Moral Hazard Premium: Valuation of Moral Hazard under Diffusive and Jump Risks

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We provide an equilibrium asset pricing formula under moral hazard、 which is defined as a firm's change of measure that is incontractible, on the assumption of a power utility function and an endogenous riskless rate. Moral hazard distorts asset prices by (1) moving the market price of diffusive risk in the opposite direction to an investor's marginal utility, (2) amplifying the market price of jump risk, and (3) stipulating a positive premium, called a "moral hazard premium" in this paper, on the riskless rate.

Thus, the risk-free rate puzzle, which was explored first by Weil (1989), is further exaggerated under moral hazard. Financial markets alleviate the allocation conflict caused by moral hazard.

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