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Corporate Governance at BES: Would new recommendations have avoided the failure?

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Abstract

Corporate Governance has been widely discussed throughout the recent years. In Portugal, Banco Espírito Santo (BES) was recognized for being the only institution with a maximum score regarding its implementation of Corporate Governance rules. However, the bank collapsed in 2014 after nearly 150 years of existence.

In the first part of this paper, we show that, although in theory BES had perfect corporate governance, these rules were not truly adopted. Research points to the lack of independent of directors, heavy influence of the Espírito Santo family, and oversized board as possible causes for its downfall. In the end, a perfect system failed.

In the second part of this paper we show that the new rules could not have prevented the fall of an historic Portuguese bank.

Keywords: Corporate Governance, Board of Directors, Independency, Incentives

Introduction

Banco Espírito Santo, in existence for almost 150 years, was the second most important private bank in Portugal. It was the only Portuguese-listed company able to achieve the maximum score in the degree of acceptance of CMVM¹ recommendations of corporate governance for four consecutive years (*Económico*, 2014). Nonetheless, the bank collapsed in 2014.

After this fall, the topic of corporate governance was broadly discussed in Portugal. The question imposed is how did the best corporate governance model fail? According to Carlos Tavares, the president of CMVM between 2005 and 2015, the rules were formally there but they were not adopted (*Público*, 2014).

Around the world, corporate governance has been a widely discussed concept, particularly since 2002 when Enron, Tyco, Global Crossing, Adelphia and WorldCom collapsed. It refers to *“the way companies are governed and to what purpose”* (Coyle, 2008). The Cadbury Report in 1992, a UK review of corporate governance, defines it as *“the system by which companies are directed and controlled”*. According to Monks and Minow, *“it is the structure that is intended 1) to make sure the right questions get asked and that 2) the checks and balances are in place to make sure that the answers reflect what is best for the creation of long-term, sustainable, renewable value”*.

Corporate governance is an important issue due to the separation between ownership and management, particularly in publicly-traded companies. While shareholders want to maximize the value of the firm, managers, whose job is to effectively run a company, may have different interests². To minimize conflicts of interest and assure shareholder value is maximized, a board of directors is elected. The board is intended to be independent, competent and motivated (Monks, 2011). They are responsible for monitoring managerial performance and governing the company. A company has strong corporate governance when it is able to align shareholders, directors and external groups interests.

¹ CMVM, Securities Market Commission in English, is a Portuguese institution responsible to *“supervise and regulate the financial instruments markets as well as those who operate within those markets, promoting the investors protection”* (<http://www.cmvm.pt/pt/CMVM/Apresentacao/Pages/Apresentacao-o-que-e-a-CMVM.aspx>).

² Agency-theory: The principal (shareholders) and agents (executives) do not have the same goals. While the principal wants to maximize the profitability of his business, agents are often seeking to maximize their welfare and act on their own interests rather than further the interests of the principal.

Throughout the years, several approaches to the topic of corporate governance have been developed. Recommendations were first designed in the UK by the Cadbury Committee in 1992, following the financial scandals involving UK firms during the 1980s. After several reformulations to the Cadbury Report, the Combined Code was issued in 2003. The Combined Code functions in a “*Comply or Explain*” approach for listed companies.

While in Europe recommendations issued by institutions were meant to be voluntary, the process has been dominated by statutory regulations in the US (the Sarbanes-Oxley Act issued in 2002).

There were several institutions issuing recommendations on the subject. The OECD published a set of principles for good corporate governance in 1999 and revised them in 2004; the Basel Committee on Banking Supervision has also been publishing some suggestions.

In Portugal, CMVM issued several recommendations in 1999 until it produced a first Corporate Governance Code in 2007. This Code also applies in a “*Comply or Explain*” approach and to all listed-companies in the country. There was also an initiative taken from a private institution, IPCG³, which soon published a book in order to promote and facilitate the discussion about corporate governance in Portugal.

All of these codes were attempts to minimize problems regarding corporate governance, making suggestions on subjects such as remuneration and independence of directors. Although several important steps were taken, corporate governance continues to fail in a large number of institutions. BES was supposedly applying every recommendation of the regulator, such as having a reasonable number of non-executive directors capable of evaluating and supervising the executives, and having a reasonable number of independent directors at the board. This project intends to analyse corporate governance at BES according to several authors and regulators recommendations in order to understand what failed. The second part of this work is an attempt to answer the following question, “*If recommendations issued after the fall of BES were in place before, would the bank still have fallen?*”

³ IPCG, Portuguese Institute of Corporate Governance in English, was created in May of 2004 and had soon published a book named White Book (“Livro Branco sobre Corporate Governance in Portugal”) with several recommendations on the issue of Corporate Governance. Nowadays IPCG is responsible to publish recommendations on the subject, while CMVM supervises.

Evaluating BES Corporate Governance

The separation of ownership and control hints at the possibility of the principal-agent problem as a culprit for the bank's fall. Thus, a board of directors is needed in order to run the company on behalf of the shareholders.

The interdependence between the board, directors who do not have the time or expertise to fulfil their roles adequately, and the CEO, who sometimes do not have a vested interest in the firm, are the major problems surrounding the existence of a board. In other words, there is an agency problem where the directors do not always act in the shareholders' best interest. (Kim, Nofsinger and Mohr, 2010)

Good corporate governance eliminates the risk of misleading during financial reporting, improves reputation and encourages investors to hold shares in the company (Coyle, 2008). The major issue with corporate governance is the relation between shareholders and directors and the way directors exercise their powers.

This paper will proceed to present an analysis of the key components of BES' corporate governance structure.

Owners

Public companies are owned by several different people. For this reason, shareholders have limited rights and limited liability. They have the right to elect directors and have their interests protected by them.

The IPCG recommends that the General Meeting of Shareholders should be independent from both the executive commission and shareholders. It proceeds further by commenting that shareholders should be active in their role of monitoring the board.

However, monitoring costs shareholders time. For this reason, only large shareholders have the incentives to enrol in active monitoring leading to the *free-rider problem*⁴ – the larger the amount of money they have invested in the company, the larger the amount of money they may lose, thus the higher the incentives to monitor and control the board.

⁴ Free-rider problem: a shareholder may not uphold its duty to monitor in order to save money, expecting the others to fulfill this duty instead.

To provide the level of monitoring necessary, the owner must ideally be an individual with the information, ability, and alignment of interests with other corporate constituencies. The motives and actions of the shareholder should reinforce the idea that director and management interests should mirror theirs and in the event of a conflict of interest, shareholders make the decisions (Monks and Minow, 2011).

BES maintained a fairly stable shareholder structure since 1991. The majority part of BES shareholders were institutional investors with a heavy influence from the Espírito Santo family and BES group (Exhibit I).

BES shareholders with voting rights, *one vote for each one hundred shares*, may vote on subjects such as the election of board members and their remuneration.

The General Meeting was composed by a Chairman, a Vice-Chairman and a secretary. None of them were shareholders, and they were all independent.

Board of Directors

“A key issue in corporate governance is that a company must have an effective board of directors who are dedicated to ensuring that the company achieves its objectives” (Coyle, 2008).

Shareholders cannot possibly oversee the managers they hire. Therefore directors are their representatives to oversee the management of the company on their behalf. The board of directors should be composed by the chairman, CEO, independent directors, executive and non-executive directors.

While an executive director is responsible for the daily operations of the company, a non-executive director has no executive responsibilities. According to Coyle, the author of *“Corporate Governance Essentials”*, executive directors have to understand the company’s business but their experience and qualities can be obtained from working at other industries.

Under the Portuguese Company Law, Art. 64.º/1, directors have the duty of care and loyalty. While duty of loyalty means that a director must demonstrate unyielding and undivided loyalty to the company’s

shareholders, duty of care means that a director must exercise due diligence in making decisions (Monks and Minow, 2011).

The board of directors has to protect the interests of not only larger shareholders but also smaller ones. The protection of smaller shareholder interests cannot be compromised by the possible heavy influence of larger shareholders in the board. At BES, that influence was quite evident with 50% of the directors representing larger shareholders. Moreover, a large number of directors belonged to the Espírito Santo family. In 2013, the Espírito Santo family composed approximately one third of the board. Ricardo Salgado, the CEO of BES, held several positions within BES and other group companies (see Exhibit II), which contributed to his heavy influence at the board.

There are numerous issues regarding the board of directors such as size, independency, term, qualifications, the separation between the roles of CEO and chairman, diversity, committees, compensation and incentives, CEO succession, nomination and time dedicated to the company.

1. Size

It is difficult to define an ideal number of directors. A board should be neither too large (otherwise it is impossible for everyone to contribute), nor too small (so it can increase the diversity of backgrounds and skills).

According to a study conducted in 2014 by Spencer Stuart, one of the world's leading executive search consulting firms, the average size of S&P 500 Boards was 10.8, a stable size since 2002. In 2010, the average size of the European boards was 8.5 directors (Ferreira and Kirchmaier, 1013). Specifically in Portugal, by 2008, the average size of a board was 9.4 members (OECD Report on Corporate Governance).

By 2013 BES board was composed by 25 directors, 10 executives and 15 non-executives, representing the largest board in Portugal. The large number of directors may represent a problem, the *free-rider problem* for instance. Boards with few directors may make members feel obligated to exert more effort

than they would have otherwise. With larger boards, each member may simply assume that the other members are monitoring (Kim, Nofsinger and Mohr, 2010).

2. Independency

The study of worldwide independency gave rise to the development of several definitions of the idea. According to some definitions, independent directors must have no connection to the company, which means they cannot be company employees, relatives, or any other professional who works for the company as lawyers and consultants. Broader definitions also exclude people with connections to suppliers, clients, creditors, or even recipients of corporate donations. There are also some definitions considering that the CEO should never have met the candidate. *“The theory is that if the director is a friend of the CEO, it is just as difficult for him to be objective as it would be if he were an employee.”* (Monks and Minow, 2011). The concept is closely related to directors compensation and nomination.

Executive directors cannot be independent since they are involved in the running of the company’s operations, are accountable to the CEO and rely on the company for most of their remuneration (Coyle, 2008). Thus, only non-executive directors can be independent.

According to 2013 BES financial report, from the 15 non-executives directors 7 were considered independent, representing 28% of the board. As it can be depicted, BES was theoretically fulfilling CMVM recommendation since the board of directors had no less than 25% of independent directors. After taking a deeper look at annual reports, one may conclude that at least three of the independent directors were not fully independent, which means the percentage required was not being reached. Firstly, Nuno Godinho de Matos was a lawyer at the law company that represented Ricardo Salgado; Rita Amaral Cabral was also a director at Semapa, Cimigest and Sodim - companies with strong ties to BES; and João Faria Rodrigues was a member of the Fiscal Committee at T-Vida.

According to Brian Coyle, a board of directors should have a sufficient number of independent non-executive directors to create a suitable balance of power and prevent the dominance of the board by one individual or a small number of individuals.

3. Term

The study of Spencer Stuart showed that the number of companies with one-year director terms have considerably grown, representing now approximately 95% of the S&P 500 boards.

Term is an important topic, especially in relation to independent directors. One case at BES can exemplify the importance of this topic. The bank had four-years director terms; and after those four years, a director could be again elected. By 2011, BES had two independent directors that were seated at the board since 2002 and 2003. Such a long history with the company may cast some doubts regarding their independence. To overcome this issue, the UK Corporate Governance Code specifies that any term beyond six years (for non executive directors) should be subject to revision and after nine years, it should be determined whether the individual is still independent.

4. Qualifications

People with different skills and backgrounds should comprise a board, but it is essential that they show the ability to learn what is necessary. The board as a whole must understand the industry, markets, consumers, and the different subjects in finance.

According to Monks, board members should have frequent interaction with upper management and operations. Moreover, they should be evaluated regarding their contribute and be replaced whenever they under-performed.

The board of directors of BES was comprised of lawyers, auditors, university professors, and also bankers. Although different backgrounds may bring different perspectives, one may doubt the possible advantages of diversified boards when one of the directors, the already mentioned Nuno Godinho Matos, says *“I know as much about banks as I know about being a stonemason”*.

5. CEO/Chairman

While the CEO is the person responsible for the management team, the chairman has to monitor the CEO and the board of directors. For this description, one may conclude there is an obvious conflict of having the CEO being the same person as the Chairman since it may be the case that the CEO needs to evaluate

his own performance, which would make it impossible to have an objective evaluation. Thus, there are strong arguments regarding the separation of the two roles, appointing an independent Chairman who is able to ask the right questions. If the Chairman is incapable of applying critical thought to crucial decisions, then it is difficult to conclude that effective monitoring took place.

By the end of 2013 two different people occupied the two positions. While the CEO was Ricardo Salgado, the Chairman was Alberto Pinto. The chairman was independent, with no ties to the company except the position he occupied since 2008. However, until 2007 the Chairman was António Luís Roquette Ricciardi, who was uncle of Ricardo Salgado, the CEO.

Hence, until 2007, when CMVM made new suggestions, it was clearly evident that although the role of CEO and Chairman was separated, the Chairman was not independent, with strong ties to the CEO.

6. Diversity

There are several studies emphasizing the importance of having women as directors. According to a report written by the non-profit organization Catalyst, *The Bottom Line: Corporate Performance and Women's Representation on Boards*, Fortune 500 companies with at least three women on the board had a stronger-than-average performance. However, according to the Stuart and Spencer and Stuart report, by 2014 women only represented 19% of directors in the S&P 500 Boards.

Female directors benefit corporate board performance through better monitoring of management (Adams and Ferreira, 2009). At BES there were only 2 women at the Board by 2013, representing 8% of the total number of directors.

7. Committees

It is common practice for the board to delegate responsibility to committees since it is more efficient if a group of directors specializes on a subject rather than raising issues to the entire board (Kim, Nofsinger, Mohr, 2010). Usually, the committees present in a board are the executive, finance and corporate governance committee. While the most common subcommittees are the audit, compensation and nomination committee. The audit committee should regularly meet alone with internal and external

auditors as well as with management, guaranteeing that the independent auditor does its job in an independent and objective way. The compensation committee exists to set up the executive compensation and the nomination committee is responsible for nominating candidates for the board of directors.

BES adopted the Anglo-Saxon corporate governance model, thus operating under a single board of directors with an executive committee comprised of executive directors and an audit commission that together with an external auditor, were responsible for auditing the bank (BES report and accounts, 2013). The Compliance and Risk Committees supported the executive and audit committee. The subcommittees were the Corporate Governance and the Remuneration Advisory Committee.

Although all of the committees looked good on paper, they had some problems regarding independency. One of these examples is Luís Lorena who belonged to the audit committee until 2011 and received a compensation of 246.000€. Another example is Nuno Godinho de Matos who belonged to the Remuneration Committee but was at the same time a lawyer at the law firm that defended Ricardo Salgado.

8. Director Compensation and Incentives

Executive compensation is intended to align managers' and shareholders' interests. Several authors agree that the compensation package of executive directors should include a fixed and a variable part. The variable part is intended to give an incentive for directors to achieve performance targets of the company.

According to the Portuguese code of corporate governance recommendations (written by CMVM) the remuneration of the executive directors *“should be structured so that their interests are capable of being aligned with the long-term interests of the company. Firstly, despite of having a fixed compensation, executives' directors should also be paid with a variable remuneration according to the performance of the company. This variable part of executives' compensation should be in a way that directors have no incentives to incur in excessive risk taking.”*

When designing compensation schemes based on performance, one should be careful about short-term incentives based on financial targets in order to avoid maximizing short-term profit rather than long-term. A way of aligning long-term interests is share plans, for example stock options. Stock options give executive directors the incentives to manage the company in a way that share prices increase, which happens by increasing the level of risk. Since increasing risk may misalign shareholders and directors interests, one should carefully anticipate the problems that may arise when planning this scheme. CMVM issued a valuable opinion on this subject by recommending that *“a significant part of the variable compensation should be deferred for a period not less than 3 years and its payment should depend on the company’s steady positive performance during said period”* and that *“when the variable compensation includes stock options, the period for exercising this should be deferred for a period of not less than 3 years”*.

Concerning independent directors remuneration, it should be enough to make them care, but should not make them dependent on the company. Monks and Minow argue that directors may be considered independent, however they will only be interested and engaged directors if part of their wealth is tied to the company. As such, they should be shareholders. However, critics agree that non-executive directors’ payment should not be linked with performance in order for them to continue being independent of the executive directors. CMVM agrees with the last reasoning by clearly recommending that *“a variable part should not be included in their salary”* and *“it should be calculated in a way that it does not compromise directors independence”*.

By 2013 the remuneration of executive directors of BES had only a fixed part. Besides this, every executive director except one received stock options with a vesting period of three years. Still in the year of 2013 there was a non-executive director, Bruno de Laage de de Meux, that was not being paid by BES. Since he held a position at a major shareholder of the bank, BESPAR⁵, these two facts may compromise his ability to perform his duty of loyalty to the company and align his interests with

⁵ BESPAR – Sociedade Gestora de Participações S.A., was a subsidiary of BES, holding approximately 35% of the bank in 2013.

BESPAR rather than with BES, harming smaller shareholders. Furthermore, there were two cases in 2010 that undoubtedly exemplify the relationship between independency and remuneration. Luís Lorena and José da Pena, both referred to as independent directors, were paid 246.000€. Such a high payment made them clearly dependent on the company compromising their ability to criticize CEO decisions.

A second concern regarding directors' compensation is who decides the level of remuneration. This issue also rises problems concerning independency since whoever decides the remuneration of another will for certain have an influence in that person, even if not consciously.

At BES there were two commissions in charge of this subject, Remuneration Committee⁶ and Remuneration Advisory Committee⁷. Although these commissions were designated independent, their members had some indirect ties to the CEO. In 2013, Daniel Proença de Carvalho, member of the Remuneration Committee, was partner and President of the law firm that represented Ricardo Salgado, father of Ricardo Salgado lawyer, and President of Cimpor, a company closely related to BES. In the Advisory Remuneration Committee there were two people related to the same circle of friends as Ricardo Salgado, and the third person was Nuno Godinho de Matos, whose issues about independence were already mentioned above.

9. CEO Succession

The board of directors should be held responsible for the CEO succession planning. They should always be ready to substitute the CEO in any case, for instance when the CEO takes a new job, retires or makes a huge mistake. The board of directors should try to ensure a smooth succession in order to avoid disruptions to the company's decision-making processes or unexpected changes in policy or direction. An existing executive manager would be the best option to succeed the CEO (Coyle, 2008). Poor planning can lead to disruption and turnover. It can also mean having to go outside the organization, which can result in excessive and misaligned pay packages (Monks and Minow, 2011).

⁶ Remuneration Committee was elected by the shareholders and its function was to determine directors' compensation.

⁷ Remuneration Advisory Committee was nominated by the non-executive directors in January 2012 in order to prepare recommendations regarding remuneration of both executive and non-executive directors, audit committee as well as the CEO.

At BES, José Maria Ricciardi, cousin of the CEO and member of the Executive Commission, refused to give a vote of trust to Ricardo Salgado months before the crisis, arguing that he should be substituted. However, directors were clearly not ready to replace the CEO despite the last unsatisfactory results. Ricciardi changed his position, compromising his chances to be nominated CEO, which turned it even harder to replace the CEO.

10. Director Nomination

Independence cannot be truly claimed if the CEO controls the nomination process. Monks and Minow argue that the CEO should not give the names of candidates and that *proxy access*⁸ and majority vote is important to increase boards independence. At BES, the entity responsible for proposing the names for the board was a major shareholder, BESPARG. However by checking the list of candidates, one can conclude that their connections to Ricardo Salgado are truly evident. This is not surprising since he was the President of BESPARG. Hence, one can conclude that the CEO was indirectly proposing the candidates.

At BES the election of directors was indeed determined by majority shareholder vote, but this proved irrelevant since the CEO indirectly selected almost all the directors. Furthermore, after the fall of the bank, José Maria Ricciardi said in the Portuguese Parliament that voting against the opinions of CEO was tremendously hard. He went further by saying *“if someone said no to Ricardo Salgado, that person would have a hard time”*.

11. Time

Directors’ ability to oversee management is further undermined by the fact that many directors are unable to devote sufficient time or resources to the job (Monks and Minow, 2011). According to Lorsh, Senior Associate Dean of the Harvard Business School, a non-executive director needs at least 100 hours per year to do a good job at the board. Research findings go further by saying that at least 250 hours per year are needed. Executive directors should dedicate at least 40 hours per week.

⁸ Proxy access is the nomination of directors by shareholders. Advocates of proxy access believe shareholders should have the right to nominate directors since they will represent them on the board. Critics believe proxy access does not allow investors to be activist.

Looking at other functions that some directors at BES occupied, it is physically impossible for them to devote that time. For instance, Rui Manuel Duarte Sousa de Silveira, executive director since 2000, held positions in other 24 companies (11 outside the BES Group). Another example is José Manuel Pinheiro Espírito Santo Silva, executive director since 1992, who had responsibilities in 19 companies (14 outside the BES Group).

Still considering the subject of availability, in 2013, Aníbal da Costa Reis de Oliveira, a non-executive and non-independent director that held positions in 9 companies outside the BES Group, was only physically present in 37,5% of the meetings. José Maria Ricciardi also attended only 37,5% of the meetings. However, if we consider attendance with representation, then they both attended 100% of the meetings. Representation at meetings also raises some questions. First, since BES is a bank, it is subject to bank secrecy. Hence, if the person representing them is an outsider, this does not hold. Second, if the person is an existing director, then the number of people thinking is reduced.

Monks concludes that Corporate Governance is assuring that *“the right questions get asked and the right checks and balances are in place”*. From the analysis conducted, one may conclude this was not happening at the meetings. According to José Maria Ricciardi *“Dr. Ricardo Salgado centralized the powers in himself. Everything was decided by him, who sometimes did not even communicate what he had decided (..)”*. Moreover, there were more people on the board saying they could not raise questions. One of those examples is supported by Nuno Godinho de Matos as he said, *“In 6 years I have never said a word”*.

There was a problem of the heavy influence of the CEO and Espírito Santo family on the board, undermining smaller shareholders interests. The CEO had a strong leadership position concentrating all the powers and decision-making on himself. He influenced the appointment of candidates to the board of directors as well as voting decisions. For this reason, it was impossible to have truly independent

directors. Finally, directors held an incredible number of positions at other companies, which compromised their commitment with BES.

In conclusion, BES used the “box-ticking” approach, which means they were following regulators recommendation but only on paper. In reality, they presented several problems that were outside the suggestions. Thus, it is difficult to define this as good corporate structure.

With a “box ticking” approach regulators cannot say a company does not follow the rules. To overcome this problem, one possible solution is to have supervisors investigating if the company is indeed following this approach and suggest the implementation of more adequate rules. For instance, BES had in theory more than 25% independent directors. However, when looking more closely into the matter, one can conclude that some of those directors were not truly independent. In this case, a regulator should implement additional rules, such as narrowing the definition of independency. Regarding capital, if a supervisor perceives the “box-ticking” approach is being applied, he should put in place the ICAAP⁹.

It would not have been difficult for Portuguese regulators to conclude BES was not truly following the rules. The “box ticking” approach was indeed clearly evident.

⁹ ICAAP, Internal Capital Adequacy Assessment Process, is the Pillar 2 of Basel II. In certain cases, a supervisor may ask for stronger capital requirements when he thinks they are needed.

New Rules

In July of 2015, the Basel Committee on Banking Supervision published a report with new recommendations regarding the Corporate Governance of banks.

The Principles of Basel report appoints the essential need of “*an effective independent risk management function, under the direction of a chief risk officer (CRO)*”. This principle could indeed be a solution for the fact that BES did not have an independent and effective individual as CRO. With this, they could have better identified risks that the bank was exposed to, question risky decisions, and propose actions to mitigate those risks.

By the end of 2015, OECD published the G20/OECD Principles of Corporate Governance, a version written with the contribution of several organizations and experts on the matter. The II second principle of this publication is about one of the major problems at BES--protecting minor shareholder interests by ensuring “*equitable treatment of all shareholders*”. In order to achieve equal treatment among shareholders, they should be given timely general meeting information regarding the date, place and issues. Moreover, “*company procedures should not make it unduly difficult or expensive to cast votes*” and *proxy voting*¹⁰ is widely recommended in order to facilitate shareholder participation. From a BES minute of a general meeting in 2013, one can conclude that in theory minor shareholder interest was being protected and recommendations from this OECD report were already being fulfilled. BES communicated the date of the annual shareholders meeting a month in advance and the location was less than 10 minutes walking distance from the headquarters, making it accessible to everyone. As already mentioned, the voting policy was one vote per one hundred shares, and only holders of at least one hundred shares could go to the meetings. However, shareholders holding less than one hundred shares could decide together and then one representative could vote. There were also no restrictions concerning *proxy voting* and there were not *golden shares*¹¹ or *priority shares* policies in place. Thus, this problem

¹⁰ Proxy voting happens when a shareholder that cannot attend a meeting votes before it, for instance by email. Moreover, when a shareholder delegates the voting power to another member is also using a proxy voting.

¹¹ Golden shares allow its holders to decisively participate in the company's decisions without the corresponding needed percentage participation.

would not be solved with new recommendations and major shareholders could still have a heavy influence on the board, especially due to the major participation of the Espírito Santo family on the board.

Another recommendation of the OECD report is allowing employee participation. This can be achieved through “*employee representation on boards, and governance processes such as work councils that consider employee viewpoints in certain key decisions.*” The report goes further by saying that the employee representative “*should be able to freely communicate their concerns about illegal or unethical practises to the board and to the competent public authorities.*” A good employee representative could be the worker’s union representative. Initiatives like this one may be a good solution to improve the quality of the decision-making process by decreasing risk-taking since worker’s union would act in the best interest of employees.

In Portugal, CMVM stopped issuing recommendations since 2013 in order to focus on a better monitoring function. Recommendations were then published by the IPCG in 2016. One of the Principles contained in this Code addresses the need for diversity within the board by increasing the number of women with the expectation of better performance. Indeed, there are several studies corroborating this suggestion. According to a study conducted by Campbell and Minguez-Vera in 2008, Spanish companies exhibited a positive relationship between board diversity and performance. Moreover, studies conducted by McKinsey (2007), Catalyst (2007) and Credit Suisse (2012) also showed that firms with more boardroom diversity perform better. Men are more risk prone, making riskier financial decisions than women (Lemaster and Strough, 2014) since high levels of testosterone are associated with willingness to incur greater risk (Stanton, Liening and Schulthesis, 2011). Another important evidence is that female directors are also more likely to raise more questions than their male counterparts (Carter et al., 2003), which is tremendously important in order to have an effective board.

The IPCG Report also recommends that “*the company should not fix an excessive number of shares necessary to confer the right to vote*” in order to increase shareholder involvement in decision-making.

Regarding independence, IPCG considers that a director is not independent if he has in the last three years been an employee or director of the company or a related company, or if he has provided services to the company, directly or indirectly to a manager or director. Thus, José da Pena, Luís Lorena, Nuno Godinho de Matos and Rita Amaral Cabral, among others, could not be considered independent.

After studying new recommendations, some conclusions can be drawn. Firstly, a better risk committee as suggested by the Basel recommendations could indeed have prevented some risky transactions. Secondly, as studies show, the increase in the number of women as proposed by IPCG could have helped improve decision-making and performance.

Although new rules could have mitigated some of the issues related to BES corporate governance, they still would not be sufficient to eliminate BES major problems, such as the heavy influence of Espírito Santo family and major shareholders, the large size of the board, and the centralized power of the CEO and his several positions inside the BES Group and related companies. Solving these problems would have been essential to avoid the fall of the bank, since a smaller board would have allowed for seamless communication, and a non-centralized power of the CEO combined with a board free of the influence of the Espírito Santo family would have permitted the contribution of all of the directors.

New rules are still allowing the “box-ticking” approach to be utilized, since the rules fail to mention the supervisor’s importance in deciding whether recommendations are truly taking place or the company is simply checking it off; if that is the case, additional actions are more than necessary. Thus, new regulations and recommendation could not have avoided the failure of BES.

Conclusion

Corporate governance refers to the way companies are governed and to what purpose (Coyle, 2008). Investors evaluate if a company has strong corporate governance when making investment decisions, especially after the corporate governance scandals in the beginning of the century, such as the ones at Enron in the U.S. and Parmalat in Italy.

A company enrolls in good corporate governance when decisions are taken in accordance with shareholder interests and board of directors use their powers with independence and responsibility. The major concern regarding this topic is indeed the relation between the owners of the company and the board of directors and possible conflict of interests. In order to decrease possible conflict of interests and to align incentives, there are several principles that should be taken into consideration.

A board should be composed by executive and non-executive directors. Among the non-executive directors, some should be independent. Independence is applicable when a director has no ties to the company or related companies except the position he occupies as a director. The number of directors that compose the board should be sufficient to have people with different backgrounds, but should not exceed a certain limit to maintain efficiency.

Compensation of directors is also an important topic regarding corporate governance. Overall, compensation schemes should be designed in a way that long-term interests of shareholders are aligned with those of directors. Executive directors should have part of their benefits tied to the performance of the company.

Nomination of directors is a relevant issue as well. Directors nominated by the CEO may face true difficulties challenging their authority. For this reason, Monks and Minow do not recommend CEO director nomination.

In order to address all these issues a considerable number of Codes, Regulations and Recommendations were developed. Despite this, institutions still fail due to bad application of the codes.

In Portugal, BES was one of those institutions. Although BES was known for having strong corporate governance in place, one may conclude upon detailed analysis that corporate governance at BES was far from being strong.

With 25 people, BES had one of the largest boards of directors in Portugal, a size that made it nearly impossible for many of the members to contribute. Some directors believed that the CEO centralized all the power within himself and that it was difficult to question his decisions, while another director had no professional understanding of banks. Moreover, the dominant influence of the CEO, CEO's family and major shareholders, were evident from the nomination process and also from what some directors said after the fall of the bank. Thus, another failure at BES was the fact that minor shareholder interests were not protected.

Independence was also an issue at the Portuguese bank. Although they claimed that 28% of directors were independent, which was higher than the expected 25% from regulators, this was not true. For instance, one of the independent directors was a lawyer at the law company that defended the CEO and another independent director was a director at a company with strong connections to the bank.

After the fall of the bank it was expected that new regulations could address the several problems mentioned. However, the answer to the question *"If recommendations issued after the fall of BES were in place before, would the bank still have fallen?"* is believed to be yes.

There are no regulations specifically addressing the issue of centralization of powers, heavy influence of the CEO and exaggerated size of the board. Concerning independence, new recommendations reformulated its definition, but only if regulators deeply investigated directors' situation could reach the conclusion that they were not fulfilling the criteria of independency.

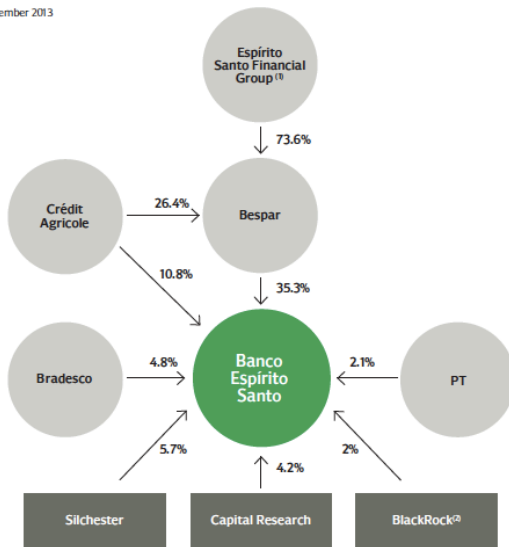
BES is a clear example that perfect corporate governance on paper does not mean good corporate governance in practice. Further recommendations by regulators have to be developed in order to prevent similar cases from occurring again. Even more important than recommendations, it is important to have better supervision, since monitoring clearly failed in this case.

Appendix

Exhibit I: BES Main Shareholders (source: BES 2013 Annual Report, page 23)

BES Main Shareholders

31 december 2013



(1) Direct and indirect stake of ESFG in Bespar.
 (2) BlackRock increased its stake in February 2013 to 5.1%.

Exhibit II: Positions occupied by Ricardo Salgado, the CEO of BES (source: BES 2013 Annual Report, page 241)

Ricardo Espírito Santo Silva Salgado

A. Corporate positions held in companies of BES Group

Board of Directors

Banco Espírito Santo de Investimento, S.A. (Chairman)
 Banque Espírito Santo et de la Vénétie, S.A. (Member)
 BES África, S.G.P.S. S.A. (Chairman)
 BES Finance, Ltd (Member)
 BEST – Banco Electrónico de Serviço Total, S.A. (Chairman)
 ES Tech Ventures, S.G.P.S., S.A. (Chairman)
 ESAF – Espírito Santo Activos Financeiros, S.G.P.S., S.A. (Chairman)
 Espírito Santo – Empresa de Prestação de Serviços 2, ACE (Chairman)
 Espírito Santo Ventures, Sociedade de Capital de Risco, S.A. (Chairman)

Other Positions

Banco Espírito Santo de Investimento, S.A. (Member of the Remuneration Committee)

B. Corporate positions held in companies outside BES Group

Board of Directors

Banque Privée Espírito Santo, S.A. (Member)
 Bespar – Sociedade Gestora de Participações Sociais, S.A. (Chairman)
 Casa dos Pórticos – Sociedade de Administração de Bens, S.A. (Chairman)
 E.S. Holding Administração e Participações S.A. (Vice-Chairman)
 ES Bankers (Dubai) Limited (Chairman)
 Espírito Santo Control S.A. (Member)
 Espírito Santo Financial (Portugal) - Sociedade Gestora de Participações Sociais, S.A. (Chairman)
 Espírito Santo Financial Group S.A. (Chairman)
 Espírito Santo International S.A. (Member)
 Espírito Santo Resources Limited (Member)
 Espírito Santo Services, S.A. (Member)

Partran - Sociedade Gestora de Participações Sociais, S.A. (Chairman)
 Sociedade de Administração de Bens Pedra da Nau, S.A. (Chairman)

Other Positions

Associação Portuguesa de Bancos (Vice-Chairman of the Board, in representation of Banco Espírito Santo, S.A.)
 Fundação Stanley Ho (Member of the General Board)
 Instituto Internacional de Estudos Bancários IIEB (Member)

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