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*Agata Wieczorek**

CHAPTER 6

INDEPENDENT SUPERVISORY BOARD MEMBERS IN POLISH PUBLIC BANKS

Introduction

One of the factors significantly affecting the effectiveness of a company's operations is the amount of capital. In order to raise capital companies go public and thus provide conditions for accumulating capital for the development and extension of their business activity. However, to attract potential investors, a company must advertise, demonstrating that it has effective supervisory and managing bodies. On the one hand, the management team may increase the value of a company, but, on the other hand, through opportunist actions, it may also lead to numerous undesirable situations which are not in line with the goals of the company and its shareholders. The supervisory board is an institutional solution to prevent such situations.

Major corporate scandals (e.g., the collapse of Enron and WorldCom) triggered numerous debates over the effectiveness of work of supervisory boards. It was noted that they were passive, their members lacked sufficient expertise and demonstrated loyalty to the management teams. One way to prevent such situations is to appoint independent supervisory board members, who are not related to the shareholders or any other entities associated with the company. Independent supervisory board members may also help settle disputes and facilitate the operation of the supervisory body. This idea has been supported by numerous organizations (including the European Commission and the Warsaw Stock Exchange), which recommend the appointment of independent members to company boards.

The objective of this paper is to determine to what extent the banks listed on the Warsaw Stock Exchange (WSE) observe the regulations concerning the appointment of independent supervisory board members as well as whether the members meeting the criteria of independence are appropriately educated and have qualifications to perform their tasks on supervisory boards.

* University of Lodz

1. Independence of supervisory board members in legal and corporate governance regulations

Modern enterprises are characterized by the separation of ownership and control. The management board is in a position to accomplish its own goals which may not always be in line with the interests of the shareholders. Therefore, it is essential that a company has a body supervising its executives. In a joint-stock company, it is the supervisory board which is to watch whether the management board acts in harmony with the corporate goals. Depending on the composition of the supervisory body, the board may perform its tasks more or less effectively. The supervisory board members related to the main shareholder are guided by its interests in taking strategic decisions, while the representatives of employees are guided by employee interests. Board members who are related to the management team tend to accept all the decisions taken by the executives, including those that may diminish the value of the company. Therefore, it is crucial that supervisory board members be independent and have no relationships with the company or its stakeholders. In their decisions they should be primarily guided by the best interests of the company, which will minimize the opportunistic behaviour of the management board.

In the United States, the document which the companies listed on the New York Stock Exchange are obliged to comply with is the Corporate Governance Rule Proposals [NYSE, 2002], which stresses the significance of independent board members. According to these proposals, listed companies must have a majority of independent directors on the board, which will increase the quality of board oversight and lessen the possibility of damaging conflicts of interests. Yet, the exact number of independent board members is not specified there. Section 303A specifies the criteria to be met by independent members of the board of directors. According to the definition [NYSE, 2002]:

a) No director qualifies as "independent" if that director has material relationship with the listed company (directly or as a partner, shareholder or officer of an organization that has a relationship with the company).
b) No director who is, or in the past five years has been, affiliated with or employed by an auditor of the company.
c) No director who is a former employee of the listed company can be "independent" until five years after the employment has ended.
d) No director can be "independent" if he or she is, or in the past five years has been, part of an interlocking directorate in which an executive officer of the listed company serves on the compensation committee of another company that concurrently employs the director.

e) Directors with immediate family members in the foregoing categories are likewise subject to the five-year "cooling-off" provisions for purposes of determining "independence."

The document released a year later also enumerates recommendations concerning independent directors on the company board [Breeden, 2003]. Importantly, all the members of this body, including its chairman, should be absolutely independent of executives, which will allow the board of directors to vote through projects consistent with the goals of shareholders but not necessarily with the managers' needs. Moreover, the document sets forth standards of independence, according to which a director is not independent if:

a) The individual or any close relative by blood or marriage is currently or has been an employee of the company within the past five years with compensation above a level specified by the board;
b) The individual receives (or within the past three years has received) any form of compensation for services as an employee, or as any outside consultant or other professional retained by the Company other than standard fees for board or committee service and is not a partner or employee of any law firm, investment banking firm or other firm providing professional services to the Company;
c) If the individual is an officer, director, partner or employee of any firm that does business with the Company, the director shall not be independent if the volume of cross-business exceeds a level set by the board, with 1% of revenues for either firm or $3 million in any three year period as a recommended starting level; provided that this restriction should not apply to purchase of telecom or other services from the Company by an entity affiliated with the director so long as the director played no role in negotiating any such transaction, and the business took place on arm's length terms;
d) If the individual serves as an officer of any company on whose board an officer of the Company sits, the individual is not independent while any such interlock is in effect;
e) If the individual is an officer, director or employee of a non-profit organization that receives donations from the Company in excess of $100,000 during any year, except for grants to a university, under certain conditions;
f) If the individual is a spouse or relative living in the same household of (i) any elected political official who has received donations from the Company or any senior officer during the current or past five years, (ii) any senior member of any regulatory body with authority over the company, (iii) any person with government contracting responsibility for the company, (iv) a governor

or member of a political executive body, or (v) a legislator who sits on any committee with jurisdiction to enact laws governing the Company or its business operations;
g) If the individual has had any personal commercial transactions with the CEO during the past ten years, or serves as an officer, employee, partner or owner of any organization that has been involved in any commercial transactions with the CEO personally during the past five years, except for routine retail or consumer transactions;
h) The individual has previously served as the Company's CEO.

Given recent corporate scandals, the Organization for Economic Cooperation and Development (OECD) has also emphasized the significance of appointment of independent members to company boards. The document prepared by the OECD [OECD, 2004] recommends the presence of such members on supervisory boards or boards of directors. The appointment of independent members will make it possible for the company board to apply objective criteria of performance evaluation. The OECD stresses that people who meet the criteria of independence are in a position to objectively evaluate the performance of executives. Moreover, they may play a significant role in areas where the interests of the management team, the company, and the partners/shareholders may diverge, such as executive remuneration, succession planning, change of entities auditing the company, take-over defence, and auditing of financial statements [OECD, 2004, s. 70 – 71]. Therefore, each company should declare which members of the board are independent. As regards issues which may result in conflicts of interests, such as financial reporting, nomination of members of the supervisory board or directors on the board of directors, and remuneration of members of corporate bodies, the company's supervisory board may establish special committees. The companies where such committees have been established should guarantee that a specified number of their members meet the criteria of independence. Moreover, supervisory boards should precisely describe in their regulations the mandate, composition and working procedures of such committees.

In view of the importance attached to the role of independent members in the effective operation of the company board, the European Commission issued Recommendation of 15 February 2005 on the role of non-executive directors or members of supervisory boards of listed companies or committees of the (supervisory) board [European Commission, 2005]. The European Commission offered a definition of an independent member, his or her responsibilities, as well as the criteria of independence. The document requires companies to appoint a sufficient number of independent members to ensure that any material conflict of interest

involving directors will be properly dealt with. This also guarantees that the company's board will primarily be guided by the company's best interests. Annex II to the Commission Recommendation enumerates the criteria to be met by independent members of company boards. While the European Commission explains that the criteria should be tailored to the national context, it stresses that an independent company board member means a person who [European Commission, 2005]:

a) Is not an executive or managing director of the company or an associated company and has not been in such a position for the previous five years;
b) Has not been an employee of the company or an associated company and has not been in such a position for the previous three years;
c) Has never received significant additional remuneration from the company or an associated company, apart from a fee received as a non-executive or supervisory director;
d) Is not or in any way represents the controlling shareholder;
e) Does not have, or have had within the last year, a significant business relationship with the company or an associated company directly or as a partner, shareholder, director or senior employee of a body having such a relationship. Business relations include the situation of a significant supplier of goods or services (including financial, legal, advisory or consulting services), of a significant customer, and of organisations that receive significant contributions from the company or its group;
f) Is not or has not been within the last three years, partner or employee of the present or former external auditor of the company or an associated company;
g) Is not an executive or managing director in another company in which an executive or managing director is a non-executive or supervisory director and has no other significant links with executive directors or the company through involvement in other companies or bodies;
h) Does not or has not served on the (supervisory) board as a non-executive or supervisory director for more than three terms (or alternatively, more than 12 years where national law provides for normal terms of a very small length);
i) Is not a close family member of an executive or managing director, or of persons specified in the situations referred to in points (a) to (h).

When appointing the company's board, the general meeting of shareholders should be guided by the above criteria. After a decision is taken as to whether a board member can be regarded as independent, the board is obligated to make such information publicly available. Thus, anybody can ascertain whether or not the company follows the regulations concerning the appointment of independent board members. Apart from the criteria of independence, Annex II [European

Commission, 2005] to the European Commission Recommendation enumerates a number of rules which should be followed by a person who meets independence criteria. First of all, when making decisions, independent board members should not be guided by suggestions of other members serving on the board, but only by their own opinion. During the term of office they should not accept or demand any additional remuneration which could undermine the independence of their actions. When taking decisions, they should also be guided by the interests of the company and, if any actions of the board could harm the company, they should clearly express their objections.

Despite the fact that for over ten years independent supervisory board members have played increasingly important roles in the world and in the domestic market, the Polish law does not regulate this area of corporate governance. The Code of Commercial Partnerships and Companies [Commercial Companies Code, 2000] includes provisions concerning the powers, composition, and election of the supervisory board, adoption of resolutions, convocation of meetings, preparation of minutes, and setting the remuneration of board members, but the Code does not cover such issues as independent members on the supervisory board, their characteristics, the criteria they should meet, or the principles they should follow.

As regards corporate governance regulations, the situation looks much better. In 2002, the Warsaw Stock Exchange introduced the Polish version of the Code of Good Practice – "Best Practices in Public Companies in 2002" [WSE, 2002] to be complied with by the companies listed on the WSE. Each public company must submit a statement in which it specifies which rules of the Code it observes and which it does not, along with the reasons for its decision (comply or explain). Moreover, the part dealing with good practices for supervisory bodies includes regulations concerning the independence of supervisory board members. The first part of Best Practices gives a definition of a supervisory board member. Apart from adequate education as well as professional and personal experience, they are expected to dedicate enough time so that they could duly perform their duties. Further regulations concern independent members of the supervisory board. According to rule 20 "(a) At least half of the members of the supervisory board should be independent members. Independent members of the supervisory board should not have relations with the company and its shareholders or employees which could have a significant impact on their ability to make impartial decisions. (b) Detailed criteria of independence should be laid down in the statutes of the company. (c) Without the consent of at least one independent member of the supervisory board, no resolutions should be adopted on the following issues: – all kinds of considerations granted by the company or any entities associated with the

company to management board members; – consent to the execution by the company or its subsidiary of a key agreement with an entity associated with the company, member of the supervisory board or the management board, and with their associated entities; and – appointment of an expert auditor to audit the financial statements of the company" [WSE, 2002]. Moreover, it is recommended to publicly state which members of the supervisory board are related to the shareholders and in particular, the strategic investor. However, the document does not include any provisions concerning the establishment of supervisory board committees designed for streamlining the operations of the supervisory body.

Unfortunately, the regulation concerning the number of independent members on the supervisory board has been ignored by the majority of the companies listed on the stock exchange. They explained their decision not to apply this principle by the fact that section 20 of the Code excessively restricts the corporate rights of the dominant shareholders and violates the principle of primacy of the rule of the majority.

Consequently, the Warsaw Stock Exchange introduced amended Best Practices [WSE, 2005] in 2005. Although the regulations concerning the independence of supervisory board members were left mostly unchanged, the Stock Exchange Board did introduce an amendment in view of the arguments given by the listed companies concerning the number of independent members. Rule 20 was extended with subsection (d): "In companies where one shareholder holds a block of shares over 50% of all voting rights, the supervisory board should consist of at least two independent members, including an independent chairman of the audit committee, should such a committee be set up" [WSE, 2005]. The listed companies approved of this change, but still many of them disregarded the rule on independent members. The Stock Exchange Board continued work on improvement of the code. In 2007, the WSE introduced another version of the code [WSE, 2007] with Part III of Best Practices devoted to supervisory boards and including regulations on their independence. Each member on the supervisory board should notify the management board of any economic, financial or family relationship with the holders of 5% or more of voting rights, as such a relationship may affect his or her decisions. The Code recommends that at least two members of the supervisory body should meet the criteria of independence specified in Annex II to the Commission Recommendation of 15 February 2005. However, subsection 6 of Part III of Best Practices stipulates that a person who is an employee of the company or an associated company, as well as persons related to the majority shareholder cannot be deemed to meet independence criteria described in the Annex.

Despite the fact that an increasing number of companies decided to follow all the rules contained in the Code, the Stock Exchange Board issued another set of Best Practices [WSE, 2010]. However, amendments to Best Practices did not concern the part devoted to the independence of supervisory board members. In this respect, Best Practices referred companies to the European Commission Recommendation of 15 February 2005. This may result from the fact that the majority of listed companies had already followed these rules. Many companies realized that success on the stock exchange depends not only on economic performance, but also on adherence to the rules of best practice.

Table 1. Criteria of independence in different legal regulations

Criteria of independence	USA	European Commission	Code of Best Practice*
Is not an executive director or member of the management board	Yes	Yes	Yes
Does not hold more than 5% of voting rights at general meetings	-	Yes	Yes
Is not employed by the company	Yes	Yes	Yes
Has not been a member of management board in another company where the board member is concurrently a chief executive director or a non-executive director on the board of the company	Yes	Yes	Yes
Does not have any business relationship with the company	Yes	Yes	Yes
Has not been employed by a chartered auditor cooperating with the company	Yes	Yes	Yes
Is not paid any extra remuneration by the company	Yes	Yes	Yes
Is not a member of the family of the executive director	Yes	Yes	Yes
Has not been an independent member for longer than 12 years	-	Yes	Yes

* The Code of Best Practice adopted in 2007 and 2010 with regard to independent criteria refers companies to the Recommendation of the European Commission, while Best Practices of 2002 and 2005 require companies to define the criteria on their own in their statutes.
Source: Author's own compilation

When comparing the provisions concerning independence criteria in the legal regulations of the United States, the European Union, and Poland (Table 1) it is worth noting that most of the characteristics of an independent board member are similar in all the above-mentioned documents. Thus, one could argue that the criteria of independence are uniform.

2. Literature review

Taking into account how important the supervisory board is as an internal mechanism of corporate governance, there arises an important question as to whether the composition of the board, and particularly the presence of independent members on the board, enhances its effectiveness of the board.

R.C. Hanson and Moon H. Song examined whether the composition of the board and the ownership structure affect the internal control system in companies [Hanson and Song Moon, 1998], including the monitoring of managers, evaluating management performance, and, when necessary, firing the CEO. They observed that supervision plays a significant role as regards boards with independent members. Moreover, they proved that in companies where most members of the supervisory board met the criteria of independence, executives and the CEO held a small block of shares. According to Hanson and Song, the findings show that two conditions must be met to provide an effective corporate system of internal control: monitoring should be conducted by independent members and the CEO should hold a block of shares. Yet, a number of the companies they studied preferred managers who were owners rather than independent board members.

M.S. Weisbach [1988, s. 431 - 460] tested the hypothesis that outside and inside directors behave differently in their decisions concerning dismissal of top executive officers. Inspired by the work of MacAvoy, he found that inside directors are employed by the company, i.e., apart from sitting on the board they also perform other duties in the company. In turn, those who do not work for the company and are in no way related to it are regarded as outside directors. The remaining directors who are not employed by the company but may have some relationship with it are regarded as "grey directors." To find which board is more effective (outsider-dominated or insider-dominated) in terms of monitoring the management team, Weisbach studied the relationship between CEO dismissals and company performance. A stronger correlation between these factors in companies with boards dominated by outside members would mean that such boards play a more significant role in monitoring the executives. The study involved 367 companies listed on the New York Stock Exchange in 1980. They were divided into 3 groups:

1. Insider-dominated firms with outside directors accounting for less than 40 per cent of the board composition,
2. Mixed firms with outside directors accounting for 40 to 60 per cent of the composition,
3. Outsider-dominated firms with outside directors accounting for at least 60 per cent of the composition.

Analysis revealed that in firms with outsider-dominated boards, the correlation between corporate performance and CEO turnover was stronger than in companies with a different makeup of the board. This means that outsider-dominated boards tend to add to firm value through their CEO changes. This value will be greater if a CEO change was the result the company's poor performance. As regards insider-dominated boards, Weisbach found no such results. These findings do not appear to be influenced by differences in the ownership structure, firm size, or the industry in which the firm operates.

Byrd et al. [2007, s. 1 - 23] analysed the impact of the presence of independent directors on the financial performance of the company and CEO compensation. They introduced a standard two-way director classification scheme. In the first classification, the company board was divided into inside and outside directors. The latter were subdivided into those related to the company and independent ones. The other classification involved a distinction between independent outside "problem" and "non-problem" directors[1]. The underlying hypothesis of the paper was the question whether the presence of truly independent outside directors (so-called non-problem directors) has a significant impact on the effectiveness of corporate governance. To test this hypothesis, 672 publicly-traded firms from the 2004 Russell 1000 index were used. The survey revealed that there is a significant positive correlation between the presence of "non-problem", independent board members and the financial performance of the company, and a negative correlation between the presence of these directors and excessive CEO compensation. Using the standard three-way director categorization (affiliated outside directors, also known as grey directors, independent outside directors and inside directors) did not confirm those findings. Authors concluded that these results may indicate that a truly independent board member may not necessarily be synonymous with a person who is in no way related to the company. Therefore, the definition of an independent director should also include their previous experience in corporate governance.

Studies on the impact of the presence of independent outside directors on the company board have been conducted not only in the United States. C.Y. Wang [2008] analysed the relationship between corporate cash holdings[2] and the presence of independent board members in firms listed on the Taiwan Stock Exchange. Wang proposed two hypotheses. According to the first one, firms with a higher pro-

[1] Problem directors are those individuals who have been personally involved, as a director or executive, in one or more corporate bankruptcies, major litigation and other corporate scandals, or have served on remuneration committees that have approved particularly egregious CEO compensation packages.

[2] The marginal value of cash holdings shows how much added value is generated for the company by another cash asset.

portion of independent directors on boards are associated with a higher marginal value of cash holdings. According to another hypothesis, firms with independent directors have a higher marginal value of cash holdings than firms without independent directors. The study did not prove conclusively whether there is a positive relationship between the presence of independent directors and the marginal value of cash holdings. The author observed that the presence of independent directors may increase the marginal value of cash holdings only in small firms and those which are unlikely to increase their value. This is possible due to the reduction of agency costs resulting from cash holdings.

Lawrence and Stapledon [1999, s. 1 - 64] focused on two problems: First, is there any relationship between board composition and company performance? Second, does the presence of independent directors on the board positively affect the remuneration of executives? They surveyed corporations listed on the Australian Securities Exchange in late 1995. The survey covered nearly 700 persons who filled almost 900 board positions (some directors were members of more than one board). Non-executive directors accounted for 73 per cent of the sample, out of which 43 per cent were independent non-executive members, and 30 per cent were affiliated non-executive directors. As regards chairpersons, non-executive directors accounted for 83 per cent, of which 45 per cent were independent chairpersons. The first part of the survey was to determine whether the presence of independent board members affects share prices. Analysis did not reveal any substantial evidence supporting this thesis. The second part of the survey was to show whether the remuneration of the CEO is higher when inside directors sit on the remuneration committee. Analysis took into account the classification of companies by size, performance, and ownership structure. The results suggest that Australian companies, regardless of who sits on the remuneration committee, pursue the same policy with regard to CEO remuneration.

In their study, Kiel and Nicholson [2003] also investigated firms in the Australian market. They sought to establish whether there was a correlation between board composition and corporate performance in these firms. They proposed eight hypotheses including one that the number of outside directors on the board did not affect corporate performance. The survey covered 348 companies listed on the Australian Securities Exchange (ASX) in 1996. The results of the analysis only partially supported the hypothesis. As regards market indices, correlation was observed between the number of outside directors sitting on the board and the financial performance of the company. Yet, when accounting measures were used, such results were not valid, which confirmed the hypothesis proposed by the authors that the number of independent board members did not affect the company's financial performance.

Many attempts to establish whether the presence of independent directors on the board has a positive or negative impact on the company's performance have not provided a clear answer. On the one hand, research has shown that the presence of independent members on the board has a positive impact on the effectiveness of the company's system of control. This means that there is a correlation between the company's performance and CEO turnover (in the one-tier model) or the turnover of presidents of the management board (in the two-tier model). In addition, some of the authors dealing with this issue have demonstrated that independent board members have a positive impact on the financial performance of the company. On the other hand, the analysed studies may lead to the conclusion that there is no correlation between the presence of independent members and the profitability indicators of the company or the price of its shares. This means that one cannot draw a definite conclusion that board members meeting the independence criteria have any effect on the performance of the company and the way it is perceived in the market. This does not mean, however, that such board members are not needed on boards since no studies have shown negative effects of employing independent members.

3. Independent supervisory board members in the internal regulations of public banks in Poland

The companies listed on the Warsaw Stock Exchange must comply with the Polish and European Union law, and they also should apply the Best Practices issued by the WSE. Moreover, some sectors of the economy have their own regulations to be observed by companies; e.g., the Banking Act is binding for the banking sector [Journal of Laws, 1997]. Part C of Chapter 2 of the Act is devoted to banks incorporated as joint stock companies. Among other things, it contains recommendations for supervisory boards, which should consist of no fewer than 5 natural persons, with the main competence including the power to appoint and dismiss members of the management board of the bank. The supervisory board must advise the Polish Financial Supervision Authority of any changes in the composition of the management board. Although there are many regulations concerning supervisory boards, the Banking Act includes no recommendations with regard to independent supervisory board members.

This study involved 14 banks listed on the WSE[3] and included data from 2006–2010. Information about supervisory boards was acquired from individual annual reports posted on the banks' websites.

[3] Analysis excluding UniCredito bank, which has adopted the one-tier model of corporate governance.

Apart from observing the hard and soft law, in their operations Polish public banks refer also to their internal regulations such as statutes, supervisory board regulations, and management board regulations. These regulations concern not only the activities of the company but also those of its supervisory and management bodies. Depending on the bank, regulations on the supervisory board composition (the number of independent members), criteria of independence and the definition of an independent member may be included either in the statute or in supervisory board regulations (see Table 2).

Table 2. Regulations on independent members in the documents of Polish public banks

	Definition of an independent member	Number of independent members	Criteria of independence
Bank statutes	4	4	3
Supervisory board regulations	0	1	4
Both documents	1	2	0
Lack of regulations	9	7	7*

* PKO BP does not specify criteria of independence in any document and refers to the Code of Best Practice for WSE Listed Companies.
Source: Author's own compilation

According to the documents given in the table, only five banks decided to include a definition of an independent supervisory board member in their internal regulations. ING Bank put it in its statute as well as in its supervisory board regulations, while such banks as Pekao SA, Millennium, BPH and Fortis gave a definition only in their statutes. Other banks did not develop a definition of an independent member in their documents and or refer to the European Commission Recommendation or to the Code of Best Practice for WSE Listed Companies in this respect.

Appreciating the role of independent members of the supervisory board, some companies in the banking sector decided to put definitions of an independent member in their statutes or supervisory board regulations. Generally speaking, an independent member means an individual who does not have any relationship with the bank or the bank's shareholders or employees, as such a relationship could significantly affect this individual's ability to make impartial decisions. Regulations specify the minimum number of independent members on the supervisory board. Five banks accepted that at least two independent members should sit on the supervisory board. This provision is consistent with the provision on the number of independent members included in the Code of Best Practice adopted by the WSE in 2010. Two banks were more restrictive as regards the number of independent members: BPH had a provision in its statute which required that at

least 30 per cent of the members of the supervisory board be independent, while Pekao SA required that at least half of the members of the supervisory board be independent. On the other hand, seven banks did not specify the number of independent members in their supervisory board regulations or statues. Along with the provision in its supervisory board regulations specifying the number of independent board members, ING additionally referred in its statute to the Code of Best Practice for WSE Listed Companies, which also determines the minimum number of persons deemed to be independent on the supervisory board.

Apart from the number of independent supervisory board members, firms in the banking sector often formally define the characteristics of independent members. Seven banks listed on the WSE have included such criteria in their statutes or supervisory board regulations; PKO BP referred to the Code of Best Practice, while six banks did not have such provisions at all. The most frequently applied criteria for an independent member involve, someone who[4]:

- Is not and has not been in the past three years (in three banks) or five years (in four banks) a board member or executive in the bank, its subsidiary companies or its parent company (notwithstanding the form of employment);
- Is not and has not been in the past three years employed in the bank, its subsidiary or associated entity in the understanding of the Polish Accounting Act (in six banks);
- Is not and has not been a shareholder with a block of voting shares of over five per cent (an identical provision in two banks, two per cent in Bank Millennium, while four banks did not set a threshold at all) and is not employed by a shareholder who owns a block of voting shares of over five per cent (provision effective in four banks, no such provision in Bank Millennium, a one per cent limit in Fortis, while BZ WBK uses the phrase: "a controlling shareholder");
- Has not been in the past three years an auditor or an employee of an entity authorized to audit financial statements, which audited the bank's financial statements (all banks);
- Is not paid any extra remuneration (apart from that of a supervisory board member) or any other considerations by the bank, its subsidiary or parent company, except the remuneration paid to the supervisory board member acting as a customer who concluded a standard contract with the firm (all banks);
- Is not a member of the management board in another company where a member of the bank's management board is a supervisory board member (all banks);

[4] Based on statutes and supervisory boards regulations of the banks listed on the WSE.

- Within the last year has not been and is not a substantial customer or counterparty, either directly or as a partner, shareholder, director or senior employee in an entity being in a such relationship with the bank (5 banks apply this rule including two banks not specifying a time limit);
- Has served as an independent supervisory board member for no longer than 12 years (three banks);
- Is not and has not been a spouse, a common-law spouse, or a relative by blood or marriage of a management board member or an employee holding another management position (all banks apply this rule and Bank Handlowy and Pekao SA set a 3-year limit in this respect).

In addition, two banks, Fortis and BZ WBK, included in their supervisory board regulations the basic principles to be followed by the independent members of supervisory bodies. The regulations require the independent members to maintain independence of opinion, to object if a decision may harm the company, and not to demand any additional tangible or intangible benefits.

Table 3. Criteria of independence in internal regulations of Polish public banks

Criteria of independence	Internal bank regulations
Is not a member of the bank's management board	Fortis, BRE, ING, Pekao SA, Millennium, Bank Handlowy, BZ WBK
Is not an employee of the bank	Fortis, BRE, ING, Pekao SA, Bank Handlowy, BZ WBK
Is not a shareholder of the bank	Fortis, BRE, ING, Pekao SA, Millennium, Bank Handlowy, BZ WBK
Is not employed by a certified auditor who has audited the bank	Fortis, BRE, ING, Pekao SA, Millennium, Bank Handlowy, BZ WBK
Is not paid extra remuneration by the bank	Fortis, BRE, ING, Pekao SA, Millennium, Bank Handlowy, BZ WBK
Is not a member of the management board in another company where a member of the bank's management board is also a member of the supervisory board	Fortis, BRE, ING, Pekao SA, Millennium, Bank Handlowy, BZ WBK
Has no business relations with the bank	BRE, ING, Pekao SA, Millennium, BZ WBK
Is not a relative of any member of the bank's management board	Fortis, BRE, ING, Pekao SA, Millennium, Bank Handlowy, BZ WBK
Has not served as an independent member for longer than 12 years	BRE, ING, BZ WBK

Source: Author's own compilation

When one compares the provisions on independence criteria in banks' internal documents (Table 3), it can be seen that they are quite similar. Therefore, it can be said that companies in the banking sector follow the same legal regulations while adopting internal rules for independent supervisory board members.

4. Results of the study

All the listed companies must comply with the Code of Best Practice, but in their compliance statements they may indicate that they do not conform to certain provisions, explaining why. The principle of supervisory board member independence is a provision of the Code which was found unnecessary and was not observed by some companies. Table 4 shows the attitude of banks in this respect.

Table 4. Banks' attitudes towards independent members of the board between 2006 and 2010

Bank	2006	2007	2008	2009	2010
BPH	Yes	Yes	Yes	Yes	Yes
BOŚ	No	No	Yes	Yes	Yes
BRE	Yes	Yes	Yes	Yes	Yes
BZ WBK	Yes	Yes	Yes	Yes	Yes
Fortis	Yes	Yes	Yes	Yes	Yes
Getin Holding	No	No	No	No	No
Noble Bank	No	No	No	No	No
Bank Handlowy	Yes	Yes	Yes	Yes	Yes
ING	Yes	Yes	Yes	Yes	Yes
Kredyt Bank	Yes	Yes	Yes	Yes	Yes
Millennium	Yes	Yes	Yes	Yes	Yes
Nordea	No	No	No	No	No
Pekao SA	Yes	Yes	Yes	Yes	Yes
PKO BP	No	No	Yes	Yes	Yes

Source: Author's own compilation based on annual reports

Table 4 shows that only 3 banks failed to observe the provision on independent board members during the period under study. While PKO BP and BOŚ did not apply this provision in 2006 and 2007, they decided to observe it in 2008 and in subsequent years probably because in July 2007 the Stock Exchange Board lowered the requirement as to the minimum number of independent board members. Previously, independent board members had to account for 50 per cent of supervisory board members, while since July 2007 two independent members on the board have been found to be sufficient. Companies explained that they failed

to observe this point of the Code because of the principle of majority rule and protection of minority shareholders. Shareholders who contribute more capital bear a greater economic risk, therefore, it is justified that their interests be considered in proportion to the capital contributed. Accordingly, they should be entitled to appointing candidates to the supervisory board who would ensure the implementation of the strategy adopted by the company. The companies argued that they had strategic investors whose corporate rights would be largely restricted were they to apply this rule.

As it is known which banks declared to observe the rules on independent board members, it is worth reviewing whether they actually applied them. Table 5 presents the number and percentage share of independent members on supervisory boards over the period under study. The banks that declared not to observe the rule were not taken into account, therefore, the data concern only 11 banks.

Table 5. Number and percentage share of independent supervisory board members

	2006		2007		2008		2009		2010	
	No.	%	No.	%	No.	%	No.	%	No.	%
BPH	3	23	3	27	5	42	5	38	6	46
BOŚ	-	-	-	-	5	63	5	63	5	56
BRE	5	56	4	50	5	56	5	50	5	50
BZ WBK	5	71	5	63	5	63	5	71	6	67
Fortis	2	25	2	40	2	33	2	40	3	43
Bank Handlowy	5	56	6	50	6	50	6	50	6	50
ING	4	50	4	50	4	50	4	50	3	38
Kredyt Bank	5	56	5	56	5	56	5	56	4	57
Millennium	7	50	7	50	5	56	6	55	6	55
Pekao SA	5	56	6	67	6	67	6	67	6	67
PKO BP	-	-	-	-	2	29	2	29	2	29

Source: Author's own compilation based on annual reports

Given the original provision of Best Practices in Public Companies in 2002 concerning independent supervisory board members, one can argue that over the entire period under study, three banks (Fortis, BPH, and PKO BP) did not apply it to the full extent, despite their compliance declaration. It can be said that these companies misled the Stock Exchange Board and investors by declaring that they complied with the principles of good practice. However, in 2005 an amendment was introduced to Best Practices in Public Companies allowing fewer independent members on a supervisory board than a half. BPH and Fortis had strategic shareholders owning more than 50 per cent of voting rights. Consequently, to conform to this principle, they had to employ at least two independent supervisory board members, which they actually did. PKO BP observed this regulation since

2008, that is, after successive amendments were introduced to the Code of Best Practice for WSE Listed Companies.

Importantly, the supervisory board should comprise people with appropriate qualifications, regardless of whether they are related to the strategic investor or not. Therefore, it is necessary to determine whether independent members employed in banks have sufficient expertise to perform their tasks well. Table 6 shows the qualifications of independent supervisory board members in banks.[5]

Table 6. Education of independent supervisory board members in the banking sector between 2006 and 2010

Bank	Number of independent members 2006–2010	Education					
		1	2	3	4	5	6
BPH	9	4	2	2	-	1	-
BOŚ	5	3	1	-	-	1	-
BRE	7	5	1	-	1	-	-
BZ WBK	6	1	2	-	1	2	-
Fortis	5	2	-	-	-	-	1
Bank Handlowy	7	2	2	1	2	-	-
ING	4	2	1	-	-	1	-
Millennium	7	-	2	2	-	-	3
Pekao SA	6	1	-	-	1	-	3
PKO BP	4	3	1	-	-	-	-

1 – Economics, 2 – Law, 3 – Foreign Trade, 4 – Technology, 5 – Finance and Management, 6 – Other.
Source: Author's own compilation based on annual reports

The data given in Table 6 show that the majority of independent supervisory board members have a degree in economics or law, which reflects professional qualifications of independent members as this knowledge is especially useful in sitting on supervisory boards. The majority of independent supervisory board members with technological education (3 out of 5) attended additional training courses and post-graduate studies aimed to improve their knowledge of organization, management, finance, and marketing. The column "Other" includes persons with artistic education (two masters of art), as well as sociological, biological, or physics graduates. Fortis bank did not provide any information about two board members, while Pekao SA did not show such information about one board member (he is only known to have cooperated with FIAT throughout his career).

[5] As Kredyt Bank does not reveal which supervisory board members are deemed to be independent (their annual reports provide information only about the number of independent members), this bank is not considered. Therefore, table presents 10 companies.

Apart from appropriate education, independent supervisory board members should have professional experience that would help them perform their duties on the supervisory board more effectively. Table 7 presents professional experience of independent members employed in banks. A number of independent members declared professional experience in more than one field and thus the number of individuals in terms of their professional experience differs from the number of independent members.

Table 7. Professional experience of independent supervisory board members in banks between 2006 and 2010

Bank	Number of independent supervisory board members	Professional Experience					
		1	2	3	4	5	6
BPH	9	5	2	1	3	5	3
BOŚ	5	4	1	1	2	4	2
BRE	7	2	1	3	2	6	1
BZ WBK	6	2	1	1	0	6	2
Fortis	5	2	0	2	0	1	1
Bank Handlowy	7	4	2	3	2	5	1
ING	4	3	1	0	1	3	0
Millennium	7	4	2	4	1	4	1
Pekao SA	6	4	0	3	0	4	1
PKO BP	4	4	0	3	0	1	0
Total	60	34	10	21	11	39	12

1 - University teacher, 2 - Legal counsel, 3 - Financial sector, 4 - Business owner/Partner, 5 - Supervisory/ Management board member in another company, 6 - Financial consultant/ adviser.
Source: Author's own compilation based on annual reports

The above table shows that more than half of independent members sitting on supervisory boards in banks were previously or currently scholars or lecturers at universities. Another 35 per cent had gained experience in the financial sector, which gave them an additional advantage as this specific professional background enabled them to help the supervisory body make difficult decisions. Moreover, as many as 39 out of 60 individuals regarded as independent sat on supervisory or management boards of other companies. Thanks to this, they had the opportunity to compare the activities of these bodies in various corporations and, through their experience, add to the value of the supervisory board of the bank in which they worked.

Conclusion

Due to the separation of ownership and control, the owners of capital possess no direct control over the operation of the company. The management board determines through its decisions the company's policy, which is not always in line with the goals of the shareholders. Therefore, one of the bodies operating in the company is the supervisory board whose primary task is to take care of the interests of the company. Through its attitude, the board can reduce opportunistic behaviour of the members of the management board. Therefore, it is important that the supervisory board include people who have no relationship either with the investors or other entities having significant relations with the bank. Thanks to their independence, these persons are able to take impartial decisions focused only on the best interests of the company.

The banks listed on the Warsaw Stock Exchange must comply with the provisions of the Code of Best Practice concerning the independence of board members or explain why they fail to do so. This paper includes an analysis designed to verify whether between 2006 and 2010 all banks listed on the WSE complied with this rule when appointing supervisory board members. It was found that the majority of companies in the financial sector observed this rule. This is good, because this confirms that Polish public companies in the banking sector are aware of the growing importance of complying with the Code of Best Practice with a view of achieving success.

Moreover, the purpose of the study was to determine whether independent members employed on the supervisory boards of banks listed on the Warsaw Stock Exchange had sufficient professional knowledge and expertise to perform their jobs. The results show that the majority of them held a degree in economics or law. This means that they were well prepared professionally to fulfil their duties. Moreover, a considerable number of independent supervisory board members were previous or current members of supervisory or management boards in other companies, academics, or worked in the financial sector. Their professional experience confirms the opinion that independent supervisory board members in banks are well prepared for performing their tasks.

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