Essays on malpractice in finance

Sakalauskaite, I.

Citation for published version (APA):

General rights
It is not permitted to download or to forward/distribute the text or part of it without the consent of the author(s) and/or copyright holder(s), other than for strictly personal, individual use, unless the work is under an open content license (like Creative Commons).

Disclaimer/Complaints regulations
If you believe that digital publication of certain material infringes any of your rights or (privacy) interests, please let the Library know, stating your reasons. In case of a legitimate complaint, the Library will make the material inaccessible and/or remove it from the website. Please Ask the Library: https://uba.uva.nl/en/contact, or a letter to: Library of the University of Amsterdam, Secretariat, Singel 425, 1012 WP Amsterdam, The Netherlands. You will be contacted as soon as possible.

UvA-DARE is a service provided by the library of the University of Amsterdam (http://dare.uva.nl)
Bibliography


Basel Committee on Banking Supervision. 2015. Corporate Governance Principles for Banks Guidelines, BIS.


Erickson, Merle, Michelle Hanlon and Edward L. Maydew. 2006. Is There a Link between Executive Equity Incentives and Accounting Fraud?. *Journal of Accounting Research* 44, 113-143.


Financial Conduct Authority. 2016. The FCA review into failings in the way some banks sold interest rate hedging products, 4 November.


Financial Stability Board. 2017. Stocktake of efforts to strengthen governance frameworks to mitigate misconduct risks.

Financial Stability Board. 2018. Recommendations for consistent national reporting of data on the use of compensation tools to address misconduct risk.


Luyendijk, Joris. 2016. Big banks still have a problem with ethics and morality. The Guardian, 18th January.


Summary

This dissertation consists of three chapters in which I study malpractice within banks as well as in the environments in which they operate. It illustrates how the multiple ways in which malpractice manifests itself are important to the health of financial firms.

In the first two chapters, I focus on the role of agency conflicts in driving bank conduct failures, as well as the importance of leverage and risk-taking when considering the behaviour of financial firms. The first chapter, entitled “A Survey on Bank Malpractice,” overviews the current state of knowledge on bank malpractice and its causes. It shows that from a theoretical perspective, misconduct can arise as a result of shareholder profit maximisation as well as managers acting in self-interest. Empirical studies overviewed provide evidence which could be seen as supporting both of these explanations. The paper also outlines potential future research directions, as studies on how malpractice is affected by bank capital structure and fragility are lacking.

The second chapter “Bank Risk-taking and Misconduct” builds a theoretical model which shows how misconduct arises as a side-effect of compensation schemes designed to induce managerial risk-taking. There, the implementation of profitable but risky projects requires more aggressive pay structures, in turn increasing manager incentives to engage in other activities that boost short-term returns. The paper introduces a novel dataset on malpractice that resulted in conduct costs in a sample of 30 financial institutions during 2000-2016, and shows that misconduct initiation is indeed related to bank remuneration schemes, increasing with CEO bonuses in periods of high economic growth and when bank leverage is high.

In the final chapter, entitled “Corruption and Failing Bank Resolution,” I examine how political corruption affects bank resolution in a cash in the market pricing framework. Using a theoretical model, I show that corruption can make bank failures costlier by reducing the health of potential acquirers. There, lower profitability of banks operating in a corrupt area depresses the price that the deposit insurer can realise through purchase and assumption transactions, increasing the risk of liquidations. Such effects can prevail even after accounting for the direct effects through which corruption reduces bank charter value. Data on bank failures in the United States during 1976-2013 confirms that financial institutions operating in corrupt areas are less likely to purchase their failing counterparts. Such banks are more likely to be liquidated, and their resolution results in higher costs to the deposit insurance corporation.
Samenvatting

Dit proefschrift bestaat uit drie hoofdstukken waarin de wanpraktijken van banken worden bestudeerd. Dit proefschrift concludeert dat factoren die doorgaans niet in acht worden genomen belangrijk zijn voor de financiële prestaties en gezondheid van banken.

In de hoofdstukken 1 en 2 ligt de focus op de rol van principaal-agent problemen in het verklaren van bank misdragingen en het verklaren van de essentiële rol die het hefboomeffect en risico nemen spelen in bankgedragingen. Hoofdstuk 1 “A Survey on Bank Malpractice” laat zien dat van een theoretisch oogpunt misdragingen niet alleen voortkomen uit winstmaximalisatie voor aandeelhouders, maar ook als het gevolg van managers die in hun eigenbelang handelen. Empirische studies leveren bewijs dat deze beide gevallen ondersteunen.

In het tweede hoofdstuk, “Bank Risk-taking and Misconduct”, laat ik met behulp van een theoretisch model zien dat bank misdragingen voortkomen als neveneffect van compensatieregelingen die ontworpen zijn om het nemen van risico te stimuleren. Een nieuwe data set bestaande uit data van 30 financiële instituties ondersteund de bevinding dat bank misdragingen gerelateerd zijn aan de vergoedingen voor managers. In periodes van economische groei en als het financiële instituut gebruikt maakt van een groot hefboomeffect zijn er meer misdragingen als CEO-bonussen hoger zijn.

In het laatste hoofdstuk “Political Corruption and Bank Resolution,” bestudeer ik hoe politieke corruptie bank resolutie beïnvloed in een “cash in the market pricing” framework. Ik laat met behulp van een theoretisch model zien dat corruptie bankfalen duurder maakt door de financiële gezondheid van mogelijke kopers te verminderen. De data wat betreft falende banken in de United States in de periode 1976-2013 bevestigd dat er een kleinere kans is dat financiële instituties die in een corrupte omgeven opereren falende medebanken op kopen. Zulke banken worden dus vaker geliquideerd, en hun resolutie heeft hogere kosten voor het depositoverzekeringsstelsel.
The Tinbergen Institute is the Institute for Economic Research, which was founded in 1987 by the Faculties of Economics and Econometrics of the Erasmus University Rotterdam, University of Amsterdam and VU University Amsterdam. The Institute is named after the late Professor Jan Tinbergen, Dutch Nobel Prize laureate in economics in 1969. The Tinbergen Institute is located in Amsterdam and Rotterdam. The following books recently appeared in the Tinbergen Institute Research Series:

678. T. BOOT, *Macroeconomic Forecasting under Regime Switching, Structural Breaks and High-dimensional Data*


681. Y. GAO, *Stability and Adaptivity: Preferences over Time and under Risk*

682. M.J. ZAMOJSKI, Panta Rhei, *Measurement and Discovery of Change in Financial Markets*

683. P.R. DENDERSKI, *Essays on Information and Heterogeneity in Macroeconomics*

684. U. TURMUNKH, *Ambiguity in Social Dilemmas*


686. M. LAMMERS, *Financial Incentives and Job Choice*

687. Z. ZHANG, *Topics in Forecasting Macroeconomic Time Series*

688. X. XIAO, *Options and Higher Order Risk Premiums*

689. D.C. SMERDON, “Everybody’s doing it”: Essays on Trust, Norms and Integration


691. E. SILDE, *The Econometrics of Financial Comovement*

692. G. DE OLIVEIRA, *Coercion and Integration*

693. S. CHAN, *Wake Me up before you CoCo: Implications of Contingent Convertible Capital for Financial Regulation*
694. P. GAL, Essays on the role of frictions for firms, sectors and the macroeconomy

695. Z. FAN, Essays on International Portfolio Choice and Asset Pricing under Financial Contagion

696. H. ZHANG, Dealing with Health and Health Care System Challenges in China: Assessing Health Determinants and Health Care Reforms

697. M. VAN LENT, Essays on Intrinsic Motivation of Students and Workers

698. R.W. POLDERMANS, Accuracy of Method of Moments Based Inference

699. J.E. LUSTENHOUWER, Monetary and Fiscal Policy under Bounded Rationality and Heterogeneous Expectations

700. W. HUANG, Trading and Clearing in Modern Times

701. N. DE GROOT, Evaluating Labor Market Policy in the Netherlands

702. R.E.F. VAN MAURIK, The Economics of Pension Reforms

703. I. AYDOGAN, Decisions from Experience and from Description: Beliefs and Probability Weighting

704. T.B. CHILD, Political Economy of Development, Conflict, and Business Networks

705. O. HERLEM, Three Stories on Influence

706. J.D. ZHENG, Social Identity and Social Preferences: An Empirical Exploration

707. B.A. LOERAKKER, On the Role of Bonding, Emotional Leadership, and Partner Choice in Games of Cooperation and Conflict

708. L. ZIEGLER, Social Networks, Marital Sorting and Job Matching. Three Essays in Labor Economics

709. M.O. HOYER, Social Preferences and Emotions in Repeated Interactions

710. N. GHEBRIHIWET, Multinational Firms, Technology Transfer, and FDI Policy

711. H. FANG, Multivariate Density Forecast Evaluation and Nonparametric Granger Causality Testing

712. Y. KANTOR, Urban Form and the Labor Market

713. R.M. TEULINGS, Untangling Gravity
714. K.J. VAN WILGENBURG, Beliefs, Preferences and Health Insurance Behavior
716. D. NIBBERING, The Gains from Dimensionality
717. V. HOORNWEG, A Tradeoff in Econometrics
718. S. KUČINSKAS, Essays in Financial Economics
719. O. FURTUNA, Fiscal Austerity and Risk Sharing in Advanced Economies
720. E. JAKUČIONYTĖ, The Macroeconomic Consequences of Carry Trade Gone Wrong and Borrower Protection
721. M. LI, Essays on Time Series Models with Unobserved Components and Their Applications
723. N.M. BOSCH, Empirical Studies on Tax Incentives and Labour Market Behaviour
725. S. ALBRECHT, Empirical Studies in Labour and Migration Economics
726. Y.ZHU, On the Effects of CEO Compensation
727. S. XIA, Essays on Markets for CEOs and Financial Analysts
This dissertation consists of three chapters that focus on misconduct in the financial sector. The first two chapters attempt to tackle the question of what factors contribute to misconduct in banks, focusing on the role of agency conflicts and how these change with bank risk. The final part of this dissertation studies how misconduct by public officials - corruption - is related to bank health, resolution methods and costs. The common theme in this dissertation is malpractice, and both theoretical models and empirical methods are employed to investigate how it arises in financial firms or affects their functioning.

Ieva Sakalauskaite holds an MPhil degree in Economics (2013) from the Tinbergen Institute and the University of Amsterdam, an MSc degree in Economics (2010, cum laude) from the University of Amsterdam, and a BA degree in Business and Economics (2009, first-class class honours) from the University of Sheffield. She started her doctoral programme at the University of Amsterdam in 2013 and worked under the supervision of Professors Enrico Perotti and Tanju Yorulmazer. During her PhD, she visited the European Systemic Risk Board and the Bank of Lithuania, and is currently a research economist at the Bank of England.