

Do the Recovery Rate and the Accounting Regime Matter for
Pricing Corporate Bonds and Loans?
Evidence from Models with Incomplete Accounting
Information*

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Abstract

In this paper I examine the effect of different recovery rate assumptions and different accounting regimes on credit spreads in the context of credit risk models with incomplete accounting information. I derive a general pricing framework for corporate bonds/loans under different recovery rate assumptions and incomplete asset information. Furthermore, noise parameters for IAS, US GAAP, and German GAAP (HGB) are estimated under the assumption of a naive investor. I find that the recovery rate assumption matters for the pricing of corporate bonds/loans whereas the accounting regime matters only marginally. While the recovery rate assumption is important for long times to maturity, low reported asset values, and low previous year reported asset values, the effect of the accounting regime is particularly strong for short times to maturity. The effect of different accounting regimes is almost independent of the market in which the company is traded.

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