Introduction

Banks' governance has drawn much attention in the context of recent financial crisis. Since banks are considered to play a vital role in the financial world and in the economy at large, problems with poor governance in the banking sector are more severe and have more significant costs. One of the central mechanisms of an organization's internal governance system is its board of directors (Fama and Jensen, 1983). A board should make sure that the systems of risk monitoring and control are effective, which means that directors are aware of risks and are able to take remedial decisions if necessary. For the Basel Committee on Banking Supervision too, the board is a crucial element of the firm risk management framework.

Many studies have analyzed the link between the quality of boards and performance in banks (Adams and Mehran, 2012; Andres and Vallelado, 2008), but less research exists on the association between board characteristics and risk at banks. For the United States (U.S.), several studies find evidence of the relevance of board structure to bank risk (Akhigbe, Martin, and Newman, 2008; Andres and Vallelado, 2008; Pathan, 2009), but there are few studies for Europe and none with comparisons between U.S. and European publicly-held banks.

The article explores the association between bank board characteristics and risk-taking behaviors by comparing samples in U.S. and Europe. We are motivated to study the comparison between U.S. and European banks for the following reasons. Firstly, the two areas are different in terms of regulatory standards and social norms. However, they are still comparable given that both are developed areas. U.S. banking industry has a large number of banks, approximately 7 200 commercial banks, many of which are local banks. The monitoring system in the U.S. banking industry is fragmented, including the Federal Reserve System (F.E.D.) and the Federal Deposit Insurance Corporation (F.D.I.C.). The Sarbanes Oxley law requires listed companies to have 100% of independent directors on audit committees while independency is only a recommendation in many countries in Europe. According to the newspaper Les Echos (2011), among the 27 countries in the European Union, the number of banks is about 9000, which is quite similar to that in the U.S.. The monitoring agencies include the Banque Centrale Européenne (B.C.E.), which monitors only the banks in the Euro zone and the European Banking Authority (E.B.A.), which is a new supervision institution established in January 2011. Whereas U.S. and European banks are both supposed to comply with the measures of the Basel Committee, the implementation of standards is less followed in the U.S..The Fed announced in November 2012 that U.S. banks would not implement Basel III standards in January 2013. Secondly statistics show that U.S. banks were more likely than European banks to be in financial distress between 2007 and 2010. According to the F.D.I.C. (February 2012) the financial crisis led to the collapse of hundreds of American banks and two out of five large investment banks had to be financially rescued to avoid bankruptcy. In Europe, although the situation varies by countries, it seems to be less severe than that in the U.S..

Using a sample of 65 large European banks and 125 large U.S. banks over the period 2005-2006, this study examines the characteristics of U.S. and European banks right before the financial crisis, aiming to deepen our understanding of whether board characteristics were associated with bank risk-taking and whether this association was different in the U.S. and in Europe. In addition, this work has policy implications concerning bank governance. The paper focuses on the period right before the financial crisis in order to explore the causes and driving forces of the crisis. The empirical results can provide valuable insight into whether any governance actions could be undertaken to prevent or reduce the severity of the financial crisis.

This study contributes to the existing literature in several ways. First, this paper provides new evidence on the relation between certain bank board characteristics and bank risk-taking. Second, it brings an international comparison of the influence of the board on risk-taking in the banking sector (United States versus Europe). The remainder of the paper is structured as follows. Section 2 presents a review of academic literature and hypotheses development. Section 3 describes the data, the variables and the empirical method. Section 4 provides the results and Section 5 concludes the paper.

1. Related literature and hypotheses development

Several bank board characteristics can have an association with bank risk-taking. We investigate the association between bank risk-taking and the size of the board, the percent of independent directors, the number of meetings, the characteristics of an audit committee, the characteristics of a risk committee and Chief Executive Officer (CEO) duality.

1.1 Board Size

From a disciplinary point of view, a smaller board could facilitate control. Jensen (1993) argues as board size increases, boards' ability to monitor management decreases, due to a greater ability to shirk and an increase in