

Managerial Risk-Taking Incentives and the Systemic Risk of Financial Institutions[☆]

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Abstract

This paper examines whether the systemic risk of financial institutions is associated with the risk-taking incentives generated by executive compensation. We measure managerial risk-taking incentives with the sensitivities of chief executive officer (CEO) and chief financial officer (CFO) compensation to changes in stock prices and stock return volatility. Using data on large U.S. financial institutions, we document a negative association between CEO and CFO risk-taking incentives and systemic risk. Nevertheless, our results also demonstrate that financial institutions with greater managerial risk-taking incentives were associated with marginally higher levels of systemic risk in the midst of the global financial crisis in 2008. Overall, our findings contrast with the common view that the excessive risk-taking of financial institutions around the financial crisis is attributable to compensation incentives of the top executives.

JEL classification: G01, G20, G21, G30, G32, G34

Keywords: executive compensation, delta, vega, risk-taking incentives; systemic risk; bank risk-taking; financial crisis

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