Corporate Governance of Banks and Financial Stability

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PII: S0304-405X(18)30171-5
DOI: 10.1016/j.jfineco.2018.06.011
Reference: FINEC 2918

To appear in: *Journal of Financial Economics*

Received date: 2 October 2014
Revised date: 25 October 2017
Accepted date: 26 October 2017

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This draft: June 2018

ABSTRACT

We find that shareholder-friendly corporate governance is associated with higher stand-alone and systemic risk in the banking sector. Specifically, shareholder-friendly corporate governance results in higher risk for larger banks and for banks that are located in countries with generous financial safety nets as banks try to shift risk toward taxpayers. We confirm our findings by comparing banks to nonfinancial firms and examining changes in bank risk around an exogenous regulatory change in governance. Our results underline the importance of the financial safety net and too-big-to-fail guarantees in thinking about corporate governance reforms at banks.

Keywords: corporate governance; bank insolvency; systemic risk

JEL classification: G21, M21

* We thank an anonymous referee and participants at the 18th annual International Banking Conference at the Federal Reserve Bank of Chicago, and the EBC Network Conference at the Lancaster School of Management for useful comments and suggestions. This paper's findings, interpretations, and conclusions are entirely those of the authors and do not necessarily represent the views of the World Bank, its executive directors, or the countries they represent.