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Board to Death: How Busy Directors Could Cause the Next Financial Crisis

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BOARD TO DEATH: HOW BUSY DIRECTORS COULD CAUSE THE NEXT FINANCIAL CRISIS

Jeremy C. Kress*

In the aftermath of the Great Recession, shareholders and regulators expect financial institution boards of directors to play an active role in risk management. To date, however, shareholders, policymakers, and academics have ignored a critical shortcoming: the directors of the United States' largest financial institutions are too busy to fulfill their governance responsibilities. Many financial institution directors hold full-time executive positions, and most serve on the board of at least one other company. While these outside commitments provide important learning and networking opportunities, they also contribute to cognitive overload and limit the time that directors spend assessing strategy and risk.

This Article argues that overcommitted directors impair the governance of large financial institutions. These firms, by virtue of their complexity and systemic importance, require enhanced risk monitoring that busy directors are ill equipped to provide. Nonetheless, the boards of many large financial institutions remain alarmingly overcommitted. Through a series of case studies—including Wells Fargo's fraudulent accounts scandal and JPMorgan's London Whale trades—this Article explores how busy directors inhibit oversight of management, increase the risk of firm failure, and could cause the next financial crisis. The Article proposes a series of reforms to alleviate director overcommitment and thereby enhance the stability of the financial system.

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I. Introduction

The winter of 2012 was a busy time for James Crown. As the lead independent director of Sara Lee Corporation,[1] Crown began the year by conducting a search to replace Sara Lee's CEO and overseeing a spin-off of Sara Lee's non-core businesses.[2] Meanwhile, defense contractor General Dynamics Corporation—where Crown also served as lead independent director—was scrambling to cope with $1 trillion in congressionally mandated defense budget cuts.[3] At the same time, Crown—the grandson of a wealthy industrialist—managed stakes in the Chicago Bulls, New York Yankees, Rockefeller Center, and the Aspen ski resort as president of his family's multi-billion dollar investment company.[4]

As if that were not enough, Crown also served on the board of the largest financial institution in the United States, JPMorgan Chase & Co.[5] Crown, in fact, occupied a crucial role on JPMorgan's board—he chaired the Risk Policy Committee (RPC), which was responsible for overseeing significant risks facing the firm.[6]

JPMorgan's winter proved to be eventful. A trader in the firm's London office began amassing risky credit derivatives.[7] The trader's position soon dominated the market—rival firms started referring to him as the "London Whale." Neither the RPC nor JPMorgan's risk management systems, however, detected the escalating risk within the company. While Crown attended to crises at Sara Lee and General Dynamics, the market turned against JPMorgan's now-massive derivatives position. Just weeks before Crown finalized Sara Lee's spin-off,[8] JPMorgan publicly disclosed billions of dollars of losses on the London Whale trades.[9]

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[1] *See* Sara Lee Corp., Proxy Statement (Form DEF 14A) 6 (Sept. 15, 2011).

[2] *See* Melissa Korn & Ilan Brat, *Sara Lee to Split Into Two Public Companies*, WALL ST. J., Jan. 29, 2011, at B4; Emily B. York, *Sara Lee Hires Soup Exec to Lead MeatCo*, CHI. TRIB., Jan. 7, 2012, at 10; *see also Sara Lee Chief Is Leaving After a Stroke*, N.Y. TIMES, Aug. 10, 2010, at B6.

[3] *See* General Dynamics Corp., Annual Report (Form 10-K) 10, 19 (Feb. 17, 2012); *see also* Marjorie Censer, *Defense Contractors' Earnings Down as Pentagon Makes Cuts*, WASH. POST, Jan. 30, 2012, at A11 (quoting General Dynamics' CEO warning that the company is "bracing for significant change" as a result of cuts).

[4] *See* Luisa Kroll, *The Forbes 400: Billionaires 11-99*, FORBES, Oct. 11, 2010, at 36 (describing Crown family's investments); Melissa Harris, *JPMorgan Board Members Targeted: Advisory Firms Recommend Shareholders Reject Re-election After 'London Whale'*, CHI. TRIB., May 12, 2013, at 1 (noting that Crown signs off on all of his family's major investment decisions and oversees the management of all Crown family businesses).

[5] *See* JPMorgan Chase & Co., Proxy Statement (Form DEF 14A) 4 (Apr. 4, 2012).

[6] *See id.* at 9.

[7] For a detailed discussion of JPMorgan's trading loss, see Section IV.B. For further background, see Jill E. Fisch, *The Mess at Morgan: Risk, Incentives and Shareholder Empowerment*, 83 U. CIN. L. REV. 651, 655-59 (2015); Hillary A. Sale, *J.P. Morgan: An Anatomy of Corporate Publicness*, 79 BROOK. L. REV. 1629, 1636-39 (2014).

[8] *See* Press Release, Hillshire Brands Co., The Hillshire Brands Company Announces Completion of Spin-off and Payment of Special Cash Dividend (June 28, 2012), http://www.businesswire.com/news/home/20120628006413/en/Hillshire-Brands-Company-Announces-Completion-Spin-off-Payment.

[9] *See* Dan Fitzpatrick et al., *J.P.Morgan's $2 Billion Blunder*, WALL ST. J., May 11, 2012, at A1. JPMorgan ultimately incurred $6.2 billion in losses and more than $1 billion in fines for inadequate risk monitoring. *See* JPMorgan Chase & Co., Quarterly Report (Form 10-Q) 12 (Nov. 8, 2012); Danielle Douglas, *CFTC Will Fine JPMorgan $100 Million in 'Whale' Case*, WASH. POST, Oct. 17, 2013, at A17.

America's boardrooms are filled with directors, like Crown, who serve as directors or executives of other firms.[10] Shareholders believe that leaders of other companies will be strong contributors in the boardroom.[11] Directors with many affiliations, the conventional wisdom goes, are more effective because they acquire valuable knowledge and practice by serving in governance capacities at other firms.[12] As a result, director candidates who sit on many corporate boards and serve as full-time executives are in high demand among the United States' largest companies.[13]

This Article challenges the conventional wisdom that more is better when it comes to directors' professional commitments. To the contrary, the Article argues that other board seats and outside employment limit a director's availability, contribute to cognitive overload, and thereby diminish the director's effectiveness. Drawing on psychological principles and empirical evidence, the Article demonstrates that overcommitted directors withdraw from corporate decision-making, tend not to challenge management, and experience attention shocks that distract them from company business.[14]

This Article's key insight is that the drawbacks of director busyness are especially severe for large, complex financial institutions because of the special governance demands imposed on their boards. In contrast to nonfinancial firms, financial institutions' unique combination of high leverage and short-term funding can trigger sudden liquidity crises that spread rapidly through interconnectedness and contagion.[15] Shareholders and regulators, therefore, expect financial institution directors to implement and oversee monitoring systems to detect misconduct and excessive risk-taking.[16] Enhanced risk monitoring, however, is precisely the type of oversight that busy directors are ill equipped to provide.

This Article assesses the drawbacks of director busyness through case studies of Wells Fargo's fraudulent accounts scandal and JPMorgan's London Whale trades. In both cases, key directors who were overextended with outside commitments inhibited oversight and prevented the firms from responding more effectively to nascent risks. A third case study of PNC Financial Group, by contrast, demonstrates how directors who were unusually focused on their governance responsibilities helped PNC emerge as one of the biggest winners of the financial crisis. To be clear, the Article does not argue that directors with fewer outside commitments necessarily would have averted the crises at Wells Fargo and JPMorgan. The Article contends, however, that directors who were less busy would have been more likely to detect and deter misconduct.

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[10] *See infra* notes 70-74 and accompanying text.

[11] *See* Johan S. G. Chu & Gerald F. Davis, *Who Killed the Inner Circle? The Decline of the American Corporate Interlock Network*, 122 AM. J. OF SOC. 714, 720 (2016) ("[D]irectors sitting on many boards gain[] broad-based business intelligence … thus making them attractive as codirectors.").

[12] *See* Eliezer M. Fich & Anil Shivdasani, *Are Busy Boards Effective Monitors?*, 61 J. FIN. 689, 690 (2006) ("There is a growing literature that shows that serving on multiple boards can be a source of … valuable experience … for outside directors.").

[13] *See* SPENCER STUART, 2016 SPENCER STUART BOARD INDEX 11 (2016), https://www.spencerstuart.com/~/media/pdf%20files/research%20and%20insight%20pdfs/spencer-stuart-us-board-index-2016_1mar2017.pdf [hereinafter SPENCER STUART 2016 BOARD INDEX] (finding that more than two-thirds of new S&P 500 directors have prior board experience and more than half are active senior executives or professionals).

[14] *See infra* Sections III.A, III.B.

[15] *See infra* Section II.B.1.

[16] *See infra* Section II.B.2.

The European Union, recognizing the risks of overcommitted directors, has adopted regulations limiting outside employment and board seats for directors of large, complex financial institutions.[17] The United States, however, does not restrict board members' professional engagements. Alarmingly, the directors of the largest and most complex U.S. financial institutions rank among America's busiest board members.[18] Nearly two-thirds of Citigroup's independent directors, for example, serve on three or more public company boards.[19] This Article concludes that, absent policy reforms, overcommitted financial company boards will hinder oversight of management, increase the risk of firm failure, and could cause the next financial crisis.

This Article contributes to the growing literature on corporate governance and board composition in four distinct ways. First, the Article applies psychological principles to assess how directors' outside commitments affect their governance abilities. Second, the Article uses original case studies to advance the novel claim that director overcommitment is especially detrimental for large, complex financial institutions—firms whose misconduct or excessive risk-taking could inflict harm on the broader economy. Third, the Article asserts that a financial institution's key directors—namely, its lead independent director and the chairs of its risk and audit committees—should have extremely limited outside commitments because they bear special responsibility for overseeing the institution's risk. Finally, the Article explains why private ordering, on its own, will not sufficiently restrain director overcommitment, and it proposes specific reforms to safeguard the financial system.

The Article proceeds as follows. Part II explores corporate governance generally and the role of the board of directors, focusing on the unique challenges of corporate governance in financial firms. Part III examines how director busyness affects corporate governance, drawing on psychological principles and existing empirical evidence. Part IV presents original case studies analyzing how director busyness impairs the governance of large, complex financial institutions. Part V provides evidence that the boards of many U.S. financial companies remain troublingly overcommitted. Part VI offers recommendations for alleviating the problem of director overcommitment. Part VII concludes.

II. Corporate Governance and the Board of Directors

A. The Dual Roles of the Board

The board of directors plays a central role—indeed, *the* central role—in U.S. corporate governance.[20] As Berle and Means taught, agency problems arise when managerial control is separated from corporate ownership, as is the case in large, public companies.[21] Unchecked by

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[17] Parliament and Council Directive 2013/36/EU, On Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms, 2013 O.J. (L 176) 338, art. 91.3 [hereinafter CRD IV]. See *infra* Section VI.B.2 for a discussion of the European Union's rules.
[18] *See infra* Part V.
[19] *See* Citigroup Inc., Proxy Statement (Form DEF 14A) 45-58 (Mar. 15, 2017); *see also infra* Part V.
[20] *See, e.g.*, JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 51 (2008) ("The board of directors is at the epicenter of U.S. corporate governance.").
[21] *See* ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 5-7 (1932); *see also* Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 304-05

dispersed shareholders who lack the incentive and ability to supervise the corporation, management might pursue ill-advised strategies or enrich themselves with corporate funds.[22] A board helps alleviate these agency problems by centralizing control of the corporation in a group of shareholder-elected directors who are vested with plenary authority to govern the firm.[23]

Boards of directors have traditionally fulfilled their governance responsibilities in two ways.[24] First, boards of directors serve an advising role, using their expertise to provide strategic guidance to the firm's management.[25] While management is responsible for the day-to-day operation of the firm, directors acting in their advisory capacity "consult[] with management regarding the … operational direction of the company."[26] Directors may, for instance, counsel management about new product offerings, geographic expansion, potential merger and acquisition activity, and other significant strategic decisions.[27]

Second, boards of directors serve a monitoring role. In their capacity as monitors, directors oversee management to ensure that managers execute their responsibilities faithfully and effectively.[28] Directors evaluate the performance of the firm's CEO and other senior-level management, set the CEO's compensation, and terminate the CEO when necessary.[29]

Tensions invariably arise between a board's advising and monitoring duties.[30] Directors, for instance, experience conflicts of interest when evaluating, as monitors, decisions in which they

(1983); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308-10 (1976).

[22] *See* Fama & Jensen, *supra* note 21, at 304 ("Without effective control procedures … decision managers are more likely to take actions that deviate from the interests of residual claimants.").

[23] *See* STEPHEN M. BAINBRIDGE, CORPORATE GOVERNANCE AFTER THE FINANCIAL CRISIS 47 (2012) ("[T]he board of directors serves as one of the chief constraints on the problem … [of] agency costs."); *see also* Del. Code Ann. tit. 8, § 141(a) (2016) (providing that "[t]he business and affairs of every corporation … shall be managed by or under the direction of the board of directors…"); Model Bus. Corp. Act § 8.01(b) (2010) ("the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors").

[24] *See, e.g.*, DAVID LARCKER & BRIAN TAYAN, CORPORATE GOVERNANCE MATTERS: A CLOSER LOOK AT ORGANIZATIONAL CHOICES AND THEIR CONSEQUENCES 67 (2011) (identifying advising and monitoring as a board's two primary duties); J. Robert Brown, Jr., *Demythification of the Board of Directors* 52 AM. BUS. L.J. 131, 134 (2015) ("Boards are commonly said to both monitor and advise management.").

[25] *See, e.g.*, Kelli A. Alces, *Beyond the Board of Directors*, 46 WAKE FOREST L. REV. 783, 798 (2011) ("[T]he board performs an advisory function, offering advice and opinions to management about general business concerns."); Jonathan L. Johnson et al., *Boards of Directors: A Review and Research Agenda*, 22 J. MGMT. 409, 424 (1996) ("one of the more prevalent functions of directors is to advise and support the CEO").

[26] LARCKER & TAYAN, *supra* note 24, at 67.

[27] *See generally* Brown, Jr., *supra* note 24, at 159-60 (describing directors' advising role).

[28] *See* STEPHEN BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE 160-61 (2008).

[29] *See* LARCKER & TAYAN, *supra* note 24, at 68. Directors, of course, serve other roles in addition to advising and monitoring. Politically connected board members, for instance, might help the company obtain government contracts or assist the company in achieving its public policy objectives. *See* BAINBRIDGE, *supra* note 23, at 49. Directors affiliated with financial institutions might help the corporation obtain outside sources of funding. *See id.* Directors might also help to facilitate information sharing among the firm's stakeholders, *see* Lynne L. Dallas, *The Relational Board: Three Theories of Corporate Boards of Directors*, 22 J. CORP. L. 1, 12 (1996), or resolve disputes among the firm's stakeholders, *see* Margaret M. Blair, *Boards of Directors as Mediating Hierarchs*, 38 SEATTLE U. L. REV. 297, 298-300 (2015).

[30] *See* Tamar Frankel, *Corporate Boards of Directors: Advisors or Supervisors?*, 77 U. CIN. L. REV. 501, 502-04 (2008).

participated as advisors.[31] More subtle conflicts arise when directors develop relationships with management and become psychologically invested in their success.[32] Board "capture" inhibits directors from vigorously monitoring management.[33] It may be untenable, therefore, for directors to serve equally as advisors to and monitors of management.[34]

Perhaps to reconcile these tensions, boards of large, public corporations have, over time, largely abandoned their advising role and instead focused on monitoring.[35] In response to shareholder pressure and regulatory requirements, companies have dramatically increased the proportion of independent directors comprising their boards in the last several decades.[36] This shift away from manager-directors reflects shareholders' and policymakers' preferences for directors who primarily monitor, rather than advise, management.[37]

At the same time, recent legal decisions and industry codes of conduct have enhanced directors' monitoring responsibilities. A director's monitoring role, it is now commonly recognized, extends beyond mere oversight of the firm's top-level management.[38] Indeed, in *Caremark*, Delaware courts recognized directors' duty to implement and oversee, on an ongoing basis, effective enterprise-wide risk monitoring systems.[39] The Business Roundtable's Principles of Corporate Governance reinforce that a board of directors is responsible for "[s]etting the company's risk appetite, reviewing and understanding the major risks, and overseeing the risk

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[31] *See* Jill E. Fisch, *The Overstated Promise of Corporate Governance*, 77 U. CHI. L. REV. 923, 928-29 (2010) (citing MACEY, *supra* note 20, at 53-63).

[32] *See* MACEY, *supra* note 20, at 57 ("The problem with boards is their unique susceptibility to capture by the managers they are supposed to monitor.").

[33] *See* Kobi Kastiel & Yaron Nili, *"Captured Boards": The Rise of "Super Directors" and the Case for a Board Suite*, 2017 WIS. L. REV. 19, 25-31 (2017).

[34] *See* MACEY, *supra* note 20, at 54 (arguing that it is "unreasonable to expect directors to perform both [advising and monitoring] functions simultaneously because there is a fundamental and irreconcilable conflict between the monitoring function and the management function").

[35] *See* Stephen M. Bainbridge & M. Todd Henderson, *Boards-R-Us: Reconceptualizing Corporate Boards*, 66 STAN. L. REV. 1051, 1062 (2014) ("The role of the typical public corporation board shifted from a mainly advisory function in the 1970s to an emphasis by the late 1990s on active and independent monitoring of the top management team."); Brown, Jr., *supra* note 24, at 163 ("The boards of the largest public companies do not perform an advisory role, at least in any systematic or meaningful fashion…. Instead, directors mostly ensure legal sufficiency and establish outer boundaries for management."); Fisch, *supra* note 31, at 929 ("Corporations largely have sacrificed the potential value of managing boards in favor of the independent monitoring board."); Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1469 (2007) ("[F]rom the post-World War II era to the present … the board's principal role shifted from the 'advising board' to the 'monitoring board'….").

[36] *See* Gordon, *supra* note 35, at 1465 (noting that the percentage of independent directors on large public company boards increased from 20% in 1950 to 75% in 2005); *see also* Yaron Nili, *The "New Insiders": Rethinking Independent Directors' Tenure*, 68 HASTINGS L.J. 97, 106-12 (2016) (assessing the shareholder- and regulatory-driven reasons for the increase in independent directors).

[37] *See* MACEY, *supra* note 20, at 54-55 ("a board structure that emphasizes independent directors reflects a corporate governance policy of favoring monitoring over managing"); *id.* at 55 ("the U.S. board structure … reflects an implicit policy choice promoting a monitoring corporate governance paradigm rather than an advising corporate governance paradigm").

[38] *See* Eric J. Pan, *A Board's Duty to Monitor*, 54 N.Y.L. SCH. L. REV. 717, 720 (2010) (characterizing the board's duty to monitor as "an obligation to prevent harm to the corporation").

[39] *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

management processes."[40] The effectiveness of board-level risk oversight, moreover, is a key consideration in the Department of Justice's determination of whether to charge a corporation with criminal wrongdoing and in subsequent sentencing decisions.[41] Thus, while management remains the first line of defense against risks, directors have taken on an increasingly significant role in monitoring and responding to risks throughout the firm.[42]

B. Financial Firms are Special

Risks associated with financial markets pose unique corporate governance challenges.[43] Financial institutions differ from nonfinancial firms in at least three key respects: they are opaque and highly leveraged with short-term debt, they benefit from government support, and their actual or perceived instability may trigger systemic externalities. These characteristics have important implications for the way in which financial firms are governed.[44]

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[40] BUSINESS ROUNDTABLE, PRINCIPLES OF CORPORATE GOVERNANCE: 2016, at 7 (2016), https://businessroundtable.org/sites/default/files/Principles-of-Corporate-Governance-2016.pdf; *see also* COMMONSENSE PRINCIPLES OF CORPORATE GOVERNANCE 4 (2016), http://www.governanceprinciples.org/wp-content/uploads/2016/07/GovernancePrinciples_Principles.pdf (noting directors' responsibilities to focus on "significant risks, including reputational risks").

[41] *See* U.S. DEP'T OF JUSTICE, U.S. ATTORNEYS' MANUAL § 9-28.300 (2015), https://www.justice.gov/usam/usam-9-28000-principles-federal-prosecution-business-organizations#9-28.300 (identifying "the existence and effectiveness of the corporation's pre-existing compliance program" as a factor to be considered in determining whether to charge a corporation); U.S. SENTENCING COMM'N, U.S. SENTENCING GUIDELINES MANUAL § 8B2.1 (2016), https://www.ussc.gov/guidelines/2016-guidelines-manual/2016-chapter-8 (providing that a company's board of directors must "exercise reasonable oversight" of its compliance and ethics programs in order for the company to receive a reduced sentence).

[42] *See* Stephen J. Lubben, *Separation and Dependence: Explaining Modern Corporate Governance*, 43 SETON HALL L. REV. 893, 900 (2013) ("This is not to say that the board is the corporation's risk and compliance manager. That power belongs with management. The directors should determine the company's reasonable risk appetite … and satisfy themselves that the risk management processes designed and implemented by managers are consistent with the company's goals."); Martin Lipton, *Risk Management and the Board of Directors*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE & FIN. REG. (Dec. 17, 2009), https://corpgov.law.harvard.edu/2015/07/28/risk-management-and-the-board-of-directors-3/ ("the risk oversight function of the board of directors … has taken center stage … and expectations for board engagement with risk are at all-time highs").

[43] *See* Frank Partnoy, *Delaware and Financial Risk*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES (Steven Davidoff Solomon & Randall Thomas eds., forthcoming 2017) (manuscript at 2), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2958893 (arguing that "financial risk is categorically different"). *See generally* David Min, *Balancing the Governance of Financial Institutions*, 40 SEATTLE U. L. REV. 743 (discussing financial institutions' unique governance problems).

[44] *See* Daniel K. Tarullo, Governor, Fed. Reserve Bd. of Governors, Remarks at Ass'n of Am. Law Schs. 2014 Midyear Meeting: Corporate Governance and Prudential Regulation (June 9, 2014), https://www.federalreserve.gov/newsevents/speech/tarullo20140609a.htm ("The risks associated with financial intermediaries … pose a particular challenge for corporate governance."); *see also* Renee Adams & Hamid Mehran, *Is Corporate Governance Different for Bank Holding Companies?*, 9 FRBNY ECON. POL'Y REV. 123, 124 (2003) ("The governance of banking firms may be different from that of unregulated, nonfinancial firms for several reasons."); Kose John et al., *Corporate Governance in Banks*, 24 CORP. GOVERNANCE 303, 304 (2016) ("[B]anks have special features that intensify governance problems and might reduce the effectiveness of standard governance mechanisms."); Hwa-Jin Kim, *Financial Regulation and Supervision in Corporate Governance of Banks*, 41 J. CORP. L. 707, 709 (2016) ("The corporate governance of banks has always been treated differently than general corporate governance due to the special nature of the banks….").

1. Differences Between Financial and Nonfinancial Firms

Financial firms, for one, are more opaque and highly leveraged with short-term debt than their nonfinancial counterparts. Opacity—*i.e.*, information asymmetries between a financial company's risk-takers and other stakeholders—makes it difficult for a firm's shareholders, creditors, and even its directors to monitor the firm's asset quality and trading risks.[45] A financial institution's margin for error, moreover, is smaller than for a nonfinancial firm because financial companies tend to be funded with a greater proportion of debt relative to equity.[46] Many financial firms rely primarily on short-term debt, which creditors may withdraw with little warning.[47] This unique combination of opacity, high leverage, and short-term funding can trigger sudden liquidity and solvency crises.[48]

Second, in contrast to nonfinancial companies, many financial institutions benefit from explicit or implicit government guarantees. The Federal Deposit Insurance Corporation (FDIC) and, if necessary, the U.S. Treasury insure bank and thrift depositors against losses, up to a statutory limit.[49] State guaranty funds provide similar protection to insurance policyholders.[50] In times of crisis, however, the government has repeatedly bailed out uninsured depositors and other financial institution creditors, creating the expectation that the government will step in even when

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[45] *See* Marco Becht et al., *Why Bank Governance is Different*, 27 OXFORD REV. ECON. POL'Y 437, 438 (2011) ("Banks have the ability to take on risk very quickly, in a way that is not immediately visible to directors or outside investors."); Gerard Caprio, Jr. & Ross Levine, *Corporate Governance in Finance: Concepts and International Observations*, *in* FINANCIAL SECTOR GOVERNANCE: THE ROLES OF THE PUBLIC AND PRIVATE SECTORS 17, 29-35 (Robert E. Litan et al. eds., 2002) (discussing opacity problem in banking and implications for corporate governance); Luc Laeven, *Corporate Governance: What's Special About Banks?*, 5 ANN. REV. FIN. ECON. 63, 67 (2013) ("Banks are more opaque than the typical nonfinancial firms because of large informational asymmetries surrounding loan quality…. Trading activities may also make banks more opaque than nonfinancial companies without such activities … because trading positions and associated risk profiles can be easily changed in real time."); *see also* Viral V. Acharya et al, *Corporate Governance in the Modern Financial Sector*, *in* RESTORING FINANCIAL STABILITY: HOW TO REPAIR A FAILED SYSTEM 185, 185 (Viral V. Acharya & Matthew Richardson, eds., 2009) ("Unlike in industrial firms, it has become increasingly difficult for infrequently meeting boards to fully grasp the switftness and forms by which risk profiles of [large, complex financial institutions] can be altered by traders and securities desks.").

[46] *See* Jonathan R Macey & Maureen O'Hara, *The Corporate Governance of Banks*, 9 FRBNY ECON. POL'Y REV. 91, 97 (2003) ("Although it is not uncommon for typical manufacturing firms to finance themselves with more equity than debt, banks typically receive 90 percent or more of their funding from debt."); *see also* John et al., *supra* note 44, at 304 ("[T]he average leverage of banks, measured as the ratio of debt to assets, is between 87 and 95 percent, whereas the average leverage of nonfinancial companies is in the range of 20-30 percent.") (internal citation omitted).

[47] *See* Laeven, *supra* note 45, at 67 ("[M]uch of the debt held by banks is short-term, whereas assets tend to be longer-dated. Such maturity transformation exposes banks to liquidity risk and bank runs.").

[48] *See* Tarullo, *supra* note 44 ("All firms bear the risk that problems may unexpectedly arise because of, say, product flaws…. But in the case of financial intermediaries, these problems can be incredibly fast-moving; including runs on funding that can quickly place the very survival of the firm in doubt.").

[49] *See* 12 U.S.C. § 1821(a)(1) (2012) (providing that the FDIC shall insure depositors up to $250,000 per ownership account category, per depositor, per institution); *see also* 12 U.S.C. § 1824(a)(1) (2012) (providing the FDIC authority to borrow from the Treasury Department, as needed).

[50] *See* MICHAEL S. BARR, HOWELL E. JACKSON & MARGARET E. TAHYAR, FINANCIAL REGULATION: LAW AND POLICY 351 (2016) (describing system of state-based insurance guaranty funds).

not required to do so.[51] Government backing of financial institutions puts the public fisc at stake.[52] Even more critically for purposes of corporate governance, explicit and implicit government guarantees reduce incentives for depositors and other creditors to monitor a financial institution's risk-taking.[53] Creditors of a nonfinancial firm typically exert some level of control over the firm's risk profile by entering into debt covenants or, if necessary, refusing to roll over their loans.[54] In the presence of explicit or implicit guarantees, however, financial institution creditors do not impose market discipline as effectively because they know that they are protected from losses.[55]

Financial companies, finally, are unique in that interconnectedness and contagion create systemic externalities.[56] Financial and nonfinancial firms alike impose losses on their shareholders and creditors when they fail. Financial companies are different, however, because their instability has the potential to trigger serious knock-on effects.[57] Counterparties, for instance, may incur catastrophic losses when a financial institution defaults on its obligations.[58] A financial institution's actual or perceived insolvency, moreover, can cause not only that firm's creditors to withdraw funding but also other firms' creditors to run on their banks.[59] Thus, as the recent crisis demonstrated, poorly managed financial firms can paralyze not only the entire financial system but also the real economy.[60]

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[51] *See, e.g.*, *id.* at 250-52 (discussing implicit guarantees of uninsured depositors and short-term wholesale creditors). The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) limited the government's authority to extend guarantees to uninsured creditors but did not completely eliminate it. *See, e.g.*, Dodd-Frank Act § 1105, 12 U.S.C. § 5612 (2012) (prohibiting the FDIC from issuing broad-based guarantees of bank debt unless authorized by a joint resolution of Congress); *see also* 12 U.S.C. § 1823(c)(4)(G) (2012) (permitting the FDIC, with the concurrence of the Federal Reserve and Secretary of the Treasury, to guarantee an institution's uninsured deposits if failing to do so would "have serious adverse effects on economic conditions or financial stability").

[52] *See, e.g.*, CONG. OVERSIGHT PANEL, THE FINAL REPORT OF THE CONGRESSIONAL OVERSIGHT PANEL 51 (2011) (estimating that the federal government guaranteed at least $4.4 trillion of financial assets under emergency programs at the peak of the financial crisis).

[53] *See* Caprio, Jr. & Levine, *supra* note 45, at 36 ("Deposit insurance reduces the incentives of depositors (and any other creditors who believe the government insures their claims) to monitor banks and thus directly hinders corporate governance."); *see also* BARR, JACKSON & TAHYAR, *supra* note 50, at 248 ("Deposit insurance dampens depositors' incentives to monitor their banks' performance because the depositors are indemnified against loss even if risky activities lead to failure.").

[54] *See, e.g.*, Caprio, Jr. & Levine, *supra* note 45, at 22 (discussing market discipline by creditors in a generic model of corporate governance).

[55] *See* Tarullo, *supra* note 44 ("[I]n traditional, deposit-reliant banks … market discipline associated with … creditor monitoring will be attenuated…. [T]o the degree uninsured depositors or other bank creditors expect that they will be protected by the government in the event the bank encounters serious difficulties, those same features of market discipline will again be weakened.").

[56] Andreas Kokkinis, *A Primer on Corporate Governance in Banks and Financial Institutions: Are Banks Special?*, *in* THE LAW ON CORPORATE GOVERNANCE IN BANKS 1, 2-3 (Iris H-Y Chiu et al. eds., 2015) ("Profit maximisation necessarily entails taking substantial risks that, even if desirable from the point of view of bank shareholders, may still be excessive from the society's perspective, due to the systemic consequences of crises in any major bank. This problem is not unique to the banking sector, but is far more severe in banks than in other large companies….").

[57] *See* HAL S. SCOTT, CONNECTEDNESS AND CONTAGION 5-11 (2016).

[58] *See* Janet L. Yellen, Vice Chair, Fed. Reserve Bd. of Governors, Remarks at Am. Econ. Ass'n/Am. Fin. Ass'n Joint Luncheon: Interconnectedness and Systemic Risk: Lessons from the Financial Crisis and Policy Implications (Jan. 4, 2013), https://www.federalreserve.gov/newsevents/speech/yellen20130104a.htm.

[59] *See id.*

[60] *See* FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT 389-401 (2011), https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf (describing economic consequences of financial crisis).

2. The Unique Role of a Financial Institution Board

These characteristics impose unique demands on a financial institution's board of directors to establish effective risk monitoring systems within the firm.[61] Reflecting this imperative, shareholders expect a financial institution's board to play an active role in preventing misconduct and excessive risk-taking.[62]

Moreover, financial company boards have traditionally been subject to special legal and regulatory requirements to monitor risks within their firms.[63] These risk-monitoring obligations exceed the relatively low bar established in *Caremark*.[64] All bank holding company (BHC) boards, for instance, are subject to supervisory mandates to understand and address the key market, operational, compliance, and legal risks within their firms.[65] More stringent risk-monitoring standards apply to the boards of the largest and most complex financial firms. For instance, the Federal Reserve requires that the directors of companies engaged in an expanded range of financial activities must be "forward-looking and active participants in managing risk."[66]

Following the financial crisis, policymakers imposed new risk-monitoring requirements on financial institutions' boards of directors. The Dodd-Frank Act, for example, directs all BHCs with more than $10 billion in assets to maintain a risk committee on its board of directors that is responsible for the enterprise-wide risk-management practices of the company.[67] The risk committee must oversee a risk-management framework that includes processes and systems for "identifying and reporting risks" and "ensuring effective and timely implementation of actions to address emerging risks."[68]

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[61] *See* Tarullo, *supra* note 44 ("[T]he information and monitoring processes and systems established for … boards of financial institutions may need to be more extensive than those in large, nonfinancial firms.").

[62] *See, e.g.*, Martin Lipton, *Risk Management and the Board of Directors*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE & FIN. REG. (Feb. 15, 2017), https://corpgov.law.harvard.edu/2017/02/15/risk-management-and-the-board-of-directors-4/ ("Major institutional shareholders and proxy advisory firms now evaluate risk oversight matters when considering withhold votes in uncontested director elections and routinely engage companies on risk-related topics.").

[63] *See* Partnoy, *supra* note 43, at 5 (asserting that financial company directors "already are held to significantly higher standards than non-financial institution directors" and that effective risk management "involves much more than simply setting up a monitoring system").

[64] *See id.*

[65] *See* BD. GOVS. FED. RES. SYS., SR 95-51 (SUP), RATING THE ADEQUACY OF RISK MANAGEMENT PROCESSES AND INTERNAL CONTROLS AT STATE MEMBER BANKS AND BANK HOLDING COMPANIES (1995), https://www.federalreserve.gov/boarddocs/srletters/1995/sr9551.htm ("Boards of directors have ultimate responsibility for the level of risk taken by their institutions…. [A]ll boards of directors are responsible for understanding the nature of the risks significant to their organizations and for ensuring that management is taking the steps necessary to identify, measure, monitor, and control these risks…."); *see also id.* ("Directors of large banking organizations that conduct a broad range of technically complex activities … should … have a clear understanding of the types of risks to which their institutions are exposed and should receive reports that identify the size and significance of the risks….").

[66] Bank Holding Company Rating System, 69 Fed. Reg. 70,444, 70,450 (Dec. 6, 2004) (establishing criteria for a BHC to receive a "strong" risk management rating); *see also* 12 U.S.C. § 1844(*l*)(1)(C) (2012) (providing that a BHC must be well managed to engage in expanded financial activities); 12 C.F.R. § 225.2(s) (2017) (providing that a BHC is well managed if it receives at least a satisfactory risk management rating).

[67] Dodd-Frank Act § 165(h), 12 U.S.C. § 5365(h) (2012).

[68] 12 C.F.R. § 252.33(a)(2) (2017).

Directors of financial companies, in sum, have special risk management responsibilities. While most large, public company boards have increased emphasis on their monitoring responsibilities,[69] risk monitoring is particularly important for financial company directors due to the unique characteristics of their firms.

III. Why Director Busyness Matters

The increased emphasis on risk monitoring for public company boards—and especially for boards of large, complex financial institutions—raises a question as to whether directors are equipped to fulfill their governance responsibilities. Drawing on psychological principles and empirical research, this Part explores how directors' outside professional commitments affect their governance abilities.

A. The Psychology of Busyness

By any measure, public company directors lead exceptionally busy lives. More than half of new independent directors of S&P 500 firms, for example, are actively employed as corporate executives or in other professions.[70] Most directors, moreover, serve on the board of at least one other public company.[71] Many directors also serve on private company boards, nonprofit boards, councils, or advisory groups.[72] Examples of extraordinarily busy directors abound.[73] In 2015, for instance, former AOL, Inc. CEO Jonathan Miller served as a director of eight publicly traded companies, sat on the board of 11 private companies and nonprofit organizations, and held a day job as a partner in a venture capital company.[74]

In general, there are two ways in which a director's outside professional commitments might affect his or her governance abilities.

On one hand, outside engagements could enhance a director's effectiveness. Directors might acquire valuable knowledge and practice by serving in governance capacities at other companies. Outside engagements are opportunities for the director to sharpen his or her oversight skills, refine decision-making processes, and observe what governance practices succeed or fail at

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[69] *See supra* Section II.A.
[70] SPENCER STUART 2016 BOARD INDEX, *supra* note 13, at 11 (reporting that 53% of new S&P 500 independent directors in 2016 were active senior executives or other professionals).
[71] *Id.* at 16 (reporting that the average S&P 500 director serves on 2.1 public company boards).
[72] *See, e.g.*, Citigroup, Inc., Proxy Statement (Form DEF 14A) 44-58 (Mar. 15, 2017) (describing Citigroup's directors' nonprofit and private company board service).
[73] *See, e.g.*, Joan S. Lublin, *Inside America's Boardrooms: How Many Board Seats Make Sense?*, WALL ST. J., Jan. 21, 2016, at B1 (noting that former U.S. congressman Richard Gephardt served on five public company boards while spending more than 60 hours per week running his own consulting and lobbying firm); Mark Rogers, *When Directors (Like Gregory Maffei) Serve on Too Many Boards*, FORTUNE, July 31, 2014, https://www.forbes.com/sites/forbesleadershipforum/2014/07/31/when-directors-like-gregory-maffei-serve-on-too-many-boards/#16227dc86ae2 (discussing Liberty Media CEO Gregory Maffei's service on seven public company boards).
[74] *See* Todd Wallack & Sacha Pfeiffer, *Debate Swirls on Multiple Directorships; Critics Say Too Many Can Sap Energy, Weaken Challenges to Executives*, BOS. GLOBE, Dec. 10, 2015, at A1.

other organizations.[75] Professional engagements also broaden a director's network and enable the director to facilitate strategic partnerships or suggest other strong director candidates.[76]

On the other hand, however, a director's outside commitments could detract from his or her governance responsibilities. Director workloads have increased substantially since the early 2000s.[77] Directors now devote, on average, more than 20 hours per month to each board on which they serve.[78] Time commitments are even higher for board chairs, lead independent directors, and directors who chair board committees.[79] Directors with many professional engagements, therefore, might lack time to carefully review reports, assess strategy and risk, and attend board and committee meetings for all of the companies with which they are affiliated.[80]

In addition to imposing time constraints, outside commitments could restrict a director's cognitive capacity. Psychologists long ago established that humans suffer from innate cognitive limitations.[81] Working memory, for example, can store only a finite amount of information.[82] Even if directors had unlimited time, therefore, the "limited capacity of the human information-processing system" might cap the number of enterprises that a director can effectively understand, monitor, and advise.[83]

The psychological literature, moreover, suggests that busy directors are particularly susceptible to a variety of situational factors that could further impair their cognition. Divided attention and distractedness, for example, have been shown to diminish executive functioning, memory, and workplace performance.[84] Burnout from stressful or time-consuming jobs likewise

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75 *See* Stephen P. Ferris et al., *Too Busy to Mind the Business? Monitoring by Directors with Multiple Board Appointments*, 58 J. FIN. 1087, 1089 (2003).

76 *See* Ira C. Harris & Katsuhiko Shimizu, *Too Busy to Serve? An Examination of the Influence of Overboarded Directors*, 41 J. MGMT. STUD. 775, 777 (2004).

77 *See* James S. Linck, *The Effect and Unintended Consequences of the Sarbanes-Oxley Act on the Supply and Demand for Directors*, 22 REV. FIN. STUD. 3287, 3306 (2009) (finding "dramatic increase in directors' workload" following enactment of the Sarbanes-Oxley Act in 2002).

78 NAT'L ASS'N CORP. DIRECTORS, 2016-2017 NACD PUBLIC COMPANY GOVERNANCE SURVEY 2 (2017), https://www.nacdonline.org/files/2016%E2%80%932017%20NACD%20Public%20Company%20Governance%20Survey%20Executive%20Summary.pdf.

79 *See* BUSINESS ROUNDTABLE, *supra* note 40, at 12; *see also* NAT'L ASS'N CORP. DIRECTORS, 2015-2016 NACD PUBLIC COMPANY GOVERNANCE SURVEY (2016) (reporting that board chairs spent an average of 292 hours per year on their board responsibilities, compared to 248 hours for other directors).

80 *See* Michal Barzuza, *Board Interlocks and Corporate Governance*, 39 DEL. J. CORP. L. 669, 691 (2015) ("Sitting on many boards could also result in directors who are so busy that they cannot give sufficient attention to any given firm. At a certain point, board members might be too busy to conduct their monitoring role diligently and effectively.").

81 *See, e.g.*, George A. Miller, *The Magical Number Seven, Plus or Minus Two: Some Limits on Our Capacity for Processing Information*, 101 PSYCHOL. REV. 81, 81-83, 95-96 (1956) (discussing limitations on humans' capacity to retain information in working memory); *see also* Nelson Cowan, *The Magical Number 4 in Short-term Memory: A Reconsideration of Mental Storage Capacity*, 24 BEHAV. & BRAIN SCI. 87, 94-108 (2000) (providing evidence of even stricter capacity limits).

82 *See* Earl K. Miller & Timothy Buschman, *Working Memory Capacity: Limits on the Bandwidth of Cognition*, 1 DAEDELUS 112, 112-14 (2015) (reviewing evidence of working memory capacity limits).

83 Harris & Shimizu, *supra* note 76, at 777.

84 *See, e.g.*, Catherine D. Middlebrooks et al., *Selectively Distracted: Divided Attention and Memory for Important Information*, 28 PSYCHOL. SCI. (forthcoming 2017) (manuscript at 1), http://journals.sagepub.com/doi/pdf/10.1177/0956797617702502; Joshua S. Rubinstein et al., *Executive Control of*

impairs cognition.[85] Sleep deficits, which are widespread among corporate directors,[86] weaken critical cognitive functions that directors need to succeed in their roles.[87] Age-related cognitive declines, moreover, exacerbate these limitations.[88] Age-related impairments may be especially worrisome, as the average age of corporate directors continues to climb.[89]

Finally, psychological biases may blind corporate executives to their cognitive limitations, preventing them from self-regulating their workloads. Indeed, the Dunning-Kruger Effect is a cognitive bias whereby individuals consistently overestimate their own abilities and underestimate their limitations.[90] Highly skilled and highly educated people are particularly vulnerable to misjudging their own abilities.[91] In one of the most common manifestations of the Dunning-Kruger Effect, individuals regularly overestimate their ability to balance many tasks at once.[92] Thus, ignorant of their cognitive limitations, directors may take on more professional obligations than they can competently handle.

In sum, notwithstanding a busy director's talent and intelligence, time restrictions and cognitive limitations may prevent the director from understanding many complex, multinational corporations well enough to govern them effectively.

Cognitive Processes in Task Switching, 27 J. EXPERIMENTAL PSYCHOL. 763, 774-90 (2001); *see also* Edward M. Hallowell, *Overloaded Circuits: Why Smart People Underperform*, HARV. BUS. REV., Jan. 2005, at 55.

[85] *See, e.g.*, Pavlos Deligkaris et al., *Job Burnout and Cognitive Functioning: A Systematic Review*, 28 WORK & STRESS 107, 113 (2014); I. H. Jonsdottir et al., *Cognitive Impairment in Patients with Stress-Related Exhaustion*, 16 STRESS 181, 188-89 (2013).

[86] *"Epidemic" of Sleep Deprivation Spreads among Busy Britons*, DAILY MAIL (May 1, 2007), http://www.dailymail.co.uk/news/article-451760/Epidemic-sleep-deprivation-spreads-busy-Britons.html (reporting that company directors were the most sleep-deprived in a survey of more than 5,000 individuals from 30 different careers).

[87] *See, e.g.*, Adrienne M. Tucker et al., *Effects of Sleep Deprivation on Dissociated Components of Executive Functioning*, 33 SLEEP 47, 54-55 (2010); Vinod Venkatraman et al., *Sleep Deprivation Elevates Expectations of Gains and Attenuates Response to Losses Following Risky Decisions*, 30 SLEEP 603, 607-08 (2007); Matthew P. Walker & Robert Stickgold, *Sleep, Memory, and Plasticity*, 57 ANN. REV. PSYCHOL. 139, 160-61 (2006).

[88] *See generally* Timothy Salthouse, *Consequences of Age-Related Cognitive Declines*, 63 ANN. REV. PSYCHOL. 201 (2012) (discussing the effects of aging on cognition and workplace functioning).

[89] The average age of independent directors on S&P 500 boards has risen from 60 to 63 years since 2002. *See* SPENCER STUART 2016 BOARD INDEX, *supra* note 13, at 9; SPENCER STUART, 2012 SPENCER STUART BOARD INDEX 8 (2012) [hereinafter SPENCER STUART 2012 BOARD INDEX] (on file with author).

[90] *See* Justin Kruger & David Dunning, *Unskilled and Unaware of It: How Difficulties in Recognizing One's Own Incompetence Lead to Inflated Self-Assessments*, 77 J. PERSONALITY & SOC. PSYCHOL. 1121, 1132 (1999) (exploring "why people tend to hold overly optimistic and miscalibrated views about themselves"); *see also* David Dunning et al., *Why People Fail to Recognize Their Own Incompetence*, 12 CURRENT DIRECTIONS IN PSYCHOL. SCI. 83, 83 (2003) (discussing research that "suggests that people are not adept at spotting the limits of their knowledge and expertise").

[91] *See* Katherine A. Burson et al., *Skilled or Unskilled, but Still Unaware of It: How Perceptions of Difficulty Drive Miscalibration in Relative Comparisons*, 90 J. PERSONALITY & SOC. PSYCHOL. 60, 71 (2006) (finding that skilled test subjects predict their performance on difficult tasks less accurately than unskilled subjects).

[92] *See* Jason R. Finley et al., *Metacognition of Multi-Tasking: How Well Do We Predict the Costs of Divided Attention?*, 20 J. EXPERIMENTAL PSYCHOL. 158, 158 (2014) (concluding that people "have little metacognitive insight on the extent to which they are personally vulnerable to the risks of divided attention").

B. Market-Wide Empirical Evidence

It is not immediately obvious from the foregoing theoretical discussion whether the governance-enhancing effects of outside professional engagements outweigh the negative consequences of busyness, or vice versa. To assess which effect predominates, this Section draws on empirical studies that have analyzed how director busyness influences firm performance and risk across a wide variety of industries. These studies, at first glance, appear to yield contradictory results.

In one of the earliest studies on director busyness, Stephen Ferris et al. found no evidence that busy directors are associated with worse financial outcomes.[93] To the contrary, Ferris et al. detected a positive, although statistically insignificant, association between director busyness and firm performance in a sample of more than 3,000 publicly traded firms.[94] Ferris et al., in addition, found that shareholders perceive the appointment of busy outside directors as value enhancing. Indeed, firms in their study experienced positive stock market returns after appointing a new director who held three or more board seats.[95] This study, in sum, suggests that directors with multiple professional affiliations are more effective board members.

Eliezer Fich and Anil Shivdasani, by contrast, concluded in another study that busy directors are associated with weak firm performance.[96] Analyzing *Forbes* 500 firms, Fich and Shivdasani detected a strong link between busy directors and worse financial outcomes: firms in which at least half of the independent directors held three or more board seats had market-to-book ratios 4.2% lower than other firms, as well as significantly lower return on assets.[97] Further, shareholders in Fich and Shivdasani's sample reacted negatively when directors took on many outside commitments. Indeed, the announcement of a director accepting his or her third board seat resulted in negative abnormal stock market returns for the other firms where the director served.[98] Overall, these results support the view that busy directors detract from effective corporate governance.[99]

These two early studies present a puzzle: why did Ferris et al. and Fich and Shivdasani reach contradictory results? George Cashman et al. resolve the discrepancy in a subsequent study.[100] Noting that Fich and Shivdasani analyzed *Forbes* 500 firms while Ferris et al. used a sample comprised primarily of smaller firms, Cashman et al. hypothesize that director busyness is

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[93] Ferris et al., *supra* note 75.

[94] *Id.* at 1101-02 (finding that a firm's market-to-book ratio is positively correlated with the average number of directorships held by its outside directors).

[95] *Id.* at 1101-03.

[96] Fich & Shivdasani, *supra* note 12.

[97] *Id.* at 721. Fich and Shivdasani, like Ferris et al. and nearly all other governance studies, take into account membership on public company boards but not private company boards. *See id.* at 695. Public company board seats are a common proxy for director busyness because the Securities and Exchange Commission (SEC) requires publicly traded companies to disclose other public company boards on which their directors sit. *See* 17 C.F.R. § 229.401(e)(2) (2017).

[98] Fich & Shivdasani, *supra* note 12, at 719-20.

[99] *Id.* at 722 ("[O]ur results suggest that boards relying heavily on outside directors that serve on several boards are likely to experience a decline in their quality of corporate governance.").

[100] George D. Cashman et al., *Going Overboard? On Busy Directors and Firm Value*, 36 J. BANKING & FIN. 3248 (2012).

more detrimental for larger firms than smaller firms.[101] This explanation is intuitively appealing. Smaller, less established firms might benefit from busy directors' connections and experience,[102] while larger, more established firms might require more intense monitoring that busy directors are unable to provide.[103] To test their hypothesis, Cashman et al. analyze the effects of director busyness using two samples—one comprised of S&P 500 firms and the other comprised of non-S&P 500 firms. They find statistically significant evidence that busy directors detract from firm performance for S&P 500 firms but enhance performance for non-S&P 500 firms.[104]

Further studies have confirmed that busy directors generally detract from firm performance[105] and that the drawbacks of director busyness are more severe for larger firms.[106] Researchers have determined that busy directors are associated with lower return on assets,[107] decreased market value,[108] and deeper diversification discounts.[109] These studies verify that the negative relationship between busy boards and firm performance holds across a wide range of time periods and industries.[110] Several studies, moreover, establish that busy directors are not merely

[101] *Id.* at 3249.
[102] *See* Laura Field et al., *Are Busy Boards Detrimental*, 109 J. FIN. ECON. 63, 65 (2013) ("IPO firms' demands for advising exceed their demands for monitoring, and thus, IPO firms will garner greater benefits from busy directors than will seasoned firms.").
[103] *See id.* ("[T]he complexity and lower levels of managerial ownership among [Forbes 500] firms might lead them to require more monitoring, which, due to time constraints, busy directors are arguably less equipped to provide.").
[104] Cashman, *supra* note 100, at 3252 ("Tobin's Q is inversely related to the presence of busy directors for S&P 500 firms, consistent with Fich and Shivdasani. However … for the non-S&P 500 firms, the opposite is true—that is, consistent with the Ferris et al. findings, there is a positive association between busy directors and Tobin's Q.").
[105] *See* LARCKER & TAYAN, *supra* note 24, at 153 (finding that studies on director busyness "yield consistent and convincing results: [c]ompanies with busy boards tend to have worse long-term performance and worse oversight" than firms whose directors have fewer professional engagements); Christophe Volonte, *Boards: Independent and Committed Directors?*, 41 INT'L REV. L. & ECON. 25, 27 (2015) ("Most empirical studies on multiple directorships find that there is a negative relationship with firm performance.").
[106] *See* Field et al., *supra* note 102, at 73 (concluding that busy boards are associated with higher market-to-book ratios for S&P 1500 firms but lower market-to-book ratios for Forbes 500 firms); Stephen P. Ferris et al., Better Directors or Distracted Directors? An International Analysis of Busy Boards 17-21 (May 11, 2017) (unpublished manuscript) (on file with author) (finding that busy directors detract from firm value and profitability for all but the youngest firms in a sample of more than 54,000 global companies); *see also* Curtis Clements et al., *The Impact of Company Size and Multiple Directorships on Corporate Governance Effectiveness*, 12 INT'L J. DISCLOSURE & GOVERNANCE 354, 363-67 (2015) (concluding that busy directors benefit smaller companies but not larger companies).
[107] *See* Cashman et al., *supra* note 100, at 3254 (finding negative association between director busyness and return on assets in S&P 500 companies); John E. Core et al., *Corporate Governance, Chief Executive Officer Compensation, and Firm Performance*, 51 J. FIN. ECON. 371 (1999) (finding negative association between director busyness and return on assets in sample of large, publicly U.S. traded companies); Ferris et al., *supra* note 106, at 20-21 (finding negative association between director busyness and return on assets in a sample of more than 54,000 global companies).
[108] *See* Cashman et al., *supra* note 100, at 3254 (finding negative association between director busyness and Tobin's Q—the ratio of a firm's market value relative to its total assets—in S&P 500 companies); Ferris et al., *supra* note 106, at 17-20 (finding negative association between director busyness and market-to-book ratio in a sample of more than 54,000 global companies).
[109] *See* Pornsit Jiraporn et al., *Multiple Directorships and Corporate Diversification*, 15 J. EMPIRICAL FIN. 418, 425-32 (2008) (concluding that boards of industrial firms in which at least 50 percent of outside directors hold three or more directorships suffer deeper diversification discounts).
[110] *Compare* Cashman, *supra* note 100 (studying non-financial and non-utility companies from 1999 through 2008) with Core, *supra* note 107 (studying firms in 14 industries from 1982 through 1984).

correlated with, but actually cause, decreased firm performance.[111] The studies suggest that three total boards is the threshold at which directors' professional commitments begin to detract most strongly from their governance abilities.[112]

The empirical evidence points to three behaviors by busy directors that lead to weaker firm performance. Specifically, busy directors impair corporate governance because they are (1) less likely to participate in corporate decision-making, (2) less likely to challenge management, and (3) subject to attention shocks that draw focus away from company business.

First, busy directors are less inclined to participate actively in corporate decision-making. Busy directors, for example, are more likely to miss board meetings[113] and are less likely to serve on board committees.[114] Crucially, board committees meet less frequently when their members have many outside professional commitments,[115] and fewer committee meetings are associated with worse financial outcomes.[116]

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[111] Cashman et al., for instance, find that one-to-three year lagged values of director busyness are correlated with lower firm performance. *See* Cashman et al., *supra* note 100, at 3245. Fich and Shivdasani use a similar lagging technique and find a negative association between lagged values of director busyness and firm performance. *See* Fich & Shivdasani, *supra* note 12, at 704-05. This approach confirms that director busyness causes poor performance because "director busyness in prior years could not have been caused by the firm's [performance] in subsequent years." Cashman et al., *supra* note 100, at 3245. Using another approach to control for endogeneity, a separate study finds that exogenous reductions in directors' professional commitments lead to increases in firm performance. *See* Roie Hauser, Busy Directors and Firm Performance: Evidence from Mergers (Dec. 2014) (unpublished Ph.D. dissertation, University of Chicago) (on file with author) (finding that an exogenous reduction in a director's professional commitments—*i.e.*, the termination of an outside directorship by merger or acquisition—is associated with increases in earnings and market-to-book ratios for the firms with which the director remains affiliated). Exogenous increases in directors' workloads, meanwhile, are associated with decreases in firm performance. *See* Antonio Falato et al., *Distracted Directors: Does Board Busyness Hurt Shareholder Value?*, 113 J. FIN. ECON. 404 (2014) (finding a long-term reduction in market value when an S&P 1500 firm's director sits on the board of another firm that experiences an "attention shock"—*i.e.*, the sudden death of a co-director or CEO that necessitates the director's increased attention on the affected firm). These findings thus help resolve the issue of causality and provide strong support that busy directors detract from firm performance.

[112] *See, e.g.*, Cashman, *supra* note 100, at 3255 ("[T]he negative association between busy directors and firm performance is strongest when the definition of busy is a director serving on three or more boards.").

[113] *See* Renee B. Adams & Daniel Ferreira, *Do Directors Perform for Pay?*, 46 J. ACCT. & ECON. 154, 162-63 (2008); Pornsit Jiraporn et al., *Too Busy to Show Up? An Analysis of Directors' Absences*, 49 Q. REV. ECON. & FIN. 1159, 1164-65 (2009).

[114] *See* Pornsit Jiraporn et al., *Ineffective Corporate Governance: Director Busyness and Board Committee Memberships*, 33 J. BANKING & FIN. 819, 824 (2009); *see also* Kevin D. Chen & Andy Wu, *The Structure of Board Committees* 9 (Harv. Bus. Sch., Working Paper No. 17-032, 2016), http://www.hbs.edu/faculty/Publication%20Files/17-032_22ea9e7a-4f26-4645-af3d-042f2b4e058c.pdf. *But see* Ferris et al., *supra* note 75, at 1103-05 (finding that directors with three or more public company board seats serve on more committees than directors with fewer board seats).

[115] *See, e.g.*, Vineeta Sharma, *Determinants of Audit Committee Meeting Frequency: Evidence from a Voluntary Governance System*, 23 ACCT. HORIZONS 245, 258-59 (2009) (finding that audit committees meet less frequently when members of the committee hold multiple directorships).

[116] *See* Francesca Battaglia & Angela Gallo, *Risk Governance and Asian Bank Performance: An Empirical Investigation over the Financial Crisis*, 25 EMERGING MKTS. REV. 53, 66 (2015) (finding a positive relationship between a firm's market value and the frequency of its risk committee meetings in a sample of Asian banks); *cf.* Hugh Grove et al., *Corporate Governance and Performance in the Wake of the Financial Crisis: Evidence from U.S. Commercial Banks*, 19 CORP. GOVERNANCE 418, 431 (2011) (finding positive association between board meeting frequency and financial performance among U.S. commercial banks during the financial crisis).

Second, busy directors tend not to challenge management; as a result, firms with busy directors are more susceptible to managerial self-dealing, misconduct, and excessive risk-taking. Firms with busy directors, for example, are less likely to replace underperforming CEOs[117] and are more likely to overpay their CEOs.[118] Busy directors, moreover, are more likely to be associated with severe governance problems, including bankruptcies, major litigation, regulatory violations, and major accounting restatements.[119] Further, companies in which outside directors hold a greater number of board seats are more likely to commit accounting fraud.[120] Corporate misconduct is particularly prevalent when key directors—such as committee chairs—are busy.[121]

Third, busy directors detract from firm performance because they are susceptible to attention shocks that distract them from company business. When a firm with which a director is associated experiences a major event—e.g., a merger or acquisition proposal, the departure of a key officer or director, or a sustained period of poor performance—the director's time commitment to that firm increases.[122] The director, in turn, neglects his or her other board memberships, leading to poor performance by those firms.[123]

In sum, the empirical evidence leads to an inescapable conclusion: directors with many professional commitments are detrimental for large, public companies. While busy directors may benefit smaller companies, they lack the time and attention to provide the monitoring and oversight that larger, more complex companies require.

[117] *See* Fich & Shivdasani, *supra* note 12, at 722.

[118] *See* Core, *supra* note 107, at 387-88. *But see* John Byrd et al., *Director Tenure and the Compensation of Bank CEOs*, 36 MANAGERIAL FIN. 86, 95 (2010) (finding that the average number of directorships held by outside directors is negatively correlated with CEO pay in a sample of publicly traded depository institutions).

[119] Flora Niu & Greg Berberich, *Director Tenure and Busyness and Corporate Governance*, 6 INT'L J. CORP. GOVERNANCE 56, 62, 64-65 (2015).

[120] Mark S. Beasley, *An Empirical Analysis of the Relation Between the Board of Director Composition and Financial Statement Fraud*, 71 ACCT. REV. 443, 461 (1996). Some conflicting evidence suggests that busy directors are not associated with a higher risk of securities litigation. *See* Ferris et al., *supra* note 75, at 1105-09 (finding a statistically insignificant relationship between the number of directorships per outside director and the likelihood of securities litigation); Eric L. Talley, *Public Ownership, Firm Governance, and Litigation Risk*, 76 U. CHI. L. REV. 335, 352, 354 (2009) (finding an association between the percentage of board members who serve on four or more boards and a lower risk of securities litigation). These studies, however, are comprised predominantly of smaller firms and thus are consistent with the view that busy boards are more harmful to larger firms. *See* Ferris et al., *supra* note 75, at 1090-91 (sample comprised primarily of non-S&P 500 and non-Forbes 500 firms); Talley, *supra* at 345 (sample weighted toward S&P Smallcap and Midcap firms).

[121] *See* Nandini Chandar, *Does Overlapping Membership on Audit and Compensation Committees Improve a Firm's Financial Reporting Quality?*, 11 REV. ACCT. & FIN. 141, 153 (2012) (finding that audit committee members with more work-intensive committee assignments are associated with weaker financial reporting quality).

[122] *See, e.g.*, JAY W. LORSCH WITH ELIZABETH MACIVER, PAWNS OR POTENTATES: THE REALITY OF AMERICA'S CORPORATE BOARDS 115-16 (1989) (describing directors' elevated time commitments during corporate crises).

[123] *See* Falato et al., *supra* note 111 (finding a long-term reduction in market value when an S&P 1500 firm's director sits on the board of another firm that experiences the sudden death of a co-director or CEO that necessitates the director's increased attention on the affected firm); Ronald. W. Masulis & Emma Jincheng Zhang, *Preoccupied Independent Directors*, at 12, 21-25 (Feb. 12, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2816470 (finding that 22 percent of S&P 1500 independent directors are preoccupied with major distractions every year and that firms with a higher proportion of preoccupied directors have lower firm value and worse merger-and-acquisition performance); Luke C.D. Stein & Hong Zhao, *Distracted Directors: Evidence From Directors' Outside Employment*, at 12-14 (Aug. 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2946579 (finding that companies with directors whose employing firms experience periods of poor results suffer declines in performance and value).

C. Evidence from Financial Firms

Financial institutions are particularly aggressive in seeking out other companies' directors or executives to serve on their boards. Commercial banks, for example, recruit directors affiliated with other companies to help develop lending relationships with those firms.[124] Financial institutions, moreover, prefer well-connected directors who can provide information about other sectors of the economy and broader economic trends.[125] Financial institution directors, as a result, rank among the busiest corporate board members.[126]

The empirical evidence discussed in Section III.B suggests that busy directors weaken corporate governance for large, complex financial institutions. It may not be appropriate, however, to draw conclusions from market-wide data about the effect of director busyness on financial firms.[127] Indeed, as Part II explores, governance of financial firms differs from nonfinancial firms in meaningful ways.[128] Directors' outside professional commitments might therefore affect financial firms differently than nonfinancial firms. On one hand, directors' outside commitments might uniquely benefit financial companies, as directors could connect financial firms to potential corporate borrowers or investment banking clients.[129] On the other hand, however, too many outside commitments could be particularly detrimental for directors of financial firms, in light of the intensive monitoring demanded by those companies.[130]

Recent developments in financial firm governance suggest that busy directors may, in fact, be especially problematic for financial institutions. While all directors' corporate governance responsibilities became more involved after the passage of the Sarbanes-Oxley Act, financial firm directors experienced unique increases in their monitoring duties following the financial crisis.[131] Financial institution directors receive more voluminous information—in the form of management reports and supervisory assessments—than directors of nonfinancial firms.[132] Directors of financial companies, moreover, tend to serve on more board committees than directors of nonfinancial firms.[133] Service on the board of a large, complex financial institution thus requires considerably more time and attention than a nonfinancial company board.[134]

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[124] *See* Gerald F. Davis & Mark S. Mizruchi, *The Money Center Cannot Hold: Commercial Banks in the U.S. System of Corporate Governance*, 44 ADMIN. SCI. Q. 215, 219 (1999) (discussing reasons that financial institutions appoint well-connected directors).
[125] *See id.* at 219, 225.
[126] *See infra* Part V.
[127] *See* Elyas Elyasiani & Ling Zhang, *Bank Holding Company Performance, Risk, and "Busy" Board of Directors*, 60 J. BANKING & FIN. 239, 240 (2015) ("[T]he governance dynamics of BHCs and nonfinancial firms are dissimilar and, therefore, it is improper to draw conclusions about BHC boards from research on nonfinancial firm boards.").
[128] *See supra* Sections II.B, II.C.
[129] *See* BAINBRIDGE, *supra* note 23, at 49; Davis & Mizruchi, *supra* note 124, at 219 (1999).
[130] *See supra* Section II.C.
[131] *See supra* Section II.B.2.
[132] *See* Partnoy, *supra* note 43, at 5 (asserting that risk management systems "should deliver much more information to the board of firms that have substantial exposure to financial risk than boards of firms that do not").
[133] *See* Jiraporn, *supra* note 114, at 825.
[134] *See* Andy Peters, *Are Some Bank Directors Spread Too Thin?*, AM. BANKER, May 5, 2016, at 1 ("Directors of banks and [BHCs] spend a lot more time with their companies than directors in other industries.") (quoting Latham & Watkins attorney Steven Stokdyk).

Financial institutions, moreover, are unlikely to realize the benefits that directors with governance experience at other companies might provide. According to an empirical study, busy directors enhance a firm's corporate governance effectiveness only when they serve on the boards of companies in a similar industry.[135] Busy directors, in other words, confer governance benefits only if the other companies with which they are affiliated are in a related business.[136] The Depository Institutions Management Interlocks Act (the Interlocks Act), however, prevents directors and executives of a large banking organization from serving on the board of another banking organization.[137] Busy financial institution directors therefore do not enhance governance because their other professional commitments, by law, must be in unrelated industries.

Consistent with this intuition, a handful of financial sector-specific studies have concluded that director busyness is detrimental for financial companies. Renee Adams and Hamid Mehran, for instance, studied 35 of the largest BHCs from 1986 to 1999 and found "a negative and significant relationship between performance and … the average number of external directorships held by" a BHC's independent directors.[138] Adams and Mehran found, in particular, that BHC directors holding a greater number of board seats are associated with lower Tobin's Q, the ratio of a firm's market value relative to its total assets.[139]

Other studies confirm that director busyness is associated with increased risk in financial firms. Elizabeth Cooper and Hatice Uzun, for example, analyzed 147 of the largest BHCs in 2006 and found that director busyness is correlated with higher levels of risk, as measured by stock market returns.[140] They determined, in fact, that one additional directorship per BHC director is associated with up to an 8.4 percent increase in risk.[141] Cooper and Uzun conclude that "directors with less distraction in terms of other directorships … tend to monitor banks that ultimately have less risk than banks with busy directors."[142]

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[135] *See* Curtis Clements et al., *Multiple Directorships, Industry Relatedness, and Corporate Governance Effectiveness*, 15 CORP. GOVERNANCE 590, 601-03 (2015) (finding a negative correlation between a firm's reported material internal control weaknesses and the number of industry-related outside boards on which the firm's directors serve, as measured by two-digit North American Industry Classification System code). When directors serve on the boards of companies in unrelated industries, however, they detract from the firm's governance. *See id.*

[136] *See id.*

[137] Depository Institutions Management Interlocks Act § 204, 12 U.S.C. § 3203 (2012) (prohibiting the officers and directors of a depository institution holding company with more than $2.5 billion in total assets from serving as an officer or director of a depository institution holding company with more than $1.5 billion in total assets). The Interlocks Act prohibitions are even more stringent than the Clayton Act's general prohibition on serving on the boards of direct competitors. *See* Renee Birgit Adams, *Governance of Banking Institutions*, *in* CORPORATE GOVERNANCE: A SYNTHESIS OF THEORY, RESEARCH, AND PRACTICE 451, 455 (Robert W. Kolb ed., 2010) (comparing the Interlocks Act and Clayton Act).

[138] Renee B. Adams & Hamid Mehran, *Bank Board Structure and Performance: Evidence for Large Bank Holding Companies*, 21 J. FIN. INTERMEDIATION 243, 259 (2012).

[139] *See id.* at 257; *see also* Grove et al., *supra* note 116, at 431 (finding significant negative association between busy directors and return on assets in U.S. commercial banks between 2006 and 2008).

[140] Elizabeth Cooper & Hatice Uzun, *Directors with a Full Plate: The Impact of Busy Directors on Bank Risk*, 38 MANAGERIAL FIN. 571, 580-83 (2012) (using directorships per independent director and the percentage of directors with three or more directorships as proxies for director busyness).

[141] *Id.* at 583.

[142] *Id.*

Director busyness appears to be associated with increased risks for nonbank financial companies, as well. Maureen Muller-Kahle and Krista Lewellyn studied a sample of publicly-traded nonbank lenders from 1997–2005 and determined that outside directors holding a greater number of board seats were associated with higher concentrations in subprime lending relative to safer, prime lending.[143] Muller-Kahle and Lewellyn posited that firms with busy boards were likely to be distracted by other professional commitments, leading to ineffective group decision-making and increased concentrations in subprime loans.[144] They concluded that "busy boards may not be the most effective boards when it comes to overseeing risky strategic initiatives."[145]

While the foregoing evidence strongly suggests that director busyness is problematic for financial firms, some caution is appropriate in light of a single study suggesting that director busyness is associated with better BHC performance and lower risk. In a study of 116 BHCs from 2001–2010, Elyas Elyasiani and Ling Zhang found that firms with a greater number of busy directors had better performance, as measured by Tobin's Q and return on assets.[146] Elyasiani and Zhang also determined that busy boards were associated with higher asset quality and lower levels of total, market, and idiosyncratic risk, as measured by stock market returns.[147] Elyasiani and Zhang argue that their results show that directors with multiple directorships are more capable of fulfilling BHCs' monitoring and advising needs "due to the extensive knowledge, information, and experience they have accumulated by sitting on multiple boards."[148]

This study, however, suffers from a number of serious flaws. For one, Elyasiani and Zhang fail to acknowledge the studies discussed earlier in this Section that show director busyness has a detrimental effect on financial firms, and they thus do not attempt to distinguish contradictory evidence.[149] Elyasiani and Zhang, moreover, exclude the largest BHCs from their sample.[150] This omission calls into question whether their conclusions are applicable to the largest and most complex BHCs. Elyasiani and Zhang, further, limit their sample to BHCs, and their study therefore fails to detect the effect of busy directors on nonbank financial companies. Finally, Elyasiani and Zhang acknowledge that the alleged association between director busyness and lower riskiness did not hold true during the Financial Crisis.[151] The study, therefore, is far from conclusive.

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[143] Maureen I. Muller-Kahle & Krista B. Lewellyn, *Did Board Configuration Matter? The Case of U.S. Subprime Lenders*, 19 CORP. GOVERNANCE 405, 411 (2011).
[144] *Id.* at 408.
[145] *Id.* at 413.
[146] *See* Elyasiani & Zhang, *supra* note 127, at 244-45.
[147] *Id.* at 245-46.
[148] *Id.* at 248-49.
[149] *See id.* at 239 ("To date, no study has looked at the association between busy boards and [BHC] behavior."); *see also id.* at 241 ("To our knowledge, no similar studies [of director busyness] have been conducted for BHCs.").
[150] *See id.* at 243 (noting that the largest BHC in the study had total assets of $707 billion). By 2010 (the end of the study period), six BHCs—Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, and Wells Fargo—had assets in excess of $707 billion. *See* NAT'L INFO. CTR., BHC PEER GROUP DATA (2011), https://www.ffiec.gov/nicpubweb/content/BHCPRRPT/REPORTS/BHCPR_PEER/Dec2010/PeerGroup_1_december2010.pdf. Thus, it appears that Elyasiani and Zhang excluded these BHCs from their sample. The other studies discussed in this Section, by contrast, generally included the largest BHCs. *See, e.g.*, E-mail from Elizabeth Webb Cooper, Assoc. Prof. of Fin., La Salle University (July 15, 2016) (on file with author) (confirming that Cooper's and Uzun's sample included Bank of America, Citigroup, JPMorgan Chase, and Wells Fargo).
[151] Elyasiani and Zhang, *supra* note 127, at 246 ("[D]uring the crisis, the benefits of busy directors in reducing risk were smaller than they were in non-crisis times. It appears that the strong effect of the crisis overpowered the directors' skills, curtailing their influence on risk….").

On balance, the weight of the evidence strongly suggests that busy directors are associated with worse performance and higher risk in large financial firms, just as they are in large nonfinancial companies. The studies by Adams and Mehran, Cooper and Uzun, and Muller-Kahle and Lewellyn are more strongly weighted to the largest financial firms and cover a broader range of nonbank financial companies than the sole contradictory study by Elyasiani and Zhang. The most plausible conclusion, therefore, based on the entirety of the empirical evidence is that busy directors increase risk and decrease performance for large, complex financial firms.

IV. Case Studies

Although the empirical literature strongly suggests that director busyness is detrimental for large financial companies, to date no one has explored *how* director busyness harms financial companies. The following case studies examine—for the first time—the ways in which directors' outside commitments affect the operation of corporate governance mechanisms in financial firms. The case studies focus, in particular, on how director busyness affects a board's ability to implement and oversee monitoring systems to detect and deter misconduct and excessive risks. Taken together, the case studies demonstrate that boards of large, complex financial firms are better able to mitigate risks when directors have fewer outside professional engagements.

A. Wells Fargo's Fraudulent Accounts Scandal

In late 2016, Wells Fargo infamously lost $25 billion in market capitalization when it agreed to settle charges that its employees had opened as many as 3.5 million unauthorized customer accounts in order to meet aggressive cross-selling targets.[152] Key members of Wells Fargo's board of directors learned of potential sales practices violations as early as 2005,[153] and Wells Fargo's full board became aware of the misconduct no later than 2013, when the *Los Angeles Times* published an exposé on customer abuses in the bank's west-coast branches.[154] The sales practices violations, however, persisted for three more years.[155] The important governance question, then, is why Wells Fargo's directors failed to stop the misconduct when they first learned of the violations.

[152] *See* Emily Glazer, *Wells Fargo Fined for Sales Scam*, WALL ST. J., Sept. 9, 2016, at A1; Kartikay Mehrotra & Laura J. Keller, *Wells Fargo's Fake Accounts Grow to 3.5 Million in Suit*, BLOOMBERG, May 12, 2017, https://www.bloomberg.com/news/articles/2017-05-12/wells-fargo-bogus-account-estimate-in-suit-grows-to-3-5-million.

[153] *See* OFFICE OF THE COMPTROLLER OF THE CURRENCY, OFFICE OF ENTER. GOVERNANCE AND THE OMBUDSMAN, LESSONS LEARNED REVIEW OF SUPERVISION OF SALES PRACTICES AT WELLS FARGO 5 (2017) (noting that the bank's board received regular reports indicating that the highest level of internal ethics complaints and employee terminations were related to sales practices violations).

[154] E. Scott Reckard, *Wells Fargo's Pressure-Cooker Sales Culture Comes at a Cost*, L.A. TIMES, Dec. 21, 2013, at 1; *see also* INDEP. DIRS. OF THE BD. OF WELLS FARGO & CO., SALES PRACTICES INVESTIGATION REPORT 100 (2017), https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/presentations/2017/board-report.pdf [hereinafter INDEP. DIRS.' REPORT] (acknowledging that the board was aware of *Los Angeles Times* report).

[155] *See In re* Wells Fargo Bank, N.A., CFPB No. 2016-CFPB-0015 (Sept. 8, 2016), http://files.consumerfinance.gov/f/documents/092016_cfpb_WFBconsentorder.pdf (noting that illegal conduct continued until September 8, 2016).

While many factors undoubtedly contributed to a governance failure of this magnitude,[156] the extent to which Wells Fargo's directors were distracted from their responsibilities by outside professional engagements is a key—and, as yet, unexplored—cause of the scandal. A close evaluation of Wells Fargo's board reveals that overcommitment inhibited its ability to diagnose the firm's sales practices problems and to implement and follow up on corrective measures.

While Wells Fargo's employees opened millions of fake customer accounts in response to incentives established by the bank's senior management, its directors were extraordinarily busy with other professional obligations. Wells Fargo's directors, in fact, were busier than the directors of any other U.S. banking organization.[157] As depicted in Table 1, for instance, nine of Wells Fargo's 13 independent directors served on three or more public company boards in 2014, just after the bank's sales practices became subject to public scrutiny.

Table 1: Wells Fargo & Co. Independent Directors (2014)[158]

Director	Board Role	Executive Employment	Other Public Company Board Seats
John D. Baker II			Patriot Transportation Holding, Inc.; Texas Industries, Inc.
Elaine L. Chao			News Corp.; Protective Life Corp.
John S. Chen		CEO, BlackBerry Ltd.	BlackBerry Ltd.; The Walt Disney Co.
Lloyd H. Dean	Chair, Human Resources Committee	CEO, Dignity Health	Cytori Therapeutics, Inc.; Premier, Inc.
Susan E. Engel			
Enrique Hernandez	Chair, Risk and Finance Committees	CEO, Inter-Con Security Systems, Inc.	Chevron Corp.; McDonald's Corp.; Nordstrom, Inc.
Donald M. James		CEO, Vulcan Materials Co.	Vulcan Materials Co.; Southern Co.
Cynthia H. Milligan	Chair, Credit Committee		Calvert Funds; Kellogg Co.; Raven Industries, Inc.
Federico F. Pena			Sonic Corp.
James H. Quigley	Chair, Audit Committee		Hess Corp.; Merrimack Pharmaceuticals, Inc.
Judith M. Runstad	Chair, Corporate Responsibility Committee		
Stephen W. Sanger	Lead Independent Director		Pfizer, Inc.
Susan G. Swenson			Harmonic, Inc.; Novatel Wireless, Inc.; Spirent Communications plc

Three key Wells Fargo directors bore particular responsibility for addressing the bank's sales practices issues. As the firm's lead independent director, Stephen Sanger scheduled the

[156] *See, e.g.*, Aaron Back, *Wells Fargo Shows Case For a Divide*, WALL ST. J., Sept. 30, 2016, at C8 (asserting that Wells Fargo's combined CEO-chairman position impaired oversight of management); *see also* INDEP. DIRS.' REPORT, *supra* note 154, at 4-9 (identifying decentralized organizational structure and deference to bank-level leadership as root causes of misconduct).
[157] *See* Peters, *supra* note 134, at 1 (noting that Wells Fargo and Citigroup are among the three busiest bank boards nationwide).
[158] *See* Wells Fargo & Co., Proxy Statement (Form DEF 14A) 2-9 (Mar. 18, 2014) [hereinafter Wells Fargo 2014 Proxy Statement].

board's meetings, approved the board's agenda, and coordinated coverage of governance issues among the board's committees.[159] James Quigley chaired the audit committee, which oversaw legal and regulatory compliance.[160] Enrique Hernandez chaired the risk committee, which oversaw the firm's enterprise-wide risk management framework and became primarily responsible for addressing the sales practices problems.[161]

Each of these key directors was stretched thin with outside professional commitments during the period of Wells Fargo's misconduct. Sanger and Quigley both served on the boards of two other multinational, public companies in addition to Wells Fargo.[162] Hernandez's commitments were even more extensive. Hernandez served on the boards of three other public companies: Chevron Corporation, McDonald's Corporation, and Nordstrom, Inc., of which he was the chairman of the board.[163] Hernandez's four public company boards placed him in the top 5% of the most "overboarded" corporate directors in America.[164] On top of that, Hernandez was the CEO of Inter-Con Security Systems, Inc., one of the largest private security services companies in the United States.[165]

Wells Fargo's busy directors missed crucial opportunities to eliminate customer abuses at the bank. Following the settlements, an *ad hoc* committee of Wells Fargo's independent directors commissioned a report on the root causes of the sales practices violations.[166] The report identifies several key areas in which the Wells Fargo board fell short. The report, for instance, acknowledges that senior risk managers highlighted sales practices as one of the top 10 risks facing the firm in meetings with the risk committee and board.[167] Despite these warnings, however, the board failed to act. The risk committee and board did not insist that management prepare detailed and concrete plans to address the sales practices abuses.[168] Nor did the directors press forcefully to change leadership in the parts of the bank where the abuses originated.[169] It was not until after the Los Angeles City Attorney filed a lawsuit against Wells Fargo that the board of directors began to follow up on these issues more diligently.[170]

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[159] *See id.* at 19.
[160] *See id.* at 10.
[161] *See id.* at 12; *see also* INDEP. DIRS.' REPORT, *supra* note 154, at 100-08 (describing the risk committee's engagement on sales practices issues).
[162] *See* Wells Fargo 2014 Proxy Statement, *supra* note 158, at 7-8. In addition to Pfizer, Inc., Sanger served on the board of Target Corporation until his retirement in March 2013. *See* Target Corp., Proxy Statement (Form DEF 14A) 24 (May 19, 2014).
[163] *See* Wells Fargo 2014 Proxy Statement, *supra* note 158, at 5.
[164] *See* Lublin, *supra* note 73 (noting that 5% of S&P 500 directors served on four or more public company boards in 2015).
[165] *See* Wells Fargo 2014 Proxy Statement, *supra* note 158, at 5; *see also* INTER-CON SECURITY, http://www.icsecurity.com/profile/history (last visited June 15, 2017) (describing Inter-Con's "tens of thousands of security and event personnel operating on four continents").
[166] INDEP. DIRS.' REPORT, *supra* note 154; *see also* Letter from Sen. Elizabeth Warren to Janet Yellen, Chair, Fed. Reserve Bd. of Governors (June 19, 2017), https://www.warren.senate.gov/files/documents/2017-6-19_Warren_Ltr_to_Fed.pdf (discussing Wells Fargo's "inadequate" risk management practices and arguing that the directors' inaction demonstrated "continuing disregard" for the bank's safety and soundness).
[167] *See* INDEP. DIRS.' REPORT, *supra* note 154, at 100-01.
[168] *See id.* at 17.
[169] *See id.*
[170] *See id.* at 103-10.

Wells Fargo's board missed opportunities to address the bank's sales practices issues, at least in part, because its busy directors were missing in action. As discussed above, boards comprised of busy directors meet less frequently, and fewer meetings are associated with worse financial outcomes.[171] Wells Fargo's directors were so busy that they rarely met as a full board or in their committees. Indeed, as depicted in Table 2, Wells Fargo's full board and risk and audit committees met significantly less frequently than those of peer U.S. banking organizations during the period of the misconduct.[172] Every year between 2012 and 2015, for example, Wells Fargo held fewer board and risk committee meetings than any of its peer banks.[173]

Table 2: Number of Board and Committee Meetings[174]

	2011	**2012**	**2013**	**2014**	**2015**
Full Board					
Wells Fargo	13	9	9	9	9
Peer Banks	14.9	14.1	13.7	16.6	15.3
Risk Committee					
Wells Fargo	4	4	6	6	7
Peer Banks	8.3	8.3	8.4	10.3	9.6
Audit Committee					
Wells Fargo	9	9	9	10	14
Peer Banks	14.1	14.1	14.9	15.6	15.6

In sum, from at least 2005 until 2016, Wells Fargo's directors failed to respond to red flags regarding sales practices violations, and they permitted the bank to operate with substandard risk management infrastructure. They did this, in part, because they were more overcommitted than any other bank directors in the country. The three independent directors most responsible for addressing Wells Fargo's sales practices issues—Sanger, Quigley, and Hernandez—were especially busy, leading to insufficient time and attention spent on risk oversight. Wells Fargo's fake account scandal, therefore, is a cautionary tale as to how director busyness inhibits oversight of traditional banking risks.

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[171] *See supra* text accompanying notes 115 and 116.

[172] This Article considers Wells Fargo's peer banking organizations to be the seven other companies, in addition to Wells Fargo, that the Financial Stability Board deems "global systemically important banks" (G-SIBs). G-SIBs are banking organizations whose failure would cause significant disruption to the financial system and broader economy, based on their size, interconnectedness, substitutability, cross-jurisdictional activity, and complexity. *See* BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, GLOBAL SYSTEMICALLY IMPORTANT BANKS: UPDATED ASSESSMENT METHODOLOGY AND THE HIGHER LOSS ABSORBENCY REQUIREMENT (2013), http://www.bis.org/publ/bcbs255.htm. The eight U.S. G-SIBs are Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, State Street, and Wells Fargo. *See* FIN. STABILITY BD., 2016 LIST OF GLOBAL SYSTEMICALLY IMPORTANT BANKS (G-SIBS) (2016), http://www.fsb.org/wp-content/uploads/2016-list-of-global-systemically-important-banks-G-SIBs.pdf.

[173] Data hand-collected from the 2012-2015 proxy statements of the eight U.S. G-SIBs, as filed on the SEC's EDGAR database.

[174] Data for Table 2 were hand-collected from the 2011-2015 proxy statements of the eight U.S. G-SIBs, as filed on the SEC's EDGAR database. *See supra* note 172 for a list of Wells Fargo's peer banking organizations.

B. JPMorgan and the London Whale

Director busyness also detracts from oversight of trading risks, as was the case in JPMorgan's London Whale trading losses. The London Whale was the nickname eventually given to Bruno Iksil, a trader in JPMorgan's Chief Investment Office (CIO). In late 2011, Iksil began amassing credit derivatives, allegedly to hedge JPMorgan's exposure to credit markets.[175] Iksil's trading positions, however, were imperfectly calibrated to JPMorgan's actual exposures, and the derivatives portfolio lost value.[176] Desperate to offset his initial losses, Iksil doubled down on his strategy, purchasing even more derivatives and breaching JPMorgan's risk limits more than 300 times in the process.[177] Iksil's positions dominated the market by early February 2012.[178] Rival traders ganged up on Iksil, driving down the value of his massive derivatives portfolio.[179] By the time the dust settled, JPMorgan lost more than $6 billion on Iksil's ill-conceived trades and incurred more than $1 billion in fines for inadequate risk monitoring.[180]

The seeds of the London Whale trading loss were sown in 2005, when JPMorgan created the CIO as a separate division within its bank. JPMorgan charged the CIO with managing the firm's excess deposits, a portfolio that quickly grew to more than $350 billion.[181] CIO typically invested these funds in safe, low-yielding assets like Treasury securities, but leaders within the bank soon came to view the CIO as a potential profit center.[182] Shortly after its establishment, the CIO received approval to begin trading synthetic credit derivatives.[183] Iksil and other CIO traders used this authority to generate windfall profits in 2011, leading to expectations among JPMorgan's senior leaders that CIO would repeat its performance.[184]

JPMorgan maintained a Risk Policy Committee (RPC) on its board of directors, which was responsible for overseeing senior management's efforts to address significant risks facing the firm.[185] The RPC, among other things, reviewed policies for assessing and managing risks, assisted management in establishing risk limits, and oversaw reports of JPMorgan's major risk

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175 *See* STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 113TH CONG., JPMORGAN CHASE WHALE TRADES: A CASE HISTORY OF DERIVATIVES RISKS AND ABUSES 50-53 (Comm. Print 2013) [hereinafter SENATE REPORT].
176 *See id.* at 76-77.
177 *See id.* at 75-85, 153.
178 *See id.* at 91.
179 *See id.* at 88-90.
180 *See id.* at 94; *see also* Douglas, *supra* note 9 (discussing fines).
181 *See* SENATE REPORT, *supra* note 175, at 21-22. If the CIO had been a stand-alone bank, it would have been the seventh largest bank in the United States. *See id.* at 22.
182 *See id.* at 55, 63.
183 *See id.* at 37.
184 *See id.* at 53-55, 63.
185 *See* JPMorgan Chase & Co., Proxy Statement (Form DEF 14A) 6 (Mar. 30, 2007) [hereinafter JPMorgan 2007 Proxy Statement] (providing that the RPC is "responsible for oversight of the CEO's and senior management's responsibilities to assess and manage the Firm's credit risk, market risk, interest rate risk, investment risk, liquidity risk and reputational risk…").

exposures and management's efforts to control significant risks.[186] JPMorgan's firm-wide chief risk officer and other senior risk managers regularly reported to the RPC.[187]

James Crown became the chair of the RPC around the time that JPMorgan established CIO as a separate division.[188] As chairman of the RPC, Crown was responsible for setting the committee's agenda.[189] Crown, a former investment banker at Salomon Brothers, Inc., had served on the board of JPMorgan or one of its predecessors for more than two decades.[190] The grandson of a wealthy industrialist, Crown left investment banking in the mid-1980s to join his family's multi-billion dollar investment company, Henry Crown & Co., where he took over as President in 2003.[191] In addition to running Henry Crown & Co. and chairing JPMorgan's RPC, Crown also served as the lead independent director of both Sara Lee Corp. and General Dynamics Corporation.[192] With his leadership role in the family business and key governance positions on the boards of three large, public companies, Crown ranked among the busiest corporate directors.[193] On top of these commitments, Crown also chaired the University of Chicago Medical Center Board of Trustees and served as a trustee of the Museum of Science and Industry, The Aspen Institute, the University of Chicago, and the Chicago Symphony Orchestra.[194]

While Crown juggled his professional responsibilities, the RPC failed to ensure that the new CIO division established an effective risk management infrastructure. The RPC, for example, did not address the fact that—unlike all of JPMorgan's other business lines—the CIO lacked a line-of-business chief risk officer.[195] The RPC, moreover, permitted the CIO's senior-most risk officer to report directly to the head of the CIO, rather than to the firm-wide CRO.[196] This reporting structure created conflicts of interest, with CIO risk managers more beholden to CIO management than to the firm-wide risk organization.[197] The RPC also failed to ensure that the firm paid its risk

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186 JPMORGAN CHASE & CO., RISK POLICY COMMITTEE CHARTER, https://web.archive.org/web/20100125110431/http://www.jpmorganchase.com/corporate/about-jpmc/risk-committee-charter.htm (accessed by searching "http://www.jpmorganchase.com/corporate/about-jpmc/risk-committee-charter.htm" in the Internet Archive Wayback Machine) (reflecting version of RPC charter in effect as of Jan. 25, 2010).

187 *See, e.g.*, SENATE REPORT, *supra* note 175, at 157.

188 *See* JPMorgan 2007 Proxy Statement, *supra* note 185, at 6.

189 *See* JPMorgan Chase & Co., Proxy Statement (Form DEF 14A) 6 (Mar. 31, 2010) [hereinafter JPMorgan 2010 Proxy Statement].

190 *See id.* at 3.

191 *See id.*

192 *See* Sara Lee Corp., Proxy Statement (Form DEF 14A) 6 (Sept. 14, 2007); General Dynamics Corp., Proxy Statement (Form DEF 14A) 7 (Mar. 18, 2011). Prior to becoming the lead independent director of General Dynamics in May 2010, Crown served as chair of the nominating and corporate governance committee. *See* General Dynamics Corp., Proxy Statement (Form DEF 14A) 13 (Mar 23, 2007).

193 In 2012, for example, one-third of S&P 500 directors served on three or more public company boards. *See* SPENCER STUART 2012 BOARD INDEX, *supra* note 89, at 16.

194 *See* JPMorgan 2010 Proxy Statement, *supra* note 189, at 3.

195 *See* SENATE REPORT, *supra* note 175, at 155. When the CIO finally hired a business-line CRO in early 2012, it hired the brother-in-law of JPMorgan's firm-wide CRO. *See id.* at 162.

196 *See id.* at 160.

197 *See id.* In response to regulatory pressure, JPMorgan eventually changed the reporting lines so that the senior risk manager reported directly to the firm-wide CRO and indirectly to the head of CIO. The senior risk manager, however, later testified that the functional reorganization did not, in practice, diminish his loyalty to CIO's management. *See id.*

managers competitive salaries.[198] In sum, in the early years of Crown's tenure as chair of the RPC, the RPC continually failed to identify or address shortcomings in CIO's risk management.

Troublingly, Crown's outside professional commitments became particularly time-consuming in 2011, just as Iksil began building his credit derivative portfolio.[199] Crown had just been promoted to chairman of Sara Lee's board after the prior chairman and CEO suffered a stroke and resigned.[200] In January 2011, Sara Lee announced its intention to undergo a large-scale reorganization, spinning off its international beverage and bakery business into a separate public company.[201] Throughout 2011, therefore, while Iksil dramatically increased the risk profile of the CIO, Crown faced the extraordinary tasks of overseeing Sara Lee's CEO search and spin-off. After a contentious and protracted search,[202] Sara Lee ultimately hired a new CEO in early 2012.[203] Sara Lee completed its spin-off in June 2012, just one month after JPMorgan disclosed the London Whale losses.[204]

Crown experienced additional attention shocks around the time that Iksil began amassing credit derivatives. General Dynamics, a defense contractor primarily reliant on government contracts, was coping with the effects of sequestration—congressionally mandated reductions in the defense budget of up to $1 trillion that were enacted in August 2011.[205] Crown, recently elevated to become General Dynamic's first lead director, became primarily responsible for exercising independent oversight of the firm while it reformulated its corporate strategy.[206] In the meantime, Crown continued to oversee Henry Crown & Co.'s sprawling network of operating companies and exercised authority to sign off on all of the firm's investment decisions.[207]

These attention shocks drew Crown's focus away from JPMorgan's risk governance at an especially inopportune time. Shareholders warned Crown about risk management deficiencies at JPMorgan in early 2011, just before Iksil began trading credit derivatives; yet the RPC failed to act.[208] Among other shortcomings, the CIO's line-of-business risk committee—comprised of the CIO's top managers and risk officers—met only three times in 2011 and, unlike other line-of-business risk committees at JPMorgan, did not include personnel from other divisions to provide independent evaluation of CIO's trading strategies.[209] The RPC, in the meantime, received

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[198] *See* Nelson D. Schwartz & Jessica Silver-Greenberg, *JPMorgan Was Warned About Lax Risk Controls*, N.Y. TIMES, June 4, 2012, at B1 (noting that "JPMorgan executives charged with judging risk were paid significantly less than their counterparts at other banks").
[199] *See* SENATE REPORT, *supra* note 175, at 51 (noting that CIO's credit derivative portfolio grew by more than tenfold to $51 billion during 2011).
[200] *See Sara Lee Chief Is Leaving After a Stroke*, N.Y. TIMES, Aug. 9, 2010, at B6.
[201] *See* Korn & Brat, *supra* note 2.
[202] *See* Joann S. Lublin & Julie Jargon, *Sara Lee Changes Horses*, WALL ST. J., Sept. 13, 2011, at B2 (noting that Sara Lee's board suddenly "reversed course" and decided not to promote an internal candidate to CEO).
[203] *See* York, *supra* note 2.
[204] *See* Press Release, Hillshire Brands Co., *supra* note 8; *see also* Fitzpatrick et al., *supra* note 9.
[205] *See* General Dynamics Corp., Annual Report (Form 10-K) 10, 19 (Feb. 17, 2012); *see also* Censer, *supra* note 3.
[206] *See* General Dynamics Corp., Proxy Statement (Form DEF 14A) 14 (Mar. 16, 2012) (describing lead director's authority and responsibilities).
[207] *See* Harris, *supra* note 4.
[208] *See* Schwartz & Silver-Greenberg, *supra* note 198 (noting that shareholder advocates warned Crown about risk management deficiencies during an April 2011 meeting).
[209] SENATE REPORT, *supra* note 175, at 162-63; *see also* JPMORGAN CHASE & CO, REPORT OF JPMORGAN CHASE & CO. MANAGEMENT TASK FORCE REGARDING 2012 CIO LOSSES 100 (2013),

periodic reports on CIO's risk profile, and management alerted the RPC when the CIO breached company-wide risk limits.[210] With Crown's attention diverted elsewhere, however, the RPC failed to correct CIO's risk management deficiencies in time to prevent Iksil's trading losses.

There is, of course, no guarantee that JPMorgan would have prevented the London Whale trading losses had Crown been less overcommitted. Indeed, other shortcomings undoubtedly contributed to such a significant breakdown in risk governance. JPMorgan's management, for instance, could have been more forthcoming about risks in the CIO, which might have focused the board's attention in time to prevent or mitigate the losses.[211] JPMorgan's board, moreover, could have appointed directors with more risk management expertise to serve alongside Crown on the RPC.[212]

Crown's overcommitment, however, inhibited effective risk governance at JPMorgan. Crown's early tenure as chair of the RPC overlapped with his elevation to president of his family's investment company and his assumption of leadership roles on the boards of Sara Lee and General Dynamics. With so many competing commitments, Crown failed to ensure that the nascent CIO established an appropriate risk management infrastructure. As the empirical evidence predicts, moreover, Crown's outside commitments created attention shocks—and they did so at a particularly inopportune time.[213] Just as Iksil began building his massive credit derivatives portfolio, Crown was distracted by Sara Lee's CEO search and spin-off as well as General Dynamic's sequestration challenge. Had Crown been less overcommitted, the RPC would have been more likely to address shareholders' concerns about risk management deficiencies and would have been better able to detect the emerging risks in CIO. Crown's busyness, therefore, was a key contributing factor to the London Whale losses.

All of this is not to say, of course, that the Wells Fargo would have averted its fake account scandal and JPMorgan would have avoided the London Whale losses had their respective boards been less overcommitted. Indeed, a banking organization's officers and employees bear front-line responsibility for ferreting out misconduct and minimizing excessive risks.[214] This Part's primary contention, however, is that Wells Fargo and JPMorgan would have been more likely to detect and

http://files.shareholder.com/downloads/ONE/2272984969x0x628656/4cb574a0-0bf5-4728-9582-625e4519b5ab/Task_Force_Report.pdf [hereinafter TASK FORCE REPORT] ("There was no official membership or charter for the CIO Risk Committee and attendees typically included only personnel from CIO…. Had there been senior traders or risk managers from outside CIO or had the CIO Risk Committee met more often, the process might have been used to more pointedly vet the traders' strategies in the first quarter of 2012.").

[210] *See JPMorgan Chase Whale Trades: A Case History of Derivatives Risks and Abuses: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Gov't Affairs*, 113th Cong. 877, 880 (2013) (CIO risk summary report); *id.* at 1728, 1730 (noting that JPMorgan's CRO alerted the RPC that CIO increased a key risk limit). Management did not, however, specifically inform the RPC of the burgeoning risks in Iksil's credit derivatives portfolio until after the media publicly reported on the trades in April 2012. *See* SENATE REPORT, *supra* note 175, at 162.

[211] *See* TASK FORCE REPORT, *supra* note 209, at 42-43 (noting that CIO management did not disclose increasing risks in March 20, 2012, meeting with the RPC).

[212] *See* Susanne Craig & Jessica Silver-Greenberg, *A Call for New Blood on the JPMorgan Board*, N.Y. TIMES, May 5, 2013, at B1 (noting that the two members of the RPC other than Crown had never before worked in finance).

[213] *See supra* text accompanying notes 122 and 123.

[214] *See* BD. GOVS. FED. RES. SYS., *supra* note 65 (discussing senior management's responsibility for risk management).

deter the nascent problems if the boards—and especially their key directors—had been less overcommitted.

C. PNC and the Financial Crisis

While busy directors impair governance, the inverse is also true: directors with few outside commitments are better able to mitigate risks. A case study of PNC during the financial crisis demonstrates how directors with few outside commitments enhance governance of large financial companies. PNC, the eighth largest banking organization in the United States, was one of the strongest and most resilient banks during the market crash, with one analyst calling PNC the "biggest winner of the financial crisis."[215]

PNC achieved this success under the leadership of directors who were unusually focused on their governance responsibilities, with few competing professional commitments. In the lead-up to the crisis, 12 of PNC's 17 independent directors served only on PNC's board or on the board of just one other company.[216] No independent director with a full-time executive position held more than three board seats.[217] Crucially, two of PNC's key directors—the chairmen of its risk and audit committees—were both retired and served on no other public company boards.[218] PNC's board, in sum, was among the least busy of all U.S. banking organization boards.[219]

PNC's board of directors made several critical strategic decisions in the lead-up to and during the financial crisis that positioned the firm for success. PNC, for example, decided in 2000 to divest its mortgage origination and servicing business lines.[220] PNC's chairman presciently explained that PNC sold its mortgage business because PNC was not being adequately compensated to assume the risk that borrowers would default.[221]

By limiting its residential mortgage exposure, PNC positioned itself for a series of strategic acquisitions during the crisis.[222] Most notably, PNC purchased troubled National City Corporation

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[215] *See* Roben Farzad, *A Bank CEO Thrives Far From Wall Street*, BLOOMBERG, Oct. 26, 2012, https://www.bloomberg.com/news/articles/2012-10-26/a-bank-ceo-thrives-far-from-wall-street (quoting equity research analyst Dave Bugajski).

[216] *See* PNC Fin. Servs. Grp., Proxy Statement (Form DEF 14A) 6-7 (Mar. 23, 2007) (noting that 12 of PNC's 17 independent directors held, at most, one other public company directorship).

[217] *See id.*

[218] *See id.* at 6-7, 25 (noting that neither audit committee chair Paul Chellgren nor risk committee chair Stephen Thieke held a full-time executive position or served on another public company board).

[219] PNC's independent directors served, on average, on 2.06 public company boards in 2007. *See id.* at 6-7. The mean U.S. BHC board in 2007, by contrast, was comprised of outside directors with an average of 2.5 board appointments. *See* Marco Becht et al., *supra* note 45, at 448 (sample of 500 U.S. banking organizations) (internal citation omitted).

[220] *See* Nikhil Deogun, *Washington Mutual Agrees to Acquire Residential-Mortgage Business of PNC*, WALL ST. J., Oct. 2, 2000, at B2. Washington Mutual, which bought PNC's mortgage divisions, failed infamously in 2008 due to its aggressive expansion in residential mortgage lending. *See* Robin Sidel et al., *WaMu is Seized, Sold Off to J.P. Morgan, In Largest Failure in U.S. Banking History*, WALL ST. J., Sept. 26, 2008, at A1.

[221] *See* Rob Garver, *Jim Rohr Makes Right Choices in Trying Times for PNC, Industry*, AM. BANKER, Nov. 30, 2007, at 2A (quoting PNC chairman and CEO Jim Rohr explaining that PNC divested its mortgage business because "[w]e didn't think we were getting paid for [taking credit risk]").

[222] *See, e.g.*, Dennis K. Berman & Clint Riley, *PNC Nears $6 Billion Mercantile Deal*, WALL ST. J., Oct. 9, 2006, at A3 (acquisition of Mercantile Bankshares Corp.); Jennifer Gordon, *PNC Gives Details on Sterling Buy*, AM. BANKER, Feb. 7, 2008, at 20 (acquisition of Sterling Financial Corp.); Tim Mazzucca, *Embattled Yardville Finds Buyer; Below-*

at the peak of the crisis, more than doubling PNC's size to $300 billion in assets and expanding its geographic footprint.[223] All the while, PNC's board maintained a robust risk management framework, and PNC avoided major lawsuits and enforcement actions, in contrast to most banks its size.[224]

PNC's improved competitive position since the financial crisis is attributable, at least in part, to its uncharacteristically focused and committed board of directors. PNC's directors, with few outside engagements, met more frequently than Wells Fargo's overcommitted directors, despite PNC being roughly one-fifth the size of Wells Fargo.[225] The chairmen of PNC's risk and audit committees were unaffiliated with other large, public companies and therefore were not susceptible to attention shocks like those experienced by JPMorgan's Crown.[226]

Most importantly, however, PNC directors had sufficient time and attention to monitor PNC's management. Indeed, PNC's CEO attested to the degree to which PNC's board challenged management. As the CEO later recounted in a media interview, when PNC was close to buying National City, the chairman of PNC's risk committee confronted the CEO, saying, "[W]e're in the middle of the worst recession since the Great Depression. We've had a housing collapse, a political uprising with a lot of regulatory change. And you're proposing to buy a troubled bank larger than we are?"[227] In sharp contrast to Wells Fargo and JPMorgan, PNC's directors had the bandwidth to ask these difficult questions because they were not stretched thin by outside commitments.

V. Financial Company Boards are Alarmingly Overcommitted

Encouragingly, the empirical evidence on director busyness has convinced some corporate boards to reign in their outside commitments. Some firms, for example, have declined to appoint director candidates with many professional engagements, and certain directors have voluntarily limited their outside commitments as board workloads have increased.[228] More than half of S&P 500 companies, moreover, have adopted caps on the number of outside boards on which their directors may serve.[229] These limits tend to be relatively high, and firms routinely grant waivers

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Market Deal Would Boost PNC in Wealthy N.J. Areas, AM. BANKER, June 8, 2007, at 1 (acquisition of Yardville National Bancorp); Mitchell Pacelle, *PNC to Buy Riggs for $645 Million In New Agreement*, WALL ST. J., Feb. 11, 2005, at C5 (acquisition of Riggs National Corp.).

[223] *See* Dan Fitzpatrick et al., *PNC Buys National City in Bank Shakeout*, WALL ST. J., Oct. 25, 2008, at B1.

[224] *See* Garver, *supra* note 221, at 2A (describing risk management at PNC).

[225] In 2013, for example, PNC's board, risk committee, and audit committee met 12, 9, and 12 times, respectively. PNC Fin. Servs. Grp., Proxy Statement (Form DEF 14A) 28 (Mar. 13, 2014). Wells Fargo's board, risk committee and audit committee, by contrast, met 9, 6, and 9 times, respectively. *See* Wells Fargo 2014 Proxy Statement, *supra* note 158, at 10-12.

[226] *See supra* note 218 and accompanying text.

[227] John Engen, *Reflections of a Steel City Banker*, BANKDIRECTOR.COM, Aug. 5, 2013, http://www.bankdirector.com/magazine/archives/3rd-quarter-2013/reflections-of-a-steel-city-banker/ (quoting PNC CEO Jim Rohr).

[228] *See* Chu & Davis, *supra* note 11, at 726-35 (providing evidence of firms' declining preference for busy directors); *see also* Lublin, *supra* note 73 (providing examples of firms that refuse to appoint busy directors and directors who choose to limit their board service).

[229] SPENCER STUART 2016 BOARD INDEX, *supra* note 13, at 15 (noting that 61% of S&P 500 boards establish a numerical limit for directors' outside boards).

from their restrictions.[230] Nonetheless, extreme overboarding—in which a director holds eight or more board seats—has all but disappeared.[231] As a result of these changes, directors of large, public companies generally have fewer outside professional commitments today than they had decades ago.[232]

Despite this progress, however, many financial institution boards remain severely overcommitted. This Part analyzes director busyness at the United States' largest and most complex financial institutions. Included in the analysis are the eight U.S. banking organizations that the Financial Stability Board deems to be G-SIBs: Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, State Street, and Wells Fargo.[233] Also included are American International Group, Inc. and Prudential Financial, Inc.—the two nonbank financial companies that could pose a threat to U.S. financial stability, according to the Financial Stability Oversight Council (FSOC).[234] The Article refers to these companies collectively as "systemically important financial institutions" (SIFIs).

SIFI directors continue to be extraordinarily busy. As demonstrated in Table 3, when compared to the directors of all S&P 500 firms, directors of SIFIs are substantially less likely to sit on only one public company board. SIFI directors, moreover, are much more likely than their S&P 500 counterparts to sit on three or more public company boards.

Table 3: Independent Directors' Corporate Board Affiliations (as of 2016)

	SIFIs[235]	**S&P 500[236]**
1 Board	29%	37%
3+ Boards	41%	33%

This discrepancy is worrisome for several reasons. As discussed above, directors of financial institutions have, historically, held more outside professional engagements than directors of non-financial firms, at least in part because financial institutions want professional connections

[230] *See id.* (reporting that, of the companies that establish numerical limits on board service, 19% cap total directorships at six or seven, 40% at five, 36% at four, and 5% at three); *see also* Lublin, *supra* note 73 (discussing waivers).
[231] *See* David Yermack, *Board Members and Company Value*, 20 FIN. MKTS. & PORTFOLIO MGMT. 33, 39 (2006) ("[I]n 1995, more than 120 persons held eight or more board seats simultaneously in major American companies, and that number has dropped to only two persons five years later."); *see also* Lublin, *supra* note 73 (reporting that five directors occupied six or more board seats in 2015, down from 308 in 2005).
[232] *See, e.g.*, Chu & Davis, *supra* note 11, at 726 (showing decline in number of board seats among S&P 1500 directors between 2000 and 2010).
[233] See *supra* note 172 for an explanation of the G-SIB designation.
[234] *See* Fin. Stability Oversight Council, Basis for the Financial Stability Oversight Council's Final Determination Regarding American International Group, Inc. (2013), https://www.treasury.gov/initiatives/fsoc/designations/Documents/Basis%20of%20Final%20Determination%20Regarding%20American%20International%20Group,%20Inc.pdf; Fin. Stability Oversight Council, Basis for the Financial Stability Oversight Council's Final Determination Regarding Prudential Financial, Inc. (2013), https://www.treasury.gov/initiatives/fsoc/designations/Documents/Prudential%20Financial%20Inc.pdf.
[235] SIFI data were hand-collected from the proxy statements of the relevant companies, as filed on the SEC's EDGAR database.
[236] *See* SPENCER STUART 2016 BOARD INDEX, *supra* note 71, at 16.

to other companies who might become commercial or investment banking clients.[237] But it is not clear that SIFIs actually benefit from directors who hold multiple professional commitments. Indeed, one would expect that institutions as established as Wells Fargo and JPMorgan, for instance, would not need directors to introduce them to other large, multinational companies.[238] Not only are SIFIs unlikely to benefit from busy directors but they are most likely to suffer negative consequences when directors become distracted. Because large financial firms are more opaque, leveraged, and systemically risky than non-financial firms, good governance should require that SIFI directors have fewer outside professional commitments.

The boards of a few SIFIs are especially overcommitted. As demonstrated in Table 4, Citigroup is an outlier, with nearly two-thirds of its independent directors serving on three or more public company boards.[239] Six additional SIFIs have boards on which 40% of independent directors meet the same threshold. Disturbingly, the SIFIs with the busiest boards are also those recognized as being the most systemically important. Indeed, the Financial Stability Board ranks Citigroup, Bank of America, Goldman Sachs, and Wells Fargo as four of the five most systemically important U.S. banking organizations;[240] yet nearly half of their independent directors serve on at least three public company boards. As the firms most likely to inflict damage on the broader economy, these firms require the closest monitoring. They are unlikely to receive such monitoring, however, because their directors are particularly overcommitted.

Table 4: Proportion of Independent Directors Serving on 3+ Public Company Boards (as of 2017)[241]

Citigroup	61.5%
Bank of America	46.2%
Morgan Stanley	45.4%
Goldman Sachs	44.4%
Wells Fargo	42.8%
AIG	41.7%
Prudential	40.0%
Bank of New York Mellon	33.3%
JPMorgan	27.3%
State Street	22.2%

Most troublingly, busy directors are serving in key leadership roles at many SIFIs. For most SIFIs, in fact, the directors with the most important monitoring roles—the lead independent

[237] *See supra* text accompanying notes 124-126.
[238] *See* Field, *supra* note 102, at 73 ("Firms such as those in the Forbes 500 are likely to have large networks of connections, suggesting that the connectedness of busy directors would be less advantageous to them.").
[239] MetLife Inc., which the FSOC designated as systemically important in 2014, has a board that is even busier than Citigroup's. Eighty percent of MetLife's independent directors serve on at least three public company boards. *See* MetLife, Inc., Proxy Statement (Form DEF 14A) 12-22 (Apr. 27, 2017). A federal district court, however, overturned FSOC's designation of MetLife. *See MetLife, Inc. v. Fin. Stability Oversight Council*, 177 F.Supp.3d 219 (2016), *appeal docketed*, No. 16-5086 (D.C. Cir. Apr. 20, 2016). MetLife is not included as a SIFIs in this analysis.
[240] *See* FIN. STABILITY BD., *supra* note 172, at 3.
[241] Data for Table 4 were hand-collected from the SIFIs' 2017 proxy statements, as filed on the SEC's EDGAR database.

director, the audit committee chair, and the risk committee chair—have the most outside commitments. As demonstrated in Table 5, half of all SIFI audit and risk committee chairs serve on three or more boards. By contrast, only two SIFIs—Bank of America and Prudential—appoint directors with fewer than three board seats to all three key leadership positions.

Table 5: Key SIFI Directors Serving on 3+ Public Company Boards (as of 2017)[242]

	Lead Independent Director	**Risk Committee Chair**	**Audit Committee Chair**
AIG	✓		
Bank of America			
Bank of New York Mellon	✓		✓
Citigroup		✓	✓
Goldman Sachs	✓	✓	
JPMorgan			✓
Morgan Stanley	✓	✓	✓
Prudential			
State Street		✓	
Wells Fargo		✓	✓
TOTAL	**4**	**5**	**5**

This level of overcommitment among SIFI directors is cause for alarm. SIFIs—the same institutions that, if mismanaged, could inflict material distress on the broader economy—are being governed by extraordinarily busy directors. These directors are less inclined to participate in corporate decision-making, less likely to monitor management, and more susceptible to attention shocks. Directors with key leadership positions are especially busy and, as the Wells Fargo and JPMorgan cases demonstrate, particularly vulnerable to distractedness. In sum, as a result of their many outside professional commitments, the directors of the United States' most systemically important financial institutions are ill equipped to detect and deter misconduct and excessive risk-taking.

VI. Alleviating Director Overcommitment

What, then, should be done to alleviate director overcommitment in large, complex financial institutions? One might believe that private ordering will solve the problem. Indeed, companies and shareholders could replace overcommitted directors with candidates better able to focus on their governance responsibilities, and directors might choose to limit their outside commitments to protect themselves from liability. Some commentators, in fact, point to recent declines in directors' outside commitments as evidence that further interventions are unnecessary.[243]

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[242] Data for Table 5 were hand-collected from the SIFIs' 2017 proxy statements, as filed on the SEC's EDGAR database.

[243] *See, e.g.*, Katherine W. Keally, *Public Company Directorships: Are Corporate Directors Over the Limit?*, NACD DIRECTORSHIP, May-June 2016, at 16, 17 ("[I]mposing a numeric restriction on [outside board seats held by] individual director candidates is not the optimal approach…. Most directors are … capable of regulating their own time commitments.").

Private ordering, however, is unlikely to reduce directors' outside commitments to a socially optimal level. Private ordering inadequately restrains directors' overcommitment for four reasons: (1) managers influence director selection and may prefer weak monitors, (2) shareholders face steep barriers to replacing incumbent directors, (3) bank regulation further entrenches existing directors, and (4) directors lack appropriate incentives to limit their outside commitments. This Part discusses limitations of private ordering and then recommends policies for reform.

A. Limitations of Private Ordering

Private ordering alone will not solve the problem of director busyness for several reasons. First, management's influential role in the director selection process exacerbates the overcommitment problem. It is well established that inside directors wield outsized influence on the board's selection of director candidates.[244] In order to preserve their autonomy, however, many inside directors prefer director candidates who are unlikely to monitor management closely.[245] When selecting new directors, therefore, managers prioritize candidates with many outside commitments who are more likely to be lax monitors.[246]

Corporate governance reforms have attempted to reduce management's influence over director selection by, for instance, prohibiting inside directors from serving on a company's nominating committee.[247] These reforms, however, have not meaningfully limited management's role in the selection process, and inside directors continue to exert disproportionate influence.[248]

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[244] *See* Brown, Jr., *supra* note 24 at 140 ("CEOs invariably serve on the board and are in a position to exert influence over the nomination process."); Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 811 (2001) ("Boards self-select, often with strong input from the chief executive officer."); Michael E. Murphy, *The Nominating Process for Corporate Boards of Directors: A Decision-Making Analysis*, 5 BERKELEY BUS. L.J. 131, 132 (2008) ("[M]anagement effectively controls the corporate ballot.").

[245] *See* Brown, Jr., *supra* note 24, at 138 n.37 (noting that "management dislikes" board monitoring).

[246] *See* David A. Becher et al., *Board Changes and the Director Labor Market: The Case of Mergers* 9 (Eur. Corp. Governance Inst., Finance Working Paper No. 498, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2625798 ("CEOs involved in the director selection process are more likely to appoint busy directors, which could be consistent with the appointment of less valuable monitors.") (citing Anil Shivdasani & David Yermack, *CEO Involvement in the Selection of New Board Members: An Empirical Analysis*, 46 J. FIN. 1829 (1999)); *see also* Judith H. Dobrzynski, *Seats on Too Many Boards Spell Problems for Investors*, N.Y. TIMES, Nov. 17, 1996, at A1 ("A CEO who doesn't want to be monitored closely wants a director with lots of board seats.") (quoting Professor Charles Elson).

[247] *See, e.g.*, NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL § 303A.04, http://nysemanual.nyse.com/LCM (providing that listed companies must have a nominating committee composed entirely of independent directors).

[248] *See* Brown, Jr., *supra* note 24, at 142 ("Although not a member [of the nominating committee], the CEO retains the ability to consult with the committee, submit nominees, and veto objectionable candidates."); Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 159 (2010) ([N]otwithstanding the creation of independent nominating committees, evidence reveals that CEOs continue to influence the director-nomination process through informal consultations and recommendations of directorial candidates."); Murphy, *supra* note 244, at 148 ("It is clear that CEOs may have the dominant voice in the nominating process even if not included in the membership of a nominating committees [sic] composed of independent directors."); *see also* Lucian Bebchuk et al., *Executive Compensation & Takeovers: Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 767 (2002) ("[E]ven when the CEO does not sit on the nominating committee, his influence on the nomination process is still generally thought to be considerable.").

Opportunities for managerial influence in the director selection process are particularly prevalent at large financial institutions, where CEOs overwhelmingly serve as chair of the board.[249]

Second, legal and practical barriers often prevent shareholders from replacing overcommitted directors.[250] Shareholders of companies that retain plurality voting generally cannot defeat a nominee chosen by the board without waging a prohibitively expensive proxy contest.[251] Even in companies that have switched to majority voting, defeating an incumbent director remains exceedingly rare.[252] Of more than 24,000 S&P 1500 director nominees subject to majority voting between 2007 and 2013, only eight did not receive a majority of votes.[253] Most majority voting systems, moreover, do not automatically unseat an incumbent director who fails to obtain a majority. Instead, such a director must only submit his or her resignation, which the board is not obligated to accept.[254] It is not uncommon for a board to retain a director who failed to receive a majority of shareholders' votes.[255] Corporate election processes, therefore, generally entrench overcommitted directors.

Third, replacing directors is especially difficult for shareholders of BHCs, as banking laws perversely entrench sitting directors. Large block holders seeking to remove underperforming directors of nonfinancial companies frequently coordinate opposition campaigns.[256] Such coordination, however, is rarely possible for BHC shareholders. Under the Bank Holding Company Act (BHC Act), a shareholder or association of shareholders that "directly or indirectly exercises a controlling influence over the management or policies" of the banking organization itself becomes subject to onerous regulation as a BHC.[257] The Federal Reserve Board has interpreted this provision strictly. The Federal Reserve, in fact, has found that, in some cases, shareholders who attempt to wage a proxy contest "control" the banking organization and thus become subject to banking regulation.[258] The Federal Reserve's interpretation of the BHC Act's

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[249] *See* Laura J. Keller & Katherine Chiglinksy, *Wells Fargo Splits Chairman, CEO Roles After Account Scandal*, BLOOMBERG (Dec. 1, 2016), https://www.bloomberg.com/news/articles/2016-12-01/wells-fargo-separates-chairman-and-chief-executive-officer-roles (noting that, among the six biggest U.S. banking organizations, all but Citigroup and Wells Fargo appoint their CEO as board chair).

[250] *See* BAINBRIDGE, *supra* note 23, at 48-49 ("[S]hareholders of public corporations lack the legal right [and] the practical ability … to exercise the kind of control necessary for meaningful monitoring of the corporation's [directors].").

[251] *See* Brown, Jr., *supra* note 24, at 139-40. In a plurality voting system, a nominee is elected as long as he or she receives more votes than a competing candidate. A nominee who runs unopposed, therefore, requires only one vote to be elected. *See* Stephen J. Choi et al., *Does Majority Voting Improve Board Accountability*, 83 U. CHI. L. REV. 1119, 1124-25 (2016).

[252] In a majority voting system, a nominee is elected only if he or she receives a majority of the votes cast. *See* Bo Becker & Guhan Subramanian, *Improving Director Elections*, 3 HARV. BUS. L. REV. 1, 8 (2013).

[253] *See* Choi et al., *supra* note 251, at 1122.

[254] *See id.*

[255] *See id.* at 1122 & nn.15-16 (noting that, of the eight directors at majority voting firms who failed to receive a majority, only three actually lost their board seats).

[256] *See, e.g.*, Joann S. Lublin, *Big Pension Funds Oppose Election of Six Mylan Directors*, WALL ST. J., May 30, 2017, https://www.wsj.com/articles/big-pension-funds-oppose-election-of-six-mylan-directors-1496187480 (describing four major pension funds that launched a coordinated campaign urging shareholders to oppose reelection of six pharmaceutical company directors).

[257] 12 U.S.C. § 1841(a)(2)(C) (2012).

[258] *See, e.g.*, Steven Davidoff Solomon, *In Blocking Activists, the Fed Protects Poorly Performing Banks*, N.Y. TIMES DEALBOOK, (May 8, 2012), https://dealbook.nytimes.com/2012/05/08/in-blocking-activists-the-fed-protects-poorly-performing-banks/?_r=0 (describing several instances in which the Federal Reserve has deemed proponents of a proxy

control provisions thereby dissuades shareholders from seeking to replace entrenched directors, as shareholders fear becoming subject to banking laws.[259]

Finally, directors themselves will not voluntarily reduce their outside commitments to a socially optimal level. Board service and full-time employment are extraordinarily lucrative for many directors.[260] Directors, moreover, enjoy enhanced reputations and prestige stemming from outside commitments.[261] Counteracting these monetary and psychic incentives to overcommit, directors face potential legal liability and damaged reputations if their firms perform poorly.[262] These countervailing forces, however, are unlikely to offset directors' powerful incentives to take on additional outside commitments. Claims against directors for failure to monitor are subject to exceedingly high legal standards, effectively shielding directors from liability.[263] Recent evidence further suggests that, in contrast to conventional wisdom, outside directors do not suffer reputational consequences when their firms perform poorly.[264] For many directors, therefore, the benefits of overcommitting will continue to outweigh the costs.

B. Recommendations for Reform

Private ordering, therefore, will not solve the problem of director overcommitment in financial companies. Alleviating director overcommitment requires something more. This Section proposes a series of reforms targeted to large, complex financial institutions. The proposals range from stricter proxy advisory "overboarding" thresholds to regulatory caps on outside commitments. This Section also recommends safeguards to ensure that the proposed reforms will not deplete the pool of qualified and interested director candidates.

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contest to control a banking organization); *see also* Victor I. Lewkow, *Shareholder Activism and the Bank Holding Company Act*, HARVARD LAW SCH. FORUM ON CORP. GOVERNANCE & FIN. REGULATION (June 8, 2012), https://corpgov.law.harvard.edu/2012/06/08/shareholder-activism-and-the-bank-holding-company-act/ (noting that Federal Reserve staff have taken the position that a shareholder's solicitation to elect three of a BHC's six directors could constitute exercise of a controlling influence).

[259] *See* Solomon, *supra* note 258 (arguing that the Federal Reserve's strict interpretation of control "limit[s] shareholder efforts to oust entrenched bank directors" because being subject to regulation as a BHC would be "a death knell" for the shareholder); *see also* Lewkow, *supra* note 258 ("[I]t is not uncommon … for the target of a proxy contest to use BHC [Act] control concerns as a defensive tactic (e.g., by arguing to the [Federal Reserve] that the [opposing shareholder] cannot solicit proxies without prior [Federal Reserve] approval).").

[260] *See, e.g.*, SPENCER STUART 2016 BOARD INDEX, *supra* note 13, at 34 (noting that directors of S&P 500 firms earn, on average, $285,065 in compensation per board seat).

[261] *See* David Yermack, *Remuneration, Retention, and Reputation Incentives for Outside Directors*, 59 J. FIN. 2281, 2301-05 (2004) (providing evidence that outside directors who develop reputations as effective board members are more likely to acquire additional directorships).

[262] *See, e.g.*, Ferris et al., *supra* note 75, at 1109-10.

[263] *See, e.g.*, Claire A. Hill & Brett H. McDonnell, *Reconsidering Board Oversight Duties After the Financial Crisis*, 2013 U. ILL. L. REV. 859, 859 (2013) (characterizing a claim of breach of fiduciary duty by reason of failure to monitor as "one of the hardest for shareholders to win"); Julie Anderson Hill & Douglas K. Moll, *The Duty of Care of Bank Directors and Officers*, 68 ALA. L. REV. 965, 1001 (2017) ("[C]ourts often review claims arising in the oversight context more rigorously than they would review claims that the directors … made a poor substantive decision.").

[264] *Compare* Steven M. Davidoff et al., *Do Outside Directors Face Labor Market Consequences? A Natural Experiment from the Financial Crisis*, 4 HARV. BUS. L. REV. 53, 71-72 (2014) (finding that outside directors of firms that performed poorly during the financial crisis did not suffer labor market consequences in the form of lost directorship opportunities at other firms) *with* Ferris et al., *supra* note 75, at 1098-99 (finding that directors of underperforming firms experience diminished reputations in the form of fewer board seats).

1. Stricter Proxy Advisor Voting Standards

First, proxy advisory firms should adopt more stringent "overboarding" standards for directors of large, complex financial institutions. The two largest proxy advisory firms, ISS and Glass Lewis, recently lowered the maximum number of outside commitments that a director may hold before being considered "overboarded."[265] ISS and Glass Lewis now recommend that shareholders vote against any director who serves on the board of six or more public companies.[266] ISS and Glass Lewis, in addition, generally recommend against a director who serves as the CEO of a public company and on three or more public company boards.[267] These revised thresholds—while arguably satisfactory for directors of nonfinancial companies[268]—are still far too high for directors of financial firms.

Proxy advisory firms should adopt an overboarding policy specifically for large, complex financial firms. This policy should recommend against the election of any director who sits on three or more public company boards—the threshold that is most indicative of when a director becomes distracted.[269] Recognizing that full-time employment represents a significant burden on a director's time and attention, the overboarding policy should, in addition, recommend against a director who serves as an executive officer of a public company and on two or more public company boards (including his or her own). Proxy advisory firms should also, at their discretion, recommend against directors who satisfy these standards but nonetheless are overcommitted by virtue of other employment or service on private company boards, philanthropic boards, councils, or advisory groups. Finally, proxy advisory firms should recommend against the lead independent director and members of the nominating committee of a large, complex financial company that fails to adequately limit director overcommitment.

While shareholders of financial firms face steep barriers to defeating board nominees,[270] a negative recommendation by a proxy advisory firm can influence a significant proportion of votes.[271] Proxy advisory firms' policies, moreover, encourage companies to adapt their corporate

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[265] *See* Lyuba Goltser & Megan Pendleton, *2017 Proxy Season: ISS and Glass Lewis Update Their Voting Policies*, HARVARD LAW SCH. FORUM ON CORP. GOVERNANCE & FIN. REGULATION (Nov. 30, 2016), https://corpgov.law.harvard.edu/2016/11/30/2017-proxy-season-iss-and-glass-lewis-update-their-voting-policies/.

[266] *See* INST. SHAREHOLDER SERVS., 2017 U.S. SUMMARY PROXY VOTING GUIDELINES 16 (2017), https://www.issgovernance.com/file/policy/2017-us-summary-voting-guidelines.pdf; GLASS LEWIS, 2017 PROXY PAPER GUIDELINES: AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE 15 (2017), http://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_US.pdf.

[267] The proxy advisory firms differ slightly in their overboarding thresholds for sitting executives. ISS generally recommends against a director who serves as the CEO of a public company and on the board of three or more public companies (*excluding* his or her own). *See* 2017 U.S. SUMMARY PROXY VOTING GUIDELINES, *supra* note 266, at 16. Glass Lewis, by contrast, generally recommends against a director who serves as *any* executive officer of a public company and on the board of three or more public companies (*including* his or her own). *See* 2017 PROXY PAPER GUIDELINES: AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE, *supra* note 266, at 15.

[268] Some commenters have criticized the revised standards as inadequate. *See, e.g.*, Keally, *supra* note 243, at 17 (arguing that the threshold reductions "will remain largely inconsequential" because "[m]ost directors are already well below these new limits").

[269] *See* Cashman, *supra* note 100, at 3255 ("[T]he negative association between busy directors and firm performance is strongest when the definition of busy is a director serving on three or more boards.").

[270] *See supra* Section VI.A.

[271] *See* Jie Cai et al., *Electing Directors*, 64 J. FIN. 2389, 2404 (2009) (finding that directors with a negative recommendation from ISS receive 19% fewer votes); Stephen J. Choi et al., *The Power of Proxy Advisors: Myth or*

governance practices in order to avoid negative recommendations.[272] The proxy advisory firms should bring this power to bear on large, complex financial firms by adopting more stringent overboarding standards.

2. Enhanced Supervisory Assessments

If financial company directors remain overcommitted despite enhanced proxy advisory thresholds, then the financial regulatory agencies should adopt policies to address the problem directly. The Federal Reserve, as the umbrella supervisor of BHCs and systemically important nonbank financial companies, would be best suited to implement policies to limit director overcommitment.

As an initial step, the Federal Reserve should downgrade a company's supervisory rating if its directors are too overcommitted to monitor risks effectively. The Federal Reserve annually evaluates a BHC's "ability to monitor and manage all risks" and assigns a numeric risk management rating.[273] Companies with weak risk management ratings are subject to a variety of sanctions, including limitations on activities and geographic expansion.[274] Although board engagement comprises a portion of the risk management rating, the current evaluation process does not expressly take into account directors' outside commitments.[275] The Federal Reserve should begin assigning an unsatisfactory risk management rating to a company if, in the Federal Reserve's supervisory discretion, the company's directors are too busy to execute their governance roles effectively.

3. Targeted Regulatory Intervention

As a further step, the Federal Reserve should enact a regulatory cap on directors' outside professional commitments to disqualify extraordinarily busy candidates from serving on the board of a large, complex financial company. In crafting regulatory requirements, the Federal Reserve should look to the European Union as a model. In 2013, the E.U. enacted Capital Requirements Directive IV (CRD IV), which limits the outside commitments of directors of a financial institution that is "significant in terms of its size, internal organization and the nature, the scope and the complexity of its activities."[276] Under CRD IV, a director of such a firm may not hold more than

Reality?, 59 EMORY L. J. 869, 906 (2010) (concluding that a negative recommendation by ISS shifts up to 10% of shareholder votes).

[272] *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO-17-47, PROXY ADVISORY FIRMS' ROLE IN VOTING AND CORPORATE GOVERNANCE PRACTICES 18 (2016) (summarizing evidence that proxy advisory firms' policies influence corporate governance practices).

[273] *See, e.g.*, Bank Holding Company Rating System, *supra* note 66, at 70,446 (explaining that the Federal Reserve rates a company's risk management on a 1 to 5 scale, with 1 representing the strongest risk management practice and 5 representing the weakest).

[274] *See, e.g.*, 12 U.S.C. § 1843(j)(4)(B)(i) (2012) (providing that a BHC may not engaged in expanded financial activities if it has not received at least a satisfactory risk management rating); 12 U.S.C. § 1842(d)(1)(A) (2012) (authorizing the Federal Reserve to approve an interstate acquisition otherwise prohibited by state law only if the acquiring BHC has received a satisfactory risk management rating).

[275] *See, e.g.*, Bank Holding Company Rating System, *supra* note 66, at 70,446 (noting that the risk management rating "represents an evaluation of the ability of the BHC's board of directors and senior management … to identify, measure, monitor, and control risk").

[276] CRD IV, *supra* note 17.

four board seats or, if the director is a full-time executive, more than two board seats (excluding his or her own company).[277] The EU enacted these limitations to ensure that directors of a financial institution "allot sufficient time and attention to discharge their duties in the institution and thus reduce the riskiness of its activity."[278]

The Federal Reserve should adopt limitations similar to CRD IV to eliminate the most severely overcommitted directors of large, complex financial companies in the United States. The Federal Reserve's numeric limit on directorships, however, should be more stringent than under CRD IV. EU regulators apply the CRD IV limits to many financial companies, including some with as little as $685 million in assets.[279] The Federal Reserve, by contrast, typically applies enhanced prudential standards to a much more limited set of firms with $50 billion or more in assets, and it reserves its most stringent standards for the ten SIFIs.[280] Accordingly, the Federal Reserve should prohibit directors of a BHC with $50 billion or more in assets or a systemically important nonbank financial company from serving on the board of more than three public companies or, if the director is a public company executive, more than two public companies (including his or her own).

The Federal Reserve should go beyond CRD IV, moreover, and adopt additional restrictions for key directors. The directorship limitations in CRD IV apply uniformly to all members of a financial institution's board.[281] As discussed above, however, some financial institution directors bear special responsibility for ensuring the firm's safety and soundness. A firm's lead independent director, risk committee chair, and audit committee chair, in particular, are critical to effective risk management.[282] These directors, therefore, should be uniquely focused on the firm. The Federal Reserve should establish more stringent restrictions for the three key directors of each SIFI. Specifically, the Federal Reserve should limit SIFI lead independent directors, risk committee chairs, and audit commitment chairs to serving on the board of one other public company. The Federal Reserve, moreover, should not permit a current public company executive to serve in one of these key leadership roles, as it is unlikely that a sitting executive would be able to devote sufficient time and attention to the role.

4. Increased Director Compensation

There is, of course, a tension between trying to attract the strongest and most highly qualified directors for large, complex financial companies and limiting their outside professional

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[277] *See id.*
[278] EUR. BANKING AUTH., SINGLE RULEBOOK Q&A, Question 2014_1595 (2014), https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2014_1595.
[279] *See* FIN. CONDUCT AUTH., IFPRU HANDBOOK § 1.2.3, https://www.handbook.fca.org.uk/handbook/IFPRU/1/2.html (applying CRD IV limits on directorships to investment firms with total assets exceeding £530 million). £530 million is equivalent to approximately $685 million as of July 2017.
[280] *See* Dodd-Frank Act §§ 165(a), (b)(1)(A)(iii), 12 U.S.C. §§ 5365(a), (b)(1)(A)(iii) (2012) (directing the Federal Reserve to adopt enhanced risk management requirements for BHCs with more than $50 billion in assets and systemically important nonbank financial companies that increase in stringency based on the institution's systemic importance).
[281] *See* CRD IV, *supra* note 17.
[282] *See* Tarullo, *supra* note 44 (emphasizing the importance of a firm's lead independent director, risk committee chair, and audit committee chair).

commitments. Director candidates already complain that serving on a financial company's board is unattractive due to onerous regulations and potential liability.[283] Imposing limits on directors' outside commitments is likely to further dissuade well-qualified candidates from serving.[284] The Federal Reserve can limit the depletion of qualified and interested director candidates by applying the most stringent regulatory caps only to key SIFI directors—about 30 directors in total—as the previous Section suggests. Further safeguards may be needed, however, to ensure a consistent supply of well-qualified candidates who are willing to comply with limits on their professional obligations.

To that end, large, complex financial companies should substantially increase directors' pay to compensate them for foregone professional opportunities. Financial firms already compensate their directors generously. Indeed, in 2016, average outside director compensation among the eight U.S. G-SIBs ranged from $286,000 at Bank of New York Mellon to more than $600,000 at Goldman Sachs.[285] Large financial companies, however, generally cap their board members' compensation to deter shareholder litigation over directors' earnings.[286]

Directors are likely to require higher pay if they are going to be subject to limits on their outside engagements.[287] Key SIFI directors, in particular, should receive substantial raises in exchange for severely limiting their outside board seats. To align directors' interests with those of other stakeholders in the firm, financial companies should, to the extent possible, structure enhanced pay packages in compliance with compensation guidelines proposed by the financial regulatory agencies for executives and significant risk takers.[288]

VII. Conclusion

This Article has argued that busy directors detract from effective governance at large financial institutions. These institutions, by virtue of their complexity and systemic importance, require enhanced monitoring from their boards—oversight that busy directors are ill equipped to provide. The directors of the United States' largest and most complex financial institutions, however, remain alarmingly busy. Preserving the safety and soundness of the financial system, therefore, requires that financial company directors—and especially those with key board

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[283] *See, e.g.*, Lisa DiCarlo, *America's Most Overworked Directors*, FORBES, Aug. 6, 2002, https://www.forbes.com/2002/08/06/0806directors.html ("[H]eadhunters are having a tough time filling board seats, partly out of concern for personal liability…. Some are backing off because of … greater scrutiny from shareholders and U.S. federal agencies."); Ben Marlow, *Overboarding is Corporate Governance Gone Mad*, THE SUNDAY TELEGRAPH, Apr. 30, 2017, at 2 ("[B]ig banks … say it is painfully difficult to find people willing to deal with the dizzying complexities and regulation that has been piled on to financial institutions since the financial crisis.").

[284] *Cf.* Francesco Guerrera & Peter Thal Larsen, *Gone By the Board? Why the Directors of Big Banks Failed to Spot Credit Risks*, FIN. TIMES, June 26, 2008, at 13 (quoting an anonymous former banking executive who declined several financial company board seats because they would have conflicted the executive out of working in the financial sector).

[285] SPENCER STUART 2016 BOARD INDEX, *supra* note 13, at 47.

[286] *See Why Big Banks Are Putting Caps on Director Salaries*, FORTUNE, Sept. 1, 2016, http://fortune.com/2016/09/01/big-banks-salary/.

[287] *See id.* (noting that "competitive pay can help lure qualified directors who otherwise would choose less time-consuming and highly scrutinized jobs"). *But see* LORSCH, *supra* note 122, at 26 (reporting that compensation and stock ownership are among the least important reasons that directors give for joining a board).

[288] *See* Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37,670 (proposed June 10, 2016).

leadership positions—reduce their outside commitments. This Article has proposed a series of reforms to ensure that financial company directors focus on their governance responsibilities. The reforms outlined in this Article will enhance oversight of management, deter misconduct and excessive risk-taking, and—potentially—help prevent the next financial crisis.