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Risk management, capital structure and lending at banks â˜†

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Abstract

We test how active management of bank credit risk exposure through the loan sales market affects capital structure, lending, profits, and risk. We find that banks that rebalance their loan portfolio exposures by both buying and selling loans â€“ that is, banks that use the loan sales market for risk management purposes rather than to alter their holdings of loans â€“ hold less capital than other banks; they also make more risky loans (loans to businesses) as a percentage of total assets than other banks. Holding size, leverage and lending activities constant, banks active in the loan sales market have lower risk and higher profits than other banks. Our results suggest that banks that improve their ability to manage credit risk may operate with greater leverage and may lend more of their assets to risky borrowers. Thus, the benefits of advances in risk management in banking may be greater credit availability, rather than reduced risk in the banking system.

JEL classification

G21; G32

Keywords

Bank risk management; Loan sales

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