

They Who Pay the Piper Call the Tune: Bailouts and Political Connections of Bank Boards

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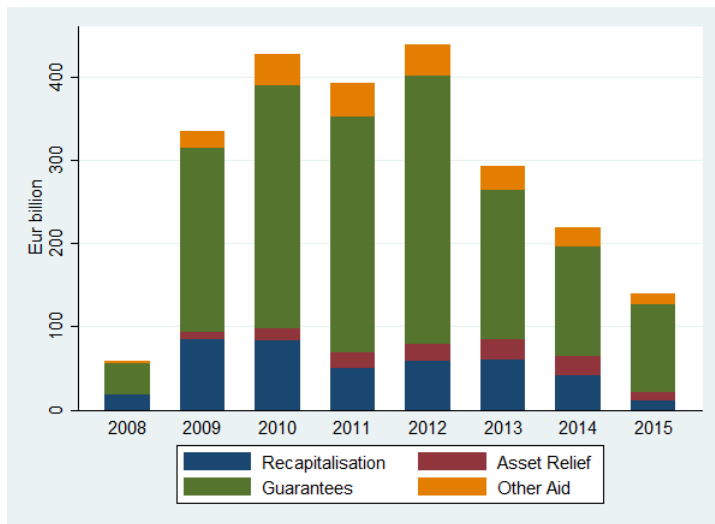
Workshop on Banking and Institutions, 22-23 August 2022, Helsinki

- The financial crisis following the Lehman Brothers collapse led to an unparalleled wave of state aid to the banking sector.
 - Over 2007-2012, EU governments provided €836 bn guarantees, €448 bn recapitalisations, €188 bn asset reliefs, and €70 bn liquidity measures.
 - Two waves of state aid: global financial turmoil (UK, Germany, France, Belgium) European debt crisis (Greece, Spain, Portugal, Cyprus)
- Nexus between banks & politics has arguably become more opaque in the process. (Duchin and Sosyura 2012)

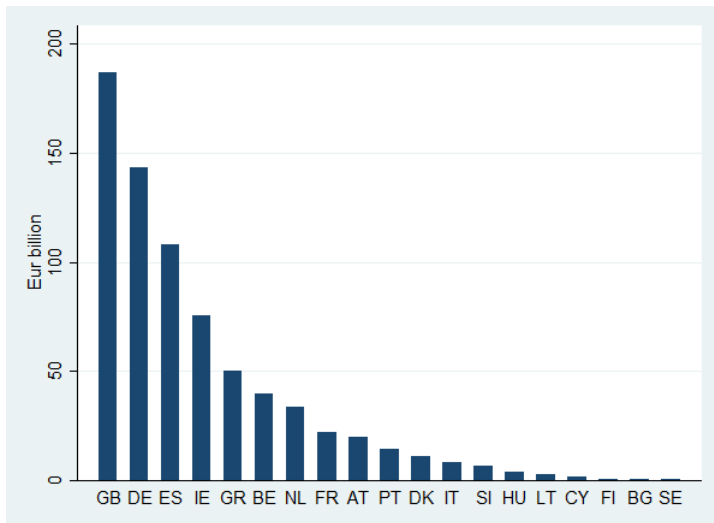
→ Governments are likely to influence bank board compositions in order to secure control rights after a state aid intervention.

→ What will these new politically appointed directors do?

Types of State Aid in €bn, 2008-2015.



State Aid by member state in €bn, 2008-2015.



- Board of directors. Hermalin and Weisbach (1998) Ferreira, Kirchmaier, and Metzger (2010) Ferreira, Ferreira, and Mariano (2018)
→ Political ties of bank boards increase following state aid.
- State aid to the banking sector.
 - Theory Bhattacharya and Kjell (2013) Bruche and Llobet (2014) Philippon and Schnabl (2013)
 - Empirics Acharya et al. (2021) Berger and Roman (2016) Black and Hazelwood (2013) Duchin and Sosyura (2014) Duchin and Sosyura (2012) Koetter and Noth (2016) Li (2013)
→ Political ties of bank boards depend on types of state aid.
- Political links on firm (bank) performance. Dinç (2005) Bircan and Saka (2019) Duchin and Sosyura (2012) Goldman, Rocholl, and So (2009) Khwaja and Mian (2005) Mücke et al. (2021) Sapienza (2004)
→ Within bailed-out banks, newly connected banks perform better compared to their bailed-out peers without such new board members.

State aid from DG Competition online database:

- State aid within the meaning of Article 107(1) TFEU granted to financial institutions.
- Hand-collect information on amount and type of state aid on bank-level for 28 EU countries covering 2007-2015.
- Four aid instruments: recapitalisation measures, asset relief measures, guarantees, other aid (liquidity support).
- Important: information about *implemented* state aid.
- Of the 111 too-big-to-fail banks in the sample, 45 banks received state aid and 66 banks did not. [▶▶ Sum Stats Bailout](#)

Political connections from CapitalIQ Professionals Database:

- Extract the full employment history of all board members of the banks in the sample.
- **Politically Connected Board Member**: if they hold current or former positions in ministry, party, state/local government.
- Collect the period of active board membership.
→ Gives the number of active politically connected board members of bank i in a certain year t .
- Of the 111 too-big-to-fail banks, 56 are politically connected and 55 are not. [▶ Sum Stats Pol Con](#)

Empirical Strategy I

- Staggered DiD setup.
- **Political links:**

$$Y_{it} = \beta_1 \text{Bailout}_i \times \text{Post}_t + \beta_2 \text{Bailout}_i + \beta_3 \text{Post}_t + \beta X_{i,t-1} + \phi_i + \phi_{ct} + \varepsilon_{it} \quad (1)$$

Y_{it} log of number of (politically connected) board members

Bailout_i equal to one if bank i received a bailout, zero otherwise.

Post_t equal to one in year t state aid was given, zero before.

- Concerns:
 - No random assignment of treatment: lagged bank-level controls for size, health and leverage.
 - Reverse causality: lagged explanatory variable.
 - Confirm parallel trend assumptions [▶▶ Par Trends](#)
 - Goodman-Bacon decomposition [▶▶ Goodman Bacon](#)
- **SubHP:** Board composition depends on type of state aid.

- **Bank performance:**

$$Y_{it} = \delta_1 NPC_i \times Post_t + \delta_2 NPC_i + \delta_3 Post_t + \delta \mathbf{X}_{i,t-1} + \phi_i + \phi_t + \varepsilon_{it} \quad (2)$$

Y_{it} is a bank outcome

NPC_i is an indicator variable equal to one if bank i saw an increase in new political connected board members after the government aid, and zero if not.

Effect of State Aid on Banks' Board Composition

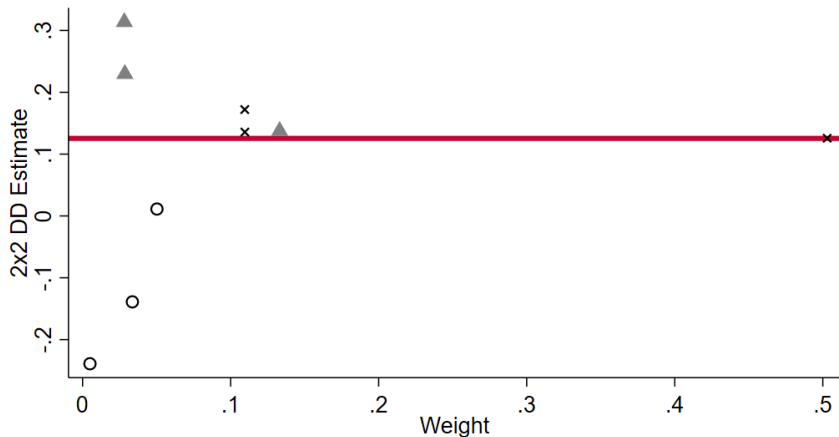
VARIABLES	(1) log(PC)	(2) log(PC)	(3) log(PC)	(4) log(no PC)	(5) log(no PC)	(6) log(no PC)
Bailout $(0/1)_i \times \text{Post}_t$	0.209** (0.080)	0.211** (0.085)	0.216** (0.085)	0.314** (0.129)	0.085 (0.197)	0.079 (0.201)
ln(Total Assets)			0.025 (0.043)			-0.013 (0.061)
Leverage Ratio			-0.008 (0.023)			0.003 (0.020)
Tier One Ratio			-0.002 (0.011)			-0.009 (0.018)
Observations	379	379	379	379	379	379
R-squared	0.774	0.830	0.830	0.747	0.829	0.829
Bank FE	Yes	Yes	Yes	Yes	Yes	Yes
Country \times Year FE	No	Yes	Yes	No	Yes	Yes
Cluster	Bank	Bank	Bank	Bank	Bank	Bank

Effect of Type of State Aid on Board Composition

VARIABLES	(1) log(PC)	(2) log(no PC)	(3) log(PC)	(4) log(no PC)	(5) log(PC)	(6) log(no PC)	(7) log(PC)	(8) log(no PC)
Recap _t	0.187** (0.072)	0.177 (0.149)						
Asset Relief _t			0.112 (0.080)	-0.024 (0.534)				
Guarantees _t					0.215 (0.205)	0.121 (0.346)		
Liquidity _t							0.097 (0.108)	-0.233 (0.331)
Observations	486	486	63	63	84	84	114	114
R-squared	0.828	0.893	0.901	0.804	0.857	0.852	0.882	0.851
Bank Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Bank FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Bank	Bank	Bank	Bank	Bank	Bank	Bank	Bank

Goodman-Bacon Decomposition

▶ back



○ Timing groups ▲ Always treated vs timing
× Never treated vs timing

Overall DD Estimate = .12543095

- TWFE Estimator *DID*: 0.125*
- Alternative Estimators robust to dynamic effects in binary and staggered applications:
 - De Chaisemartin and d'Haultfoeuille (2020)'s *DID^M*
 - control group: not yet treated
 - Callaway and Sant'Anna (2021)'s *DID^{CS}*
 - control group: never treated (and not yet treated)

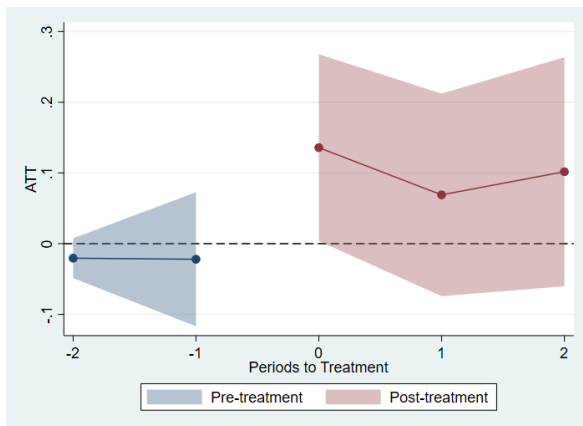
Effect of State Aid on Board Composition I

Table 1: **De Chaisemartin & D'Haultfoeuille estimator**

	Estimate	SE	LB CI	UP CI	N	Switchers
Effect ₀	0.136	.076	-0.014	0.286	372	35
Placebo ₁	-0.022	.047	-0.114	0.070	260	21
Placebo ₂	-0.020	.017	-0.053	0.012	162	5

Effect of State Aid on Board Composition II

Figure 1: Callaway-Sant Anna estimator aggregation by event



- TWFE Estimator w/o covariates, bank and year fixed effects: *DID*: 0.125*
- Alternative Estimators robust to dynamic effects in binary and staggered applications:
 - De Chaisemartin and d'Haultfoeuille (2020)'s *DID^M*: 0.136**
 - Callaway and Sant'Anna (2021)'s *DID^{CS}*: 0.137**

Effect of New Political Board Members on Bank Performance (Book Data)

VARIABLES	(1) Revenue-to- Assets Ratio	(2) Deposits-to- Assets Ratio	(3) Loans-to- Assets Ratio	(4) Debt-to-Assets Ratio	(5) ROA (%)	(6) $\ln(\sigma(ROA_b)^y)$
$NPC_i(0/1) \times$	-0.138	-7.572*	-2.341	11.123**	0.454*	0.124***
$Post_{it}$	(0.332)	(4.295)	(4.270)	(4.699)	(0.268)	(0.036)
$Post_{it}$	0.000	5.091	5.255	-0.729	0.269	-0.030*
	(0.273)	(3.617)	(3.920)	(6.149)	(0.482)	(0.017)
Observations	307	278	274	308	308	136
R-squared	0.893	0.921	0.841	0.859	0.712	0.962
Bank Controls	Yes	Yes	Yes	Yes	Yes	Yes
Bank FE	Yes	Yes	Yes	Yes	Yes	Yes
Country \times Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Bank	Bank	Bank	Bank	Bank	Bank

Effect of New Political Board Members on Bank Performance (Market Data)

VARIABLES	(1) Net Debt Issues	(2) Net Equity Issues	(3) Marketcap	(4) tobins_q
$NPC_i(0/1) \times Post_{it}$	0.368 (1.486)	0.382 (0.344)	0.368* (0.187)	0.103** (0.045)
Observations	94	94	62	94
R-squared	0.627	0.730	0.987	0.864
Bank FE	Yes	Yes	Yes	Yes
Country \times Year FE	Yes	Yes	Yes	Yes
Cluster	Bank	Bank	Bank	Bank

- Following state aid, banks experience an increase in their number of politically connected board members.
 - Governments influence bank board compositions as a way to secure control rights after a bailout ([Aghion and Bolton 1992](#)).
- Bailed-out banks with such new political ties perform better in terms of market capitalisation and valuation than bailed-out banks without such ties.
 - Highlights the role of political board members in providing valuable information during crisis times ([Downs 1957](#))

Summary Statistics I

Table 2: **Summary Statistics (Bank level, split by bailout).** Data as of 2010.

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	No Bailout			Bailout		
	mean	sd	count	mean	sd	count
Bailout (0/1)	0.00	0.00	66	1.00	0.00	45
Recapitalisation (0/1)	0.00	0.00	66	0.96	0.21	45
Asset Relief (0/1)	0.00	0.00	66	0.33	0.48	45
Guarantees (0/1)	0.00	0.00	66	0.44	0.50	45
Other Aid (0/1)	0.00	0.00	66	0.60	0.50	45
PolCon (0/1)	0.44	0.50	66	0.60	0.50	45
Nr. of political board members	0.32	0.66	66	0.58	0.87	45
New political board members (0/1)	0.44	0.83	66	0.91	1.02	45
Nr. of other board members	4.89	3.21	66	4.36	2.84	45
Total Assets (in mn EUR)	101.32	155.49	66	234.22	368.68	45
Loans-to-Assets Ratio	64.87	15.36	66	60.56	14.84	45
Revenue-to-Assets Ratio	1.88	1.07	66	1.16	1.44	45
Tier1ratio	11.69	3.80	66	10.06	2.92	45
Debt-to-Assets Ratio	40.64	22.96	66	44.87	21.89	45
Cash-to-Assets Ratio	2.92	4.75	66	3.04	2.96	45
Deposits-to-Assets Ratio	45.33	23.70	66	42.92	20.92	45
Loan-Losses-to-Assets Ratio	-1.85	2.01	66	-2.90	2.31	45
ROA (%)	0.32	0.56	66	-0.27	0.93	45
ROE (%)	5.57	6.16	66	-6.23	19.33	45

Summary Statistics II

Table 3: **Summary Statistics (Bank level, split by political connection).**
Data as of 2010. [» back](#)

	No Pol Con			Pol Con		
	mean	sd	count	mean	sd	count
PolCon (0/1)	0.00	0.00	55	1.00	0.00	56
Nr. of political board members	0.00	0.00	55	0.84	0.89	56
New political board members (0/1)	0.00	0.00	55	1.25	0.98	56
Nr. of other board members	4.05	3.01	55	5.29	3.02	56
Bailout (0/1)	0.33	0.47	55	0.48	0.50	56
Recapitalisation (0/1)	0.31	0.47	55	0.46	0.50	56
Asset Relief (0/1)	0.11	0.31	55	0.16	0.37	56
Guarantees (0/1)	0.13	0.34	55	0.23	0.43	56
Other Aid (0/1)	0.18	0.39	55	0.30	0.46	56
Total Assets (in mn EUR)	117.22	253.36	55	192.49	282.89	56
Loans-to-Assets Ratio	62.19	16.47	55	64.05	14.00	56
Revenue-to-Assets Ratio	1.57	1.09	55	1.60	1.45	56
Tier1ratio	11.21	3.63	55	10.85	3.49	56
Debt-to-Assets Ratio	41.71	22.06	55	42.99	23.15	56
Cash-to-Assets Ratio	2.84	4.47	55	3.09	3.74	56
Deposits-to-Assets Ratio	45.88	21.97	55	42.86	23.19	56
Loan-Losses-to-Assets Ratio	-2.20	2.11	55	-2.36	2.28	56
ROA (%)	0.11	0.66	55	0.05	0.90	56
ROE (%)	1.58	13.73	55	0.01	15.01	56