

# THE **BANKERS' NEW CLOTHES**



What's Wrong with Banking  
and What to Do about It

**ANAT ADMATI** and **MARTIN HELLWIG**

House	Mortgage
	Equity

**FIGURE 2.1**  
Balance sheet diagram  
for buying a house.

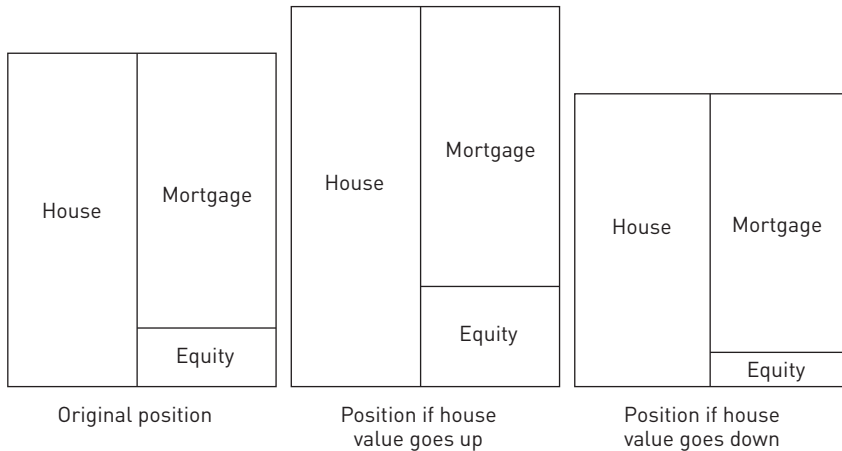
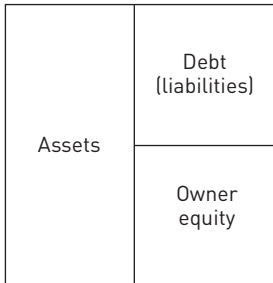


FIGURE 2.2 Balance sheet diagrams for buying a house and selling it a year later.

**TABLE 2.1** Debt and Equity When Buying a \$300,000 House in Two Down Payment Scenarios (with a nonrecourse mortgage loan)

<i>Buying with a \$30,000 down payment (initial equity)</i>				
<i>Year-end house price (dollars)</i>	<i>Percentage change in house price</i>	<i>Mortgage debt (dollars)</i>	<i>Final equity (dollars)</i>	<i>Return on equity (percent)</i>
345,000	15	270,000	75,000	150
315,000	5	270,000	45,000	50
300,000	0	270,000	30,000	0
285,000	-5	270,000	15,000	-50
255,000	-15	270,000	0	-100
<i>Buying with a \$60,000 down payment (initial equity)</i>				
<i>Year-end house price (dollars)</i>	<i>Percentage change in house price</i>	<i>Mortgage debt (dollars)</i>	<i>Final equity (dollars)</i>	<i>Return on equity (percent)</i>
345,000	15	240,000	105,000	75
315,000	5	240,000	75,000	25
300,000	0	240,000	60,000	0
285,000	-5	240,000	45,000	-25
255,000	-15	240,000	15,000	-75



**FIGURE 2.3**  
Balance sheet diagram  
for a business.

Assets	Debt (liabilities)
	Shareholder equity

**FIGURE 2.4**  
Balance sheet diagram  
for a corporation.

Assets	Liabilities
Reserves Short-term loans Long-term loans Other investments	Deposits Short-term debt Long-term debt  Shareholder equity

**FIGURE 4.1**

A traditional commercial bank's balance sheet.

Cash	Deposits
Loans	
Trading and other assets	Other debt (mostly short-term)
	Long-term debt
	Equity

Cash	Deposits
Loans	
Trading and other assets	Other debt (mostly short-term)
	Long-term debt
	Equity

**FIGURE 6.1** JPMorgan Chase balance sheet, December 31, 2011, by U.S. accounting rules (left) and international rules (right).

**TABLE 8.1** Borrowing at 4 Percent to Buy a \$300,000 House in Two Down Payment Scenarios (assuming a nonrecourse clause)

<i>Borrowing with a \$30,000 down payment (initial equity)</i>				
<i>Year-end house price (dollars)</i>	<i>Percent change in house price</i>	<i>Mortgage debt (dollars)</i>	<i>Final equity (dollars)</i>	<i>Return on equity (percent)</i>
345,000	15	280,800	64,200	114
315,000	5	280,800	34,200	14
300,000	0	280,800	19,200	-36
285,000	-5	280,800	4,200	-86
255,000	-15	280,800	0	-100
<i>Borrowing with a \$60,000 down payment (initial equity)</i>				
<i>Year-end house price (dollars)</i>	<i>Percent change in house price</i>	<i>Mortgage debt (dollars)</i>	<i>Final equity (dollars)</i>	<i>Return on equity (percent)</i>
345,000	15	249,600	95,400	59
315,000	5	249,600	65,400	9
300,000	0	249,600	50,400	-16
285,000	-5	249,600	35,400	-41
255,000	-15	249,600	5,400	-91

TABLE 9.1 How Kate Benefits from Guarantees When Borrowing

*Kate's position with no guarantees (borrowing at 4 percent)*

<i>Year-end house price (dollars)</i>	<i>Percent change in house price</i>	<i>Mortgage debt (dollars)</i>	<i>Final equity (dollars)</i>	<i>Return on equity (percent)</i>
345,000	15	280,800	64,200	114
315,000	5	280,800	34,200	14
300,000	0	280,800	19,200	-36
285,000	-5	280,800	4,200	-86
255,000	-15	280,800	0	-100

*Kate's position with guarantees (borrowing at 3 percent)*

<i>Year-end house price (dollars)</i>	<i>Percent change in house price</i>	<i>Mortgage debt (dollars)</i>	<i>Final equity (dollars)</i>	<i>Return on equity (percent)</i>
345,000	15	278,100	66,900	123
315,000	5	278,100	36,900	23
300,000	0	278,100	21,900	-27
285,000	-5	278,100	6,900	-77
255,000	-15	278,100	0	-100

TABLE 9.2 How Guarantees Make Borrowing More Attractive to Kate

<i>\$30,000 down payment (initial equity)</i>				
<i>Year-end house price (dollars)</i>	<i>Percent change in house price</i>	<i>Mortgage debt (dollars)</i>	<i>Kate's final equity (dollars)</i>	<i>Aunt Claire's position (dollars)</i>
345,000	15	278,100	66,900	0
315,000	5	278,100	36,900	0
300,000	0	278,100	21,900	0
285,000	-5	278,100	6,900	0
255,000	-15	278,100	0	-23,100
<i>\$10,000 down payment (initial equity)</i>				
<i>Year-end house price (dollars)</i>	<i>Percent change in house price</i>	<i>Mortgage debt (dollars)</i>	<i>Kate's final equity (dollars)</i>	<i>Aunt Claire's position (dollars)</i>
345,000	15	298,700	46,300	0
315,000	5	298,700	16,300	0
300,000	0	298,700	1,300	0
285,000	-5	298,700	0	-13,700
255,000	-15	298,700	0	-43,700