"When do Laws and Institutions Affect Recovery Rates on Collateral?"

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Abstract: We examine when laws and institutions affect banks’ expected recovery rates on collateral. Exploiting within country and firm variation, we document that laws that govern the efficiency of enforcement and institutions that mitigate asymmetric information problems have a large impact on banks’ expected recovery rates when collateral is susceptible to borrower agency problems and has low redeployability. Laws and institutions are otherwise found to have little impact on banks’ expected recovery rates on collateral. We also show that higher expected recovery rates reduce firms’ cost of credit.