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## Professor analyzes bank crisis

Posted by [Tina Reed](#) | [The Ann Arbor News](#) September 01, 2008 06:02AM

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Banks spurred the U.S. sub-prime mortgage crisis by offering excessively risky loans to borrowers and selling the bad loans to other lenders, a recent University of Michigan study found.

Using what's called the "originate to distribute" model of lending, many banks made a practice of selling their mortgages to third-party investors, and - with the loans off their books - were willing to offer riskier loans, said Amiyatosh Purnanandam, a finance professor at U-M's Stephen M. Ross School of Business. The more poorly capitalized a bank was, the more likely the bank was to sell its mortgages and make risky loans, he said.

The study was meant to add academic evidence for the causes of the housing crisis, Purnanandam said. He will present his findings to Federal Reserve researchers in Washington, D.C., in December.

Purnanandam recently talked to The News about what he found:

Reporter **Tina Reed** can be reached at 734-994-6843 or [treed@annarbornews.com](mailto:treed@annarbornews.com).

**Q: What is "originate to distribute" lending?**

**A:** Think about two banks. Let's say both banks have \$100 in assets and both banks are making \$50 in mortgage loans. But then, one of the banks sells \$40 of its loans to some other (investors). The other bank keeps that \$50 of loans on its own books. I'm basically showing that the bank that sold its loans was giving loans of inferior quality.

**Q: How'd that contribute to the mortgage crisis?**

**A:** Historically, a bank will give a mortgage and hold on to that mortgage until it's paid off. So that bank really cares if that loan defaults or not. ... In the OTD model, the bank's incentive to make sure the loan is of good quality comes down. The OTD model provides banks with an incentive to originate excessively risky loans.

**Q: How much more likely were those banks to give risky loans?**

**A:** It's a continuum. It's not like one bank might do it and another didn't. They were all doing it, but some more than others.

**Q: What needs to change?**

**A:** How these banks are funded has a lot to do with the kind of quality loans they are issuing. If they are funded mostly by equity capital and demand deposits (money available through their own sources of financing, such as bank account balances), those banks were most likely to behave. ... That problem was concentrated into poorly capitalized banks - those funded by Wall Street. That tells me the OTD market in itself is not bad. ... You don't have to stop OTD loans, you should start thinking about the liability structure of how a bank is funded.

**Q: How does this affect consumers?**

**A:** The moment you have a banking crisis, this spills over into the corporate sector and that influences our jobs, our house prices. Another reason people like you and I start caring about this is, ultimately, the (government) will have to come up with, possibly, a bailout package. Then it becomes the taxpayers' liability. ... In the long term, we have to figure out what policies we should set now so we don't have to bail these banks out in the future.



Amiyatosh Purnanandam: "The moment you have a banking crisis, this spills over into the corporate sector and that influences our jobs, our house prices."

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