

Pricing credit baskets with stochastic recovery and amortizing notionals.

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Abstract

Making recovery stochastic in credit basket pricing got attention during the increased structured credit market volatility of 2008. Several approaches dealing with stochastic recovery have been proposed. It is important to realize, however, that moving to stochastic recovery may require quite substantial changes even in the single name modelling approach and will be considerably slower in terms of calculation speed than traditionally used models based on binomial convolution. This review illustrates important trade-offs in implementing the stochastic recovery models and provides several recipes for implementing such models.

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