Study reveals impact of powerful CEOs and money laundering on bank performance

August 4 2020

Credit: CC0 Public Domain

Banks with powerful CEO's and smaller, less independent, boards are more likely to take risks and be susceptible to money laundering, according to new research led by the University of East Anglia (UEA).

The study tested for a link between bank risk and enforcements issued by US regulators for money laundering in a sample of 960 publicly listed US banks during the period 2004-2015.

The results, published in the *International Journal of Finance & Economics*, show that money laundering enforcements are associated with an increase in bank risk on several measures of risk. In addition, the impact of money laundering is heightened by the presence of powerful CEOs and only partly mitigated by large and independent executive boards.

Researchers Dr. Yurtsev Uymaz and Prof John Thornton at UEA, and Dr. Yener Altunbas of Bangor University, conclude that banks with powerful CEOs warrant the particular attention of regulators engaged in anti-money laundering efforts, especially when boards of directors are small and not independent.

The study is believed to be the first to show that money laundering is also a significant driver of bank risk, alongside banks' business models and ownership structures, the regulatory and supervisory framework, and market competition.

Previously banking research on the determinants of risk-taking has largely ignored the potential role of money laundering, which the authors say is surprising given combatting money laundering is a major focus of US, and other, bank regulators concerned with the stability of the financial system.

For example, the US Office of the Comptroller of the Currency views it as posing risks to the safety and soundness of the financial industry and the safety of the nation more generally as terrorists employ money laundering to fund their operations.

The Financial Action Task Force, the global money laundering and terrorist financing watchdog, also cites changes in money demand and increased volatility of international capital flows and exchange rates due to unanticipated cross-border asset transfers as being among the potential adverse economic consequences of money laundering.

Lead author Dr. Uymaz, of UEA's Norwich Business School, said: "It is important to understand all possible risks, given those from money laundering have been increased by the growth in volume of cross-border transactions that have made banks inherently more vulnerable.

"They are also impacted by the fact that regulators are continually revising rules as their focus expands from organized crime to terrorism, while governments have expanded their use of economic sanctions to target individual countries, entities, and even specific individuals as part of their foreign policies.

"Money laundering exposes banks to serious reputational, operational, and compliance risks that could result in significant financial costs, for example through fines and sanctions by regulators, claims against the bank, investigation costs, asset seizures and freezes, and loan losses. It also results in the diversion of valuable management time and operational resources to resolve money laundering-related problems.

"We show that board size and independence can mitigate but not fully offset the impact of money laundering on bank risk, and that powerful CEOs impact adversely on bank risk taking and accentuate the negative impact of money laundering on risk."

The authors use three measures of bank risk. The first is default risk, the assumption being that money laundering enforcements could lead to the failure of an individual bank because of reputational damage and/or the impact of severe financial penalties on bank capital.

The second measure is systematic risk, where, for example, money laundering in the banking sector could be so widespread so as not to be diversifiable against within the sector.

The final one is a measure of systemic risk, which captures the reaction of individual banks to systemic events, for example if financial penalties and other costs associated with enforcements because of money laundering have debilitated the bank.

The study 'Money laundering and bank risk: evidence from US banks', Yurtsev Uymaz, John Thornton and Yener Altunbas, is published in the International Journal of Finance and Economics on 1 August 2020.

More information: Yener Altunbaş et al. Money laundering and bank risk: Evidence from U.S. banks, *International Journal of Finance & Economics* (2020). DOI: 10.1002/ijfe.2044

Provided by University of East Anglia

Citation: Study reveals impact of powerful CEOs and money laundering on bank performance (2020, August 4) retrieved 25 May 2024 from https://phys.org/news/2020-08-reveals-impact-powerful-ceos-money.html

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.