

Prepayment risk and bank performance

Alex Fayman; Ling T. He

[+ Author & Article Information](#)

Journal of Risk Finance (2011) 12 (1): 26–40.

<https://doi.org/10.1108/15265941111100058>

Purpose

The purpose of this paper is to identify effects of prepayment risk on performance of commercial banks in the USA. Understanding how various risks impact banks' performance can help to improve performance of financial institutions and better estimate risk premia charged by banks on the loans they extend to their customers.

Design/methodology/approach

The paper measures the prepayment risk premium and aims to gauge its effect on various ratios that measure bank performance. Since, risk management is an important goal of financial management, it is important to learn how prepayment risk pertains to bank performance.

Findings

The results of this paper suggest that prepayment risk may significantly impact return on loans, return on equity and real estate loans to total loans ratios of various commercial banks. The impacts, in terms of strength and direction, vary between the periods of pre- and post-passage of the Financial Institutions Reform and Recovery Act. The results indicate that the addition of prepayment risk variable to regression models can generally increase their ability to explain bank performance metrics.

Originality/value

To the authors' knowledge, there is no existing literature that gauges the impact of prepayment risk on various components of bank performance. There is existing literature that shows that bank stocks move in response to prepayment risk.

Keywords: [United States of America](#), [Banks](#), [Payments](#), [Risk management](#)

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