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Panagiota Papadimitri, Portsmouth Business School

Fotios Pasiouras, Montpellier Business School

Gioia Pescetto, Portsmouth Business School

Ansgar Wohlschlegel, Portsmouth Business School

# Does Political Influence Distort Banking Regulation? Evidence from the US

Panagiota Papadimitri<sup>†</sup>    Fotios Pasiouras<sup>‡</sup>    Gioia Pescetto<sup>†</sup>    Ansgar Wohlschlegel<sup>†</sup>

## Abstract

This study examines the interplay between political influence and regulatory decision-making in the US banking industry. In particular, we assess whether elected officials with power in Congress impact regulatory decision making in the banking industry. Political influence is captured by whether a bank is headquartered in a state where an elected official holds a chair position on a congressional committee related to the banking and financial services industry. As a proxy for regulatory decisions, we take into account formal regulatory enforcement actions issued against US commercial banks over the period 2000-2015. We find an inverse relationship between our political influence variable and enforcement likelihood. In general, the results are robust to the use of alternative model specifications and the restriction of our sample. However, we find that various bank and environmental characteristics are important conditional factors.

**Keywords:** Political influence · Congressional Committees · Banking supervision · Enforcement actions

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<sup>‡</sup> Contact author. Mailing Address: Montpellier Business School, Montpellier, France. E-mail: f.pasiouras@montpellier-bs.com

<sup>†</sup> Mailing Address: Portsmouth Business School, University of Portsmouth, Portsmouth, UK.

E-mail(s): panagiota.papadimitri@myport.ac.uk, gioia.pescetto@port.ac.uk, ansgar.wohlschlegel@port.ac.uk

*“[...] the connection between politics and finance is complex. It differs across countries with different political and financial systems. It changes over time within countries, as some constituencies gain power, others lose power, and political and financial systems evolve.”*

— Barth *et al.* (2012, p.17)

## 1 Introduction

The regulatory and supervisory architecture of the banking sector has received extensive attention, with interest therein being renewed during the crisis and the post-crisis period. While policy makers and academics have traditionally focused on prudential - and most recently macro-prudential - regulations, attention has, since the financial crisis, increasingly been shifted to the role of political influence, which runs high on the agenda of the banking industry.

The interest in this latter issue is not surprising for at least two reasons. First, regulatory capture and political influence has been cited as one of the reasons that led to the crisis. For instance, the 2011 report of the national commission on the causes of the financial and economic crisis in the US concludes that *"widespread failures in financial regulation and supervision proved devastating to the stability of the nation's financial markets. More than 30 years of deregulation and reliance on self-regulation by financial institutions, championed by former Federal Reserve chairman Alan Greenspan and others, supported by successive administrations and Congress, and actively pushed by the powerful financial industry at every turn, had stripped away key safeguards, which could have helped avoid catastrophe"* (p. xviii). Second, the high level of regulatory oversight and policy complexities in the banking industry imply that political connections, lobbying, and influence, may be particularly valuable (Gropper *et al.*, 2015; Igan and Lambert, 2018). In fact, according to data provided by the Center for Responsive Politics, the financial sector ranks amongst the top spenders in lobbying and campaign contributions. Igan and Lambert (2018) also point out that between 1998 and 2016 the U.S. financial sector spent \$7.4 billion on lobbying. Most importantly, during the 2016 US election cycle, the dollar amount of lobbying and campaign contributions by large banks, hedge funds and other financial institutions hit a record high approximately 25% higher than the amount spent during the 2007-2008 elections (McLannahan and Jopson, 2017)

Focusing on the US banking sector, the main objective of the present study is to examine whether and how political influence on a local state level impacts the decision making of financial regulators. As in Lambert (2018) we consider regulatory enforcement actions issued against

banks as a proxy of regulatory decisions. In his study, which is the most closely related one to our work, he finds that lobbying banks are less likely to receive regulatory enforcement actions. However, we differentiate our work from the one of Lambert in some crucial respects. The most important one is that, while he focuses on bank lobbying activities, we investigate the impact of the political influence of elected officials on regulatory decisions. This is particularly important for at least two reasons. First, Igan and Lambert (2018) highlight that, while the size of the bank lobbying market appears to be big, the expenditures are actually rather small when compared to the size of the banking industry, the value of policies, and the benefits at stake. One potential explanation that they provide is that special interest groups do not need to spend much once they have reached out to the legislator or regulator and provided some key information. As an example, they mention that for a congressman, the relevant piece of information could be the impact of his vote for or against a particular bill on his re-election prospects. Another explanation that they offer is that lobbying expenditures are supplemented by other mechanisms of influence like quid pro quo agreements, career concerns, relationships, and persuasion. In the present study, to account for such factors, political influence is captured by whether or not a bank's headquarters are located in a state represented by a Senator or Congressman who is a Chairman in a Committee relevant to banking and financial services. The second reason for which the impact of the political influence of elected officials on regulatory decisions is important is that it has received considerably less attention compared to firms' corporate political strategies, such as lobbying (e.g. Lambert, 2018), campaign contributions (e.g. Correia, 2014) or employment connections (e.g. Shive and Forster, 2016)

Therefore, we attempt to shed more light on one of the mechanisms through which political influence may work. This approach makes our work related to recent studies by Gropper et al. (2013, 2015) who use the same proxy for political influence to conclude that it "pays" to have friends in high places. However, these two studies focus on bank profitability and stock market performance, which do not relate to regulatory decisions. In contrast, by focusing on regulatory enforcement actions against banks headquartered in an elected official's home state, the present study provides direct evidence on a channel via which this elected official may exert the political influence associated with holding a chair position in a congressional committee (House or Senate) relevant to the financial industry. Shielding banks from regulatory enforcement actions is a plausible channel for a committee chair to exert his influence for two reasons: First, enforcement actions must be appropriately "tailored" around the unique features and needs of each institution. Essentially, this means that the regulators have some flexibility on the severity and type of action that will be imposed. Second, the regulators have in many instances worked

in the past with members of the Senate or they have been nominated and supported by them <sup>1</sup>.

To fulfill the objective of the study, we hand-collect data for US Commercial Banks and biographical information of Congressional Committee Chairmen from the period 2000-2015. Overall, the results confirm that banks with friends in high places are less likely to receive a severe type regulatory enforcement action. These results hold when we perform a set of estimations to examine the robustness of our results. First, we use alternative econometric specifications, and we address endogeneity concerns. Second, we include alternative control variables and examine whether the results hold for several sub-samples (e.g. crisis vs non-crisis years, large banks, poor vs top capitalized banks). In all these cases, the results remain the same. Third, we examine alternative factors that could enhance our understanding of political channels or influence the reported results. Briefly, our findings suggest that in cases where the Chair's seniority is higher, the financial sector's contributions are higher, and the level of vote concentration is greater, the impact of local political influence on regulatory enforcement likelihood is enhanced. Furthermore, our findings suggest that although committee membership exerts a significant impact on regulatory enforcement likelihood; sub-committee chairmanship is insignificant. In terms of bank-related traits, the results indicate that the committee chair dummy is negative and statistically significant for both listed and non-listed parent companies. When we examine parent company age, we find that our core variable of interest is highly significant in the case of older than average parent companies, whereas the chair effect is much weaker and only significant at the 10% level for younger parent companies. Moreover, we find that political influence is statistically significant only in the case that operate in a single State. Last but not least, we find that the overall state environment plays a role in our empirical investigation. In particular, political influence appears to matter in states with lower economic freedom, higher corruption, lower levels of religiosity, and higher polarization.

Our study is related to several strands of the literature. First, it relates to studies examining

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<sup>1</sup>Take for example, Martin J. Gruenberg, the 20th Chairman of the FDIC, who received Senate confirmation on November 15, 2012. Previously he held other important positions in the FDIC board, and before that he had broad congressional experience in the financial services and regulatory areas. He served as Senior Counsel to Senator Paul S. Sarbanes (D-MD) on the staff of the Senate Committee on Banking, Housing, and Urban Affairs from 1993 to 2005. Mr. Gruenberg advised the Senator on issues of domestic and international financial regulation, monetary policy and trade. He also served as Staff Director of the Banking Committee's Subcommittee on International Finance and Monetary Policy from 1987 to 1992. As another example, on July 27 2017, U.S. Senator Mike Crapo (R-Idaho), Chairman of the United States Senate Committee on Banking, Housing and Urban Affairs, delivered the following remarks during a full committee hearing on the nominations of Mr. Joseph Otting, of Nevada, to be Comptroller of the Currency; and The Honorable Randal Quarles, of Colorado, to be a Member of the Board of Governors of the Federal Reserve System."Mr. Otting brings a particular expertise and understanding of our banking system from a long career in financial services.I am confident that Mr. Otting will bring strong leadership to the OCC" and "Mr. Quarles has a wealth of government and private sector experience dealing with both domestic and international financial markets. He is no stranger to public service, having previously served in multiple top posts in the Treasury Department".

the interplay between political economy and general regulation. This literature dates back to Stigler (1971), Posner (1974), and Peltzman (1976), the pioneers of the theoretical models of regulatory influence. Besley and Coate (2001) and Grossman and Helpman (2001) provide theoretical models on how firms can influence policy outcomes. Other studies (e.g. Mailath and Mester, 1994; Acharya and Yorulmazer, 2007) have explored why and to what extent regulators use their discretion. More recently, Holburn and Bergh (2008) develop a theoretical argument suggesting that firms operating in heavily-regulated industries, have a higher probability to engage in corporate political strategies, in order to influence changes in legislation/laws towards their own interest. Gibson et al. (2018) and Kerr et al. (2014) examine the determinants and dynamics of lobbying activities, respectively.

Second, our work is related to a growing number of empirical studies providing evidence that regulatory decisions and firm outcomes are subject to political influence exerted by organizations. Many of them focus on SEC enforcement actions (Kedia and Rajgopal, 2011; Correia, 2014; Fulmer et al., 2017) while others examine fraud detection and enforcement against fraud (Yu and Yu, 2011; Wu et al., 2016), tax enforcement effectiveness (Lin et al., 2018), public reports of major violations for safety compliance (Fisman and Wang, 2015), government procurement contracts (Goldman et al., 2013), corporate bailouts (Faccio et al., 2006), and preferential access to finance (Claessens et al., 2008). However, only a limited number of studies focus on the banking industry. In an early study, Kroszner and Strahan (1999) examine bank branching deregulation in 1970s and 1980s in US and find that pressure exerted by special interest groups had an impact on the elimination of restrictions on bank branching. Along the same lines, Igan and Mishra (2014) suggest that higher lobbying from financial sector encouraged deregulation during the pre-crisis period. Focusing on the financial crisis, Mian et al. (2010) find that higher financial sector contributions increased the probability of Congressional members supporting bailout legislation of 2008. In a somehow related study, Duchin and Sosyura (2012) find that politically connected financial firms are more likely to be funded through the Capital Purchase Program (CPP). Examining the lending pattern of lobbying and non-lobbying firms, Igan et al. (2012) reveal that institutions that lobby on issues related to mortgage lending and securitization engaged in more risky lending practices ex ante and had worse performance ex post. Others focus on the revolving door channel in the banking sector. For example, Braun and Raddatz (2010) find that banks that are politically connected are larger and more profitable than other banks, despite being less leveraged and having less risk. They suggest that banks may hire former politicians, in order to ensure favourable treatment. Adams (2013) finds that officers of larger banks are more likely to obtain Federal Reserve directorship; adding value in terms of positive average market reaction. Moreover, her findings reveal some evidence that banks with

Federal Reserve directorships have lower probability to cease their operations in comparison to other banks within the industry. Using cross-state enforcement actions of regulators, Lucca et al. (2014) find that gross worker inflows into regulation from the private sector, and gross outflows from regulation are both higher during periods of intense enforcement; albeit the outflows are significantly smaller in magnitude. They conclude that their results are in favour of the regulatory schooling hypothesis rather than the quid-pro-quo explanation of the revolving door<sup>2</sup>. Shive and Forster (2016) reach a similar conclusion. They find that financial firms hire ex-employees of their regulators with an aim to reduce risk, and there is limited direct evidence of quid pro quo behavior in regulatory event frequency and fines.

The remainder of this paper is structured as follows. Section 2 provides an overview of the institutional background of U.S. Congressional Committees, U.S. Banking supervision and hypotheses development. Section 3 describes the sample data and variables. Section 4 provides an overview of the methodology employed and contemplates the results. Section 5 presents the findings of our further analysis and finally, Section 6 offers concluding remarks and future direction of research.

## 2 Institutional background and hypothesis development

### 2.1 U.S. Senate, House of Representatives and Congressional Committees

The U.S. Congress is the legislative branch of the U.S. Federal government and is composed of two chambers; the Senate (upper chamber) and House of Representatives (lower chamber). Senators and Congressmen (members of House of Representatives) are primarily chosen through direct election<sup>3</sup>.

The U.S. Senate is made up of 100 Senators (two for each state), who serve a six year term. The Senate's powers and functions, as outlined by the Article One of the United States Constitution<sup>4</sup>, vary from "advice and consent" and approval of legislation suggested by the House of Representatives, to electing one of the top two recipients for Vice President's office in the case where no candidate receives a majority of electors. The House of Representatives consists of 435 voting members, each representing a congressional district and 6 non-voting members. Each member serves a two year term and there is no limit as to the number of

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<sup>2</sup>However, the example discussed by Fan et al. (2007) shows that the regulatory experience of former government bureaucrats does not necessarily make them more effective CEOs

<sup>3</sup> In some cases Senators may be chosen through gubernatorial appointment.

<sup>4</sup>For further information visit <https://constitutioncenter.org/interactive-constitution/articles/article-i>.

terms an individual can serve. Each state is allocated a minimum of one member. The primary function of the House of Representatives is to initiate bills, which are then sent to Senate.

The U.S. Congress deals with a range of policy issues. The Committees of the U.S. Congress are legislative sub-organizations that are in charge of dealing with specific issues. This enables the efficient handling of such policy issues and it allows members to develop specialized knowledge on specific policy matters within their area of jurisdiction. A Committee's main tasks lie among monitoring government operations, identifying issues suitable for legislation, examining information on specialized issues and suggesting lines of action in their respective controlling body. The House has 23 Committees, whereas the Senate has 20. In regard to the Committee assignments (including Chair position), members are appointed by majority vote. For the chair position, seniority had traditionally been an important factor considered during the appointment procedure. Although all members exert influence on policy issues related to the committee's area of jurisdiction, the chair has considerable power to influence the policy-making procedure<sup>5</sup>. The powers of the Chairman lie among setting the legislative agenda, organizing meetings with the members of the committee, shaping debates related to particular issues, as well influencing the legislation brought to a vote.

As discussed earlier, our aim is to examine the level of influence of elected officials (member of House or Senate) in shaping bank regulatory decisions. There are two Committees closely related to the financial services industry which are taken into consideration in this study, namely the Committee of Banking, Housing and Urban Affairs (Senate's Committee) and the Financial Services Committee (House of Representatives' Committee)<sup>6</sup>. For example, the Banking, Housing, and Urban Affairs Committee engages in writing and passing legislation related, among other things, to banking, insurance, financial markets, securities and housing. The Committee also oversees the work of the Federal Reserve System, U.S. Department of Treasury, U.S. Securities and Exchange Commission and other financial regulators. Although all members of the Committee can exert, up to some extent, political power and influence; the Chair has considerable power to influence and shape regulatory issues related to the Committee's area of jurisdiction. Since Chairmen are also elected officials, one could expect the existence of a channel of influence flowing from the political environment within a state to the regulatory treatment of banks at a local state level.

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<sup>5</sup>There is a growing body of literature that examines the role of Congressional Committees in policy making. For example, Berry and Fowler (2017) find that the majority of a committee's power is concentrated among chairs. Gropper et al. (2013) find that banks head-quartered in states where an elected official serves as a chair in their respective committee, tend to outperform banks in other states. Cohen et al. (2011) reveal that there is increased federal spending in the states where an elected official is a chair of an important committee.

<sup>6</sup>The names of the House of Representatives Committee have changed, however the "Financial Services Committee" is the most up to date name.



## 2.2 Enforcement Actions & U.S. Banking supervision

The US Banking sector operates under a dual banking system. This relates to the co-existence of federal and state banking systems. Three main regulatory agencies are responsible for the regulation and supervision US banks: (i) the Office of the Comptroller of the Currency (OCC) which is in charge of federally chartered banks (national banks), (ii) Federal Reserve Bank (FRB), which supervises state-chartered institutions that are members of the Federal Reserve System and (iii) the Federal Deposit Insurance Corporation (FDIC), which is responsible for federally insured depository institutions, which includes FED chartered banks that are not members of the Federal Reserve System, as well as state-chartered thrift institutions. For banks that are chartered on both a federal and state level, supervisory responsibilities are allocated amid the three regulatory agencies. According to the Dodd-Frank Wall Street Reform and Consumer Protection Act; safety and soundness, deposit insurance, capital adequacy and systemic risk are considered to be the traditional components of US banking regulation. Regulatory agencies, therefore, monitor the safety and soundness conditions of the banks they supervise by conducting examinations on an on-site and off-site basis.

"Full-scope" on-site examinations are carried out by the regulatory agency in charge at least once a year <sup>7</sup>. Depending on the information collected through the above process, the agency assigns a rating, which reveals the financial condition and performance of the bank. The aforementioned procedure concerns the evaluation of the components of the Uniform Financial Institutions Rating Systems (UFIRS). This system is commonly referred to as the CAMELS rating system, which includes: Capital Adequacy (C), Asset quality (A), Management (M), Earnings (E), Liquidity (L) and Sensitivity to market risk (S) <sup>8</sup>. After the assessment procedure, a composite rating is assigned on each regulated institution and ranges among 1 to 5. Institutions assigned a rating of 1 or 2, appear to have a small weakness that may be controlled by its management or Board of Directors. A rating 3 or 4 suggests that there may be moderate to severe weaknesses encountered by the examined institution. In such cases, the managerial department may not be able or willing to promptly address the deficiencies that led to the weaknesses observed during the examination process. Finally, a rating of 5 reflects risky practices

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<sup>7</sup>Federal Deposit Insurance Corporation Improvement Act, 1991.

<sup>8</sup>Capital adequacy refers to the amount and quality of the institution's capital. Asset quality assesses the levels of existing and potential credit risk related to the institution's loan and investment portfolio. In addition, the management component, which is primarily a qualitative measure, refers to the effectiveness of internal control and audit systems; as well as the overall capability of board of directors and management to meet their roles. The earnings component rates the bank's earnings (current and expected). Liquidity refers to the assessment of the bank's ability to honour its cash payments as they fall due. Finally, sensitivity to market risk considers the management's capability to determine and control risks derived from the institution's exposure to its trade operations in the financial markets, as well as interest rate risk from non-trading positions.

adopted by the institution and may lead to poor performance, as well as other severe problems. CAMELS ratings are strictly confidential, are not revealed to the public and are only available to each institution's senior management.

Off-site audits complement the CAMELS ratings from the on-site examinations and are implemented in order to monitor supervised institutions. In this case, information obtained by prior examinations and financial information provided in the Quarterly Reports of Condition and Income (Call Reports) is assessed. The above mechanisms are helpful in developing "early warning" models, which aid to identify institutions with riskier behaviour and thus, require supervisory attention. An important element to be highlighted at this point is that information derived by on-site and off-site programs, in combination with the CAMELS composite ratings assigned to each depository institution, play a key role in determining the type of enforcement action imposed on a bank.

There are two types of regulatory enforcement actions. First, informal enforcement actions are mainly voluntary commitments formed by the bank's management, board of directors or trustees when the level of misconduct is less severe. These actions are not publicly disclosed or legally enforceable and their main objective is to correct weaknesses identified during the supervisory process and reassure conformity with laws and regulations. Informal actions are imposed in cases where CAMELS ratings are of 3 or above. Common type of informal enforcement actions are commitments, Board resolutions, Memorandum of Understanding <sup>9</sup>. Second, formal enforcement actions are imposed in the case where misconduct is severe or in the case where informal actions previously imposed have not been adequate or effective. These types of actions are publicly disclosed and legally enforceable and are issued against institutions with CAMELS composite ratings of 4 or 5 or in some cases 3. The most common types of formal actions are termination of insurance, cease and desist orders, removal and prohibition orders, suspension orders and civil money penalties <sup>10</sup>.

One particular aspect in the context of our work is that enforcement actions must be "tailored" around an institution's individual characteristics and requirements. In general, enforcement actions target at correcting imperfections identified during the examination procedure and restoring an institutions financial health. The level of severity of an action depends on a variety of factors. For instance, overall financial performance, weaknesses, attitude of an institution's bank management in committing play an important role on the decision of the type of formal enforcement action to be imposed. Moreover, composite CAMELS ratings play a crucial role the this decision. Finally, prior non-addressed problems or shortcomings can lead to the implementation of formal enforcement actions , or even in some cases additional formal actions.

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<sup>9</sup>OCC PPM, 5310,-3 at 8-9, 2011; FDIC, 2014, II - 8.1.

<sup>10</sup>FDIC, 2014, II - 8.1; OCC PPM, 5310,-3 at 8-9, 2011.

## 2.3 Hypotheses development

The research objective of the present study is to examine whether banks headquartered in a "politically important state" are more likely to receive more favourable regulatory treatment. Within this context, a "politically important state" refers to any state where an elected official (Senator or Congressman) holds a chair position within a congressional committee related to the banking and financial services industry. It is important to note that Senators and Congressmen very often visit their home states in order to meet with citizens and/or other systematically important parties, like banking institutions. During such interactions, banks can collectively or individually exert influence towards congressional officials and can gauge their attention more conveniently to regulatory and supervisory matters. In the meantime, banks adopt various corporate political strategies, such as spending money on campaign contributions, in order to further influence and support the congress and bureaucrats. In turn, members of Congress listen to the issues raised during these meetings and have the power to raise these on a higher level. This is even more pronounced if the elected official holds a chair position in a congressional committee, which is in fact one of the principal reasons for which we focus on the political influence of the chair.

Reasonably, the above can be beneficial for a bank, depending on the intentions of the elected official. For instance, the politician may be a "social planner", thus, aiming to maximise social welfare. Under this view, the politician will act in such ways as to promote the proper implementation of regulations, reforms and enforcement mechanisms. Alternatively, the politician may be "selfish", in terms of catering for his/her own interests, aiming to maximise his/her own personal agenda, (i.e. the possibility of re-election). Under this view, the politician will provide accommodating treatment for the banks in his/ her home state. This accommodating treatment could include delaying or avoiding the closure or punishment of financially troubled institutions, or the implementation of less stringent regulation for a particular group of banks. In exchange, banks provide their support through campaign contributions, lobbying or even future employment.

Moreover, a prior study by Correia (2014) attributes the political control of regulatory agencies to two distinct theories: The Iron Triangles and the Congressional Dominance theory. The former states that a mutually beneficial, three-way relationship exists between agencies (such as regulators), special interest groups and congressional committees. Under this view, congressional committees offer political support and funding to agencies, which provide a lax regulatory environment or specific favours to special interest groups. Special interest groups support (e.g. through votes, monetary contributions) congressional committees, who in turn have the power to pressurize agencies to implement favourable treatment or policies towards

the special interest groups. The latter theory suggests that a principal-agent problem arises between congress and agencies. In particular, it suggests that Congress assigns various tasks and formulates alternative monitoring systems in order to motivate agencies to act on their behalf, i.e. to maximize political support.

In addition, there is some evidence of a geographic component of firms' political influence and, more specifically, that firms located in a politician's home state enjoy preferential treatment. Faccio and Parsley (2009) measure the value of this political influence to companies by showing that the unexpected termination of this influence (e.g. because the politician resigns) is associated with a 1.7% reduction in the company's market value. Preferential treatment may be manifest in the form of higher federal investment in that state generally (Cohen et al., 2011), or banks from this state being less likely to fail despite higher leverage (Kostovetsky, 2015) or more likely to receive government funding (Duchin and Sosyura, 2012). In that last context, Chavaz and Rose (2016) suggest that the preferential treatment might have been motivated by the expectation that banks which benefit from such treatment will adopt investment policies that are more in line with the politician's preferences, but other motives such as the expectation that this behaviour be rewarded by voters, or politicians being more likely to have personal or financial ties with local banks also seem plausible.

Given the above discussion, the main hypothesis to be tested is the following:

*H1. Banks that are headquartered in a politically important state are more likely to receive favourable treatment by their supervisors, in the form of lower probability of receiving an enforcement action.*

### 3 Sample, data and Variable selection

The working sample of the present analysis consists of a fully hand-collected dataset including information for U.S. Commercial banks for the years 2000q1 - 2015q4. Financial characteristics of banks are obtained by the 031/341 Call-report files available from the Federal Financial Institutions Council (FFIEC) and Chicago Fed website. The sections below provide an overview of the construction procedure of the final working sample, the variables included in the analysis, and their descriptive statistics. Table 1 provides a list of the variables.

[Insert Table 1 Around Here]

### 3.1 Enforcement action variables

Data on enforcement actions are retrieved from the three federal regulatory agencies' websites; namely Federal Reserve Bank (FRB), Federal Deposit Insurance Corporation (FDIC) and the Office of Comptroller of the Currency (OCC). The types of actions taken (in order of severity) are: Deposit Insurance Termination, Cease and Desist orders, Formal Written Agreement/ Supervisory Agreement, Prompt Corrective Action/ Capital Directive, Civil Money Penalty, Call Report Penalty, Penalties on violations of specific laws. A detailed description of each type along with their classification, can be found in Appendix I. Enforcement actions are split into two categories: severe and less severe. While we initially consider all types of actions, we subsequently focus on the severe ones, i.e. Deposit insurance termination, Cease and Desist orders, Formal Written Agreements and Prompt Corrective Actions. There are various reasons for this. First, severe actions are more closely related to safety and soundness issues of banks. In contrast, less severe actions are usually issued against institutional affiliated parties and are therefore, not related to deficiencies observed over the financial condition of an institution. Moreover, Delis et al. (2016) show that such actions do not have an impact on a bank's financial condition. Finally, our preliminary results show that these types of actions are not associated with political influence.

In order to match the enforcement action data to the Call Report Data, we follow two steps. First, in cases where the unique identifier number of the punished institution (cert or rssid9001) is available, this is directly matched with the one provided by the Call Report data. Second, if this information is not provided, we match the name, city and state of each institution. Since Call Report data are provided on a quarterly basis, enforcement actions are also matched quarterly. For example, if Bank XX received an enforcement action during January 1st- March 31st, then this information is assigned to the 1st quarter. In the case where a bank received multiple types of enforcement actions during a given period; the most severe type is retained.

A dummy variable ("*Action all types*") is constructed, which takes the value of 1 if a bank received a formal enforcement action of any type (severe or less severe) in a particular quarter and the value of 0 otherwise. We construct two additional variations of this dummy variable. The first ("*Severe actions*") takes the value of 1 in the case of severe actions, and the value of 0 otherwise. Similarly, the second ("*Less severe actions*") takes the value of 1 in the case of less severe actions, and the value of 0 otherwise. The bank-quarter number of all types of enforcement actions in the sample is 3,925. Table 2 provides the descriptive statistics of the enforcement actions of the sample. Overall, there is a general increase in the total number of enforcement actions issued around the crisis years. As it concerns the severe type of enforcement actions, which are the core focus of the present study, it appears that Formal Written agreements

and Cease and Desist orders are the most common types of severe actions imposed; whereas the least frequent is Deposit Insurance termination. In regard to the actions issued per agency, FDIC appears to have issued the most severe actions in comparison to the actions issued by the FED and the OCC.

[Insert Table 2 Around Here]

### 3.2 Political influence variable

Information related to Committee Chairmanships is obtained by the relevant committee's website: U.S. Senate Committee on Banking, Housing and Urban Affairs <sup>11</sup> and U.S. House of Representatives Financial Services Committee <sup>12</sup>. Biographical information of Committee Chairmen is obtained by the Biographical Directory of the United States Congress <sup>13</sup>. The timeframe of the analysis addresses the period between 2000q1 - 2015q4; thus, covering 9 Congresses (106th -114th). Table 3 provides a summary of the available information of banking committee chairs for the sample.

[Insert Table 3 Around Here]

As mentioned previously, the present study focuses on two particular Committees that specialize on policy issues related to banking and financial services. These are the Committee of Banking, Housing and Urban Affairs (Senate) and the Financial Services Committee (House of Representatives). We do so because their area of jurisdiction is closely related to the banking sector and thus, we expect that it is more likely that they would be approached by banks in order to discuss or settle any issues. In the core analysis of our study we focus on elected officials that hold a chair position on these Committees. The rationale of our approach is that the chair of a committee exerts superior influence than that of any other member. However, in a robustness check we will extend the scope of the political variable by including all members of both committees.

In order to capture political connections, we employ a binary variable ("*Committee chair*"), which takes 1 if a bank's parent company operates in a state where an elected official (Senator or Congressman) holds a chair position in their respective committee in a given year, and 0 otherwise. In the working sample, the number of connections identified is 18,603 (4.94%) bank-quarter observations over the total 376,358 bank-quarters for the period 2000-2015. From the summary information reported in Table 3, it appears that for the Senate committee, there are five

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<sup>11</sup><https://www.banking.senate.gov/public/index.cfm/home>.

<sup>12</sup><https://financialservices.house.gov>.

<sup>13</sup><http://bioguide.congress.gov/biosearch/biosearch.asp>.

different chairmen present in the sample, representing Texas, Maryland, Alabama, Connecticut and South Dakota. As for the House Committee, there are four different chairmen, who represent the states of Ohio, Massachusetts, Alabama and Texas. In terms of party affiliation, there are six Chairmen representing the Republican party and four representing the Democratic party. The Chairmen’s experience while in service ranges from 11 to 33.5 years (on average), whereas their age ranges from 57 to 82 years (on average).

### 3.3 Financial variables

As outlined in Section 2.2., the CAMELS ratings play a crucial role, for regulatory purposes, in assessing the financial condition and performance of banking institutions. However, these ratings are confidential and we therefore have to use individual financial ratios proposed in the literature. Cole and White (2012) show that such traditional proxies for CAMELS components do an excellent job in explaining the bank failures during 2009 as they did in the 1985-1992 crisis. Our approach is consistent with the one followed in past studies (Lambert, 2018; Delis et al., 2016). Moreover, we control for bank size to account for differences in terms of organizational complexity, too-big-to fail issues, and that large firms may have more political influence (Schiffer and Weder, 2001).

In particular, we capture capital adequacy by the risk-based capital ratio. To control for asset quality, and in particular credit risk, we use the risk-weighted assets ratio. We also use the return on assets ratio as a measure of earnings and managerial ability. To proxy for the liquidity component we use the ratio of liquid assets to total assets. Finally, we include the natural logarithm of total assets to account for bank size. A detailed description of these variables is available in Table 1. Financial variables have been trimmed in the (-3,+3) standard deviations window around their mean.

Table 4 provides the descriptive statistics of the above variables, for the full sample (part i), political connected banks only (part ii) and punished banks (part iii). Table 5 reports the mean difference of all variables for two groups: non-punished banks and those punished with a severe enforcement action. There is divergence in the mean values of the variables across samples in Table 5. According to the figures reported, it is apparent that punished banks are of lower quality in terms of capitalization, asset quality and earnings. However, it appears that punished banks are more liquid than non-punished banks. Moreover, punished banks appear to be larger. Focusing on the political influence variable, it appears to be higher for non-punished banks and this difference is statistically significant at the 1% level. At this point there is preliminary evidence of the fact that politically connected banks are less often enforcement targets. The following section provides a multivariate analysis in order to examine the relationship more

thoroughly.

[Insert Table 4 , 5 Around Here]

## 4 Analysis and results

### 4.1 Baseline results

To examine the relationship between political influence and the likelihood of an enforcement action, we follow prior literature and use a non-linear probability model. Therefore, as in Lambert (2018) ,we estimate our baseline equation with a Probit model of the following form:

$$Action_{i,k,t} = \alpha + \beta_1 Pol.Influence_{i,k,t} + \beta_2 Controls_{i,k,t} + \gamma state_{k,t} + \delta quarter_t + \varepsilon_{i,k,t} \quad (1)$$

where  $i$  refers to bank  $i$ ,  $k$  refers to state  $k$  and  $t$  refers to quarter  $t$ .  $Action_{i,t}$  is a dummy variable that takes 1 if a bank  $i$  received an enforcement action in quarter  $t$  and 0 otherwise.  $Political Influence_{i,t}$  is a dummy variable that takes 1 if bank  $i$ 's parent company operates in a state where an elected official holds a chair position in a Congressional Committee related to banking and financial services in quarter  $t$ , and 0 otherwise. Therefore,  $\beta_1$  is the coefficient of the variable of interest and reveals the effect that politically important states have on the probability of receiving a severe type of enforcement action.  $Controls_{i,t}$  is a vector of covariates accounting for bank-level characteristics for bank  $i$  at quarter  $t$ . Given the nature of our setting it is important to account for the observable and unobservable characteristics across states. We therefore include a full set of state dummies. In order to account for variation across time, we additionally include a set of time dummies. Equation (1) is estimated using robust standard errors clustered by bank.

Table 6 provides the estimation results of our baseline model. Column 1 reports the results for all types of actions, and Column 2 reports the results when severe types of actions taken into account. The coefficient of the core variable of interest,  $PoliticalInfluence_{i,t}$  is negative and significant at the 1% level for severe types of actions, confirming our earlier observations from Table 5. This suggests that banks whose parent company operates in a politically important state are less likely to be subject to severe types of enforcement actions. The significance of our core variable of interest deteriorates when all types of actions are taken into account. Thus, the effectiveness of our political influence measure appears to be important for cases where banks are subject to enforcement actions that are more closely related to more severe types of



misconduct.<sup>14</sup>

[Insert Table 6 Around Here]

To examine the sensitivity of our results to the use of alternative models, we re-estimate Equation (1) under six assumptions<sup>15</sup>. More specifically, we: (i) use a Linear Probability Model with bank-level fixed effects, (ii) use a Binary Logit model, (iii) use a suitably modified logit model that accounts for the fact that enforcement actions can be seen as "rare events"<sup>16</sup> (iv) use a multinomial logit model that accounts simultaneously for all three possible outcomes (i.e. severe, less severe, and no enforcement action), (v) use ordered logit and probit models that take into account the ordering of the severity of the action, and (vi) alter the dependent variable when estimating the binary model for "severe" actions. As discussed earlier, in the results shown in specification 2 in Table 6, the dependent variable takes the value of 1 in the case of severe actions and 0 otherwise. Thus, the value of zero has been assigned in cases of both less severe actions and no enforcement actions of any type. At this stage, we drop the cases of less severe actions from the analysis and essentially re-estimate the model with the dependent variable taking the value of 1 for severe actions and the value of 0 for no enforcement action of any type.

In all the six cases discussed above, our findings remain the same and consistent with the ones presented in Table 6. Therefore, in the analysis that follows we concentrate on severe-type actions only, an approach that is consistent with Lambert (2018). Lambert (2018) provides two further justifications that could possibly also explain why less severe actions appear to be insignificant. First, less severe actions are usually issued against individuals affiliated with an institution and not because of the financial condition of the institution. Second, less severe actions do not have a direct impact on bank activities.

As a further test, we use alternative variations of the control variables, by either using four quarter lags or their 1st differences. Finally, Equation (1) is re-estimated with the use of alternative bank-specific control variables. For example, instead of the risk-based capital ratio, the base model is estimated using the equity to assets ratio as a measure of capitalization. Another example is the use of the natural logarithm of deposits, which indicates the size of

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<sup>14</sup>Indeed, when re-estimating Equation (1) using a dummy for less severe actions only and dropping cases of severe actions from the analysis, the coefficient of *PoliticalInfluence* is statistically insignificant.

<sup>15</sup>To conserve space we do not present these estimations. They are available from the authors upon request.

<sup>16</sup>King and Zeng (1999) highlight that models with binary dependent variables, like logit and probit can underestimate the probability of rare events. Descriptive statistics in Tables 2 and 4 reveal that enforcement actions can be seen as rare events. Taking together both types of enforcement actions, such actions represent about 1% of the total of bank observations, whereas when we focus on severe actions only, this percentage drops to 0.50%. Therefore, as in Lambert (2018), we perform a robustness test using a rare events logistic regression approach (King and Zeng, 1999, 2001; Tomz and Zeng, 1999).

the bank's sources of stable funding. These controls are included one by one as well as jointly in these set of regressions. Our findings are robust to these variations. In all the cases, the coefficient of our political influence variable remains negative and statistically significant.

In terms of the remaining control variables, the findings appear to be in line with the ones of prior studies. Briefly, it appears that on average, punished banks are larger, less capitalized, have lower risk weighted assets, return on assets, and higher liquidity .

## 4.2 Robustness analysis

In this section we examine the sensitivity of our results while (i) restricting the sample, (ii) using additional control variables, and (iii) addressing endogeneity concerns. We discuss the results in the sub-sections that follow and we present them in Tables 7 and 8.

### 4.2.1 Alternative variable and sample specification

To begin with, we explore the potential influence of the 2007 - 2008 financial crisis on the findings of the present study. As depicted in the descriptive statistics (Table 2), the number of formal enforcement actions imposed during the crisis years reached record high. The question that arises is whether political influence during the years of the crisis remains the same. To explore this, we re-estimate the base model while restricting the sample to the years of the crisis (2007-2008). In Table 7, Column (1), the coefficient of the political influence measure is negative and significant at the 5% level.

[Insert Table 7 Around Here]

A second set of tests is carried out examining particular sub-samples of the core working sample. In particular, findings so far could be driven by a specific group of banks due to their financial and demographic characteristics or geographic location. The sensitivity tests implemented in this section aims to address three main concerns. The first relates to the fact that top performing and equally, poorly performing banks could potentially be influencing the estimation results. Thus, we first estimate Equation (1) by excluding the strongly capitalised banks of the sample (top 25%) and then by excluding the poorly capitalised banks of the sample (bottom 25%). The second concern relates to the fact that some banks may be receiving preferential treatment because they are considered systematically important. In order to control for this, we exclude large banks from our sample -in particular the top 1%- and re-estimate our base model. In all three cases, our results hold. The third concern relates to the fact that banks headquartered in states which are considered to be "important banking states" may be driving

the results of our study. We thus, perform an analysis where we exclude banks headquartered in New York, California and North Carolina. Our results suggest that even when controlling for the "important banking states"<sup>17</sup> our core variable of interest retains its sign and significance.

Then we include two dummy variables to account for potential differences between the three regulatory agencies<sup>18</sup>. The first dummy takes the value of 1 in the case of banks regulated by the FDIC and the value of 0 otherwise, whereas the second takes the value of 1 in the case of banks regulated by the OCC and the value of 0 otherwise. Banks regulated by the FED form the omitted category. The results in Table 7 show that both variables enter the regressions with a positive and statistically significant coefficient. Thus, banks regulated by the FDIC or the OCC are more likely to be subject to an enforcement action than banks regulated by the FED. The inclusion of these variables in the analysis does not alter our key finding.

#### 4.2.2 Addressing endogeneity

In this section we perform further analysis to address potential endogeneity issues. In particular, endogeneity concerns are related to the fact that it is difficult to observe a bank's actual financial condition. More specifically, one cannot observe the actual CAMELs ratings, which play a major role during the enforcement process. This could lead to omitted variables bias, which could in turn lead to misleading results. Another important issue that ought to be accounted for is the fact that perhaps it is banks and the power of their organizations at a local state level that drive the appointment of an elected official with ties in Washington. Therefore, endogeneity in our set-up may also be linked to reverse causality.

We carry out a two-stage Instrumental Variable analysis, treating the political influence dummy as the endogenous component. An integral part of performing an IV analysis, is the choice of the instruments used, both on a methodological and conceptual level. As an instrument we employ the state's overall political environment, measured by the turnout rate, which is an indicator provided by the PEW Charitable trusts, an independent non-profit research and policy organization<sup>19</sup>. Voter turnout rate constitutes a summary measure that demonstrates the level

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<sup>17</sup>According to the Global Financial Centers Index Report (2018), which examines statistics on the leading financial centers on a global scale, New York (NY), San Francisco (CA) and Boston (MA) are ranked amongst the top 25 cities. Full report can be found here: <https://www.longfinance.net/programmes/financial-centre-futures/global-financial-centres-index/>.

<sup>18</sup>Ioannidou (2005) finds that the Fed's monetary policy responsibilities alter its bank supervisory behaviour, as captured by formal actions. More detailed, she finds that a tightening of the Fed's monetary policy is associated with a lower probability of intervention. However, the monetary policy actions do not affect the behaviour of the other two agencies (i.e. FDIC, OCC). Agarwal et al. (2014) also conclude that regulators can implement identical rules inconsistency due to their institutional design and incentives. Their comparison of federal and state supervisory ratings within the same bank reveals that federal regulators are systematically tougher; however, they do not find evidence that this is due to regulator self-interest and revolving doors.

<sup>19</sup>The data set can be found at the following link: <http://hdl.handle.net/1902.1/20572>.

to which citizens that are eligible to vote, participate in democratic politics. This measure is determined by a series of factors, such as voter’s interest, demographics, political culture of a state’s citizens. Therefore, voter turnout is an excellent proxy to reflect the political environment of a state. Moreover, prior studies (e.g. Gropper et al., 2013), using a variation of the voting turnout rate, provide evidence suggesting that there is indeed a link between the dynamic nature of a state’s political setting and chairmanship effectiveness.

The following two-stage model is estimated:

$$Pol.Influence_{\kappa,t} = \zeta + \eta_1 Voter\_turnout_{\kappa,t} + \eta_2 Controls_{i,\kappa,t} + \theta state_{\kappa,t} + \kappa quarter_t + r_{i,\kappa,t} \quad (2)$$

$$Severe\_action_{i,\kappa,t} = \alpha + \beta_1 Pol.Influence_{i,\kappa,t} + \beta_2 Controls_{i,\kappa,t} + \gamma state_{k,t} + \delta quarter_t + \varepsilon_{i,k,t} \quad (3)$$

where  $i$  refers to bank  $i$ ,  $k$  refers to state  $k$  and  $t$  refers to quarter  $t$ . Equation (2) is the first stage equation, where the dependent variable is the Political Influence dummy, which is treated as the endogenous variable in our model. Voter turnout is the instrument and reflects the percentage of a state’s population that participated in the electoral procedure, over the total number of the eligible to vote population. Our instrument fulfills the requirement that changes in the instrumental variable influence the endogenous Political Influence dummy, but not directly the severe action dummy. Equation (3) is the response equation of our IV analysis and is of similar specification of our base model outlined in Equation (1). We include state and quarter dummies in both equations. Due to data availability on the voter turnout variable, the analysis is estimated for the time period 2008-2015.

The results of the IV regression analysis are reported in Table 8. The specification and validity of instruments is confirmed by the relevant diagnostic tests for under and weak identification; as well as the overall F-test reported in the first stage. Overall findings show that even when isolating the exogenous component of the core variable of interest of the study, a significantly inverse relationship exists between political influence and enforcement likelihood.

[Insert Table 8 Around Here]

## 5 Further Analysis

Thus far, our findings suggest that elected officials holding a powerful position within a congressional committee that oversees the financial services industry, can influence the probability of a bank receiving a severe type enforcement action. In this section we complement our analysis by exploring alternative explanations and potential channels that could provide further insights.

## 5.1 Committee and politician related factors

### 5.1.1 Politician's power and influence

We attempt to explore personal traits of main committee chairmen in order to assess whether individual characteristics, such as a politician's level of seniority play a role in our empirical investigation. Prior studies (e.g. Gropper et al., 2013, 2015; Vidal et al., 2012) have highlighted the importance of politician seniority. In fact, Gropper et al. (2013), find that a chairman's age have a significant effect on bank performance. We therefore estimate our baseline model by examining whether long/short seniority lead to higher/lower probability of enforcement action likelihood. We explore an elected official's level of seniority through the combined average age of two chairmen (House and Senate Committee) in a particular year. This measure captures additional dimensions of power and knowledge of the industry from prior employment. A person's age can also reveal and drive other aspects, such as their decision making, level of risk or even career concerns.

Following Gropper et al. (2013), we define quarters in which the average age of both committees' chairmen is above the overall average in the sample as "high seniority" <sup>20</sup>. We then run our baseline regression separately for the subsamples of periods with high and low seniority <sup>21</sup>.

Table 9 reports the results. Our findings confirm our main results for years where committee chairs were more senior than the average, at the 1% level of statistical significance. For periods with junior committee chairs, the coefficients of our political influence variable remains negative, but it is now insignificant. Therefore, the power, knowledge and potentially the relationships acquired over the years of age and in service appear to enhance the influence of politicians <sup>22</sup>.

[Insert Table 9 Around Here]

In our attempt to further explore the potential motives of elected officials holding powerful positions in Congressional committees, in promoting laxer treatment of banks headquartered in

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<sup>20</sup>To provide an illustrative example, consider the state of Florida, which during the years examined in our study has not had an elected official holding a chair position within a powerful committee overseeing the Financial Services industry. However, with the use of the independent sampling banks from Florida can be considered in our sample in terms of high/low seniority, depending on the bank's chair age from another state, for different time periods. Thus, in this case, there is no variation across states during a particular point in time; however there is variation across time and therefore this approach provides a ground to test the level of impact of individual characteristics.

<sup>21</sup>Due to the complications when using interactions in nonlinear models pointed out by Ai and Norton (2003), we resort to examining the impact of the individual characteristics on our main effect by splitting the sample according to these characteristics. Estimating the interactions in a linear probability model yields qualitatively similar results.

<sup>22</sup>We also examined the impact of experience specifically in the role of chairmen but did not find a difference in the chair effect between high and low levels of experience

their home state; we examine two alternative paths. First, we consider the total number of votes received by a chairman as a portion of the total number of votes within the district or state (depending on chamber). We thus explore an elected official's "popularity" within their state or district, by considering the percentage of votes they receive for each election cycle. This could be a conditional factor for whether the politician was easily elected or whether the amount of votes received could potentially translate in favors owed and in more general terms, motivate elected officials. Prior studies have shown that there exists a connection between firms' political connections and job and plant creation rates, which is more pronounced in areas where elections are highly contested (Bertrand et al., 2018). We collect voting information from the Federal Elections Commission data on Elections and Voting<sup>23</sup> and manually match this information to each elected official of our sample. Second, we collect information for the total dollar amount of contributions received by each elected official in our sample. Our decision to employ this measure is driven by the fact that campaign contributions are considered to be an indirect measure of a politician's power (Berry and Fowler, 2017). To tailor the investigation around our research question, we focus on contributions particularly from the Financial Services industry and use the ratio of the sum of contributions received from the financial sector as a fraction of the total contributions received by a candidate. We choose this measure to specifically observe the level of "aggressiveness" of financial institutions in approaching politicians<sup>24</sup>. We obtain this information from the Center of Responsive Politics (Open Secrets) website.

Once the above information is collected, we create two main measures: (i) %Votes and (ii) %ContributionsFIN. Just like in the previous subsection, we then define quarters in which the average ratio of contributions received by both committees' chairmen from the financial sector to total contributions is above the overall average as "high contribution", and quarters in which average votes ratio of both committees' chairmen in a given year is below average as "high votes". The results of our baseline regressions for the subsamples of high versus low contributions and high versus low votes are reported in Table 10.

Our findings reveal that for the sub-samples where chairmen received higher votes or high contributions, the political influence variable is negative and statistically significant. In contrast, in the case of the "Low" sub-samples, the coefficient of the core variable of interest is insignificant. Therefore, from a general and aggregate scope, it appears that higher popularity (in terms of votes received), as well as higher amounts of money received by the financial sector, enhance politician's effectiveness and potentially motivation, on reducing the likelihood of a

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<sup>23</sup>Further information on the data can be found here: <https://transition.fec.gov/pubrec/electionresults.shtml>.

<sup>24</sup>Figures reported by the "Donation Concentration Metric" study, which examines the concentration of donations during an elected official's career, show that for the banking industry, four (Spencer Bachus, Jeb Henslerling, Richard Shelby, and Tim Johnson) out of ten have been Chairmen of an important Committee in Finance and are also part of our sample in our study.

bank being punished.

### 5.1.2 Political influence, committee membership and sub-committee chairmanship

The analysis presented so far has focused on the role of the Chairmen. In this sub-section we extend our analysis to examine the role of other members of the Committees. We obtain information on members of the Senate's Committee on Banking, Housing and Urban Affairs and the House of Representative's Financial Services Committee from 103rd to the 114th Congress from the Charles Stewart III and Jonathan Woon data set <sup>25</sup>. Due to the fact that it is very likely for more than one committee member to be elected from a particular state, we aggregate the information from the Charles Stewart III and Jonathan Woon data set and construct a dummy variable (*Committee member*), which takes the value of 1 if a bank is headquartered in a state where there is at least one elected official that serves as member in one of the two Committees of interest, and the value of 0 otherwise.

Additionally, we explore the potential influence of officials serving as Chairs in sub-committees. As mentioned earlier, congressional committees are in charge of working on specific tasks and issues related to a particular area of jurisdiction. Thus, the main committees consist of a number of sub-committees, each of which is in charge of dealing with even more specific tasks within the jurisdiction of their "parent" committee. For example, the House "Financial Services" Committee currently consists of five sub-committees (Capital Markets, securities and Investment; Financial Institutions and Consumer credit; Housing and Insurance; Monetary Policy and Trade; Oversight and Investigation; Terrorism and Illicit Finance), which engage in and deal with a set of very specific issues. In terms of subcommittee organization and structure, similarly to the main committees, the subcommittees also are assigned a chairman and a group of members who are elected officials across different states <sup>26</sup>.

For the purposes of our study, we focus on the following two sub-committees, which are considered to be the more relevant to our analysis: (i) The House of Representative's subcommittee "Financial Institutions and Consumer Credit" and (ii) The Senate's subcommittee on "Financial Institutions and Consumer protection" <sup>27</sup>. We obtain historical information on sub-committee chairmanship from the Center of Responsive politics website from the 106th -114th

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<sup>25</sup>Please find further information on the data and related studies at the Charles Stewart Congressional data page <http://web.mit.edu/17.251/www/datapage.html>.

<sup>26</sup>Further information on subcommittees could be found in the following: (i) Senate's Banking, House and Urban Affairs Committee can be found: <https://www.banking.senate.gov/about/subcommittees>; (ii) House of Representative's Financial Services Committee can be found <https://financialservices.house.gov/about/subcommittee-membership.htm>.

<sup>27</sup>For example, the jurisdiction of the "Financial Institutions and Consumer protection" subcommittee lies -among others- around banking institutions, deposit insurance, regulatory activities of the Fed, as well as those of the OCC and FDIC.

Congress and construct a binary variable (*Subcommittee Chair*), which takes the value of 1 if a bank is headquartered in a state where an elected official holds a Chair position on one of the two aforementioned sub-committees and the value of 0 otherwise.

We re-estimate the baseline model with the inclusion of the "*Committee member*" and "*Subcommittee Chair*" variables. The results are reported in Table 10. Our findings reveal a statistically significant and inverse relationship between the probability of a bank receiving a regulatory enforcement action and the presence of at least one member of a finance-related committee who represents the state where the bank is headquartered. Moreover, we find that sub-committee chairmen do not appear to have any influence over regulatory enforcement likelihood. In unreported regressions, we also explore sub-committee chairmanship and committee membership on the enforcement likelihood of less severe type of actions.

[Insert Table 10 Around Here]

## 5.2 Variation across bank-related traits

In this section we aim to identify whether banks with particular profiles, may be more prone to preferential treatment. For this purpose, we explore certain traits of the bank's parent company. More precisely, we examine the ownership status, by considering whether the parent company is listed in a stock exchange or not. We also consider other characteristics, such as the parent's age, and we split the sample into banks with age above and below average. Moreover, we take into account the diversity of geographic operation, and we distinguish between parent banks that have presence through offices or subsidiaries in multiple States and banks that operate in a single State <sup>28</sup>. We obtain the aforementioned information from SNL Financial database. Using the parent's unique regulatory id, we match this information with our main working sample. Due to coverage we drop institutions for which we do not have information. We re-estimate the baseline regression while splitting the sample, in turn, along these three dimensions. The results are presented in Table 11.

First, we observe that the Chair dummy, is statistically significant at the 1% level and is inversely related to enforcement action likelihood in the case of both listed and unlisted banks. Turning to the parent banks' age, the results show that the influence of the Chair is statistically significant at the 1% in the case where parent companies are above average age and only 10% in the case of parent companies with below average age. There are at least two

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<sup>28</sup>We do not split the sample on above/below average sub-samples, on the basis of the number of States where a bank operates, as this would result in having a considerable low number of enforcement actions in the above average sub-sample. Therefore, we opt for a dummy variable that brings together all the banks operating in more than one State.



potential explanations for this finding. First, older banks may be more efficient and less likely to fail, influencing the decisions of regulators and politicians <sup>29</sup>. Second, older firms may be more experienced with the machinery of the state and political influence or they can be more valuable to governmental bodies (Desbordes and Vauday, 2007; Macher et al., 2011) <sup>30</sup>. Finally, the coefficient of the Chair dummy retains its negative sign in both the samples of multiple state and single state banks; however, it is statistically significant only in the latter. Therefore, it seems that only banks that operate locally benefit from preferential treatment. Nonetheless, this finding should possibly be treated with some caution due to the very low number of enforcement actions in the case of the sample with banks operating in multiple states.

[Insert Table 11 Around Here]

### 5.3 Social and political environment

In the previous sections, we explored factors related to committee and politician characteristics, as well as bank-related traits that could be useful in explaining the enforcement action likelihood. However, what we have not taken into account so far are institutional, political, and social attributes at the State level. These are important environmental characteristics that could shape both the level of pressure to the politicians and their reaction. Therefore, in the subsections that follow we consider, the State-level: (i) Economic freedom and corruption, (ii) Political orientation and (iii) Social norms.

#### 5.3.1 State economic freedom and corruption

We start by exploring whether a state's level of economic freedom and corruption are conditional factors driving the relationship between enforcement action likelihood and political influence.

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<sup>29</sup>For example, DeYoung and Hasan (1998) report that profit efficiency improves rapidly at the typical de novo US bank during the first three years of operation; however, on average it takes about nine years to reach established bank levels. DeYoung (2003) examines banks chartered between 1980 and 1985 and concludes that initially, new banks were no more likely to fail than established banks; however, they become substantially more likely to fail as fast growth and negative earnings depleted their capital. In a more recent study, Lee and Yom (2016) also find that compared to small established US banks, recent de novos were financially fragile and failed at higher rates during the recent crisis.

<sup>30</sup>For example, Desbordes and Vauday (2007) find that age has a positive impact on the political influence of foreign firms over government regulations. In another cross-country study, Macher et al. (2011) provide evidence that older firms are more effective in influencing governmental decision-making entities than younger firms in the cases of executive, legislative, and ministerial branches, albeit not in the case of regulatory agencies. Macher et al. (2011) provide three potential reasons for which age could matter, in general, in governmental outcomes. First, firms become more adept via "learning curve" effects in influencing governmental decision-makers. Second, firms that are unsuccessful in influencing governments may fail. Third, because older firms are more likely to survive, governmental decision-makers consider favourable decisions to older firms as more beneficial due to repeated and ongoing interactions.

We opt to explore these elements, as they are key attributes to how well a democratic government functions. One would expect that in states with higher levels of economic freedom and lower levels of corruption, rent-seeking behavior would be less pronounced and elected officials would act in the interest of the citizens<sup>31</sup>.

In measuring economic freedom, we follow prior studies (e.g. Gropper et al., 2015) and obtain information on state Economic Freedom from 2000-2015 provided on an annual basis by the Fraser Institute<sup>32</sup>. We make use of the state-level overall index of economic freedom for North America, which consists of five main components/sub-groups for its calculation: Size of government, taxation, regulation, legal systems and property rights, sound money and freedom to trade internationally. The value of the index ranges from 1-10, where higher values reflect higher levels of economic freedom. Based on this information, we split the sample into high economic freedom and low economic freedom States, depending on whether the economic freedom of a given State is above or below average in a particular year.

To measure corruption on a state level we follow prior studies and collect information on convictions of public officials provided by the U.S Department of Justice<sup>33</sup> (e.g. Smith, 2016). Information is available on district level, therefore we aggregate figures on state level in order to match information with our sample. We then express these figures on per capital basis, and classify the states into ones with high corruption and low corruption, similarly to the case of economic freedom. We then re-estimate our baseline model for these sub-samples. The results are reported in Table 12.

[Insert Table 12 Around Here]

Our findings show that while the effect of the Committee's Chair remains negative in all cases, it is statistically significant only in States with low levels of economic freedom or high corruption.

### 5.3.2 Social norms

We now turn our focus on state-level social norms and their influence on the relationship between political influence and regulatory enforcement. In order to capture community morals

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<sup>31</sup>For example, in a cross-country study of the banking sector, Braun and Raddatz (2010) find that countries where banks are more politically connected are shown to rank higher on corruption. Similarly, using information from over 20,000 firms from 47 countries, Faccio et al. (2006) finds that corporate political connections are less common in the presence of more stringent regulations for political conflicts of interest and more common in countries that are highly corrupt.

<sup>32</sup>Further details on the data can be found here:<https://transition.fec.gov/pubrec/electionresults.shtml>.

<sup>33</sup>Full reports with relevant data <https://www.justice.gov/criminal/pin>.

and culture on a local level, we consider a state's level of religiosity. Prior studies have considered such proxies in both national (e.g. Dyreng et al., 2012; Adhikari and Agrawal, 2016) and international samples (e.g La Porta et al., 1999) . Religion has been shown to have an effect on various aspects ranging from firm risk-taking (e.g. Adhikari and Agrawal, 2016; Hilary and Hui, 2009), misconduct (e.g. Grullon et al., 2009) or financial reporting (e.g. Dyreng et al., 2012). Moreover, in the context of politics and voting, empirical precedent shows that a community's level of religiousness can influence the voting behavior of individuals (e.g. Layman, 1997) , as well as members of the US Congress (e.g. Fastnow et al., 1999) . In the context of our study, religiosity could potentially influence the behavior of the politician in order to "serve" the beliefs of his or her potential voters. However, what is important to highlight is that this would not necessarily reflect the beliefs or ideas of the politician.

In order to test the above, we collect information from the "Churches and church membership files of American religion data archive (ARDA)"<sup>34</sup>. In particular we retrieve data on religion that are made available from surveys conducted in 2000 and 2010. We follow Adhikari and Agrawal (2016) and obtain estimates for intermediate years by linearly interpolating the decennial data. We make use of state-level version of data for consistency with the set-up of our working sample. Our measure of religiosity is defined as the total number of congregations divided by a state's population. Based on this variable, we then split our sample to above ("*Religiosity high*") and below average religious ("*Religiosity low*") state and estimate our baseline model. Results are shown in Table 13.

Our key findings show that our political influence variable is negative and statistically significant for states with low levels of religiosity; whereas for states with high level of religiosity the effect is no longer significant. A potential explanation could be that in areas with higher religious adherence, the local community would follow religious beliefs and norms; while "punishing" misconduct and unethical decisions and behaviors. Thus, in such communities, politicians aiming to reassuring the probability of re-election and social acceptance, would be more likely to perhaps conform to such situations. In contrast, when religion is less pronounced or is not as popular within a local community, then the above "unwritten rules" would deteriorate. Consequently, in such cases there is further room for less ethical behavior, the cultivation of beneficial relationships between politicians and firms and other rent-seeking behavior.

[Insert Table 13 Around Here]

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<sup>34</sup>More information on the ARDA surveys can be found here <http://www.thearda.com/Archive/ChState.asp>.

### 5.3.3 State political polarization

Our final exercise is to examine the state level political polarization. In a two-party political system, as in the US, it is very likely to observe divergence of ideologies and political attitudes towards various socio-economic issues, within Congress among Republican and Democratic parties. Academic studies state that increased polarization impedes policy making and outcomes, and could also be tied to lower quality of legislation (e.g. Epstein and Graham, 2007) . Moreover, it potentially drives Congress to "gridlock" and policy inaction (e.g. Binder, 2004; Jones, 2001) . Our goal, in the context of the present study, is to explore whether ideological distance between political elites, enhances the observed relationship between political influence and favourable treatment of banks. In essence, it could be that in states with higher divergence of political attitudes by members of congress; politicians are more prone in establishing relationships with banks in order to secure their support, in exchange for benefits such as more favourable treatment.

We obtain information provided by Voteview on Congressional Roll-Call Votes <sup>35</sup>, which provides scores of measures (DW-NOMINATE scores) that indicate on the ideological positions of elected officials over time and range from -1 (liberal) to 1 (conservative). We proceed to the construction of an "overall state polarization index", following the procedure in McCarty et al. (1997), by calculating the average distance between Democrats and Republicans within a state, based on these scores. Once the index is constructed, we then create an indicator for states with high levels of elite polarization ("*Polarisation high*") and another for states with low levels of elite polarization ("*Polarisation low*"). Using these variables, we re-estimate our baseline model for the two samples. The results are reported in Table 13.

Our results suggest that the effect of our political influence dummy on enforcement action likelihood is significantly negative for states with higher levels of polarization, whereas the coefficient of this variable is not statistically significant for states with lower levels of polarization. These findings could therefore suggest that indeed as members of congress become more diverge to each other, political influence is enhanced. Thus, it is consistent with prior literature suggesting that as polarization increases, policy outcomes are affected.

## 6 Conclusion

The core objective of the present study is to provide evidence on whether powerful politicians can exert influence on regulatory decision making. So far, the literature provides evidence that political connections are beneficial to firms, through a variety of channels. The majority of

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<sup>35</sup>Further information can be found here <https://voteview.com/data>.

studies examining the relationship between political connections and regulatory outcomes, focus on the political strategies that firms adopt (e.g. lobbying, campaign contributions) to influence policy makers. Nonetheless, there is scarce evidence on whether and how political connections to Washington can result in beneficial regulatory treatment of banking institutions. The present study addresses this gap.

Focusing on the US banking sector, we use a sample of commercial banks for the period 2000-2015, and we measure political power with a binary variable that indicates whether or not a bank's parent company operates in a state where a Senator or Congressman serves as Chairman in a finance related Congressional Committee. We consider both severe and less severe enforcement actions issued against banks as a proxy for regulatory treatment, although we mainly focus on severe ones.

Our findings suggest an inverse relationship between political influence and enforcement action likelihood. Our results hold when alternative model specification and econometric methods are implemented. In a series of robustness tests, we also find that our political influence variable exerts significant influence on enforcement action likelihood when we control for the crisis years, for different regulatory agencies supervising the banks, as well as for several sub-samples (e.g. large banks, poor vs top capitalized banks). Our results remain robust when addressing endogeneity as well. Our findings suggest that politicians with power in Congress are likely to have the ability to influence regulatory decision-making. Thus, these findings complement previous studies (e.g. Gropper et al., 2013,2015) that suggest that such connections have an impact on bank performance.

We further explore alternative patterns of influence on a politician, bank and state-level, in order to explain our baseline results. In particular, we find that Chairing a committee matters when Chairs are more senior, receive greater amounts of campaign contributions from the financial services industry or when they have higher levels of vote concentration. On a bank level, we find that political influence is important in the case of both listed and unlisted parent banks; however, the Chair is more influential in the case of older banks and banks operating in a single State. Finally, a state's overall socioeconomic and political environment also plays an important role in the treatment of banks with headquarters in politically important states. More precisely, in states with lower economic freedom, higher corruption, lower levels of religiosity and higher polarization, there appears to be room for political influence to be effective. Overall, our findings are useful in shedding light on the impact of political influence on shaping regulatory decisions. Moreover, from a policy-making perspective, we provide evidence that enables the further understanding of whether political influence enhances or impedes the effectiveness of banking supervision.

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Table 1: List of variables

Variable	Description
<b>A. Main political variables</b>	
Committee Chair	Takes "1" if bank's parent company operates in a state where an elected official (Senator or Congressman) holds a chair position in a Congressional Committee that oversees the banking and financial services industry in a given year, 0 otherwise
Committee member	Takes "1" if bank's parent company operates in a state where an elected official (Senator or Congressman) holds a chair position in a Congressional Committee that oversees the banking and financial services industry in a given year, 0 otherwise
Subcommittee chair	Takes "1" if bank's parent company operates in a state where an elected official (Senator or Congressman) holds a chair position in a Congressional Committee that oversees the banking and financial services industry in a given year, 0 otherwise
<b>B. Regulatory Variables</b>	
Action all types	Takes "1" if bank received any type of enforcement action in quarter t, 0 otherwise
Severe action	Takes "1" if bank received severe type of enforcement action in quarter t, 0 otherwise
Less severe action	Takes "1" if bank received less severe type of enforcement action in quarter t, 0 otherwise
<b>C. Financial Characteristics</b>	
Risk-based capital ratio	Total qualifying capital divided by risk-weighted assets net of allowances and other reductions
Risk-weighted assets	Risk-weighted assets net of allowances and other reductions divided by total assets
Return on assets	Income (loss) before applicable income taxes and discontinued operations divided by total assets
Liquidity ratio	Cash and cash balances plus US treasury securities divided by total assets
Size	Natural logarithm of total assets
Listed (parent)	Takes "1" if bank's parent company is listed in a stock exchange, 0 otherwise
Age (parent)	Natural logarithm of number of years that the bank's parent company is operating
Multiple states (parent)	Number of states that parent company has offices
<b>D. Politician's characteristics, elections &amp; voting information</b>	
Contributions(fin) %	% total amount of contributions received by financial sector divided by the total amount of contributions received
Votes %	%total number of votes received divided by the total number of votes within state or district
Seniority	Average combined age of chairmen in a given year
<b>E. Macroeconomic and state level variables</b>	
Economic Freedom	State- level overall index of economic freedom that takes values 1-10. Higher values indicate higher levels of economic freedom.
Corruption	Per capita number of convictions of public officials
Religiosity	Total number of congregations divided by a state's population
Political polarization	Index reflecting the level of political polarization within a state. Calculated using the average distance of DW scores for Democrats and Republicans. Higher values indicate higher levels of political polarization.
GDP (state)	Natural logarithm of Gross domestic product per state
Population (state)	Natural logarithm of Population per state

Table 2: Descriptive statistics of enforcement actions

Year	All types	Severe	Less Severe	Breakdown of severe actions				Severe Actions per regulatory agency		
				Cease & Desist	Deposit ins. term.	Prompt Corr. Action	Formal written agreements	FDIC	FED	OCC
2000	76	51	25	29	2	1	21	20	2	29
2001	111	60	51	31	0	3	26	25	2	33
2002	126	79	47	42	0	1	37	29	1	49
2003	143	70	73	51	0	0	22	37	0	33
2004	159	75	84	49	0	0	26	36	3	36
2005	171	65	106	48	0	0	22	30	0	35
2006	156	45	111	27	0	0	19	18	2	25
2007	185	63	122	48	0	0	16	39	1	23
2008	300	150	150	95	0	0	56	75	1	74
2009	593	364	229	232	0	27	106	243	11	110
2010	710	420	290	84	0	55	281	301	16	103
2011	450	228	222	163	1	37	27	169	5	54
2012	314	153	161	35	0	16	103	111	5	37
2013	186	72	114	21	0	8	45	47	0	25
2014	135	38	97	9	0	7	22	25	5	8
2015	109	22	87	5	0	2	15	18	2	2
Total	3,925	1955	1970	969	3	157	844	1223	56	676

Table 3: Summary information of banking committee chairs

Name	Year	Congress	Chamber	Committee	State	Party	Avg. service year in Congress	Aver. age while in chair service
William Philip Gramm	1999- 2000	106	Senate	Banking, Housing and Urban affairs	Texas	Republican	20.5	57.5
Paul Spyros Sarbanes	2001- 2002	107	Senate	Banking, Housing and Urban affairs	Maryland	Democratic	30.5	68.5
Richard Craig Shelby	2003- 2006	108- 109	Senate	Banking, Housing and Urban affairs	Alabama	Republican	25.5	70.5
Christopher John Dodd	2007- 2010	110- 111	Senate	Banking, Housing and Urban affairs	Connecticut	Democratic	33.5	64.5
Tim Johnson	2011- 2014	112- 113	Senate	Banking, Housing and Urban affairs	South Dakota	Democratic	26	67
Richard Craig Shelby	2015- 2016	114	Senate	Banking, Housing and Urban affairs	Alabama	Republican	37	82
Michael Garver Oxley	2001- 2006	107- 109	House	Financial Services	Ohio	Republican	30.5	59.5
Barney Frank	2007- 2010	110- 111	House	Financial Services	Massachusetts	Democratic	35.5	68.5
Spencer Bachus	2011- 2013	112- 113	House	Financial Services	Alabama	Republican	19	65
Jeb Hensarling	2013-	114-	House	Financial Services	Texas	Republican	11	57

Table 4: Descriptive statistics of financial variables

Observations	Observations	Mean	St. Dev.	Min	Max
(i) Full sample					
Risk-based capital ratio	372851	0.1627947	0.0666491	-0.1676752	0.8203545
Risk weighted ratio	372124	0.6855651	0.1273082	0.2852844	1.081971
Return on Assets	374368	0.0069594	0.0096871	-0.1567464	0.1713443
Liquidity	369494	0.0594606	0.0514141	-0.0024057	0.3194084
Size	374528	11.94797	1.333464	3.332205	21.46335
(ii) Connected sample					
Risk-based capital ratio	18454	0.1753796	0.0707974	-0.001486	0.8168582
Risk weighted ratio	18381	0.6438928	0.1287669	0.285319	1.077301
Return on Assets	18516	0.0076363	0.0073914	-0.1132164	0.1699827
Liquidity	18120	0.0667662	0.058359	0.0026748	0.3192939
Size	18528	12.09121	1.411821	6.900731	19.43696
(iii) Punished sample					
Risk-based capital ratio	1952	0.1242376	0.0578782	-0.1469169	0.5605881
Risk weighted ratio	1945	0.7210423	0.1076446	0.2898475	1.075673
Return on Assets	1950	-0.0073306	0.022274	-0.1473495	0.115203
Liquidity	1926	0.0769846	0.0597405	0.0005808	0.3169498
Size	1955	12.32602	1.670912	8.840435	21.402

Table 4 reports the descriptive statistics of the variables included in the analysis. For a detailed definition of variables see Table 1. The sample period is 2000q1 - 2015q. Section i provides the descriptive statistics of the full sample. Sections ii and iii, provide the descriptive statistics for politically connected and punished with severe type enforcement actions banks, respectively.

Table 5: Univariate test of means

	Mean (Punished with severe type action)	Mean (Non-Punished)	Difference (P-Value)
Political influence	0.0245524	0.049601	0.0000
Risk-based capital ratio	0.1242376	0.1629976	0.0000
Risk-weighted assets	0.7210423	0.6853787	0.0000
Return on assets	-0.0073306	0.0070343	0.0000
Liquidity	0.0769846	0.0593688	0.0000
Size	12.32602	11.94599	0.0000

Table 5 reports the mean values of each variable for two distinct groups; banks that received a severe type regulatory enforcement action (punished) and banks that did not (non-punished). The mean difference along with the p-value of the relevant statistical test is reported in the last column. For full definition of variables see Table 1.



Table 6: Baseline results

	(1)		(2)	
	All Actions		Severe Actions	
	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx
Committee Chair	-0.086** (0.037)	-0.002**	-0.160*** (0.055)	-0.001***
Risk based capital ratio	-2.529*** (0.222)	-0.052***	-3.827*** (0.332)	-0.034***
Risk weighted assets	-0.022 (0.078)	-0.000	-0.187* (0.102)	-0.002*
Return on assets	-19.541*** (0.538)	-0.401***	-20.393*** (0.617)	-0.183***
Liquidity ratio	1.129*** (0.130)	0.023***	1.566*** (0.159)	0.014***
Size	0.110*** (0.009)	0.002***	0.038*** (0.010)	0.000***
Constant	-3.305*** (0.172)		-2.319*** (0.212)	
Observations	366319		365686	
Cluster	8659.000		8642.000	
Time dummies	YES		YES	
State dummies	YES		YES	
Pseudo $R^2$	0.090		0.133	

Table 6 reports the baseline results of a Probit model with robust standard errors clustered by bank. Sample period is 2000q1-2015q4. In Column 1 dependent variable refers to all types of enforcement actions, Column 2 refers to severe type of actions, whereas Column 3 to less severe types only. A set of full time and state dummies are included. For detailed variable description see Table 1. The \*, \*\* and \*\*\* signs denote statistical significance at the 1,5 and 10% level.

Table 7: Robustness analysis

	(1)		(2)		(3)		(4)		(5)		(6)				
	Excl. Financial crisis years	Mfx	Excl. high capitalised banks	$\beta / SE$	Mfx	Excl. low capitalised banks	$\beta / SE$	Mfx	Excl. top 1% in size banks	$\beta / SE$	Mfx	Excl. important banking states	$\beta / SE$	Mfx	Regulator dummies
Committee chair	-0.181*** (0.061)	-0.001***	-0.171*** (0.059)	-0.002***	-0.184*** (0.065)	-0.001***	-0.141** (0.055)	-0.001**	-0.160***	-0.001***	-0.152*** (0.055)	-0.001***	-0.152*** (0.055)	-0.001***	-0.001***
Risk based capital ratio	-3.837*** (0.337)	-0.030***	-5.569*** (0.426)	-0.061***	-2.202*** (0.348)	-0.017***	-4.006*** (0.339)	-0.035***	-3.827*** (0.332)	-0.034***	-4.086*** (0.345)	-0.031***	-4.086*** (0.345)	-0.031***	-0.031***
Risk weighted assets	-0.221* (0.116)	-0.002*	-0.303*** (0.108)	-0.003***	0.109 (0.120)	0.001	-0.190* (0.104)	-0.002*	-0.187* (0.102)	-0.002*	-0.118 (0.104)	-0.002*	-0.118 (0.104)	-0.001	-0.001
Return on assets	-23.259*** (0.943)	-0.180***	-20.032*** (0.688)	-0.220***	-20.466*** (1.145)	-0.159***	-20.526*** (0.624)	-0.180***	-20.393*** (0.617)	-0.183***	-20.573*** (0.633)	-0.157***	-20.573*** (0.633)	-0.157***	-0.157***
Liquidity ratio	1.520*** (0.179)	0.012***	1.722*** (0.172)	0.019***	0.971*** (0.201)	0.008***	1.490*** (0.161)	0.013***	1.566*** (0.159)	0.014***	1.651*** (0.161)	0.013***	1.651*** (0.161)	0.013***	0.013***
Size	0.048*** (0.012)	0.000***	0.037*** (0.011)	0.000***	0.055*** (0.014)	0.000***	0.011 (0.010)	0.000	0.038*** (0.010)	0.000***	0.033*** (0.010)	0.000***	0.033*** (0.010)	0.000***	0.000***
Constant	-2.502*** (0.253)	-2.004***	-2.004*** (0.223)	-2.963***	-2.963*** (0.257)	-1.971***	-1.971*** (0.214)	-2.319***	-2.319*** (0.212)	-2.319***	-2.818*** (0.212)	-2.818***	-2.818*** (0.212)	-2.818***	-2.818***
Observations	295331	276770	276770	273135	273135	362249	362249	365686	365686	365686	365686	365686	365686	365686	365686
Time dummies	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
State dummies	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Regulator dummies	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
Cluster	8601.000	7897.000	7897.000	8178.000	8178.000	8566.000	8566.000	8642.000	8642.000	8642.000	8642.000	8642.000	8642.000	8642.000	8642.000
Pseudo $R^2$	0.126	0.140	0.140	0.069	0.069	0.136	0.136	0.133	0.133	0.133	0.150	0.150	0.150	0.150	0.150

Table 7 reports the results of a set of additional sensitivity tests. Results reported in Column 1 refer to the results obtained when crisis years are excluded from the sample, in Columns 2 and 3 high and low capitalised banks are excluded. In Column 5 we exclude large banks from our sample, in Column 6 we exclude banks headquartered in "important banking states" and finally in Column 6 we add regulator dummies. Models are estimated with a Probit model with robust standard errors clustered by bank. Sample period is 2000q1-2015q4. A set of full time and state dummies are included. For full variable description see Table 1. The \*, \*\* and \*\*\* signs denote statistical significance at the 1, 5 and 10% level.

Table 8: Addressing Endogeneity

First stage results	
	Dep var: Political influence
Voter turnout	0.0513496 ***
	0.0006056
State dummies	YES
Time dummies	YES
F-test	7189.99
Second stage	
	Dep var: Severe action
Committee Chair	-0.003477 ***
	0.0006094
Observations	364064
R-squared	0.0206
Bank-controls	YES
State dummies	YES
Year dummies	YES
Kleibergen-Paap rk LM statistic	741.677
Kleibergen-Paap rk Wald F statistics	7189.988

Table 8 reports the results of the IV analysis. The model estimated with robust standard errors clustered by bank. Sample period is 2008q1-2015q4. A set of full time and state dummies are included in both stages. The \*, \*\* and \*\*\* signs denote statistical significance at the 1,5 and 10% level.

Table 9: Politician's power and influence

	(1)		(2)		(3)		(4)		(5)		(6)	
	High seniority	Low Seniority	Financial sector contr. (Above average)	Financial sector contr. (Below average)	Financial sector contr. (Above average)	Financial sector contr. (Below average)	Financial sector contr. (Above average)	Financial sector contr. (Below average)	Financial sector contr. (Above average)	Financial sector contr. (Below average)	Financial sector contr. (Above average)	Financial sector contr. (Below average)
	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx
Committee chair	-0.186*** (0.068)	-0.002***	-0.149 (0.104)	-0.001	-0.193*** (0.072)	-0.002***	-0.079 (0.086)	-0.000	-0.174*** (0.059)	-0.002***	0.083 (0.139)	0.000
Risk based capital ratio	-4.095*** (0.397)	-0.044***	-3.050*** (0.606)	-0.015***	-4.626*** (0.443)	-0.053***	-2.592*** (0.492)	-0.015***	-4.239*** (0.394)	-0.042***	-1.763*** (0.492)	-0.010***
Risk weighted assets	-0.257** (0.114)	-0.003**	-0.240 (0.232)	-0.001	-0.252** (0.122)	-0.003**	-0.372** (0.187)	-0.002**	-0.141 (0.108)	-0.001	-0.484* (0.284)	-0.003*
Return on assets	-18.629*** (0.651)	-0.201***	-22.683*** (1.800)	-0.110***	-17.721*** (0.683)	-0.205***	-20.775*** (1.731)	-0.122***	-18.945*** (0.654)	-0.187***	-20.812*** (2.343)	-0.118***
Liquidity ratio	1.700*** (0.177)	0.018***	0.757** (0.367)	0.004**	1.701*** (0.182)	0.020***	0.590* (0.330)	0.003*	1.411*** (0.166)	0.014***	0.829 (0.687)	0.005
Size	0.036*** (0.011)	0.000***	0.037* (0.021)	0.000*	0.036*** (0.011)	0.000***	0.021 (0.020)	0.000	0.039*** (0.011)	0.000***	0.007 (0.029)	0.000
Constant	-2.238*** (0.227)		-2.284*** (0.422)		-2.164*** (0.249)		-2.105*** (0.366)		-2.310*** (0.236)		-1.964*** (0.489)	
Observations	247889	110797	198421	160650	288219	66191						
Time dummies	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
State dummies	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Cluster	7574.000	7790.000	7130.000	8053.000	8116.000	6887.000						
Pseudo $R^2$	0.128	0.092	0.137	0.068	0.129	0.051						

Table 9 reports the estimation results when seniority, financial sector contributions and % votes received by elected officials are taken into consideration. We run the regressions separately for sub-samples of periods with high/low seniority, contributions and votes concentration. We make use of a Probit model with robust standard errors clustered by bank. Sample period is 2000q1-2015q4. A full set of state dummies are included. For detailed variable description see Table 1. The \*, \*\* and \*\*\* signs denote statistical significance at the 1,5 and 10% level.

Table 10: Committee membership and sub-committee chairmanship

	(1)		(2)	
Dep. Var: Severe type enforcement actions	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx
Committee member	-0.056** (0.024)	-0.001**		
Sub-committee chairman			-0.113 (0.071)	-0.001
Risk based capital ratio	-3.766*** (0.334)	-0.034***	-3.772*** (0.334)	-0.034***
Risk weighted assets	-0.160 (0.103)	-0.001	-0.163 (0.103)	-0.001
Return on assets	-20.095*** (0.624)	-0.180***	-20.077*** (0.625)	-0.180***
Liquidity ratio	1.520*** (0.161)	0.014***	1.528*** (0.160)	0.014***
Size	0.039*** (0.010)	0.000***	0.040*** (0.010)	0.000***
Constant	-2.310*** (0.215)		-2.385*** (0.213)	
Observations	362645		362645	
Time dummies	YES		YES	
State dummies	NO		NO	
Cluster	8536.000		8536.000	
Pseudo $R^2$	0.124		0.124	

Table 10 reports the estimation results when committee membership and sub-committee chairmanship are explored. We make use of a Probit model with robust standard errors clustered by bank. Sample period is 2000q1-2015q4. A full set of state dummies are included. For detailed variable description see Table 1. The \*, \*\* and \*\*\* signs denote statistical significance at the 1,5 and 10% level.

Table 11: Bank-related traits

Dep. var: Severe type enforcement actions	(1)			(2)			(3)			(4)			(5)			(6)		
	Listed	Non-listed		Above average age parent			Below average age parent			Multiple state			Single state					
	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx		
Committee chair	-0.492** (0.220)	-0.004**	-0.236*** (0.091)	-0.001***	-0.420*** (0.143)	-0.002***	-0.178* (0.106)	-0.001*	-0.145 (0.149)	-0.001	-0.306*** (0.101)	-0.001	-0.306*** (0.101)	-0.002***				
Risk based capital ratio	-1.714* (0.908)	-0.012*	-2.399*** (0.442)	-0.014***	-1.336** (0.523)	-0.007**	-3.065*** (0.629)	-0.022***	-0.237 (0.491)	-0.001	-2.769*** (0.509)	-0.001	-2.769*** (0.509)	-0.017***				
Risk weighted assets	0.246 (0.286)	0.002	-0.018 (0.168)	-0.000	0.265 (0.200)	0.001	-0.256 (0.211)	-0.002	0.281 (0.255)	0.002	-0.128 (0.173)	0.002	-0.128 (0.173)	-0.001				
Return on assets	-18.454*** (2.084)	-0.134***	-24.876*** (1.246)	-0.150***	-21.817*** (1.756)	-0.117***	-22.626*** (1.412)	-0.160***	-16.422*** (2.302)	-0.103***	-25.443*** (1.323)	-0.103***	-25.443*** (1.323)	-0.154***				
Liquidity ratio	2.701*** (0.465)	0.020***	0.843*** (0.257)	0.005***	1.755*** (0.300)	0.009***	0.882*** (0.326)	0.006***	2.933*** (0.448)	0.018***	0.759*** (0.259)	0.018***	0.759*** (0.259)	0.005***				
Size	0.097*** (0.016)	0.001***	0.027 (0.018)	0.000	0.094*** (0.014)	0.001***	-0.014 (0.023)	-0.000	0.082*** (0.018)	0.001***	0.041** (0.018)	0.001***	0.041** (0.018)	0.000**				
Constant	-3.801*** (0.412)		-2.659*** (0.324)		-3.865*** (0.347)		-1.997*** (0.427)		-4.186*** (0.461)		-2.619*** (0.336)		-2.619*** (0.336)					
Observations	44702		195934		125117		117611		47651		194327		194327					
Time dummies	YES		YES		YES		YES		YES		YES		YES					
State dummies	YES		YES		YES		YES		YES		YES		YES					
Cluster	1349.000		4009.000		3607.000		4029.000		1543.000		3888.000		3888.000					
Pseudo R <sup>2</sup>	0.113		0.091		0.100		0.093		0.104		0.098		0.098					

Table 11 reports the estimation results when bank-related characteristics are explored. We make use of a Probit model with robust standard errors clustered by bank. Sample period is 2000q1-2015q4. A full set of state and time dummies are included. For detailed variable description see Table 1. The \*, \*\* and \*\*\* signs denote statistical significance at the 1,5 and 10% level

Table 12: State economic freedom and corruption

	(1)		(2)		(3)		(4)	
	Economic freedom (above average)		Economic freedom (below average)		Corruption (above average)		Corruption (below average)	
	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx
Committee chair	-0.102 (0.070)	-0.001	-0.204*** (0.074)	-0.002***	-0.197*** (0.063)	-0.002***	-0.110 (0.086)	-0.001
Risk based capital ratio	-3.072*** (0.451)	-0.023***	-4.089*** (0.496)	-0.048***	-3.385*** (0.517)	-0.034***	-3.833*** (0.455)	-0.036***
Risk weighted assets	-0.136 (0.138)	-0.001	-0.034 (0.135)	-0.000	-0.056 (0.151)	-0.001	-0.038 (0.130)	-0.000
Return on assets	-21.288*** (0.912)	-0.162***	-19.640*** (0.850)	-0.229***	-20.343*** (0.964)	-0.204***	-20.777*** (0.804)	-0.192***
Liquidity ratio	1.492*** (0.244)	0.011***	1.555*** (0.209)	0.018***	1.608*** (0.242)	0.016***	1.540*** (0.207)	0.014***
Size	0.038*** (0.014)	0.000***	0.043*** (0.011)	0.001***	0.025* (0.014)	0.000*	0.054*** (0.011)	0.000***
Constant	-3.731*** (0.528)		-3.019*** (0.463)		-2.369*** (0.472)		-3.484*** (0.420)	
Observations	184549		179515		146343		217721	
Time dummies	YES		YES		YES		YES	
Macroeconomic variables	YES		YES		YES		YES	
Cluster	5993.000		5782.000		6489.000		7889.000	
Pseudo $R^2$	0.103		0.119		0.102		0.123	

Table 12 reports the estimation results when state economic freedom and corruption are taken into consideration. We run the regressions separately for sub-samples of states with high/low economic freedom and corruption. We make use of a Probit model with robust standard errors clustered by bank. Sample period is 2000q1-2015q4. A full set of time dummies are included. For detailed variable description see Table 1. The \*, \*\* and \*\*\* signs denote statistical significance at the 1,5 and 10% level.

Table 13: State religiosity and political polarization

	(1)		(2)		(3)		(4)	
	Religiosity (Above average)		Religiosity (Below average)		Political polarization (Above average)		Political polarization (Below average)	
	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx	$\beta$ / SE	Mfx
Committee Chair	0.021 (0.080)	0.000	-0.316*** (0.068)	-0.003***	-0.299*** (0.074)	-0.003***	-0.072 (0.072)	-0.001
Risk based capital ratio	-2.691*** (0.455)	-0.021***	-4.094*** (0.483)	-0.045***	-4.728*** (0.438)	-0.046***	-2.116*** (0.475)	-0.020***
Risk weighted assets	-0.237 (0.185)	-0.002	0.069 (0.120)	0.001	-0.169 (0.126)	-0.002	0.163 (0.167)	0.002
Return on assets	-23.320*** (1.175)	-0.184***	-19.414*** (0.746)	-0.213***	-19.702*** (0.797)	-0.192***	-21.901*** (0.998)	-0.202***
Liquidity ratio	0.837** (0.329)	0.007**	1.914*** (0.184)	0.021***	1.782*** (0.195)	0.017***	1.155*** (0.280)	0.011***
Size	0.056*** (0.017)	0.000***	0.039*** (0.011)	0.000***	0.051*** (0.012)	0.000***	0.038*** (0.014)	0.000***
Constant	-3.242*** (0.593)		-2.183*** (0.447)		-2.311*** (0.475)		-4.034*** (0.533)	
Observations	163818		200246		198933		165131	
Time dummies	YES		YES		YES		YES	
Macroeconomic Var.	YES		YES		YES		YES	
Cluster	3991.000		5253.000		6138.000		5055.000	
Pseudo $R^2$	0.092		0.124		0.131		0.090	

Table 13 reports the estimation results when state religiosity and political polarization are taken into consideration. We run the regressions separately for sub-samples of states with high/low religiosity and political polarization. We make use of a Probit model with robust standard errors clustered by bank. Sample period is 2000q1-2015q4. A full set of time dummies are included. For detailed variable description see Table 1. The \*, \*\* and \*\*\* signs denote statistical significance at the 1,5 and 10% level.



# Appendix I

## Enforcement actions classification

<b>ENFORCEMENT ACTIONS ISSUED AGAINST BANKS</b>	
<b>A.1. SEVERE ( ordered from most severe to less severe):</b>	
<b>Deposit Insurance Termination /Threat</b>	Decision to threat to suspend or terminate a bank's deposit insurance scheme by the FDIC, when unsound and unsafe banking practices are detected or when violations of laws and regulations have taken place. Deposit Insurance Termination can be imposed if a bank has neglected previous enforcement actions issued against the bank.
<b>Cease and Desist Order</b>	Banks that receive Cease and Desist orders are required to follow specific actions outlined by their primary supervisor. C&D orders can be enforced by law, in the federal banking system. Typical reasons or the issuance of C&D orders are the engagement in unsafe and unsound activities, violations of laws and regulations. A C&D may impose specific orders to stop the bank engaging in specific banking practices or may outline a particular strategy in order to improve asset quality, promote growth, decrease risk, etc.
<b>Formal written agreement</b>	The institutions subject to this type of action, enter into an agreement with their primary regulator to take particular actions or to follow particular proscriptions in written agreement. Unlike the C&D orders, although FAs are also legally enforceable, they are however, not enforceable through the federal court. FAs can nonetheless lead to the issuance of Civil Money Penalties, when they are ignored. Reasons that FAs are imposed are unsound practises, mismanagement policies, or "insider" abuse. FAs can lead to more severe types of enforcement actions if not taken into consideration.
<b>Prompt Corrective Action</b>	Prompt Corrective Actions are issued usually when undercapitalization issues are detected. These actions order banks on taking remedial actions in order to overcome the deficiencies in their level of capital. Among the corrective measures outlined, in some cases there may be dismissal of management, restrictions on executive payments, asset growth, rates paid on deposits or even prohibition on certain activities, such as approval for acquisition deals from the regulatory authorities.
<b>A.2. LESS SEVERE TYPE</b>	
<b>Civil Money Penalty (CMP)</b>	Monetary penalties against banking institutions that engage in unsafe or unsound banking practices, violations of laws or failure to comply with an order issued previously.
<b>Call report penalty (CR-P)</b>	Monetary penalties against banking institutions that fail to file Call Reports on time or in accordance to the general outline or even for misreporting information on Call Report files.