian Plath

Production Associate(s)
Cassina Brooks

© 2010 Moody's Investors Service, Inc. and/or its licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ARE MOODY'S INVESTORS SERVICE, INC.'S ("MIS") CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MIS DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS DO NOT CONSTITUTE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS ARE NOT RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. CREDIT RATINGS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MIS ISSUES ITS CREDIT RATINGS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The ratings, financial reporting analysis, projections, and other observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. Each user of the information contained herein must make its own study and evaluation of each security it may consider purchasing, holding or selling. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

MIS, a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MIS have, prior to assignment of any rating, agreed to pay to MIS for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody.com under the heading "Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Any publication into Australia of this Document is by Moody's affiliate Moody's Investors Service Pty Limited ABN 61 003 399 657, which holds Australian Financial Services License no. 336969. This document is intended to be provided only to wholesale clients (within the meaning of section 761G of the Corporations Act 2001). By continuing to access this Document from within Australia, you represent to Moody's and its affiliates that you are, or are accessing the Document as a representative of, a wholesale client and that neither you nor the entity you represent will directly or indirectly disseminate this Document or its contents to retail clients (within the meaning of section 761G of the Corporations Act 2001).