The Political Origin of Home Bias: the case of Europe

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ABSTRACT

We show that politics is at the root of the banks-sovereign nexus that exacerbated the Eurozone crisis. First, government-owned banks or banks with politicians in the board of directors display higher home bias in sovereign debt compared to privately-owned banks throughout the 2010-2013 period. Second, only government-owned banks increased the home bias during the sovereign crisis (moral suasion). We exploit the fact that equity injections (bail-outs) by domestic governments were not directly targeted to political banks to show that, upon receiving such assistance, only government-owned banks purchase domestic debt. Such political pressure is stronger in countries under stress.

JEL classification: G01, G11, D72.

Keywords: Banks–sovereign nexus, Home bias, Government–owned banks, Banks’ recapitalization, Board of directors

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1. Introduction

The European sovereign debt crisis has emphasized the importance of the so-called banks-sovereign nexus: an adverse feedback loop between the health of the banking system and that of its sovereign. Many have argued that banks’ sovereign debt holdings are the critical channel that transmitted credit risk from sovereigns under stress in Europe to the real economy, causing sizable drops in lending and investment\(^1\). Worthy of note, European banks’ sovereign portfolios consist almost entirely of domestic government debt: the average (median) home exposure is 74\% (86\%) of the total sovereign debt exposure at the end of 2010 (Figure 1). The domestic exposure is well beyond what standard portfolio theories would predict: there is significant home bias (Figure 2).\(^2\)

In order to understand and possibly prevent this adverse feedback loop, one has to first identify what drives home bias in sovereign debt holdings at the bank level. We believe that politics may be at the root of the problem. Many European banks are government–owned or have politicians sitting on the board of directors. These politicians would then persuade the politically-controlled banks to finance national or local state borrowing by purchasing government bonds. We show that this is the case for the sample of European banks that participated in the European Banking Authority (EBA) regulatory exercises.

First, we provide cross–sectional evidence at the bank level that “politically–controlled” banks, \textit{i.e.} either those owned by the domestic government or with former politicians in the board of directors, hold a disproportionate amount of their own country’s sovereign debt. This is true both at the onset and during the European sovereign debt crisis. Second, we show how political pressure was at work during the crisis (\textit{moral suasion} channel). We exploit the fact that government equity injections (bail–outs) were used to recapitalize distressed banks, but not government–owned banks in particular, to document that government–owned banks use

\(^1\)See Gennaioli, Martin, and Rossi (2014), Acharya, Eisert, Eufinger, and Hirsch (2015), Popov and Van Horen (2015), De Marco (2015) and Altavilla, Pagano, and Simonelli (2015).

\(^2\)The Capital Asset Pricing Model (CAPM) predicts that, in frictionless financial markets, homogenous investors would hold a share of financial asset equal to the share of the financial assets of that country in the world portfolio (see Cochrane (2005), page 155, and Coeurdacier and Rey (2012)). In the context of sovereign bonds, we use the home bias measure as defined in Coeurdacier and Rey (2012):

\[
\text{HomeBias} = 1 - \frac{\text{Share of Foreign Sovereigns in Bank i Sovereign Holding}}{\text{Share of Foreign Sovereign Bonds in the Global Portfolio}}
\]

When the home bias measure is equal to zero there is perfect diversification; when it is equal to one there is perfect home bias. Anything in excess of zero indicates some level of home bias.
government funds to purchase more domestic debt. Not surprisingly, we find that the moral suasion channel is stronger among government–owned banks from the GIIPS countries, as weak governments presumably have greater need to use the domestic banks to finance borrowing.

Many European banks are still, at least partly, government–owned either at the regional (Germany) or national level (Portugal) or through private foundations whose directors are appointed by local or national politicians (Italy, Spain). Also, many politicians sit on the banks’ board of directors. We use these two as our main measures of “political influence”. In particular, the first is the total percentage of equity held by central or local governments (including banking Foundations in Italy) in the pre–crisis period (2006 or 2009) for our sample of EBA banks. We can then use government ownership either as a continuous or as a discrete variable. Second we look at the share of directors who were former politicians, either at the national (ministers, members of Parliament) or local (mayors, city councillors) level, excluding those who started their tenure at the bank after 2006. We use pre–crisis data precisely to avoid biases given by bank nationalizations and bail–outs that occurred in 2010–2012. If we were to measure government ownership contemporaneously with home bias, we would both overestimate the state’s presence in the banking sector and introduce additional endogeneity, in the sense that banks could commit to purchase more domestic sovereign debt in an attempt to get political influence and government support during the crisis.

Importantly, our results on the moral suasion channel are robust to the inclusion of country-time fixed effects, bank-specific measures of risk-taking and ECB extraordinary liquidity interventions, such as the 3 year LTRO. Thus, the increase in home bias due to moral suasion is robust to alternative explanations such as risk synchronization, carry trade, reaching for yields or zero–risk weighting (Acharya and Steffen (2015), Korte and Steffen (2015)). One may also be concerned about reverse causality in our setup: banks could increase the home bias to signal their commitment to the domestic government and get government support in return during the crisis. We address this concern in three ways. First, our measures of “political influence” use pre–crisis data (2006 or 2009). Second, we analyse the determinants of government support (Table 9) and neither the “political influence” nor the level or the change in the home bias are significantly correlated with the amount of government bail–outs. Finally, the results hold

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4 Such measures include leverage, risk-weighted assets over total assets, non-performing loans over gross loans and net charge-offs.

4 This is different from the results found in other papers (Faccio, Masulis, and McConnell (2006), Faccio, Masulis, and McConnell (2015)).
if we restrict the sample to Germany and Spain, whose banks cannot further increase their political entrenchment. In fact, savings banks in Germany are already fully owned by the local governments while the Spanish Cajas are very close to the maximum share of voting rights allotted to the government by law (Section 3).

The hypothesis that some European governments may have put pressure on domestic banks to purchase local sovereign debt (moral suasion/financial repression) during the European sovereign debt crisis is also entertained in a set of other contemporaneous studies (Acharya, Eisert, Eufinger, and Hirsch (2015), Acharya and Steffen (2015), Becker and Ivashina (2014), Ongena, Popov, and Van Horen (2015), Horváth, Huizinga, and Ioannidou (2015)). We, like some of these papers, focus specifically on the differences between “politically-controlled” (either government-owned or with former politicians in the board of directors) and private banks. Differently from these papers we emphasize the importance of measuring political connections in the pre-crisis period to avoid potential endogeneity issues. Moreover, we document for the first time a clear, bank-specific channel through which political pressure works: upon receiving government help in the form of equity injections (bail-outs), only the banks that are subject to political pressure actually increase their degree of home bias in sovereign debt holdings.

The moral suasion channel is not the only explanation for the home bias in sovereign bonds, both before and during the sovereign debt crisis. In the international finance and asset pricing literature, home bias is often explained as the result of informational asymmetries: local investors are better informed about the domestic sovereign than foreign investors are (Van Nieuwerburgh and Veldkamp (2009)). More recently, several papers focused on the home bias in the GIIPS countries during the sovereign debt crisis using creditor discrimination theories (Broner, Erce, Martin, and Ventura (2014) and Brutti and Sauré (2013)) or as arbitrage opportunities fueled by carry trades, especially for undercapitalized banks (Acharya and Steffen (2015)). We do not challenge these hypotheses; on the contrary, we complement them by showing that also political pressure on controlled banks plays a crucial role in explaining the rise in home bias at the bank level. Another frequently mentioned reason for banks to hold sovereign bonds is that, even under Basel II, government bonds are considered risk free.\footnote{According to Basel II regulation, in order to compute Risk Weight Assets (RWA), banks can use two approaches: the Standardized Approach and the Internal-Ratings Based (IRB) approach. According to the (2006)) who find that politically connected firms are more likely to receive bail-outs. Differently from these papers, we only focus on a set of developed countries in Europe whose levels of corruption tend to be lower than in developing nations.}
According to this hypothesis, banks would boost their risk–based capital ratios by loading up with sovereigns and crowding out private lending (capital arbitrage). However, since the zero risk weight applies not only to domestic sovereign debt, but to all countries in the European Union, it cannot explain home bias. On the contrary, it may have been a source of contagion from GIIPS countries to non–GIIPS banks (Korte and Steffen (2015)).

The paper proceeds as follows. Section II reviews the related literature. In Section III, we highlight some country-specific institutional details that are relevant to our analysis; Section IV describes the data and the methodology used in the paper. Section V presents the results and Section VI concludes.

2. Related Literature

Although many have suggested that moral suasion/financial repression may have been at work during the recent sovereign debt crisis, the relationship between home bias in sovereign holdings and political influence at the bank level is, to the best of our knowledge, not been empirically established in the literature.

First, we contribute to the enormous international finance literature pioneered by French and Poterba (1991) that studies home bias in portfolio holdings. Most papers in this area focus on home bias in equity rather than bond holdings. Few exceptions are Bertaut, Tabova, and Wong (2013), documenting the decline in financial bonds’ home bias among U.S. investors and Lane (2006), showing that member countries of the European Economic and Monetary Union disproportionately invest in one another and especially towards their trade partners. Several recent papers analyze the increase in sovereign home bias among banks during the recent sovereign debt crisis. Battistini, Pagano, and Simonelli (2014) document that only GIIPS banks respond to increases in country risk by increasing their exposure to domestic sovereign bonds, while banks from core countries do not, suggesting that redenomination/repatriation risk, i.e. the risk that the liabilities of banks would be renominated in the local currency, is the driving force behind the increase in home bias. Becker and Ivashina (2014), while focusing first, government bonds receive a 0% risk weight as in Basel I. Under the IRB instead, the weight should be strictly positive, because, even though the model may assign a very low probability of default (PD) to a sovereign issuer, the loss given default (LGD) is positive. In practice, PD on sovereign debt are equal 0.1% for 201 major international banks (BIS Quarterly Review, December 2013). Moreover, in the European Union, there is a loophole that allows banks using the IRB to switch back to the Standardized Approach when evaluating sovereign bonds (“IRB permanent partial use”).
on a different research question, document a positive correlation at the country level between domestic government holdings by national banks and aggregate measures of state ownership in the banking system. Brutti and Sauré (2013) analyze cross–country evidence in favor of the secondary market theory suggested by Broner, Erce, Martin, and Ventura (2014). According to this hypothesis, in a crisis period, domestic banks would buy domestic debt in the expectation that the government will not default on domestic creditors. Compared to these papers, we do not use cross–country but bank–level data, thus we are able to provide an explanation for why only some banking institutions display large degrees of sovereign home bias.

Other recent papers using bank-level data are Ongena, Popov, and Van Horen (2015), Horváth, Huizinga, and Ioannidou (2015) and Altavilla, Pagano, and Simonelli (2015). In the first paper, the authors analyze differences in purchases between foreign and domestic banks when the government needs to roll over a large amount of outstanding public debt: they find that the effects are larger for state–owned banks. The second paper looks at a wide range of determinants for the home bias in banks’ portfolios and it finds that home bias is higher in case of a risky sovereign especially for government–owned banks. The last paper documents how domestic sovereign exposures amplify the transmission of sovereign stress to banks’ default risk and lending behavior; in addition they show that domestic sovereign exposures are higher for politically controlled banks. Three aspects differentiate this paper from the above mentioned studies: first, we emphasize the importance of looking at the pre–crisis level of government ownership to avoid biases given by banks’ nationalization during the crisis; second, we provide evidence that the extent of political influence extends beyond the direct equity ownership by looking at the share of politicians sitting in the board of directors. Finally and most importantly, we document a clear channel through which moral suasion works: in the panel regressions we show that when banks are bailed–out, only the politically controlled ones use the government funds to increase their domestic exposure.

Some theoretical papers also explore the home bias issue. Other than the aforementioned study by Broner, Erce, Martin, and Ventura (2014), Diamond and Rajan (2011) advances the hypothesis that banks are keen to load up with illiquid assets because the states of nature in which these assets default are the same in which the bank itself goes bankrupt; in other words, banks rationally put all their risk in a state of the world that would be catastrophic

\footnote{Namely, the crowding out effect of sovereign debt on firms’ ability to obtain loans.}
for them anyways (*risk shifting/synchronization*). Domestic government debt may be especially suitable to achieve such a risk synchronization. Acharya and Rajan (2013) and Crosignani (2014) further show that myopic governments have incentives to increase risk synchronization; Uhlig (2014) builds a model in which risky governments have an incentive to allow domestic banks to load up on domestic bonds and potentially default. The evidence we provide suggests that, upon receiving liquidity injections, only the “political banks” boost their exposure to domestic government bonds relative to foreign ones, thus synchronizing even further their default risk with that of their respective domestic country.

Our findings also contribute to the literature on the performance of state-owned banks and the role of political connections at the corporate level more in general. Faccio, Masulis, and McConnell (2006) and Faccio (2006) assemble a large dataset on political connections at the firm level worldwide. They find that corporations where the government is a large shareholder or a top officer is a local politician are more likely to receive bail-outs. The stock price of these companies also increases when those involved in the business enter politics. Barth, Caprio Jr, and Levine (2001) provide a broad overview on the effects of regulation and ownership structure on the performance of the banking system. In general, they find that greater state ownership of banks tends to be associated with less developed banks and financial markets. Sapienza (2004) finds that firms located in areas where the party of affiliation of the bank’s chairman is stronger receive more favorable loan conditions; Cuñat and Garicano (2010) show that banks whose chairman held a political position in the past perform worse than other banks. La Porta, Lopez-de Silanes, and Zamarripa (2003) find evidence that loans extended to related parties, either family members or controlled firms, have on average lower rates, lower collateral requirements and are more likely to default than unrelated ones. Ilueca, Norden, and Udell (2013) show that political influence among Spanish savings banks is associated with higher risk-taking and loan defaults. Finally, Khwaja and Mian (2005) document that in Pakistan government banks extend a preferential treatment to politically connected firms.

3. Institutional Details

There are three European countries that stand out for the pervasive and systematic role of politicians and local governments in the management of banks: Italy, Germany and Spain. In
what follows we provide some key features that distinguish each of these countries in terms of political presence in the banking system. We also discuss the case of France as an example of a banking sector without any direct political influence, at least in the last decade.

**Italy**

State–owned banks were common in Italy until 1990 (Sapienza (2004)), when a wave of liberalizations at the European level induced the Italian government to privatize the domestic banking system. In particular, in 1990 the Amato–Carli law transformed the state-owned banks into private entities. However, since the government wanted to preserve the state–owned banks’ “social objectives” of supporting the local economy, the banks were first sold to Foundations (non–profit organizations). Foundations were established as public holdings that could not directly execute any banking activity, but that could use dividends from the controlled banks to pursue projects of public interest. The Foundations were supposed to place their shares on the market at a later date to complete the privatization. In 1998, the Amato–Ciampi law superseded the 1992 law, reiterating that Foundations are non-profit organizations, but adding that these should operate under private law and not under public law as in the previous regime. As they became private entities, they could no longer be forced to progressively sell off their shares on the market. Thus, Foundations were able to maintain their controlling stakes in most Italian banks to the present day.

In conclusion, although formally no state–owned bank exists in Italy since 1990, banking Foundations are still under the influence of political groups. For example, the members of the board of directors in the Foundations are often appointed by the local public officials or are politicians themselves\(^7\). We will then assume that ownership from a Foundation is the same as government ownership. The two may not necessarily coincide if the political party the Foundation is affiliated to is not part of the current government. We believe this is not a concern in our case. First of all, apart from Monte dei Paschi (MPS), which is almost entirely controlled by a centre–left leaning Foundation, the two other major Italian banks in our dataset have more than one Foundation among their shareholders. Moreover, most of the times, within each Foundation there are members coming from both left and right wing parties. This degree

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\(^7\)Boeri (2012): http://www.lavoce.info/i-politici-al-vertici-delle-fondazioni-bancarie/ (in Italian). This is also consistent with Bortolotti and Faccio (2009), who find that after the large privatization waves of the 1990s, many OECD governments still retained a significant control over privatized firms.
of heterogeneity should convey the idea that, in the majority of the cases, banks with a large concentration of Foundations are influenced by a wide range of political parties. Even if a given party is not in power at a specific point in time, it has an interest in inducing the controlled bank to purchase more domestic debt (see the Appendix for a discussion of political parties’ incentives).

Germany

The German banking system is organized in three different “pillars”: private banks, such as Deutsche Bank and Commerzbank; cooperative banks, based on a member-structure where each member has one vote and, finally, public banks. The latter are financial institutions, typically owned by the regional states (Lander) or by administrative districts or cities in which they are headquartered. Among these there are savings banks (Sparkassen) whose shareholders are usually local municipalities and the regional banks (Landesbanken), that are mostly owned by their respective Lander through a regional savings bank association.

Thus, in the case of Germany the definition of “political banks” is clear: those that have a direct state participation among their shareholders. In the EBA dataset, the political banks will mostly be the Landesbanken. The percentage of equity attributable to both local and regional government among the Landesbanken is essentially 100%, with the exception of HSH Nordbank which has 89.34% government shares. On the other hand, the rest of the german banks in our sample have no government equity stakes.

Spain

Savings banks (Cajas) represent a fundamental pillar of the Spanish banking system: founded in the 18th century with the objective of channeling private savings towards socially beneficial investments, savings banks accounted for 40 percent of Spanish banks’ total assets in 2010.

Similar to banking Foundations in Italy, they became financial institutions that do not distribute profits, that have no formal owner, but several governing bodies representing two different classes of stakeholders: insiders and outsiders. Insiders are employees, depositors and private founders; outsiders are the regional governments and other public entities. The voting power of the two groups in each bank depends on the specific regional law. In 2002, a national reform
capped the representation of public entities, including regional governments, at 50 percent of the voting rights in each bank. In July 2010, the ceiling on voting rights of public entities was reduced to 40 percent and professional expertise was required to sit in a governing body (see IMF (June 2012)). Prior to 2010, many of the Spanish savings banks in our sample are either above or already very close to the 40% limit set on July 2010. Therefore, they seem not to have any additional margin to increase their political entrenchment during the sovereign debt crisis. On the contrary, the 2010 reform was aimed at curbing such political presence in the banking sector.8

France

A different path has been followed by France.9 After World War II and up to the late 1980s, almost all banks, both investment and commercial, were either state-owned or co-operatives. The Chirac government changed the situation when, in 1987, he privatized several major banks, including Societe Generale and Paribas. Another wave followed few years later in 1993, with the privatization of BNP among others. The complete privatization of the banking system was accomplished in 2001.

4. Data and Methodology

4.1 Data

The dataset is the result of the merger of four different sources: detailed bank level data on the exposure to sovereign bonds and liquidity injections from the EU-wide Stress Test and Recapitalization Exercises; information on the pre-crisis degree of government ownership in each bank is collected from Annual Reports whenever available; the political affiliation of board members is obtained from BoardEx;10 other balance sheet data comes from Bankscope.

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8 In mid 2012, the Spanish savings banks underwent a series of reforms aimed at improving the stability of the banking sector; most of the savings banks’ activities have been transferred to newly created commercial banks. However, the elimination of political interference from banking activities is still incomplete, since the same savings banks morphed into holding companies of the newly created commercial banks. For more details see IMF (March 2013).

9 Alain Plessis (2003), The history of banks in France, Federation Bancaire Francaise.

10 Initially, we explored the CV of board members from Capital IQ People Intelligence to identify directors that were former politicians. While the results are qualitatively similar, BoardEx data are of better quality than Capital IQ and allow to pinpoint the entire board of directors at specific points in time.
Sovereign exposure data have been collected by the EBA in the context of the EU-wide Stress Tests and Recapitalization Exercises. In an effort to enhance transparency and restore confidence in the financial system, the EBA decided to disclose bank-by-bank results for the 2010, 2011 and 2014 Stress Test Results and the so-called 2011 and 2012 Recapitalization Exercises. These exercises contain information on the capital composition, including government bail-outs in the form of equity support measures, credit risk exposure and sovereign debt exposure to each of the 30 members of the European Economic Area (EEA 30) for all the participating banks. The sample in March 2010, which we will match to end-of-year balance sheet data in 2009, and December 2010 contain 90 banks; 61 banks in December 2011, June 2012 and December 2013 covering at least 60% of banking assets in Europe and at least 50% in each Member State.

Basically, the sovereign exposure data cover the entire European sovereign debt crisis, from the onset (2010Q1, 2010Q4), through the peak (2011Q4, 2012Q2) and until after the crisis (2013Q4). For December 2010, a breakdown of the credit portfolio by categories of borrowers is available. For instance, we know the amount of credit granted to private corporations, public institutions, small and medium enterprises, the exposure to residential mortgages and the amount of defaulted loans.

The key dataset contains the information on political influence. Specifically, we want to create a variable that captures the degree of government or politicians’ control within each bank. We also want this measure to be dated prior to the sovereign debt crisis so as not to bias the degree of political control with any bail-outs or nationalizations that occurred in 2010–2011. Hence we collect 2006 Annual Reports for all banks, except Spanish ones. It is in fact difficult to find Annual Reports at earlier dates for some small Spanish Savings banks, because many were recently acquired or merged with other banks. For this reason, we resort to IMF data, which lists for each savings bank the percentage of voting rights held by local governments prior to 2009.\footnote{IMF (June 2012).} We construct the variable \( \text{Political} \) as the sum of any participation held by the local or central governments (political foundations in the case of Italy) for each bank that participated in the EBA regulatory exercises; we then normalize it by its standard deviation. We sometimes find useful to use a dummy variable, \( 1(\text{Political}) \), which takes value of one if the degree of political control in a specific bank is above the median of the domestic country and zero otherwise. We also create a dummy variable, \( 1(\text{Cooperative}) \), which takes value of one...
if the bank is a cooperative and zero otherwise. It is important to distinguish between non-cooperative and cooperative banks, since the latter display certain features that are similar to those of highly politicized banks even though they are not owned by the state (diffuse ownership among cooperative members). Notably, cooperative banks display a high degree of home bias in sovereign bonds, similar to political banks, probably due to the very “local” nature of their business model.

But government ownership may not capture all the mechanisms through which politicians can control the banking system. For example, even if the French government has not been a shareholder in any French bank since 2001, some current and former politicians are part of the banks’ board of directors. These political board members can have a “hands-on” influence on the management of the bank. In Germany, the Minister President or the Minister of Finance of a Land is often a board member of the local Landesbank. Former ministers, members of Parliament, mayors and local councillors in other European countries, such as Italy (through Foundations), Portugal, Sweden and others are often part of the board of directors. We analyze the data from BoardEx to determine whether a board member among the EBA banks in our sample has been affiliated with the government, either at the national or local level (see list of roles in Table 1). Our sample construction starts with identifying all individuals who sit on the board of an EBA bank at any point in time between 1990 and 2006.\footnote{We exclude those that terminated their tenure before 2000, thus eliminating those that have not been running the banks for a long time. We also exclude those that were nominated after 2006 to be consistent with our government-ownership variable that is measured in 2006.} BoardEx has a separate spreadsheet (“Historical Non Board Role”) that contains the information on previous job experience of each board member present on BoardEx. We first kept all those directors in EBA banks that worked in the domestic government sector (297 matches). We then manually check these entries to distinguish the true politicians from the advisors/staff members that are also listed under “government” jobs, but have no formal political experience. In total we found 80 former politicians (see Table 1 for a list of roles) that by 2006 were on the board of directors of 37 of the 61 EBA banks present on BoardEx. Finally, we match the EBA dataset with banks’ balance sheet data obtained from Bankscope.

Table 2 reports some summary statistics of the dataset for December 2010. On average, the European banks that are part of the EBA sample have 75% (7%) of the sovereign portfolio (total assets) invested in the domestic sovereign and most of this is in excess of what the CAPM
model would predict: the Coueudacier–Rey measure of home bias (CR(2012)) is well above 0 on average. Aggregate statistics at the country level from the ECB confirm that these exposures are representative of the entire banking system (Figure 3). Moreover, these shares are moderately stable over time between 1997 and today especially for the GIIPS countries (the only notable exception being Ireland and the Netherlands, displaying larger volatility). Although home bias is high on average there is a significant degree of heterogeneity, where some banks have home bias of 100% and others almost zero. This was also evident from Figures 1 and 2.

On average, the pre–crisis (2006) ownership by domestic government or political entities in Europe is at 20% among the 90 banks participating in the European Stress Test in 2010. Moreover, only 48 banks (53% of the sample) have at least some level of government ownership. Among the 61 EBA banks present on BoardEx, former politicians represent 6% of the board of directors, but in the 37 banks that have at least one former politician as a board member the average increases to 10%. Although government ownership and the share of political board member are clearly positively correlated ($\rho = 0.5$), it is also true that the two variables have a different informational content. In fact, as Figure 4 shows, there are quite a few banks that have at least one former politician on the board of directors although they are not formally government owned. Also, 35 banks in our sample received some form government bail–out at the end of 2010, with an average, conditional on the help being positive, of 3.6% of RWA. These are large numbers considering that, on average, the Tier1 over RWA ratio, gross of government equity injections, is at 11% for EBA banks. Among these, 20 (12) banks have at least some degree of government ownership (at least one director being former politician), but these “politically influenced” institutions do not appear to receive a preferential treatment from their own government. Indeed, the amount of government help over RWA is larger for private banks than it is for politically influenced ones, as shown in the last three rows of Table 2. Similarly, government help over RWA is uncorrelated with either government ownership and what we identify as political banks ($1(Political) = 1$); these unconditional correlations are 0.075 and −0.030 respectively.

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13 In the EBA dataset, government help is listed as part of Core Tier 1 capital as “Ordinary shares subscribed by government” and “Other existing government support measures”
4.2 Empirical Methodology

Cross-Sectional Regressions. To measure the effect of political presence in a bank on its degree of home bias in sovereign bonds, we run a set of cross-sectional regressions for 2010Q1, 2010Q4, 2011Q4, 2012Q2, 2013Q4. For each year we employ the following specification:

\[ \text{HomeBias}_i = \beta_1 \text{Political}_i + \gamma' \text{X}_i + \mathbb{1}(\text{Cooperative}_i) + \text{Country}_i + \varepsilon_i \]  

(1)

where \( \text{HomeBias} \) is one of three measures: i) the ratio of domestic government bonds held by bank \( i \) over the total European debt \( \left( \frac{O_{\text{dom}}}{T} \right) \); ii) the ratio of domestic sovereign bonds and total assets \( \left( \frac{O_{\text{dom}}}{TA} \right) \); iii) the home bias measure in Coeurdacier and Rey (2012). The first and second measures are the most intuitive, but they ignore the nominal size of each country’s debt in determining home bias. For example, it is reasonable for Italian and German banks to have a larger exposure to their home country’s debt than Belgian and Dutch banks because Italian and German public debts are much larger. While we can handle this empirical issue in our estimation by controlling for country fixed effects, we also employ a third measure of home bias, one that explicitly takes the nominal size of debt into account. It is defined as follows in Coeurdacier and Rey (2012):

\[ \text{HomeBias} = 1 - \frac{\text{Share of Foreign Sovereigns in Bank b Sovereign Holding}}{\text{Share of Foreign Sovereigns in the Global Portfolio}} \]

where \( \text{Global} \) is represented by the EEA30 countries in our data. This measure is bounded between zero (perfect diversification) and one (perfect home bias), while anything in excess of zero indicates some level of home bias. Comparing Fig. 1 and Fig. 2 reveals however that the difference between the two measures is negligible: neither the country ranking nor the level of home bias is very much affected. For example, Italian and German banks have high positive values in both cases.

\[ \text{Political}_{i,j} \] does not vary over time, so we cannot use panel regressions with bank fixed effects.

\[ \text{O}_{\text{dom}} \] The EBA sovereign exposure data contains only countries belonging to the European Economic Area (EEA30), a group of 30 countries which broadly coincides with the European Union. Only in December 2010 exposure to US and Japan was disclosed, but we drop these countries from our analysis as they are only available for one year.

\[ \text{Share of Foreign Sovereigns in Bank b Sovereign Holding} \] Note that the first measure of home sovereign bonds over total sovereigns does not exactly replicate this: it is also equal to one in case of perfect home bias, but it is equal to zero if the bank does not own any domestic debt, not if the bank is perfectly diversified. This difference turns out not to matter in the regression analysis.
Political is also one of three measures. It is either the percentage of shares owned by the domestic government or other domestic political entities (Foundations in Italy, for example) divided by its standard deviation, \( \text{GovtOwn/\text{std.dev}} \); or it is a dummy, \( 1(\text{Political}) \), equal to one if the bank is above the median of the distribution of government ownership in each country; finally, it is the share of board of directors who have been former domestic politicians (ministers, MPs, mayors etc), \( \text{PolDir/TotDir} \).

Other explanatory variables we use are \( X \), a set of lagged bank balance sheet characteristics (log of Total Assets in Euros, Tier 1 ratio, Deposits over Total Funding, ROAA, Non Performing Loans over Gross Loans) and \( 1(\text{Cooperative}) \), a dummy equal to one if bank \( i \) is a cooperative bank. We allow for a different intercept in home bias for cooperative banks because these banks are characterized by dispersed ownership among members (one–head–one–vote) and no share directly owned by the domestic government: nonetheless, they usually exhibit a large home bias given by the very “local” nature of their business model. It is also possible that others, more indirect forms of political influence are at play in cooperative banks: it is often the case, in Italy for example, that cooperative firms have strong ties with political parties. Finally, \( \text{Country} \) a country dummy where the bank is headquartered. Country dummies are important because they control for country specific factors; more specifically, they take into account i) institutional characteristics and ii) optimal portfolio considerations.

The first motivation pertains to countries’ institutional heterogeneity; for example, we need to control for the fact that in Spain the government participation in each bank, by law, cannot exceed 50%, whereas in Germany the local government can hold any number of shares. German \( \text{Landers} \), both directly and indirectly, very often hold above 90% of shares in the \( \text{Landesbanken} \). Since we are interested in evaluating whether a certain political ownership is large or small in a given country, a set of country–specific intercepts in the above regression is appropriate, especially when the main regressor is the percentage of shares owned by the domestic government.

The second consideration has to do with asset pricing theory. The CAPM implies the following pricing equation: 

\[
1 = E_t[M_{j,t+1}R_{i,t+1}] = Cov_t[M_{j,t+1}, R_{i,t+1}] + E_t[M_{j,t+1}]E_t[R_{i,t+1}].
\]

\( M_{j,t+1} \) is the stochastic discount factor or pricing kernel of country \( j \) at time \( t + 1 \) and \( R_{i,t+1} \) is the real rate of return on asset \( i \) at time \( t + 1 \). The above equilibrium condition implies that the optimal holding of any asset, sovereign bonds included, depends on the covariance between a country
specific factor and an asset specific component. Therefore, each bank in country \( j \) should have the same exposure to the set of sovereign bonds. For this reason, the set of country dummies also reflects country specific portfolio aspects. We use country dummies with both dependent variables, the home exposure over the total and the Coeurdacier and Rey (2012) home bias measure.

**Panel Regressions.** In our second specification, we exploit the time dimension of the panel to investigate how home bias varied *during* the crisis. We want to test the hypothesis that, upon receiving an equity injection from the domestic government, only political banks increase their home bias relative to other banks, especially if they are located in the periphery. This would be consistent with a *political pressure/moral suasion* hypothesis, where the domestic government calls on banks to buy sovereign debt at a time of low demand for these securities. Therefore, we run the following *panel* regression:

\[
\Delta \text{HomeBias}_{i,t} = \beta_1 \text{GovHelp}_{i,t-1} + \beta_2 (1(GIIPS) \times 1(\text{Political})) \text{GovHelp}_{i,t-1} + \\
+ \beta_3 (1(\text{nonGIIPS}) \times 1(\text{Political})) \text{GovHelp}_{i,t-1} + \gamma'X_{i,t-1} + \eta_i + \lambda_t + \varepsilon_{i,t}
\]

(2)

where \( \Delta \text{HomeBias}_{i,t} \) represents the change in home bias of bank \( i \) at time \( t \), \( \text{GovHelp}_{i,t-1} \) is the amount of equity injection given by the domestic government to bank \( i \) at the beginning of the year as a fraction of Risk Weighted Assets (RWA). \( 1(\text{Political}) \) is a non–time varying dummy which equals one if bank \( i \) is above the median political control in each country and \( 1(GIIPS), 1(\text{nonGIIPS}) \) are dummies for whether bank \( i \) belongs to GIIPS or not. In this regression we allow for the effect of equity injections to differ depending on whether a bank is politically influenced and *at the same time* whether or not it belongs to the GIIPS. Finally we control for bank fixed–effects, \( \eta_i \), and for either year– or country–year fixed–effects \( \lambda_t \).

**Omitted Variables and Reverse Causality.** We find that upon receiving government support, only political banks increase their home bias in sovereign debt; moreover, political banks in the periphery (GIIPS) increase home bias by much more than political banks belonging to the core countries (non–GIIPS). Importantly, these results are robust to a number of alternative channels and explanations.
First of all, we rule out a mechanical explanation: government bail–outs are not only targeting government–owned banks. On the contrary, both unconditional and conditional correlations of government support and political control are very weak and insignificant (see Sections 4.1 and 5.5). Then, our results cannot be explained by various other factors that affect sovereign debt purchases. The zero risk–weight on sovereign bonds, that under Basel I and II rules, applies to all sovereigns from the EU, does not involve any preferential treatment for domestic sovereign debt and thus cannot explain home bias. The risk synchronization/risk shifting motives (Acharya and Steffen (2015)) that could potentially explain home bias for banks in distressed countries are all accounted for by controlling for country-time fixed effects, change in yields of domestic sovereigns, 3–year LTRO uptakes, leverage and Tier1 ratio.

One possibility is also that of reverse causality: banks could load up on domestic sovereigns in an attempt to buy political influence and receive equity injections. We argue that this argument cannot drive our results in three steps. First, we use measures of political control that are constructed using 2006 data, and therefore do not include any political ownership resulting from the government support that was extended to banks during the sovereign debt crisis. Second, we notice that government–owned banks in Spain and Germany have already achieved the maximum degree of political entrenchment in 2006, prior to the sovereign debt crisis, and so they do not have any room to buy additional political influence during the crisis (see Section 3). If we restrict the sample only to banks domiciled in Germany and Spain the results still hold (see Table 11 in the Appendix)\textsuperscript{17}. Finally, it may still be the case that some banks that were privately–owned in 2006 would continuously increase home bias later in 2010 and 2011 in an attempt to buy political influence over bail–outs. If this were the case we would have a positive and significant effect of government help for non–political banks, which however we do not observe. Moreover, we would also see that banks that have a high level of home bias or have increased it would also be receiving more government help: none of these factors is statistically significant. All these observations make it very unlikely that our results are driven by reverse causality.

\textsuperscript{17}In the case of Italy, there is nothing that forbids banking Foundations to acquire a larger share of a bank; therefore, in separate tables (not shown here) we exclude all the Italian banks from the sample and the results are virtually unchanged.
5. Results

5.1 Cross-Sectional Regressions: Main Results

Table 3 reports the results for the main set of cross-sectional regressions. In the first five columns we regress the exposure to domestic sovereigns over total sovereigns in 2009, 2010, 2011, 2012 and 2013 on our continuous variable for political influence, $GovtOwn/\text{std.dev.}$, and a set of controls. In the last five columns we repeat the exercise but now we use a discrete dummy variable, $1(\text{Political})$, equal to one if the bank is above the median in terms of government ownership in each country. First of all, we notice that the coefficients of interest are always positive and mostly significant at 5%. This implies that banks that are more politically influenced display greater home bias in sovereign bond holdings.

In column (1), at the onset of the sovereign debt crisis (2010Q1), we find that a one standard deviation increase in the level of government ownership (30 pct.points) is associated with an increase in the domestic composition of the sovereign bond holdings by 8.6%, which is about one third of a standard deviation of $Own_{TS}$. Alternatively, in column (6) the coefficient on $1(\text{Political})$ in 2010Q1 implies that a bank that moves from the bottom 50% to the top 50% of the distribution of political influence displays on average 14% more weight to domestic sovereigns relative to the total, which is about half of a standard deviation of $Own_{TS}$. These are large effects. During the development of the sovereign debt crisis in 2010-2011, the coefficients become smaller: 5% (vs. 8.6%) and 8–12% (vs. 14%) for the continuous and discrete measure of political influence, respectively. Finally the effect of the share of government ownership is further reduced in 2012–2013 (3.8–2.5%) while the discrete measure $1(\text{Political})$ is no longer significant in 2012 and 2013.\footnote{Note that this is not due to the reduced sample size between 2012Q2 and 2010Q1 (61 vs 90 banks). In unreported results, when we rerun the regression on 2010Q1 data using the sample banks in 2012Q2 we still get a large and positive coefficient.}

These results would seem to imply that, for the average European bank, the political influence on the banking system is being reduced exactly at the time of the sovereign debt crisis (2012Q2) and towards the end (2013Q4). However this interpretation of our results hides an important cross-sectional heterogeneity in the data, as we show in Section 5.3. In fact, we shall see that the coefficients on political influence are significant for GIIPS banks, that presumably received more pressures to purchase domestic debt during the sovereign debt crisis, and are not significant non–GIIPS banks that had no such pressure.
A covariate that is always highly significant is bank size, as measured by the log of total assets. The sovereign portfolios of larger institutions are more diversified: the coefficient is a semi-elasticity and it implies that for a 1% increase in total assets, the own exposure is expected to decline by 0.1 percentage points on average across all the years. Also cooperative banks, on average and all else equal, have a own exposure 16 to 18 percentage points higher than other banks, at least before 2011. Note that cooperative banks have no direct political or state ownership, but the significant degree of home bias may be explained by the very “local” nature of their business model. Or, possibly, it indicates that cooperative banks may be subject to other forms of indirect political influence, that our measure of political control cannot capture. It is often the case, at least in Italy, that cooperative savings bank have strong political ties to political parties.

Next, in Table 4 we run the same regression but changing the dependent variable to domestic sovereign bonds as a fraction of total assets or the home bias measure in Coeurdacier and Rey (2012) measure. The main results are basically unchanged, if anything both the magnitude and the significance of the coefficients are larger with the Coeurdacier and Rey (2012) measure.

5.2 Cross-Sectional Regressions: Politicians in the Board of Directors

Equity ownership may not capture all the mechanisms through which politicians can control the banking system. For example, some former politicians are often part of the banks’ board of directors, even if the bank is completely privately owned (Faccio, Masulis, and McConnell (2006), Faccio (2006)). These “politically influenced” board members can have a “hands-on” influence on the management of the bank. For example, Banco Comercial Português (Millennium BCP), the largest private bank in Portugal, has had three former ministers and two members of Parliament on the board of directors between 1998 and 2006. Credit Agricole, a large French multinational bank that was fully privatized at the beginning of the 1990s, has had four former local politicians (mayors, city councillors) as board members between 1999 and 2006. We analyzed data on past political affiliation from BoardEx and we found 80 politicians (mostly former ministers and members of parliament) that by 2006 were on the board of directors of 37 of the 61 EBA banks present on BoardEx. We then run a regression similar to before but using the share of politicians over total number of directors ($PolDir/TotDir$). The results are
in Table 5.

The results imply that, between 2010 and 2013, a 1 percentage point increase in the share of political directors is associated with an increase in home exposure over total exposure of around 0.8%. The estimated magnitude are broadly similar to before, because they imply that for a one standard deviation increase in the degree of political influence (std.dev of PolDir/TotDir=7%) the home bias would increase by around 5%, which is around one fifth of the standard deviation of Own/TS. The estimated effect again decreases in 2012Q2. Overall the results indicate that not only government equity ownership, but also political influence on the board of directors may be important in explaining home bias. However, given the small sample size (80 politicians in 37 banks) the results should be interpreted with caution.

5.3 Cross-Sectional Regressions: GIIPS vs non–GIIPS banks

If our main hypothesis is correct, i.e. that government–owned banks have a higher home bias in sovereign bonds, we should expect that moral suasion is more severe at the height of the sovereign debt crisis for the countries under stress (GIIPS). That is, we should expect the estimated coefficient on political influence to be larger and more significant for GIIPS banks in 2011 and 2012, because GIIPS governments faced a higher pressure to reduce their borrowing costs during the debt crisis compared to non–GIIPS countries. We test the implication of this hypothesis in Table 6.

The results in columns clearly indicate that the degree of political influence is heterogeneous across countries and over time. In particular, non–GIIPS government–owned banks have a higher home bias than other banks at the onset of the sovereign debt crisis (2010Q1, 2010Q4), but not during the crisis in 2011 and 2012. On the other hand, GIIPS government–owned banks, including Foundations in Italy, do not have a statistically significant higher home bias before crisis, but they do increase it when their countries go under sovereign stress (2011Q4 and 2012Q2). Columns (6)–(9) show a similar pattern if we use the dummy variable 1(Political) instead of the share of government equity ownership. Finally, it seems that at the end of 2013, when the sovereign debt crisis has tapered off, political influence does not have a significant impact on home bias.

These results overall indicate that GIIPS governments, while not strongly encouraging pur-
chases of home sovereign debt before the crisis, really push on their controlled banks to purchase domestic debt at a time of increased borrowing costs. In the next section we explore one possible way in which GIIPS governments may be exerting pressure on the banking system: the use of government funds to recapitalize banks.

5.4 Panel Regressions: Government Help and Moral Suasion

In the previous section we have shown that politically influenced banks are more likely to have a large amount of home bonds if they are headquartered in countries under stress during the sovereign debt crisis. In this section we want to test whether politicians exert further pressure to purchase home bonds on banks that need government assistance during the crisis. Specifically, we want to test whether, upon receiving equity injections, political banks increased their exposure to domestic sovereign bonds. We expect the effect to be stronger for banks in the GIIPS, where the respective governments had an incentive to encourage the purchase of government bonds so as to lower the yields. Table 7 summarizes the heterogeneous impact of government equity injections (bail-outs) on banks’ sovereign bond portfolio decisions as described in equation (2).

This is a panel regression where the dependent variable is now the change in exposure to domestic relative to total sovereigns. The key explanatory variable here is government help. The data come from the EBA Stress Tests and Recapitalization exercises, where either purchase of ordinary bank shares by the government or other forms of government support measures count as government help in the calculation of the Tier 1 capitalization ratio. The amount of government help is expressed as a fraction of Risk Weighted Assets (RWA). Column (1) suggests that receiving government help by itself does not affect the bank’s choice between buying domestic or foreign sovereigns. However, a government–owned bank that receives liquidity injections by the local government would increase its exposure to domestic sovereigns by 6.8% more than a private bank.

The effect is larger if the bank is located in particularly distressed countries, namely the GIIPS. Column (2) indicates that an additional equity injection of 1% of risk weighted assets is associated with an increase in domestic relative to total sovereign exposure by almost 7.5%, compared to 5% for non GIIPS banks. The two coefficients are sufficiently precisely estimated
so that a simple hypothesis test rejects the null that the two effects are the same at the 5% level. The results would look very similar if we used the alternative definition of home bias in Coeurdacier and Rey (2012) (not shown). These results suggest that sovereign countries, especially the GIIPS, use domestic political banks to purchase the bonds they issue when there is a lack of demand. Indeed, upon receiving freshly injected equity, only the politically controlled banks increase their degree of home bias.

The panel regressions in Table 7 are not controlling for the fact that, during the crisis, we may observe an increase in home bias because of country and time specific factors. In particular, it is conceivable that GIIPS banks may have decided to increase their home bias because of the very high yields in GIIPS sovereign bonds. Investing in these bonds was risky, but for GIIPS banks it may be perfectly rational to put all risk in a state of the world, a sovereign default, that corresponds to banks’ defaulting themselves (risk synchronization). Also, these risky behaviors may have been funded by the ECB 3 year Long Term Refinancing Operations (LTRO) in December 2011 and February 2012 that injected large amounts of liquidity, borrowed at 100 and 75 bps. respectively, into participating banks (part of the carry trade hypothesis advanced by Acharya and Steffen (2015)). We test these hypotheses and the robustness of our results in Table 8 below.

Columns (1)–(3) and (4)–(6) have the same set of controls, but the latter three split the effect of the interaction between government help and political banks among GIIPS and non–GIIPS banks. In particular, column (1) and (4) control for the change in the yearly average sovereign yield and CDS for each sovereign. \(^{19}\) The estimated coefficients on the change of sovereign yields and CDS turn out to be non–significant. Column (2)–(3) and (5)–(6) use a set of country–time FE that absorb all unobserved heterogeneity that is country and time specific, including yields and CDS. Finally, column (3) and (6) include bank specific usage of LTRO funds divided by total assets. Bank by bank figures on LTRO usage have not been released by the ECB, however we have collected data from banks’ annual reports and industry reports for 47 major EBA banks. These banks borrowed €514 bn. in both LTROs, around half of total gross funds.\(^{20}\) Figure 5 reveals that the LTRO have been dominated by Italian and Spanish banks

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\(^{19}\) The number of observations is different in column (1) and (2) because we do not have data for the sovereign yields and CDS in all countries. We do not have information on sovereign yields for Cyprus, Malta and Luxembourg.

\(^{20}\) According to industry reports by Morgan Stanley Research (2012), only around half of gross funds were actually new net funding, as banks rolled over existing ECB facilities into the LTRO. The data we have collected
(50% of the LTRO 1+2 funds), although, admittedly, the disclosure for French and German banks has been poor. In some cases we had to rely on industry estimates by Morgan Stanley Research (2012), because although it is known that a bank has participated, the actual amount was not disclosed on annual reports. Since both 3 year LTRO operations took place in December 2011 and February 2012, the LTRO variable \( \text{LTRO/TotalAssets} \) takes a value of zero before 2011Q4 for all banks and then it is equal to the amount borrowed only for the 47 banks for which information is available (it is missing in 2011Q4 for the other banks).

The results in all columns show that our hypothesis is robust even controlling for country–time specific trends and the LTRO interventions: the coefficient on the interaction term between government help and political banks is significant in all specifications. Moreover, it appears that, after we take into account country–time characteristics, the political banks in the GIIPS are the only ones that increase home bias after receiving government help. It makes sense that the significance of the coefficient survives only for GIIPS banks, because these are the countries whose governments have a higher incentive to pressure banks into buying domestic government bonds during the crisis.

5.5 Determinants of Government Support: Not just for Political Banks

One could think that our previous set of results – the fact that political banks buy more domestic government bonds upon receiving government bail–outs – could be explained by the fact that political banks are more likely such assistance during the crisis (Faccio, Masulis, and McConnell (2006)). If that were the case it would not be surprising to see that only political banks increase their respective own exposure to domestic governments. Moreover, one could think that banks may have progressively increased their domestic sovereign purchases in order to buy political influence over bail–outs. In Table 9 we show that this is not the case, i.e. we argue that reverse causality or other endogeneity concerns are not driving the moral suasion results presented in Tables 7 and 8. In particular, Table 9 estimates the relationship between the amount of equity, as a fraction of RWA, provided by local governments and a set of regressors, including capitalization, political influence, lagged and change in domestic sovereign exposure.

We report a set of cross sectional regression using the Tobit estimator (we report the slope coefficients in all cases). The Tobit approach is more appropriate for this scenario than standard

\textit{are mostly} on gross funds usage.
OLS regression because we should think of government help as a censored variable. It is equal to zero if the bank is solvent and the government decides not to extend support, while it takes any positive value otherwise. The right specification that takes into account both the discrete choice of whether or not to support a bank and the magnitude of the liquidity injection is the Tobit model. \(^{21}\) The punchline is that equity injections are targeting undercapitalized banks, not political banks directly nor banks with high or increasing home bias. In fact, government ownership does not play any additional role in attracting more support from the government, nor does having a high or increasing degree of home bias. The main factor that is negatively associated with government help is the capitalization of the bank, as measured by Tier 1 capital ratio. Importantly, the Tier 1 capital ratio in this regression is net of any form of government support, that otherwise would be included in both the dependent and independent variable, creating a mechanical and positive correlation between the two.

By looking at the marginal effects at the bottom panel of Table 9 we see that a decrease in Tier1 ratio (net of government help) by 1% in 2010 is associated on average with an increase in the probability of receiving positive government support by 15%. The effect is statistically significant at 1% and economically large: indeed, a 1% change in Tier1 ratio is about one-quarter of its standard deviation. The same marginal effect drops by half in 2011 and 2012. In terms of the marginal effects on the magnitude of government help, conditional on receiving support, a decrease in Tier1 ratio by 1% in 2010 is associated with an increase in government help over risk-weighted assets of 0.3%. Very similar effects are found in 2011 and 2012.

5.6 Cross Validation: Allocation of Credit and Political Influence

Next, we ask whether politically influenced banks tend to facilitate their respective governments in more general terms, not only through purchasing more domestic sovereigns, but also by extending more loans to domestic government institutions. To this purpose we take advantage of the fact that, in 2010 only, the European Banking Authority released data on each bank’s allocation of credit broken down by country of destination and by type of loan; for instance, we know the amount of credit that each bank issued to small and medium enterprises (SME) and to government institutions broken down by the country in which the borrower is located. We then call \(DomSME\) the share of domestic SME credit over total SME credit and \(DomINST\)
the share of loans to public institutions given to the domestic government. Table 10 indeed shows that the effect of political influence of banks’ behaviors is not specific to the purchase of domestic sovereign, but it is valid in more general terms: politically controlled banks extend more credit to domestic public entities than other banks do. Contrary to our expectations, we do not find strong evidence that political banks systematically extend more credit to small and medium enterprises; what seems to count to this regard is bank size. This suggests that small banks may proxy for regional banks which tend to lend more locally to small and medium enterprises.

6. Conclusion

We investigate why European banks suffer from a significant home bias in sovereign bond holdings. We believe that certain banks hold a disproportionate amount of their own country’s sovereign debt because they are coerced by domestic politicians. In order to test this, we analyze recently collected data from Stress Tests on European banks and we find evidence supportive of this hypothesis: political banks hold more domestic sovereign bonds and they increase their home bias in sovereign holdings conditional on receiving liquidity injections by the respective local governments; this effect is more than twice as big for political banks belonging to the GIIPS than for other European banks. Interestingly, these equity injections seem to be directed towards banks that need it rather than to political banks in particular. Moreover, we find that politically influenced banks tend to facilitate their respective governments in more general terms, not only through purchasing more domestic sovereigns, but also by extending more loans to domestic government institutions.
7. Appendix

7.1 Theory of Inter-Party Support

Whereas the political influence in the case of direct state ownership (Germany, Spain) is clear, the case of foundations' ownership (Italy) requires a more careful analysis: certain banks are affiliated with only one political party that is not necessarily in power at any given point in time. Monte Dei Paschi (MPS) in Italy is an example of such a bank: it is affiliated with the centre–left municipal government and it has a strong home bias (96%) even in 2010, when the national government is from centre–right. For these institutions, it is not clear why a political party that is not ruling the country would be interested in buying sovereign bonds and finance public spending of their opponents. It may be interested in doing quite the opposite in order to destabilize the incumbent government.

We claim that there are two main reasons that may explain that behavior. First of all, local politicians can sustain a central government of the opposite political affiliation in exchange for monetary transfers to the respective region or local municipality. There is suggestive evidence, for the case of Italy, that regional transfers are not primarily dictated by shared political affiliation; a more crucial determinant is the political strength of the party in the specific region, regardless of political affiliation.\(^{22}\)

Second, a theory that supports inter-party funding is borrowed from the political science literature. Katz and Mair (1995) and Katz and Mair (2009) are the first to document that political parties in a wide range of developed countries have started to behave like a cartel. Instead of competing against each other on relevant issues, they transfer more and more competences upward to technocratic and non-partisan commissions. Perhaps more importantly, they decided to alter the structure of payoffs: they agreed on the introduction of public financial subventions to political parties that are guaranteed regardless of whether a party wins or loses. This last piece of regulation severely limits the incentives to compete in order to win the elections, as the monetary payoffs are not linked to the election’s outcome. Hence, the concern that a bank affiliated with a leftist party would have the incentive to destabilize the governing right wing party is clearly downsized in light of the findings of Katz and Mair.

\(^{22}\text{Greco (2009) (mimeo).}\)
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Figure 1: Median Sovereign Home Bias by country, December 2010

Source: EBA Stress Test 2011. Home Bias defined as the ratio of domestic sovereign by bank \( b \) over the total: \( \text{HomeBias} = \frac{\text{Own}_b}{\text{TotalSovereign}_b} \). Country codes are the following: Belgium (BE), France (FR), Netherlands (NL), Great Britain (GB), Sweden (SE), Austria (AT), Finland (FI), Ireland (IE), Denmark (DK), Slovenia (SI), Portugal (PT), Germany (DE), Italy (IT), Greece (GR), Spain (ES).
Figure 2: Median Sovereign Home Bias by country, December 2010

Source: EBA Stress Test 2011. Home bias measure as defined in Coeurdacier and Rey (2012):

\[ HomeBias = 1 - \frac{\text{Share of Foreign Sovereigns in Bank's Sovereign Holding}}{\text{Share of Foreign Sovereign Bonds in the Global Portfolio}} \]

The Global portfolio in our case is the EEA30 portfolio, as we have sovereign exposure data for these countries only. When the home bias measure is equal to zero there is perfect diversification; when it is equal to one there is perfect home bias. Anything in excess of zero indicates some level of home bias.
Figure 3: Aggregate Sovereign Home Bias by country, Sept 1997 – Sept 2014

Source: ECB Monetary Financial Institutions (MFI) aggregate statistics: ratio between Home and Total of “Securities other than shares” on the Government portfolio (MFI assets). These statistics are given at the country level for all financial institutions (excl. European Central Banks) with a changing composition (i.e. this is the raw data that does not take into account mergers&acquisitions and bank failures).

Table 1: Political Directors: Past Government Roles

| Former Government Role         | N  | %    |
|-------------------------------|----|------|
| Minister                      | 34 | 42.5%|
| Member of Parliament          | 21 | 26.25%|
| Mayor                         | 7  | 8.75%|
| City Councillor               | 5  | 6.25%|
| Other Deputy roles            | 13 | 16.25%|
| Total                         | 80 | 100% |

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Figure 4: Scatter Plot Government Ownership and Share of Directors with former Political experience

Source: Hand collected data from Annual Reports (GovtOwn) and BoardEx (PolDirShare). This is the scatter plot of the percentage of shares owned by the domestic government in 2006 (GovtOwn) over the percentage of the board of directors comprised of former domestic politicians (PolDirShare). Each dot represents a bank, labeled with the country ISO code of the country where the bank is headquartered.
Figure 5: LTRO(1+2) 3 year

Source: Hand collected data from newspapers’ articles and industry estimates from Morgan Stanley. This chart shows the amount borrowed between the 3-year LTRO 1 (December 2011) and 2 (February 2012) by a group of European banks.
Table 2: Summary Statistics at December 2010. Units are in %.

|                                | N  | Mean | St.Dev. | Min | Max |
|--------------------------------|----|------|---------|-----|-----|
| Home Bias (Own/TotSov)         | 90 | 74   | 26.4    | 9.8 | 100 |
| Home Bias (CR(2012))           | 87 | 71.7 | 29      | .05 | 100 |
| Home Bias/Assets (Own/TA)      | 90 | 7.06 | 5.57    | .42 | 32.07 |
| Government ownership in 2006 (GovtOwn) | 90 | 21.3 | 31.3    | 0   | 100 |
| Government ownership in 2006 if > 0 | 47 | 44.75 | 29.71  | .3  | 100 |
| 1(Political) in 2006           | 90 | 0.34 | 0.47    | 0   | 1   |
| Political Directors Share      | 61 | 6.09 | 7.28    | 0   | 33.33 |
| Political Directors Share if > 0 | 37 | 10.04 | 6.9  | 2.12 | 33.33 |
| Tier1/RWA                      | 90 | 11   | 3.7     | 4.3 | 34.7 |
| Gov Help/RWA                   | 90 | 1.4  | 3       | 0   | 21.85 |
| Gov Help/RWA if > 0            | 35 | 3.6  | 4       | .32 | 21.85 |
| Gov Help/RWA if > 0 and GovtOwn > 0 | 20 | 3.02 | 2.5    | .51 | 9.3  |
| Gov Help/RWA if > 0 and PolDirShare > 0 | 12 | 3.31 | 2.83   | .51 | 8.66 |
Table 3: Home Bias (Own/TotalSovereign) and Government Ownership

|                  | (1)       | (2)       | (3)       | (4)       | (5)       | (6)       | (7)       | (8)       | (9)       | (10)      |
|------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
|                  | 2010Q1    | 2010Q4    | 2011Q4    | 2012Q2    | 2013Q4    | 2010Q1    | 2010Q4    | 2011Q4    | 2012Q2    | 2013Q4    |
| GovtOwn          | 8.665***  | 5.084**   | 5.099**   | 3.864**   | 2.554     | 8.665***  | 5.084**   | 5.099**   | 3.864**   | 2.554     |
| /std.dev         | (3.66)    | (2.53)    | (2.50)    | (2.06)    | (0.6)     | (3.66)    | (2.53)    | (2.50)    | (2.06)    | (0.6)     |
| I(Political)     |           |           |           |           |           | 13.88**   | 8.446*    | 12.33**   | 9.601     | 5.496     |
|                  |           |           |           |           |           | (2.39)    | (1.97)    | (2.04)    | (1.51)    | (0.55)    |
| log(TotAss)_{t-1}| -8.438*** | -10.80*** | -15.98**  | -16.38*** | -14.70*** | -9.228**  | -10.83*** | -15.94*** | -16.31*** | -14.85*** |
|                  | (-3.01)   | (-3.86)   | (-4.66)   | (-4.87)   | (-2.93)   | (-3.60)   | (-4.10)   | (-4.99)   | (-4.92)   | (-3.13)   |
| (Tier1/RWA)_{t-1}| 1.601     | -2.139**  | -1.060**  | -1.316**  | -1.827**  | 1.469     | -1.894*   | -1.168**  | -1.351**  | -1.809*   |
|                  | (1.05)    | (-2.24)   | (-2.13)   | (-2.07)   | (-2.41)   | (0.95)    | (-1.93)   | (-2.50)   | (-2.14)   | (-1.77)   |
| (Dep/TF)_{t-1}   | -0.332    | -0.00511  | -0.177    | -0.189    | -0.141    | -0.352    | 0.0290    | -0.195    | -0.194    | -0.113    |
|                  | (-1.46)   | (-0.03)   | (-0.54)   | (-0.59)   | (-0.51)   | (-1.36)   | (0.18)    | (-0.62)   | (-0.63)   | (-0.44)   |
| ROAA_{t-1}       | 2.735     | 2.765     | 4.775***  | 5.065**   | 1.702     | 2.338     | 1.112     | 3.283**   | -4.252*   | 2.217     |
|                  | (0.66)    | (0.71)    | (4.37)    | (-2.38)   | (1.20)    | (0.53)    | (0.29)    | (2.71)    | (-1.90)   | (1.41)    |
| (NPL/GL)_{t-1}   | 2.462     | -0.944    | -0.733    | -1.247*   | -0.719    | 3.163     | -0.867    | -0.586    | -0.868    | -0.541    |
|                  | (1.42)    | (-0.95)   | (-0.79)   | (-1.82)   | (-1.29)   | (1.65)    | (-0.86)   | (-0.68)   | (-1.28)   | (-0.84)   |
| I(Cooperative)_{i}| 18.44***  | 15.81**   | 9.113     | 6.061     | 2.565     | 19.06**   | 15.69**   | 10.45     | 7.507     | 2.702     |
|                  | (3.08)    | (2.57)    | (1.37)    | (0.85)    | (0.25)    | (2.65)    | (2.43)    | (1.51)    | (1.00)    | (0.24)    |
| N (= N of banks) | 73        | 78        | 58        | 58        | 73        | 78        | 58        | 58        | 58        | 58        |

* t statistics in parentheses
* * p < 0.10, ** p < 0.05, *** p < 0.01

Note: set of cross-sectional regressions of banks in 2010Q1, 2010Q4, 2011Q4, 2012Q2, 2013Q4. The dependent variable is the ratio of domestic sovereign over total sovereign (Own/TotSov). GovtOwn/std.dev is the ratio of government ownership in 2006 over its standard deviation; I(Political)_{i} is a dummy equal to one if the bank is above the median of the distribution of political ownership in each country; I(Cooperative)_{i} is a dummy equal to one if bank i is a cooperative; log(Assets_{t-1}), (Tier1/RWA)_{t-1}, (Dep/TF)_{t-1}, ROAA_{t-1}, (NPL/GL)_{t-1} are, respectively, the log of total assets, Tier1 capital over risk-weighted assets RWA, the deposits to total funding ratio, the average return on assets and the ratio of non-performing loans over total loans, all lagged by one year. Std.err. are White HAC robust.
Table 4: Home Bias (Coeurdacier and Rey (2012) and Own/Total Assets) and Government Ownership

|                | (1)         | (2)         | (3)         | (4)         |
|----------------|-------------|-------------|-------------|-------------|
|                | CR(2012)    | CR(2012)    | Own/TA      | Own/TA      |
| 2009 × GovtOwn/std.dev. | 11.22***    | 2.456***    |             |             |
|               | (3.82)      | (3.12)      |             |             |
| 2010 × GovtOwn/std.dev. | 6.699***    | 1.562*      |             |             |
|               | (2.68)      | (1.92)      |             |             |
| 2011 × GovtOwn/std.dev. | 6.512***    | 1.322***    |             |             |
|               | (3.40)      | (4.05)      |             |             |
| 2012 × GovtOwn/std.dev. | 5.243***    | 1.202***    |             |             |
|               | (2.92)      | (2.78)      |             |             |
| 2013 × GovtOwn/std.dev. | 5.222       | 2.072***    |             |             |
|               | (1.18)      | (2.68)      |             |             |
| 2009 × 1(Political) | 17.98**     | 3.617**     |             |             |
|               | (2.57)      | (2.58)      |             |             |
| 2010 × 1(Political) | 10.54**     | 1.823*      |             |             |
|               | (2.09)      | (1.69)      |             |             |
| 2011 × 1(Political) | 14.92**     | 2.007***    |             |             |
|               | (2.48)      | (2.76)      |             |             |
| 2012 × 1(Political) | 12.18*      | 1.541*      |             |             |
|               | (1.90)      | (1.94)      |             |             |
| 2013 × 1(Political) | 8.336       | 3.028       |             |             |
|               | (0.77)      | (1.44)      |             |             |

Other: Log(TA)(-)***, Coop(+)***, Tier1(-), NPL(-), Dep(-) and ROAA(+)

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Note: set of cross-sectional regressions of banks in 2009, 2010, 2011, 2012 and 2013. The dependent variable is the home bias measure as defined in Coeurdacier and Rey (2012) in columns (1)–(2) or the domestic government bond exposure as a fraction of total assets (Own/TA) in columns (3)–(4). Other bank controls defined as before.
Table 5: Home Bias and Political Presence in the Board of Directors

|        | (1)  | (2)  | (3)  | (4)  | (5)  |
|--------|------|------|------|------|------|
|        | 2010Q1 | 2010Q4 | 2011Q4 | 2012Q2 | 2013Q4 |
| PolDir/TotDir | 0.873* | 0.716** | 0.849** | 0.676* | 0.763* |
|          | (2.01) | (2.10) | (2.07) | (1.84) | (1.97) |
| N       | 55    | 57    | 47    | 47    | 49    |
| Country Dummies | yes | yes | yes | yes | yes |
| Log(TA)(-)***, Coop(+), Tier1(-), NPL(-), Dep(-) and ROAA(+) |

\( t \) statistics in parentheses

* \( p < 0.10 \), ** \( p < 0.05 \), *** \( p < 0.01 \)

Note: set of cross-sectional regressions of banks in 2010Q1, 2010Q4, 2011Q4, 2012Q2, 2013Q4. The dependent variable is the ratio of domestic sovereign over total sovereign (Own/TotSov). Other bank controls defined as before.
Table 6: Home Bias and Political Presence: GIIPS vs non–GIIPS banks

|                  | (1)   | (2)   | (3)   | (4)   | (5)   | (6)   | (7)   | (8)   | (9)   | (10)  |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|                  | 2010Q1| 2010Q4| 2011Q4| 2012Q2| 2013Q4| 2010Q1| 2010Q4| 2011Q4| 2012Q2| 2013Q4|
| GovtOwn/ std.dev.| 6.008*| 1.947 | 9.162***| 7.566***| 5.412 |
| ×GIIPS           | (1.79) | (0.72) | (3.28) | (3.24) | (1.45) |
|                  | 8.106**| 7.518**| 1.789 | 1.162 | 4.916 |
| ×nonGIIPS        | (2.44) | (2.53) | (0.63) | (0.36) | (1.40) |
| 1(Political)     | 11.56*| 2.413 | 22.69***| 23.64***| 6.162 |
| ×GIIPS           | (1.98) | (0.49) | (3.95) | (4.48) | (0.59) |
| 1(Political)     | 12.77 | 16.91**| 5.470 | 1.545 | 12.18 |
| ×nonGIIPS        | (1.09) | (2.06) | (0.73) | (0.20) | (1.02) |
| N                | 73    | 78    | 58    | 58    | 61    |
| Country Dummies  | yes   | yes   | yes   | yes   | yes   |

Other: Log(TA)(-)***, Coop(+)***, Tier1(-), Lev(-), NPL(-), Dep(-) and ROAA(+)

\( t \) statistics in parentheses

* \( p < 0.10 \), ** \( p < 0.05 \), *** \( p < 0.01 \)

Note: set of cross-sectional regressions of banks in 2010Q1, 2010Q4, 2011Q4, 2012Q2. The dependent variable is the ratio of domestic sovereign over total sovereign (\( Own/TotSov \)). Other bank controls defined as before.
Table 7: Moral Suasion Panel regression.

|                           | (1)       | (2)       |
|---------------------------|-----------|-----------|
| \( \Delta \text{HomeBias}_{i,t} \) | -0.625    | -0.620    |
|                           | (-0.88)   | (-0.87)   |
| \( 1 \) (Political) \( \times \) GovHelp\(_{t-1} \) | 6.874***  |           |
|                           | (4.52)    |           |
| \( 1 \) (Political, GIIPS) \( \times \) GovHelp\(_{t-1} \) | 7.439***  |           |
|                           | (6.38)    |           |
| \( 1 \) (Political, nonGIIPS) \( \times \) GovHelp\(_{t-1} \) | 5.739**   |           |
|                           | (1.99)    |           |

\( N \times T \)

|                           | 238       | 238       |
|---------------------------|-----------|-----------|
| \( N \) of banks          | 77        | 77        |

Bank + Year FE

|                           | yes       | yes       |
|---------------------------|-----------|-----------|

Other Bank Controls: Tier1(-)***, Log(TA)(-)*, Lev(-), NPL(-), Dep(-)

P-Value of the Test

|                           | 0.0337    |
|---------------------------|-----------|

\( \| (\text{Pol},\text{GIIPS})\text{Gov} = \| (\text{Pol},\text{NoGIIPS})\text{Gov} \)

\( t \) statistics in parentheses

* \( p < 0.10 \), ** \( p < 0.05 \), *** \( p < 0.01 \)

Panel regressions. The dependent variable is \( \Delta \text{HomeBias}_{i,t} \), defined as the change in the ratio of domestic sovereign bonds over total sovereigns between 2010Q4–2010Q1, 2011Q4–2010Q4, 2012Q2–2011Q4, 2013Q4–2012Q2. GovHelp\(_{i,t-1} \) is the government equity injection as a percentage of RWA given to bank \( i \) at the beginning of the period. Other variables are defined as before. Std.err. are clustered at the bank–year level.
### Table 8: Moral Suasion: Robustness

|                | Yields and CDS | Country–time FE | LTRO Yields and CDS | Country–time FE | LTRO |
|----------------|----------------|-----------------|---------------------|-----------------|------|
| **(1)**        |                |                 |                     |                 |      |
| $\Delta Yield$ | -119.2         | (-0.71)         | -70.86              | (-0.70)         |      |
| $\Delta CDS_{5Y}$ | -16.10         | (0.12)          | 38.78               | (0.20)          |      |
| LTRO/TotalAssets | -2.877         | (-0.81)         | -3.360              | (-0.93)         |      |
| $Gov Help_{t-1}$ | -0.978         | (1.43)          | 0.778               | (1.17)          | 0.489|
|                | (-1.43)        | (1.17)          | 0.489               | (0.66)          | 0.179|
| $(Political) \times$ | 6.464***       | (3.66)          | 8.751***            | (2.68)          | 9.709*|
| $Gov Help_{t-1}$ | (6.991***      | (3.44)          | 14.64***            | (3.19)          | 12.03*|
| $(Political, GIIPS) \times$ | 5.464***       | (3.07)          | 5.363**             | (2.42)          | 3.889|
| $Gov Help_{t-1}$ | (5.464***      | (3.07)          | 5.363**             | (2.42)          | 3.889|
| **(Political, nonGIIPS) \times** | 5.464***       | (3.07)          | 5.363**             | (2.42)          | 3.889|
| $Gov Help_{t-1}$ | (5.464***      | (3.07)          | 5.363**             | (2.42)          | 3.889|
| $N$            | 201            | 238             | 176                 | 201            | 238  |
| $N$ bank       | 66             | 77              | 76                  | 66             | 77   |
| Bank + Year FE | yes            | yes             | yes                 | yes            | yes  |
| Country–time FE | no             | yes             | yes                 | no             | yes  |

$t$ statistics in parentheses

$^*$ $p < 0.10$, $^{**} p < 0.05$, $^{***} p < 0.01$

Panel regressions. The dependent variable is $\Delta HomeBias_{i,t}$ defined as the change in the ratio of domestic sovereign bonds over total sovereigns between 2010Q4–2010Q1, 2011Q4–2010Q4, 2012Q2–2011Q4, 2013Q4–2012Q2. $GovHelp_{i,t-1}$ is the government equity injection as a percentage of RWA given to bank $i$ at the beginning of the period. $\Delta Yield$, $\Delta CDS_{5Y}$ are the growth rates of sovereign yields for 10 year bonds and 5 years CDS rates over the relevant periods. $LTRO/TotalAssets$ is the borrowing from the 3-year LTRO operation in December 2011 and February 2012 at the bank level (47 banks) over total assets. It is equal to zero for all banks before 2012Q2 and equal to the LTRO amount for the 47 banks for which information on the borrowed amount was found and missing otherwise. Other variables are defined as before. Std.err. are clustered at the bank–year level.
Table 9: Determinants of Government Help

|                | (1)         | (2)         | (3)         | (4)         | (5)         | (6)         | (7)         | (8)         | (9)         |
|----------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
|                | Tobit       | Tobit       | Tobit       | Tobit       | Tobit       | Tobit       | Tobit       | Tobit       | Tobit       |
|                | 2010        | 2011        | 2012        | 2010        | 2011        | 2012        | 2010        | 2011        | 2012        |
| 1 (Political)  | 0.543       | -2.964      | -2.502      | 0.738       | -1.858      | -1.420      | 0.296       | -2.221      | -2.202      |
|                | (0.72)      | (-1.03)     | (-0.95)     | (0.83)      | (-0.71)     | (-0.58)     | (0.35)      | (-0.91)     | (-0.78)     |
| (Own/TS)_{t-1} | -0.0144     | -0.0649     | -0.0679     | -0.83       | (-1.30)     | (-1.46)     |             |             |             |
| Δ(Own/TS)_{t}  |             |             |             |             | -0.0255     | 0.191       | 0.165       | (-1.00)     | (1.52)      | (1.17)      |
| Tier1(Net)_{t-1} | -0.873***  | -0.970***  | -0.922**   | -0.821***  | -1.006***  | -1.003***  | -0.851***  | -1.029***  | -0.949**   |
|                | (-8.26)     | (-2.78)     | (-2.40)     | (-6.51)     | (-3.08)     | (-2.88)     | (-6.85)     | (-3.13)     | (-2.34)     |
| ROAA_{t-1}     | -1.518**    | 0.0456      | 0.293       | -1.721*     | 0.577       | 0.388       | -1.705*     | 0.626       | 0.298       |
|                | (-2.22)     | (0.06)      | (0.68)      | (-1.99)     | (0.85)      | (0.86)      | (-1.99)     | (0.73)      | (0.75)      |
| \partial Pr(GovtHelp/RWA) / \partial Tier1(Net) | -14.85%*** | -6.13%**    | -7.03%*     | -13.66%***  | -6.35%***  | -7.72%**   | -14.38%***  | -6.72%**    | -7.21%*     |
| \partial GovtHelp/RWA / \partial Tier1(Net) | -0.27%***   | -0.267%***  | -0.25%*     | -0.27%***   | -0.309%***  | -0.268%*** | -0.28%***   | -0.297%***  | -0.29%**    |
| N              | 78          | 57          | 58          | 72          | 57          | 58          | 72          | 57          | 58          |

Other controls: Log(TA)(+/-), Coop(-), GIIPS(-)*, NPL(+) and Dep(+/-)

\( t \) statistics in parentheses

\* \( p < 0.10 \), \** \( p < 0.05 \), \*** \( p < 0.01 \)

Note: Tier1(Net) is the Tier1 ratio net of government help; it is defined as the Tier1 ratio minus government help over RWA.
Table 10: Allocation of Credit and Political Influence

|                 | (1)     | (2)     | (3)     | (4)     |
|-----------------|---------|---------|---------|---------|
|                 | DomSME$_{2010}$ | DomINST$_{2010}$ | DomSME$_{2010}$ | DomINST$_{2010}$ |
| GovtOwn/std.dev. | 4.874*  | 5.751** |         |         |
|                 | (1.87)  | (2.06)  |         |         |
| 1 (Political)   |         |         | 8.687   | 17.17***|
|                 |         |         | (1.60)  | (2.15)  |
| 1 (Cooperative) | 0.483   | 3.552   | 0.361   | 5.232   |
|                 | (0.04)  | (0.37)  | (0.03)  | (0.54)  |
| log(Asset)$_{t-1}$ | -5.646*** | -7.592*** | -5.813*** | -7.346*** |
|                 | (-2.90) | (-3.49) | (-2.95) | (-3.46) |
| (Dep/TF)$_{t-1}$ | -0.425** | -0.363* | -0.392* | -0.332* |
|                 | (-2.10) | (-1.86) | (-1.86) | (-1.72) |
| Tier1$_{t-1}$   | 0.432   | -0.297  | 0.294   | -0.482  |
|                 | (0.39)  | (-0.18) | (0.27)  | (-0.29) |
| N               | 70      | 79      | 70      | 79      |

$t$ statistics in parentheses

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$
Table 11: Moral Suasion: Germany and Spain

|                      | (1)     | (2)     | (3)     |
|----------------------|---------|---------|---------|
| $GovHelp_{t-1}$      | 2.129***| 1.930***| 1.930***|
|                      | (0.411) | (0.552) | (0.558) |
| (Political) $\times GovHelp_{t-1}$ | 3.057***| 3.706***| 3.702***|
|                      | (0.894) | (0.919) | (0.965) |
| $\Delta Yield$       |         |         | 397.4   |
|                      |         |         | (394.1) |
| $\Delta CDS$         |         | -132.6  |         |
|                      |         |         | (145.7) |
| $N$                  | 70      | 70      | 70      |
| Bank + Year FE       | yes     | yes     | yes     |
| Country–year FE      | no      | no      | yes     |

Standard errors in parentheses

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$