

Probability of failure (risk),  $f$

$$f^N = \frac{3}{4}$$

A's best-response function (ICC),  $f = \frac{1}{2} + \frac{\delta}{2q}$   
 Slope  $= \frac{1}{2q}$

P's isoprofit curve,  $\hat{\pi} = \hat{\pi}^N$

$$\text{Slope} = \frac{1-f}{\delta}$$

Better for lender

$$\hat{\pi}^N = \hat{\pi}_0$$

$$\hat{\pi}_1$$

$$\delta^N = \frac{q}{2}$$

Interest factor,  $\delta$

