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# Are Make-Whole Call Provisions Overpriced? Theory and Empirical Evidence

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## Abstract


We use a structural model to examine whether make-whole call provisions - a recent yet surprisingly common innovation in corporate debt markets - are fairly priced at origination. The call provision cost is calculated as the callable bond yield minus the equivalent non-callable bond yield, producing an incremental yield attributable to the make-whole call provision. Model parameters are calibrated to match characteristics of the issuing firm, bond, and yield curve at origination for a large sample of recently issued US corporate bonds. Our analysis indicates that while our model successfully captures cross-sectional variation in incrementals yields, observed values are significantly greater than model-generated values. The discrepancy between model-generated and observed incremental yields persists even after we incorporate selected market imperfections that should widen incremental yields. Our conclusion is that make-whole call provisions at origination have been mispriced and that issuing firms have been paying too much for the financial flexibility that the call provision provides.

**Keywords:** Make-whole, call, callable, bond, credit spread

**JEL Classification:** G12

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