ETHICAL REPUTATION OF FINANCIAL INSTITUTIONS:
DO BOARD CHARACTERISTICS MATTER?

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Abstract

This paper examines the association between board characteristics and the ethical reputation of financial institutions. Using a sample of large financial institutions from 13 different countries, we run several panel regressions of ethical reputation on board characteristics and firm-specific controls. The ethical reputation of financial institutions is measured with the Covalence EthicalQuote index and the sample period covers the years surrounding the financial crisis. Our results demonstrate that financial institutions with board characteristics that reflect more stringent monitoring have better ethical reputation. In particular, we find that ethical reputation is positively associated with board size, experience, and gender diversity, while being negatively related to board busyness and the number of board meetings. The results also indicate that larger financial institutions with higher levels of equity capital are associated with better reputation. Overall, our empirical findings suggest that stronger board monitoring and oversight may promote ethical behavior in the financial industry.

Introduction

This paper focuses on the association between board characteristics and the ethical reputation of financial institutions. In the aftermath of the global financial crisis, politicians, banking supervisors, and central bankers have alleged and acknowledged that flaws in the corporate governance mechanisms and ethical culture of financial institutions had a central role in the in the development of the crisis (see e.g., Basel Committee on Banking Supervision, 2010; Board of Governors of the Federal Reserve System, 2009, 2010; Haldane, 2012). More generally, the financial crisis demonstrated that poor governance structures and absence of ethics in the financial industry may have severe adverse effects on global financial stability and societal well-being.[1] Given the amplified expectations towards more ethical behavior in the financial industry, it is of importance to empirically examine whether and how the ethical reputation of financial institutions is affected by the board of directors. If ethical reputation is a value-relevant intangible asset for financial institutions, we should observe a positive relationship between ethical reputation and board attributes that reflect more stringent monitoring and oversight.

The board of directors is the most important internal governance mechanisms within a firm. The board is responsible, among other things, for monitoring and controlling the major long-term strategic decisions of the firm and ensuring that the firm acts in the best interests of its shareholders.[2] Board members also have a fiduciary duty towards shareholders as well as other

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[1] As noted e.g. by Mitchell, Lewis, and Reinsch (1992), ethical problems in the financial industry may be related to conflicts of interest, handling of confidential information, quality of financial reporting, lending practices, antitrust compliance, compensation schemes, insider abuse, insider trading, and money laundering.

[2] See e.g. Fields and Keys (2003) for a review of the monitoring role of the board of directors.

stakeholders to monitor that the firm is following the basic ethical customs and rules of society. Hence, it can be argued that the board of directors is directly responsible for monitoring the ethical culture within the firm.[3] A vast body of literature has examined how observable board characteristics such as size, independence, and experience affect corporate decisions and outcomes.[4] The role of the board of directors in financial institution has been previously examined e.g. in Mishra and Nielsen (2000), Macey and O'Hara (2003), Sierra, Talmor and Wallace (2006), de Andres and Vallelado (2008), Jiraporn and Chintrakarn (2009), Laeven and Levine (2009), Pathan (2009), Fortin, Goldberg and Roth (2010), Aebi, Sabato and Schmid (2012), Adams and Mehran (2012), Beltratti and Stulz (2012), and Erkens, Hung and Matos (2012). These studies demonstrate that boards have a pivotal monitoring role in financial institutions, and moreover, that structural differences across boards are reflected, for instance, in the financial performance, market valuation, and the level of risk-taking of financial institutions. To the best of our knowledge, the current study is the first attempt to address the relationship between board characteristics and ethical reputation.

Although the association between board characteristics and ethical reputation has not been previously examined in the literature, our empirical analysis is closely related to three strands of literature. First, studies by Gunthorpe (1997), Fischer and Khoury (2007), Choi and Jung (2008) and Blazovich and Smith (2011) examine the association between ethical behaviour and firm

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[3] In fact, the Bank Holding Company Supervision Manual of the U.S. Federal Reserve System stipulates that the board should establish and monitor "a corporate culture that emphasizes the importance of compliance with the law and ethical business practices" (see Board of Governors of the Federal Reserve System, 2009).

[4] Hermalin and Weisbach (2003) and Adams, Hermalin and Weisbach (2010) provide comprehensive reviews of the literature on corporate boards. As noted by Adams et al. (2010), the underlying assumption in the empirical research on board of directors is that differences in observable board characteristics across boards reflect differences in the functioning and behavior of the boards.

performance. In brief, these studies show that ethical conduct benefits the firm and may matter for shareholder value. Gunthorpe (1997) conducts an event study on the impact of unethical corporate behaviour on stock prices, and documents a strong negative market reaction to public disclosures of unethical behaviour. The results of Fischer and Khoury (2007), Choi and Jung (2008) and Blazovich and Smith (2011) provide evidence to suggest that ethical business practices may have positive effects on firm profitability and market valuation. Given these findings, Blazovich and Smith (2011) argue that ethical corporate behaviour creates an intangible asset which may enhance firm value by reducing conflicts and strengthening trust between the core stakeholders of the firm.

The second related stream of literature investigates how board characteristics and other governance attributes affect the social responsibility of non-financial firms.[5] Webb (2004) examines the board characteristics of firms included in the Domini Social Index, and documents that socially responsible firms tend to have more independent and gender diverse boards and are less likely to have CEO/Chair duality than size and industry matched firms that are not classified as socially responsible firms. Harjoto and Jo (2011) and Jo and Harjato (2012) focus on the relationships between governance structures, corporate social responsibility, and firm performance. Their findings suggest that firms with more independent boards and stronger governance mechanisms are more likely to be engaged in social responsibility activities. Moreover, Jo and Harjoto (2012) document that corporate social responsibility may act as a value-enhancing conflict-resolution mechanism between shareholders and other stakeholders of the firm. Perhaps most related to our study, Bear, Rahman and Post (2010) examine the effects

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[5] Ethical behavior is considered as a central component of corporate social responsibility, and consequently, the two concepts are closely linked and somewhat overlapping (see e.g., Friedman, 1970; Epstein, 1989; Carroll, 1991).

of board diversity on social responsibility and firm reputation. Using a sample of 51 health care companies, they report that gender diversity on the board of directors is positively associated with social responsibility ratings as well as firm reputation.

Finally, our study complements a small body of literature on social responsibility in the financial industry. Simpson and Kohers (2002), Chih, Chih and Chen (2010), and Wu and Shen (2013) investigate the association between social responsibility and bank performance. While Simpson and Kohers (2002) and Wu and Shen (2013) document that socially responsible behavior is positively related to profitability of financial institutions, the results of Chih et al. (2010) suggest that the link between social responsibility and financial performance is insignificant. Scholtens (2009) develops a framework for assessing social responsibility in the banking industry, and documents that the extent of social responsibility activities varies considerably across individual banks. His findings also indicate that larger banks with higher capital ratios have higher social responsibility scores. Closely related to the current study, Jizi, Salama, Dixon and Stratling (2014) examine the association between board characteristics and social responsibility disclosure of large U.S. commercial banks. They find that board size and independence are positively related to the level of social responsibility disclosure in banks' annual reports. In this paper, we aim to extend the above literature by empirically examining whether board characteristics affect the ethical reputation of financial institutions.

The empirical findings reported in this paper demonstrate that board characteristics may matter for the ethical reputation of financial institutions. Our analysis is based on a sample of 43 large publicly traded financial institutions from 13 different countries, and we utilize the Covalence EthicalQuote index to measure the ethical reputation of these institutions. Consistent with our research hypothesis, the results indicate that financial institutions with board features

that reflect more effective monitoring have better ethical reputation. Specifically, we find strong evidence that ethical reputation is positively associated with board size, experience, and gender diversity, while being negatively related to the busyness of the board members. Nevertheless, inconsistent with our hypothesis, we also document that less frequent board meetings as well as the CEO's dual role as a board member may have a positive impact on ethical reputation. Our findings further suggest that ethical reputation is unaffected by board independence and staggered board structure. We conduct a number of additional tests to ensure the robustness of our findings. These tests indicate, for instance, that the adverse influence of the global financial crisis on ethical reputation of financial institutions may have been moderated by boards that exert more stringent oversight. Overall, our results provide considerable evidence to suggest that stronger board monitoring and oversight may have positive effects on ethical reputation in the financial industry.

The remainder of this paper proceeds in the following manner. The second section describes the data and introduces the variables used in the analysis. The third section presents the methods and reports the empirical findings on the association between board characteristics and the ethical reputation of financial institutions. Finally, the last section summarizes the results and provides concluding remarks.

Data and variables

The empirical analysis presented in this paper is based on a sample of 43 large, publicly traded financial institutions from 13 different countries.[6] We limit our sample to financial

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[6]The countries included in the sample are Australia, Bermuda, Brazil, Canada, Germany, France, Italy, Japan, Spain, Switzerland, Taiwan, the United Kingdom, and the United States.

institutions for which the Covalence EthicalQuote reputation index is available (the sample firms are listed in Appendix 1). The sample comprises of commercial banks, investment banks, diversified financial services firms, and other lending institutions, but does not include any insurance companies. The firms included in our sample are among the largest financial institutions in the world and about 60 percent of the sample firms are classified as globally systematically important financial institutions (g-SIFIs) by the Financial Stability Board. Hence, despite the very small number of individual financial institutions, our sample nevertheless covers a substantial proportion of the total amount of banking assets in the world. The sample period spans from 2005 to 2010, and thereby the covers the fiscal years surrounding the global financial crisis.

Ethical reputation

The dependent variable in our analysis is ethical reputation. Following e.g. Amazeen (2011), Erwing (2011), and Maon, Lindgreen and Swaen (2009), we use the EthicalQuote reputation index developed by Covalence to measure the ethical reputation of financial institutions. In brief, this index tracks the ethical reputation of large, international companies based on news related to ethical and responsible conduct. The data on the EthicalQuate index are obtained from Covalence. The EthicalQuote reputation index integrates information about various ethical criteria related to environmental, social and governance aspects that are divided to the following seven groups: (i) governance, commitments and engagement, (ii) economic

performance, (iii) environmental performance, (iv) labor practices and decent work conditions, (v) human rights, (vi) societal responsibility, and (vii) product responsibility.[7]

The ethical reputation of firms is assessed by analysing the quantities of positive and negative news. Positive news are considered as ethical offers, which express "information on what the company does for society", while negative news represent ethical demands, meaning "information on what the company should do for society" (see Covalence EthicalQuote, 2013). The subjectivity and credibility problems are addressed by integrating multiple opinion and information sources like search engines, individual websites, and different correspondents. Each news item is assessed and graded from the cumulative addition of positive and negative points produced by ethical offers and demands. A text can receive as many points as number of criteria are involved (i.e. a news item coded with two ethical offers related to governance and economic performance and one ethical demand concerning customer privacy would be graded as $2 - 1 = +1$ point).

An absolute ethical score (S) is calculated for each company by subtracting texts that received negative scores (B) from positive scored texts (A), i.e. $S = A - B$. To control for the potential size and media exposure bias, a rate-adjusted score (Ras) is created as $Ras = S \times |R|$. The absolute ethical score (S) is changed to a relative measure (R) by dividing each score over the overall volume of news affecting the company. This rate-adjusted score enables comparisons between companies with different size.

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[7] See http://www.ethicalquote.com/docs/CovalenceEthicalQuoteCriteria.pdf for a more detailed discussion about the Covalence EthicalQuote criteria.

Finally, to control for potential time effects, a two percent erosion factor (*E*) per month is applied in order to reduce the relevance of the older news items. Hence, the ethical reputation score *ERS* of firm *j* at time *t* is measured as follows:

$$ERS_{j,t} = S \times |R| + ERS_{j,t-1} \times (1 - E) \tag{1}$$

In our empirical analysis, we use two alternative measures of ethical reputation: (i) *Ethical score* and (ii) *Ethcial rank*. *Ethical score* is the Covalence EthicalQuote index given by Equation (1), while *Ethical rank* is the EthicalQuote index rank order of the financial institutions included in the sample. Specifically, *Ethical rank* is constructed by assigning the financial institution with the best ethical reputation to value 1 and the institution with the worst ethical reputation to value 43.

Board characteristics

The variables of interest in our empirical analysis are the following board characteristics: (i) *Board size*, (ii) *Small board*, (iii) *Board independence*, (iv) *Board meetings*, (v) *Board experience*, (vi) *Board gender diversity*, (vii) *Two or more females*, (viii) *Board affiliations*, (ix) *Busy board*, (x) *Staggered board*, and (xii) *CEO duality*. These variables have been extensively used in the prior literature to measure the functioning and monitoring effectiveness of the board of directors. The data on board characteristics are obtained from Thomson Reuters Worldscope and Execucomp.

We measure *Board size* as the logarithm of the number of board members and *Small board* is a dummy variable which equals one for firms with below median board size. Previous

studies indicate that larger boards may be more effective monitors of complex financial institutions. Hence, we predict a positive (negative) relationship between *Board size* (*Small board*) and ethical reputation. *Board independence* is measured as the percentage of independent board members. Independent directors are assumed to be more effective monitors of the firm, and therefore we expect a positive relation between *Board independence* and ethical reputation. *Board meetings* is measured as the logarithm of the number of board meetings during a fiscal year. A larger number of board meetings are assumed to reflect more stringent monitoring by the board. Therefore, a positive relationship between *Board meetings* and ethical reputation is predicted. We measure *Board experience* as the average number of years each board member has been on the board. Given that more experienced boards may have better firm-specific knowledge and expertise, we expect to find a positive association between *Board experience* and ethical reputation.

We use two variables to measure gender diversity of the boards. *Board gender diversity* is the percentage of female board members, while *Two or more females* is a dummy variable which equals one for firms with at least two female board members. Previous studies suggest that female representation on the boards of directors may have positive effects on board effectiveness and oversight. Moreover, it has been argued in the prior literature that women have higher ethical and moral standards. Hence, we predict that female board representation is positively associated with ethical reputation. *Board affiliations* is defined as the average number of other board memberships of the board members and *Busy board* is a dummy variable which equals one for firms in which board members on average have at least three other board memberships. Busy directors may not devote sufficient effort to effectively monitor the firm, and therefore, we expect that *Board affiliations* and *Busy board* are negatively related to ethical

reputation. *Staggered board* is a dummy variable which equals one for firms with staggered board structure. Staggered boards are documented to have negative consequences on monitoring, and consequently we predict a negative relation between *Staggered board* and ethical reputation. Finally, *CEO duality* is a dummy variable which equals one for firms in which the CEO is the board chair or a member of the board. Considerable empirical evidence suggests that CEO duality may hinder the monitoring function of the board. Therefore, a negative relationship between *CEO duality* and ethical reputation is predicted.

In addition to the individual board characteristics, we also build a composite variable to reflect poor monitoring by the board of directors. Specifically, we define *Poor monitoring* as a dummy variable which equals one if the board of directors fulfils at least three of the following six criteria: (i) the number of board members is below the sample median, (ii) the percentage of independent board members less than 50 %, (iii) the number of board meetings is below the sample median, (iv) there are no female board members, (v) the average number of other board affiliations is greater than two, and (vi) the CEO is the board chair or a member of the board.

Control variables

We include several firm-specific control variables in our multivariate analysis. Following e.g. Aebi et al. (2012) and de Villiers and Staden (2011), we control for firm size, capital structure, financial performance, growth, riskiness, and asset structure. Given that firm size is likely to affect the media exposure of companies, the largest companies could be over or under scored by the EthicalQuote reputation index (Covalence EthicalQuote, 2013). Although the EthicalQuote index is adjusted for firm size, it is important to control for size effects because

different-sized financial institutions may have very different business strategies, product compositions, and governance structures. Previous studies have documented, for instance, that larger financial institutions hold lower levels of equity capital and are engaged in more risky operations. Moreover, size may also surrogate for numerous omitted variables in the empirical analysis. Following the prior literature, we measure *Size* by the natural logarithm of the total assets. The second important variable that needs to be controlled for when comparing financial institutions is the amount of equity capital. We measure *Capital ratio* as the ratio of equity capital to total assets.

Furthermore, we control for the financial performance and growth of the financial institutions. Profitability and growth can be seen as signals of management quality and are both measures have been linked with better firm reputation (Bear et al., 2010). We measure financial performance with *Return on equity* which is calculated as the ratio of net income to equity capital, while *Growth* is measured as the percentage change in total assets from year $t-1$ to year t. Because that the level of risk-taking may affect firm reputation (Feldman et al., 1996), especially amidst periods of financial turmoil, we control for the volatility of stock returns. *Volatility* is measured by the logarithm of the annualized standard deviation of daily stock returns during the fiscal year. We control for asset structure with *Loans to assets*, which is defined as the ratio of net loans to total assets. Finally, given that our sample comprises of commercial banks as well as other types of financial services institutions and includes institutions from 13 different countries, we include dummy variables *Financial services* and *Non-US institution* in our analysis. *Financial services* is defined as a binary variables which equals one for other types of financial institutions than commercial banks and *Non-US institution* is assigned to one for institutions that are not headquartered in the U.S. The balance

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sheet and income statement data are collected from Bankscope, while the stock price data for calculating volatility are obtained from Thomson Reuters Datastream.

Empirical analysis

Descriptive statistics

Table 1 reports the descriptive statistics for the variables used in the empirical analysis. In general, it can be noted from Table 1 that our sample is relatively heterogeneous in terms of board characteristics and firm-specific control variables with considerable variation from the minimum to maximum values. However, given that the standard deviations are relatively low, the mean and the median values are representative of typical institutions in our sample.

Table 1 shows that the boards of financial institutions, on average, are relatively large and consist typically of 14 directors. Furthermore, it can be noted that the boards consist mostly of independent directors and hold 12 board meetings during a year. Interestingly, there is considerable variation in the number of board meetings from the minimum of four to the maximum of 47 meetings.[8] The average tenure of board members in our sample is about seven years and, on average, the directors are simultaneously holding less than two other board seats. The descriptive statistics also suggest that females are severely underrepresented in the boards of large financial institutions, as only about 13 percent of board members are women. Nevertheless, in almost 60 percent of our sample firms there are at least two female directors on the board. Table 1 further shows that the CEO is also the board chair or a member of the board

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[8] A closer look at our data indicates that for some institutions the number of board meetings increased considerably during the financial crisis.

in most of the sample institutions and that only 12 percent of the boards fulfill the criteria for poor monitoring.

(insert Table 1 about here)

Regarding the control variables, the descriptive statistics in Table 1 indicate that financial institutions included in our sample are very heterogeneous in terms of size, capital ratios, profitability, growth, and asset structure. The financial institutions included in our sample are very large in terms of total assets and approximately 60 percent of them are classified as a globally systematically important financial institution. The considerable variations in *Capital ratio* and *Loans to assets* reflect the inclusion of commercial banks as well as other types of financial institutions in the sample, while the negative minimum values for *Return on equity* and *Growth* are largely driven by the global financial crisis. Finally, it can be noted from Table 1 that a vast majority of the sample firms are commercial banks and that U.S. institutions comprise almost 50 percent of our sample.

Correlations

Pairwise correlations (not reported) indicate that our dependent variables *Ethical score* and *Ethical rank* are statistically significantly correlated with *Board size, Small board, Gender diversity* and *Two or more females*.[9] In particular, we find positive correlation coefficients

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[9] We do not tabulate the correlation coefficients for brevity. The correlation matrix is available from the authors upon request.

between the ethics measures and *Board Size* and *Gender diversity*, which may indicate that financial institutions with larger and more gender diverse boards have a better ethical reputation. Furthermore, the ethical reputation is strongly positively correlated with *Size* and *SIFI*, and negatively correlated with *Financial services*. Not surprisingly, our two ethical reputation measures are strongly negatively correlated with each other (-0.71).

Regarding the board characteristics, it is observed that *Board size* is significantly negatively correlated with *Small board*, *Board independence*, and *CEO duality* and negatively correlated with *Busy board* and *Staggered board*. The two gender diversity variables are positively correlated with *Board size, Board independence* and *Board affiliations*, indicating that female directors are more common in larger, more independent and more busy boards. Finally, it should be noted that several of our control variables are strongly correlated with each other. Most notably, *Size* is strongly positively correlated with *SIFI*, *Capital ratio, Financial services* and *Non-US institution*.[10]

Univariate analysis

We first conduct univariate tests to examine the relationship between board characteristics and ethical reputation of financial institutions. For this purpose, we divide our sample into two subsamples based on ethical reputation; the "most ethical" subsample consists of financial institutions with above median *Ethical rank*, while the "least ethical" subsample consists of institutions with below median *Ethical rank*.[11] We then perform two-tailed *t*-tests and Wilcoxon

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[10] We conduct robustness checks to ensure that our empirical findings are not affected by multicollinearity.

[11] We conduct the univariate tests also by comparing differences between the first and last quartiles and tertiles. The results of these additional tests are similar in terms of both signs and statistical significance.

rank-sum tests under the null hypothesis that there are no differences in the means and medians between the most and the least ethical financial institutions.

(insert Table 2 about here)

Table 2 reports the mean and median values for the board characteristic of both subsamples and the results of the univariate tests. As can be noted from the table, there are statistically highly significant differences in the means and medians between the most and the least ethical financial institutions in terms of *Board size*, *Small board*, *Gender diversity* and *Two or more females*. Specifically, the univariate tests indicate that financial institutions with better ethical reputation have larger and more gender diverse boards. This observation is consistent with the pairwise correlations discussed above, and thereby provides evidence to suggest that board size and gender diversity are strongly associated with ethical reputation. Furthermore, the *t*-test for differences in *Poor monitoring* indicates that the most ethical institutions are less likely to be poorly monitored. In contrast to expectations, the difference in the median number of board meetings between the two subgroups in negative and significant at the 10 percent level, suggesting that the least ethical institutions are associated with more board meetings.[12]

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[12] Further analysis suggests that financial institutions that were experiencing severe problems during the global financial crisis increased the frequency of board meetings.

Regression results

We next examine the association between board characteristics and ethical reputation in a multivariate setting. For this purpose, we estimate several alternative versions of the following panel regression specification:

$$Reputation_{j,t} = \alpha + \beta_{1-8}(Board\ characteristics)_{j,t} + \beta_{9-16}(Firm\text{-}specific\ controls)_{j,t}$$
$$+ \beta_{17-21}(Year\ dummies)_{j,t} + \varepsilon_{j,t} \tag{2}$$

where the dependent variables is one of the two alternative ethical reputation measures for bank *j* at time *t*, i.e. *Ethical score* or *Ethical rank*. In each of the alternative regressions, we include eight different board characteristics. The board characteristics included in the baseline specification are *Board size*, *Board independence*, *Board Meetings*, *Board experience*, *Board gender diversity*, *Board affiliations*, *Staggered board*, and *CEO duality*. We also estimate models in which the continuous measures of board size, gender diversity, and busyness are replaced with *Small board*, *Two or more females*, and *Busy board* dummy variables. As discussed above, the set of firm-specific control variables includes proxies for firm size, capital structure, financial performance, growth, riskiness, and asset structure. The regressions also include dummy variables to control for differences between commercial banks and other types of financial institutions as well as between U.S. and non-U.S. institutions. Finally, we control for potential time fixed-effects with fiscal year dummy variables and we also estimate two-way fixed effects regressions that allow for a firm-specific constant. Throughout the regressions, we use robust standard errors which are adjusted for heteroskedasticity and within-firm clustering.

Table 3 reports the estimates of the panel regressions with *Ethical score* as the dependent variable. Models 1 and 2 are parsimonious models which include *Size* and *Capital ratio* as the only control variables, while Models 3 and 4 include the full set of control variables. Finally, Model 5 includes both year fixed-effects as well as firm fixed-effects. As can be noted from Table 3, the adjusted R^2s of Models 1-4 are around 40 percent, whereas the inclusion of firm fixed-effects in Model 5 increases the adjusted R^2 to almost 80 percent. The *F*-statistics are statistically significant at the 1% level for all five regression specifications.

(insert Table 3 about here)

As can be seen from Table 3, the coefficient estimates for *Board size* are positive and statistically highly significant in all models, while the coefficients for *Board gender diversity* and *Two or more females* are positive and statistically significant in Models 1-4. Hence, consistent with our research hypothesis and the univariate tests reported in Table 2, the regressions indicate that financial institutions with larger and more gender diverse boards are associated with better ethical reputation. Table 3 further shows that *Board affiliations* is statistically significantly negatively associated with ethical reputation. These findings indicate that board characteristics that reflect stronger board monitoring and oversight may have positive effects of the ethical reputation of financial institutions. However, inconsistent with our hypothesis, the coefficient estimates for *Board meetings* are negative, while the coefficients for *CEO duality* are positive. With respect to the CEOs' presence on the board, our results are broadly consistent with the findings of Bear et al. (2010). The negative relation between ethical reputation and the number of board meetings may be at least partially related to the drastic

increase in the number of board meetings during the global financial crisis. Regarding the control variables, the estimates in Table 3 indicate that ethical reputation is strongly positively associated with *Size* and *Capital ratio*, suggesting that larger financial institutions with higher levels of equity capital have better ethical reputation.

(insert Table 4 about here)

The regression results with *Ethical rank* as the dependent variable are reported in Table 4. The adjusted R^2s of Models 1-4 are now around 50 percent and the inclusion of firm-fixed effects increases the adjusted R^2 to 78 percent in Model 5. Similar to Table 3, the *F*-statistics are all statistically significant at the 1 percent level. Overall, the estimates of the regressions with *Ethical rank* as the dependent variable are very similar to the results presented in Table 3. Specifically, the estimated coefficients for *Board size*, *Board gender diversity*, *Two or more females*, and *Board affiliations* suggest that financial institutions with larger, more gender diverse, and less busy boards are associated with better ethical reputation. Moreover, consistent with Table 3, the coefficient estimates for *Board meetings* and *CEO duality* suggest that ethical reputation is negatively related to the number of board meetings and positively related to CEOs' board membership. The main difference between Tables 3 and 4 is the statistical significance of the coefficient estimates of *Board experience*. As can be noted from Table 4, the coefficient estimate for *Board experience* is negative and significant throughout the regressions, suggesting that institutions with more experienced board are associated with better ethical reputation. Overall, the estimates reported in Table 4 provide further evidence to suggest that board

characteristics that are considered to reflect stronger board monitoring and oversight may have positive effects of the ethical reputation of financial institutions.

As the next step of the analysis, we utilize the composite variable *Poor monitoring* to examine the association between board monitoring and ethical reputation. Specifically, we estimate alternative versions of Equation (2) with *Poor monitoring* as the only test variable of interest. As described above, *Poor monitoring* is a dummy variable which equals one if the firm's board of directors fulfils at least three of the six criteria for poor board monitoring. The estimates of the alternative panel regressions are presented in Table 5. In Models 1-3, we use *Ethical score* as the dependent variable, whereas in Models 4-6 the dependent variable is *Ethical rank*. Models 1 and 4 include only two control variables, while Models 2 and 5 include the full set of firm-specific controls. Finally, in Models 3 and 6 include year fixed-effects as well as firm-fixed effects. The adjusted R^2s for the models with *Poor monitoring* as the only board related variable are considerably lower than the R^2s reported in Tables 3 and 4. Nevertheless, the adjusted R^2s indicate relatively good fit and the *F*-statistics are all statistically significant at the 1 percent level.

(insert Table 5 about here)

As can be noted from Table 5, the coefficient estimates for *Poor monitoring* appear negative in the regressions with *Ethical score* as the dependent variable and positive in the regressions with *Ethical rank* as the dependent variable. With the exception of Model 3, the estimated coefficients are statistically highly significant. Hence, consistent with our research hypothesis, the estimation results reported in Table 5 suggest that that poor monitoring by the

board of directors may have negative effects on ethical reputation. With respect to the control variables, it can be noted from Table 5 that *Size* and *Capital ratio* are strongly positively associated with the ethical reputation of financial institutions.

Robustness checks

We conduct several additional tests to ascertain the robustness of our empirical findings.[13] First, we re-estimate alternative versions of Equation (2) by replacing *Size* and by replacing both *Size* and *Capital ratio* with a dummy variable for systematically important financial institutions (*SIFI*). Furthermore, to ensure that our findings are not affected by size effects, we re-estimate the regressions in two subsamples from which the largest 20 percent and the smallest 20 percent of the institutions are excluded. The results of these regressions are consistent with our main analysis and provide further evidence that ethical reputation is positively related to board characteristics that reflect more effective monitoring.

We also address potential reverse causality by re-estimating the regressions by using one-year lagged board characteristics and firm-specific control variables. The estimation results of the specifications with lagged independent variables are consistent with those reported in Tables 3, 4 and 5. Moreover, we also estimate regressions with changes in ethical reputation as the dependent variable. Again, the results are consistent with our main analysis. Most importantly, the change regressions indicate that the adverse effect of the global financial crisis on ethical reputation of financial institutions may have been moderated by boards that exert more stringent oversight. Finally, following de Villiers and Staden (2011), we use squared board characteristics

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[13] We do not report robustness checks due to space limitations. However, they are available upon request.

in the regressions to address potential non-linearities. The main findings remain unchanged when squared board characteristics are included in the regressions.

Limitations

We acknowledge that there are several limitations that should be considered when interpreting our empirical findings. First, the sample used in the analysis is very small and limited to 43 large financial institutions for which the Covalence EthicalQuote index is available. The small number of financial institutions obviously limits the statistical power of our tests. Second, our sample period is limited to the fiscal years surrounding the global financial crisis. Given that the financial crisis had a strong adverse effect on the ethical reputation of financial institutions, it is possible that the relation between board characteristics and ethical reputation is different in different business conditions. Furthermore, it is important to recognize that our empirical analysis relies on the assumption that the Covalence EthicalQuote index is an effective measure of ethical reputation. Finally, as most empirical research on corporate boards, our analysis is subject to endogeneity concerns due to which causal interpretations of the findings should be made with caution.

Conclusions

In this paper, we examine the association between board characteristics and the ethical reputation of financial institutions. The motivation for this analysis comes from the public outcry and policy debate regarding the role of financial industry's unethical business practices and flawed governance mechanism for the outbreak of the global financial crisis. Given the

amplified expectations towards more ethical behavior in the financial industry, it is of interest to empirically examine whether the ethical reputation of financial institutions is affected by the board of directors. The board of directors is the most important internal governance mechanisms within a firm and is responsible, among other things, for establishing and monitoring the ethical culture of the firm. If ethical reputation is a value-relevant intangible asset for financial institutions, we should observe a positive relationship between ethical reputation and board attributes that reflect more stringent monitoring and oversight.

The empirical analysis presented in this paper is based on a sample of large publicly traded financial institutions from 13 different countries. We measure the ethical reputation of financial institutions with the Covalence EthicalQuote index and our sample period covers the years surrounding the global financial crisis. Consistent with our research hypothesis, the results demonstrate that financial institutions with board characteristics that reflect more effective monitoring and oversight have better ethical reputation. Specifically, we document that ethical reputation is positively associated with board size, experience, and gender diversity, while being negatively related to the busyness of the board members. Nevertheless, inconsistent with our hypothesis, we also find that less frequent board meetings as well as the CEO's dual role as a board member may have a positive impact on ethical reputation. Our findings further indicate that larger financial institutions with higher levels of equity capital are associated with better reputation. We conduct a number of additional tests to ensure the robustness of our findings. These tests indicate, for instance, that the adverse influence of the global financial crisis on ethical reputation of financial institutions may have been moderated by boards that exert more effective oversight. Overall, our empirical findings suggest that stronger board monitoring and oversight may promote ethical behavior in the financial industry.

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Table 1. Descriptive statistics.

Variable	Mean	Median	Min	Max	Std. dev.	No. of obs.
Ethical reputation:						
Ethical score	31.95	12.45	-157.74	362.31	58.15	220
Ethical rank	20.47	20.00	1.00	43.00	12.20	220
Board characteristics:						
Board size	13.89	14.00	6.00	22.00	3.25	220
Small board	0.14	0.00	0.00	1.00	0.34	220
Board independence	69.96	77.53	0.00	100.00	23.44	200
Board meetings	11.85	10.50	4.00	47.00	5.59	208
Board experience	7.10	6.67	0.48	16.08	3.13	211
Board gender diversity	13.54	14.29	0.00	40.00	8.51	220
Two or more females	0.59	1.00	0.00	1.00	0.49	220
Board affiliations	1.91	1.75	0.05	8.27	1.01	202
Busy board	0.10	0.00	0.00	1.00	0.29	220
Staggered board	0.02	0.00	0.00	1.00	0.13	220
CEO duality	0.87	1.00	0.00	1.00	0.34	220
Poor monitoring	0.12	0.00	0.00	1.00	0.33	198
Control variables:						
Size	20.04	20.41	14.65	22.06	1.47	220
SIFI	0.57	1.00	0.00	1.00	0.50	220
Capital ratio	9.62	5.76	0.38	90.51	15.51	220
Return on equity	10.37	11.87	-106.94	55.08	14.14	220
Loans to assets	39.44	41.74	0.00	89.77	23.72	220
Growth	11.36	8.39	-36.98	135.59	22.73	220
Volatility	45.13	35.33	9.01	151.83	30.36	220
Financial services	0.35	0.00	0.00	1.00	0.48	220
Non-US institution	0.53	1.00	0.00	1.00	0.50	220

The table reports the descriptive statistics for the sample. Ethical reputation is measured with the following two variables: (i) *Ethical score* is the Ethical Quote Index issued by Covalence and (ii) *Ethical rank* is the Ethical Quote Index rank order of the financial institutions included in the sample. The board characteristics are defined as follows: *Board size* is the number of board members, *Small board* is a dummy variable which equals one for firms with below median board size, *Board independence* is percentage of independent board members, *Board meetings* is the number of board meetings during a fiscal year, *Board experience* is the average number of years each board member has been on the board, *Board gender diversity* is the percentage of female board members, *Two or more females* is a dummy variable which equals one for firms with at least two female board members, *Board affiliations* is the average number of other board memberships of the board members, *Busy board* is a dummy variable which equals one for firms in which board members on average have at least three other board memberships, *Staggered board* is a dummy variable which equals one for firms with staggered board structure, *CEO duality* is a dummy variable which equals one for firms in which the CEO is the board chair or a member of the board, and *Poor monitoring* is a dummy variable which equals one if the firm's board of directors fulfills

at least three of the six criteria for poor monitoring. The control variables are defined as follows: *Size* is measured as the logarithm of total assets, *SIFI* is a dummy variable for systematically important financial institutions as defined by the Financial Stability Board, *Capital ratio* is the ratio of equity to total assets, *Return of equity* is the ratio of net income to equity, *Loans* to assets is the ratio of net loans to totals assets, *Growth* is the percentage change in total assets from year t–1 to year t, *Volatility* is the annualized standard deviation of daily stock returns during the fiscal year, *Financial services* is a dummy variable which equals one for other financial institutions than commercial banks, and *Non-US institution* is a dummy variable for non-US financial institutions. The 43 financial institutions included in the sample are listed in Appendix 1.

Table 2. Univariate tests.

	Most ethical		Least ethical		Diff. in means	Diff. in medians
	Mean	Median	Mean	Median		
Board size	2.684	2.708	2.514	2.485	0.170 ***	0.223 ***
Small board	0.035	0.000	0.248	0.000	-0.213 ***	0.000 ***
Board independence	68.868	80.000	70.917	76.920	-2.049	3.080
Board meetings	2.347	2.303	2.434	2.398	-0.087	-0.095 *
Board experience	7.286	6.715	6.885	6.630	0.401	0.085
Board gender diversity	15.312	15.380	11.598	11.110	3.714 ***	4.270 ***
Two or more females	0.704	1.000	0.467	0.000	0.238 ***	1.000 ***
Board affiliations	1.973	1.865	1.835	1.650	0.138	0.215 *
Busy board	0.104	0.000	0.086	0.000	0.019	0.000
Staggered board	0.026	0.000	0.010	0.000	0.017	0.000
CEO duality	0.870	1.000	0.867	1.000	0.003	0.000
Poor monitoring	0.083	2.000	0.167	2.500	-0.083 *	-0.500

The table reports the results of two-tailed *t*-tests and Wilcoxon rank-sum tests for the null hypothesis that there is no difference in the means and medians between the most and the least ethical financial institutions. The most ethical and the least ethical subsamples consist of financial institutions with below and above median *Ethical rank*, respectively. The board characteristics are defined as follows: *Board size* is the logarithm of the number of board members, *Small board* is a dummy variable which equals one for firms with below median board size, *Board independence* is percentage of independent board members, *Board meetings* is the logarithm of the the number of board meetings during a fiscal year, *Board experience* is the average number of years each board member has been on the board, *Board gender diversity* is the percentage of female board members, *Two or more females* is a dummy variable which equals one for firms with at least two female board members, *Board affiliations* is the average number of other board memberships of the board members, *Busy board* is a dummy variable which equals one for firms in which board members on average have at least three other board memberships, *Staggered board* is a dummy variable which equals one for firms with staggered board structure, *CEO duality* is a dummy variable which equals one for firms in which the CEO is the board chair or a member of the board, and *Poor monitoring* is a dummy variable which equals one if the firm's board of directors fulfills at least three of the six criteria for poor monitoring. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

Table 3. Board characteristics and ethical score.

	Model (1)	Model (2)	Model (3)	Model (4)	Model (5)
Constant	-664.219 ***	-539.307 ***	-732.582 ***	-582.628 ***	-1322.278 ***
	-(9.752)	-(11.176)	-(7.89)	-(7.44)	-(6.364)
Board characteristics:					
Board size	82.410 ***		85.734 ***		41.728 ***
	(3.47)		(3.38)		(2.88)
Small board		-2.079		-4.991	
		-(0.28)		-(0.87)	
Board independence	-0.059	-0.323 **	0.119	-0.167	0.012
	-(0.31)	-(2.25)	(0.68)	-(1.64)	(0.03)
Board meetings	-58.654 ***	-60.568 ***	-58.501 ***	-60.593 ***	-26.123 **
	-(8.62)	-(8.93)	-(7.49)	-(8.05)	-(2.00)
Board experience	-0.633	0.779	0.562	1.513 *	3.982
	-(0.79)	(1.61)	(0.63)	(1.82)	(1.46)
Board gender diversity	1.016 ***		1.260 ***		-0.298
	(3.30)		(3.38)		-(0.36)
Two or more females		26.052 ***		28.822 ***	
		(4.87)		(4.11)	
Board affiliations	-4.954 ***		-7.491 ***		-8.513 ***
	-(2.62)		-(6.18)		-(3.82)
Busy board		-18.342		-22.662	
		-(1.18)		-(1.52)	
Staggered board	-22.329	-3.114	-14.695	2.526	40.893 **
	-(1.40)	-(0.24)	-(0.64)	(0.14)	(1.99)
CEO duality	54.430 ***	41.422 ***	59.917 ***	45.658 ***	19.314
	(3.25)	(4.23)	(3.83)	(5.48)	(1.33)
Control variables:					
Size	28.308 ***	33.517 ***	29.419 ***	33.936 ***	61.512 ***
	(14.14)	(15.82)	(9.66)	(9.01)	(6.03)
Capital ratio	1.461 ***	1.567 ***	1.511 ***	1.687 ***	1.501
	(11.18)	(16.44)	(7.80)	(8.01)	(1.33)
Return on equity			-0.163	-0.148 **	-0.170
			-(1.31)	-(2.52)	-(1.00)
Loans to assets			-0.125	-0.020	-0.470
			-(0.79)	-(0.14)	-(0.82)
Growth			-0.031	-0.004	-0.153
			-(0.22)	-(0.04)	-(1.42)

Table 3. *Continued.*

	Model (1)	Model (2)	Model (3)	Model (4)	Model (5)
Volatility			0.082	0.066	16.446 ***
			(0.91)	(0.89)	(2.97)
Financial services			7.664	4.238	
			(0.62)	(0.33)	
Non-US institution			21.590 **	18.284 **	
			(2.45)	(2.22)	
Firm fixed effects	No	No	No	No	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes
Adjusted R^2	41.23%	36.94%	40.52%	35.78%	79.88%
F-stat.	9.61 ***	8.42 ***	6.97 ***	6.04 ***	13.38 ***

The table reports the estimates of five alternative versions of Equation (1). The dependent variable in the regressions is *Ethical score* which is the Ethical Quote Index issued by Covalence. The board characteristics are defined as follows: *Board size* is the logarithm of the number of board members, *Small board* is a dummy variable which equals one for firms with below median board size, *Board independence* is percentage of independent board members, *Board meetings* is the logarithm of the number of board meetings during a fiscal year, *Board experience* is the average number of years each board member has been on the board, *Board gender diversity* is the percentage of female board members, *Two or more females* is a dummy variable which equals one for firms with at least two female board members, *Board affiliations* is the average number of other board memberships of the board members, *Busy board* is a dummy variable which equals one for firms in which board members on average have at least three other board memberships, *Staggered board* is a dummy variable which equals one for firms with staggered board structure, and *CEO duality* is a dummy variable which equals one for firms in which the CEO is the board chair or a member of the board. The control variables used in the regressions are defined as follows: *Size* is measured as the logarithm of total assets, *Capital ratio* is the ratio of equity to total assets, *Return of equity* is the ratio of net income to equity, *Loans* to assets is the ratio of net loans to totals assets, *Growth* is the percentage change in total assets from year *t*–1 to year *t*, *Volatility* is the logarithm of the annualized standard deviation of daily stock returns during the fiscal year, *Financial services* is a dummy variable which equals one for other financial institutions than commercial banks, and *Non-US institution* is a dummy variable for non-US financial institutions. The *t*-statistics (in parentheses) are based on robust standard errors which are adjusted for heteroskedasticity and within-firm clustering. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

Table 4. Board characteristics and ethical rank.

	Model (1)	Model (2)	Model (3)	Model (4)	Model (5)
Constant	208.947 ***	182.532 ***	164.260 ***	136.845 ***	383.942 ***
	(12.594)	(10.273)	(9.52)	(14.58)	(4.466)
Board characteristics:					
Board size	-13.667 ***		-11.856 ***		-11.405 *
	-(4.99)		-(2.92)		-(1.87)
Small board		2.985		2.315	
		(1.44)		(1.17)	
Board independence	-0.036	0.002	-0.029	0.015	-0.109
	-(1.12)	(0.07)	-(1.33)	(0.61)	-(1.34)
Board meetings	8.116 ***	9.473 ***	7.201 ***	8.003 ***	4.177 *
	(2.97)	(3.76)	(2.96)	(3.76)	(1.70)
Board experience	-0.464 ***	-0.667 ***	-0.267 *	-0.355 *	-1.485 ***
	-(3.23)	-(4.26)	-(1.87)	-(1.84)	-(5.49)
Board gender diversity	-0.244 **		-0.244 *		-0.142
	-(2.45)		-(1.97)		-(0.64)
Two or more females		-4.230 **		-3.963 *	
		-(2.31)		-(1.85)	
Board affiliations	1.264 ***		1.883 ***		2.470 ***
	(4.27)		(6.91)		(3.16)
Busy board		3.186 *		4.111 **	
		(1.80)		(2.54)	
Staggered board	-5.670	-0.107	-3.925	0.527	-13.033 *
	-(1.41)	-(0.07)	-(1.27)	(0.25)	-(1.76)
CEO duality	-5.083 **	-3.694 ***	-8.037 ***	-6.454 ***	1.867
	-(2.36)	-(4.84)	-(5.21)	-(5.42)	(0.27)
Control variables:					
Size	-7.849 ***	-8.542 ***	-5.632 ***	-6.048 ***	-16.045 ***
	-(8.10)	-(11.74)	-(13.64)	-(20.48)	-(4.41)
Capital ratio	-0.417 ***	-0.441 ***	-0.310 ***	-0.338 ***	-0.418
	-(9.72)	-(12.73)	-(9.19)	-(14.18)	-(1.39)
Return on equity			0.007	-0.003	0.015
			(0.27)	-(0.09)	(0.79)
Loans to assets			0.064 **	0.041	-0.055
			(1.76)	(1.18)	-(0.66)
Growth			-0.009	-0.014	0.040
			-(0.33)	-(0.68)	(1.46)

Table 4. *Continued.*

	Model (1)	Model (2)	Model (3)	Model (4)	Model (5)
Volatility			-2.450 ***	-2.078 ***	-0.756
			-(3.22)	-(4.61)	-(0.99)
Financial services			8.555 ***	9.237 ***	
			(2.74)	(3.12)	
Non-US institution			-0.356	0.705	
			-(0.18)	(0.43)	
Firm fixed effects	No	No	No	No	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes
Adjusted R^2	50.26%	46.91%	52.18%	49.43%	78.15%
F-stat.	13.39 ***	12.19 ***	10.56 ***	9.84 ***	12.15 ***

The table reports the estimates of five alternative versions of Equation (1). The dependent variable in the regressions is *Ethical rank* which is the Ethical Quote Index rank order of the financial institutions included in the sample. *Ethical rank* is constructed by assigning the financial institution with the best ethical reputation to value 1 and the institution with the worst ethical reputation to value 43. The board characteristics are defined as follows: *Board size* is the logarithm of the number of board members, *Small board* is a dummy variable which equals one for firms with below median board size, *Board independence* is percentage of independent board members, *Board meetings* is the logarithm of the number of board meetings during a fiscal year, *Board experience* is the average number of years each board member has been on the board, *Board gender diversity* is the percentage of female board members, *Two or more females* is a dummy variable which equals one for firms with at least two female board members, *Board affiliations* is the average number of other board memberships of the board members, *Busy board* is a dummy variable which equals one for firms in which board members on average have at least three other board memberships, *Staggered board* is a dummy variable which equals one for firms with staggered board structure, and *CEO duality* is a dummy variable which equals one for firms in which the CEO is the board chair or a member of the board. The control variables used in the regressions are defined as follows: *Size* is measured as the logarithm of total assets, *Capital ratio* is the ratio of equity to total assets, *Return of equity* is the ratio of net income to equity, *Loans* to assets is the ratio of net loans to totals assets, *Growth* is the percentage change in total assets from year *t*–1 to year *t*, *Volatility* is the logarithm of the annualized standard deviation of daily stock returns during the fiscal year, *Financial services* is a dummy variable which equals one for other financial institutions than commercial banks, and *Non-US institution* is a dummy variable for non-US financial institutions. The *t*-statistics (in parentheses) are based on robust standard errors which are adjusted for heteroskedasticity and within-firm clustering. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

Table 5. Poor monitoring and ethical reputation.

	Model (1)	Model (2)	Model (3)	Model (4)	Model (5)	Model (6)
	Ethical score	Ethical score	Ethical score	Ethical rank	Ethical rank	Ethical rank
Constant	-520.033 ***	-446.888 ***	-1367.723 ***	160.868 ***	112.118 ***	341.708 ***
	-(14.255)	-(6.679)	-(4.44)	(11.78)	(9.448)	(5.014)
Board variable:						
Poor monitoring	-9.302 ***	-5.253 **	-2.316	5.136 ***	3.449 **	4.800 **
	-(10.35)	-(2.09)	-(0.68)	(4.14)	(2.35)	(2.03)
Control variables:						
Size	27.014 ***	26.283 ***	68.749 ***	-6.888 ***	-4.756 ***	-15.805 ***
	(15.16)	(9.73)	(5.03)	-(10.35)	-(7.26)	-(5.18)
Capital ratio	1.450 ***	1.443 ***	0.411	-0.365 ***	-0.285 ***	-0.115
	(17.78)	(10.72)	(0.55)	-(13.85)	-(14.43)	-(0.57)
Return on equity		0.399 **	0.035		-0.098 **	-0.033
		(2.51)	(0.18)		-(2.38)	-(0.64)
Loans to assets		0.049	0.386		0.025	-0.299 *
		(0.39)	(0.81)		(0.78)	-(1.79)
Growth		0.142 *	-0.191 ***		-0.029	0.048 **
		(1.85)	-(2.72)		-(1.21)	(2.27)
Volatility		-16.748 *	2.147		-0.024	1.925
		-(1.85)	(0.26)		-(0.02)	(1.08)
Financial services		-8.679			11.361 ***	
		-(1.59)			(6.24)	
Non-US institution		-6.038			4.037 ***	
		-(1.15)			(3.92)	
Firm fixed effects	No	No	Yes	No	No	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Adjusted R^2	18.25%	18.57%	40.52%	31.98%	40.69%	69.94%
F-stat.	6.50 ***	4.21 ***	6.97 ***	12.58 ***	10.65 ***	9.81 ***

The table reports the estimates of six alternative versions of Equation (1). In Models 1-3, the dependent variable in the regressions is *Ethical score* which is the Ethical Quote Index issued by Covalence. In Models 4-6, the dependent variable in the regressions is *Ethical rank* which is the Ethical Quote Index rank order of the financial institutions included in the sample. The test variable of interest is *Poor monitoring* which is a dummy variable assigned to one if the firm's board of directors fulfils at least three of the following six criteria: (i) the number of board members is below the sample median, (ii) the percentage of independent board members less than 50 %, (iii) the number of board meetings is below the sample median, (iv) there are no female board members, (v) the average number of other board affiliations is greater than two, and (vi) the CEO is the board chair or a member of the board. The control variables used in the regressions are defined as follows: *Size* is measured as the logarithm of total assets, *Capital ratio* is the ratio of equity to total assets, *Return of equity* is the ratio of net income to equity, *Loans* to assets is the ratio of net loans to totals assets, *Growth* is the percentage change in total assets from year $t–1$ to year t, *Volatility* is the logarithm of the annualized standard deviation of daily stock returns during the fiscal year, *Financial services* is a dummy variable which equals one for other financial institutions than commercial banks, and *Non-US institution* is a dummy variable for non-US financial institutions. The t-statistics (in parentheses) are based on robust standard errors which are adjusted for heteroskedasticity and within-firm clustering. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

Appendix 1 List of financial institutions.

1. Australia and New Zealand Banking Group
2. Banco Bilbao Vizcaya Argentaria
3. Banco Santander
4. Barclays Bank
5. BNP Paribas
6. Credit Agricole
7. Credit Suisse
8. Deutsche Bank
9. HSBC
10. Lloyds Banking Group
11. Royal Bank of Scotland
12. UBS
13. Intesa Sanpaolo
14. Société Générale
15. Commonwealth Bank of Australia
16. National Australia Bank Limited
17. Royal Bank of Canada
18. Bank of Nova Scotia
19. Toronto Dominion Bank
20. Macquarie Group
21. Freddie Mac
22. Fannie Mae
23. Mitsubishi UFJ Financial Group
24. Sumitomo Mitsui Financial Group
25. Fubon Financial Holding
26. Itausa- Investimentos Itau
27. Sallie Mae
28. Daiwa Securities Group
29. State Street Corporation
30. Fifth Third Bancorp
31. Goldman Sachs
32. Morgan Stanley
33. Bank of America
34. Orix Corporation
35. JPMorgan Chase
36. Citigroup
37. T. Rowe Price
38. Charles Schwab
39. Bank of New York Mellon
40. Capital One Financial Corporation
41. Invesco
42. Wells Fargo & Company
43. US Bancorp