> Thursday, June 16th, 2022
14:30 - 16:00

ACCOUNTING

IÉSEG SCHOOL OF MANAGEMENT

EMPOWERING CHANGEMAKERS FOR A BETTER SOCIETY

"REVISITING THE EFFECTS OF FAIR VALUE ACCOUNTING ON DEBT CONTRACTING"

BY MARC CLATWORTHY – BRISTOL UNIVERSITY

ABSTRACT

We re-examine how debt contracting design is affected by fair value accounting through modification of covenant definitions in private debt contracts. Prior research reports that a small but significant proportion of lenders remove the effects of fair value accounting by modifying covenant definitions. We study the incidence and antecedents of these fair value opt-outs in private lending agreements after the introduction of SFAS 159 over an extended time period. We find that just over 40% of private debt contracts contain a fair value opt-out clause – almost three times as high as previous estimates. In cross sectional analyses, we reinforce prior findings that firms that are more likely to engage in hedge accounting and contracts with liquidity covenants are less likely to have fair value opt-out clauses, whereas lending agreements containing a revolving line of credit are more likely to contain such clauses. Nevertheless, despite widespread concern that a lack of reliability and the treatment of own credit risk makes fair value accounting problematic for debt contracting, our results indicate that lenders often find it useful, even when fair value estimates are least reliable.

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Université Catholique de Lille 1875