The University of Manchester
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Calm in the Midst of a Storm: Financial Reporting Quality, Political Risk, and Bank Debt

Calm în mijlocul furtunii: Calitatea raportării financiare, risc politic și împrumuturi bancare

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Smart Diaspora 2023

April 11th, 2023

Kristalina Georgieva

"*If I had to identify a theme at the outset of the new decade it would be increasing uncertainty*. […]

We know this uncertainty harms business confidence, investment, and growth."

January 17, 2020

Peterson Institute for International Economics, Washington, D.C.

Managing Director of the International Monetary Fund

Five Economists Explain: Impacts of the U.S.-China Trade War

"The Federal Reserve Bank actually did a study last year and they show the increases in policy uncertainty in association with the trade tensions between the U.S. and China could potentially cut global GDP growth by 1% point, so I would say policy uncertainty is probably the most damaging channel for economic activity."

Dr. Huang Yiping, Professor and Deputy Dean,
National School of Development, Peking University

What is political uncertainty/risk (PU/PR)?

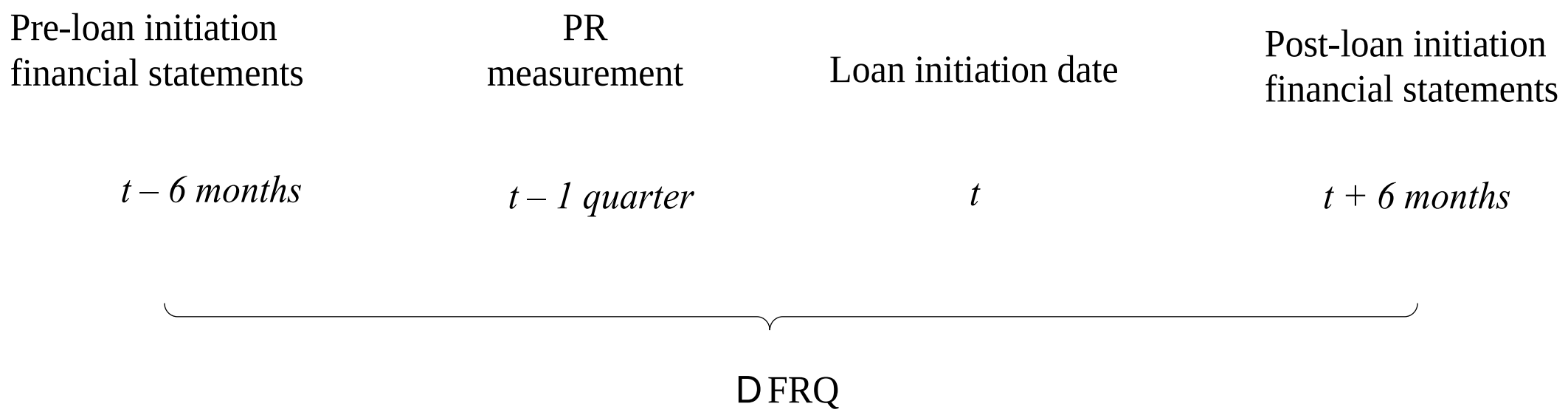
- PU is uncertainty derived from government actions that could potentially result in important changes in policy.

- In our setting, PU refers to the borrowers' exposure to risks emanating from the political system.
  - Risks associated with politics in general and with specific political topics.

- Measurement: firm-level political risk by Hassan et al. (2019) (textual analysis of quarterly earnings conference-call transcripts).

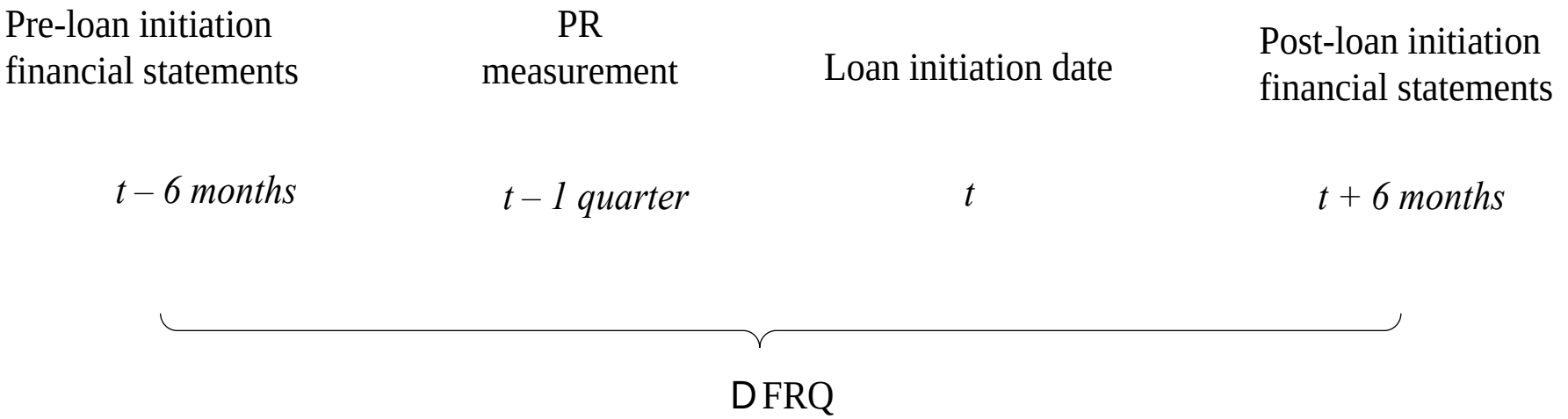
Research question

Figure 1
Illustrative Timeline of the RQ



Research question

Figure 1
Illustrative Timeline of the RQ



Our RQ: *For borrowers exposed to high PR, do banks price FRQ improvements before the public disclosure of their financial reports?*

➡ We analyze the effect of future FRQ <u>improvements</u> on the cost of lending of borrowers with high PR (private information).

Paper overview

Borrower-level PR

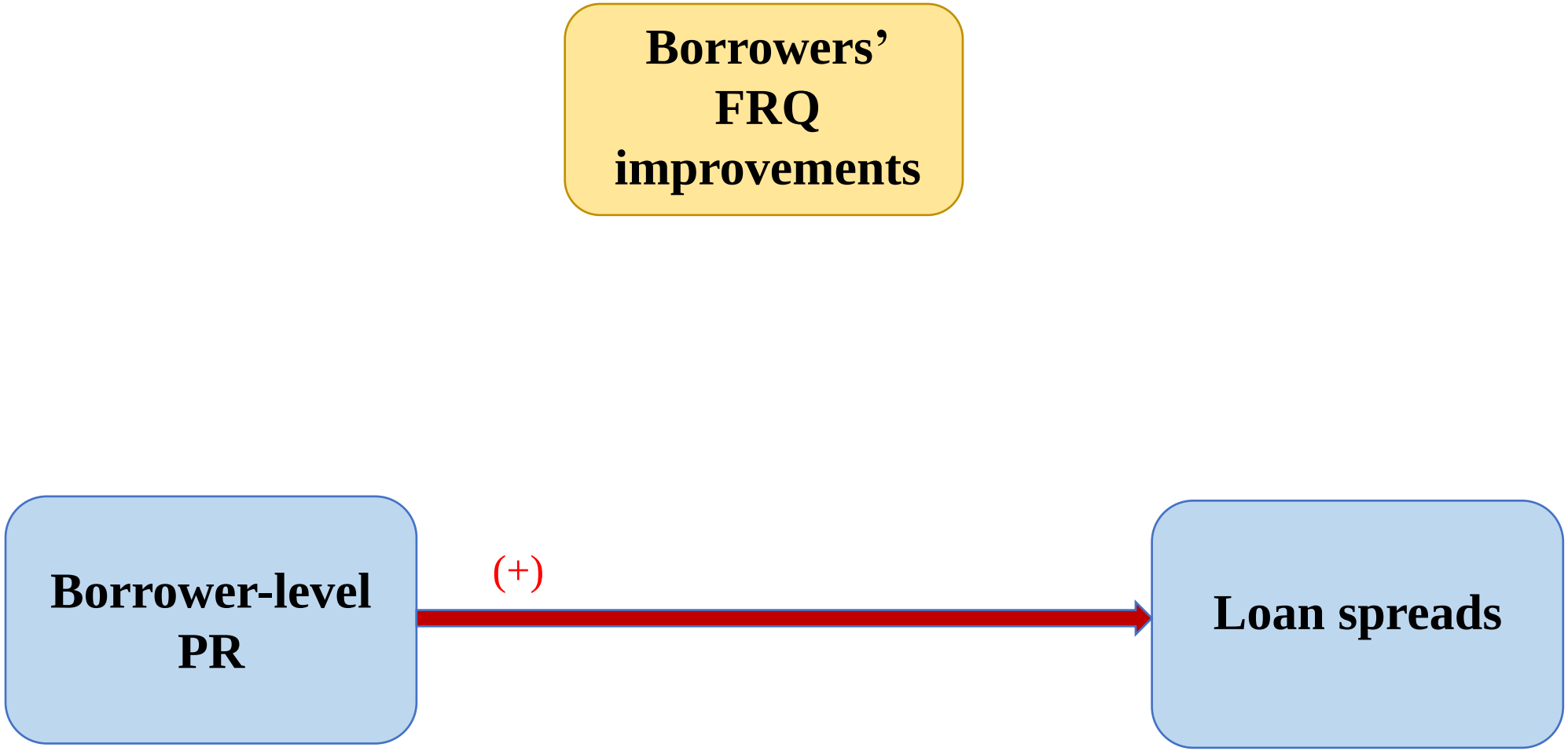
Paper overview

Borrower-level PR

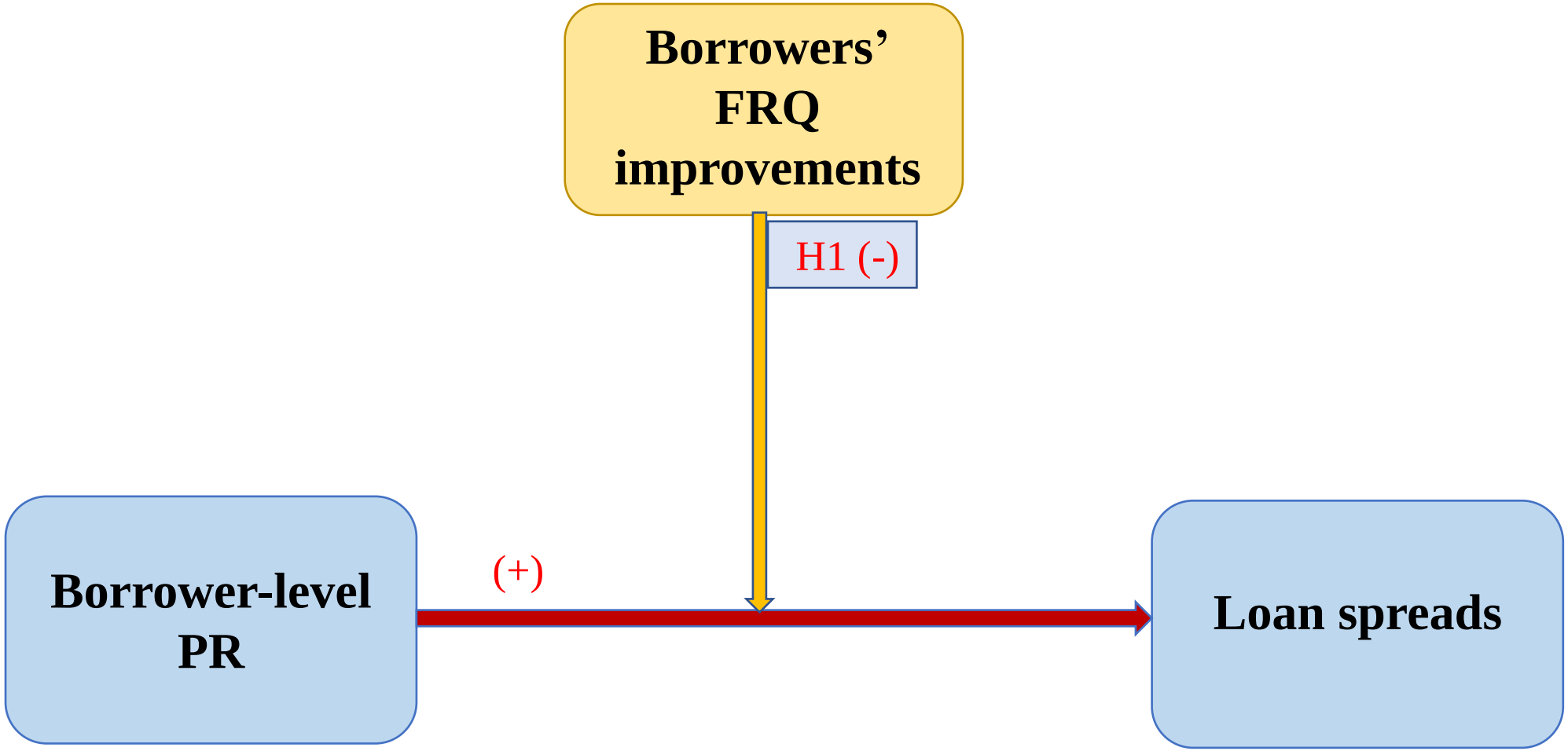
Loan spreads

Paper overview

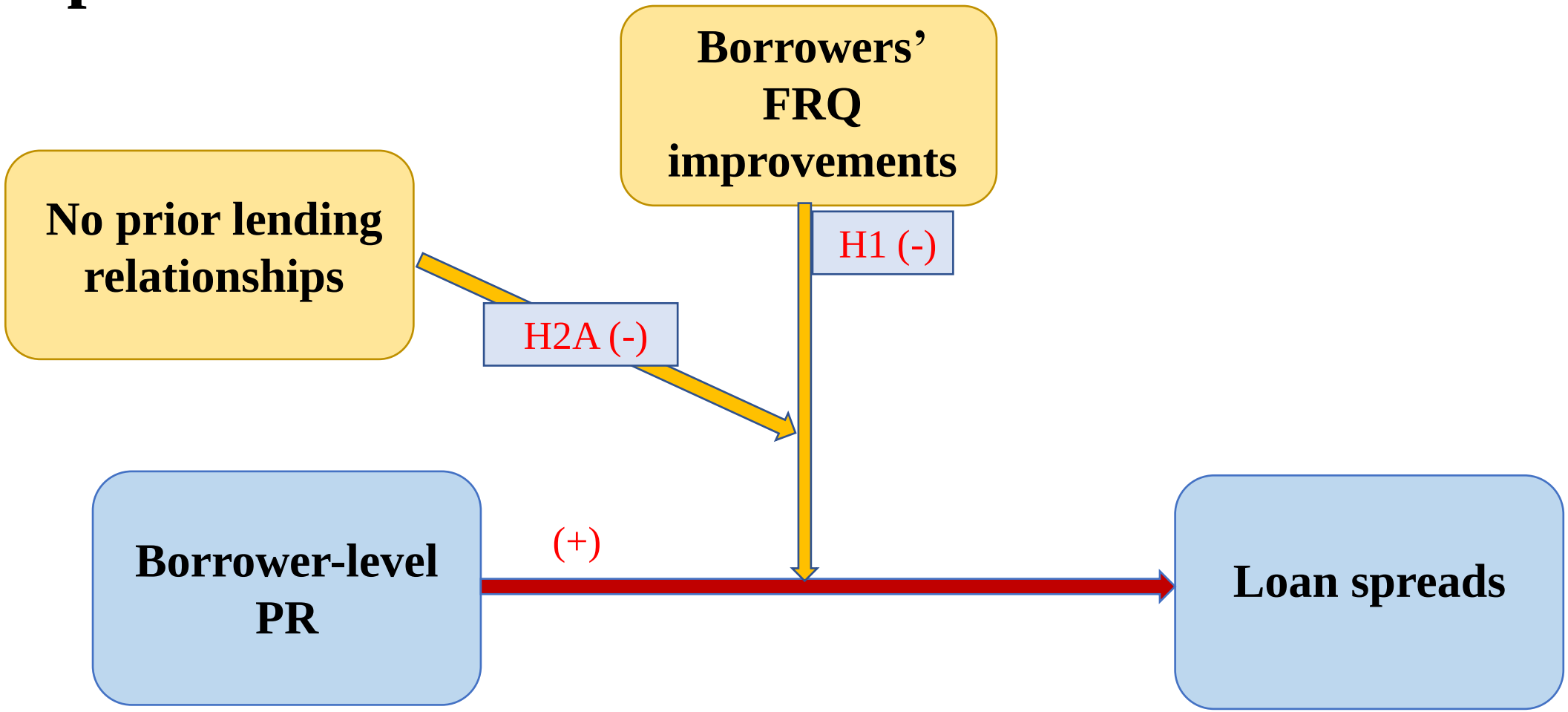
Paper overview



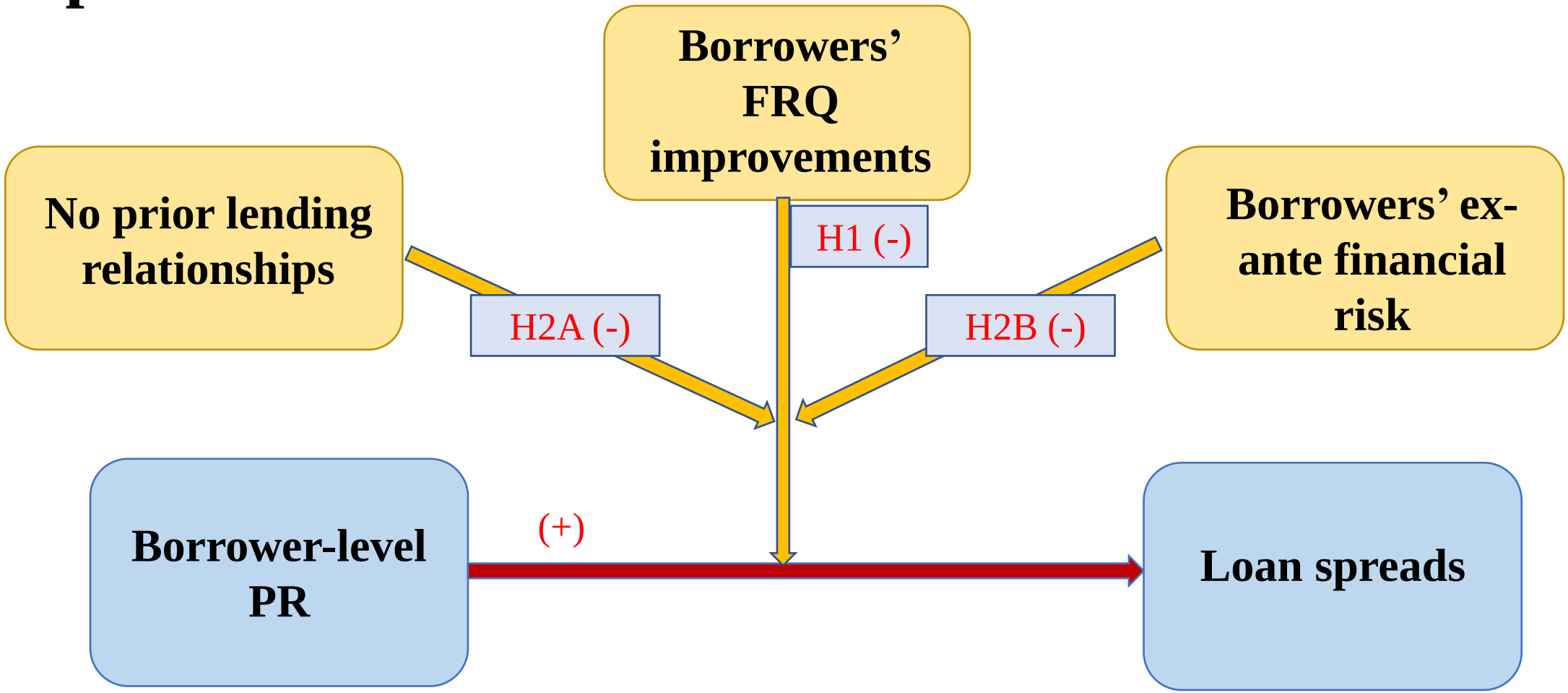
Paper overview



Paper overview



Paper overview



Main results

- Borrowers exposed to high PR that improve their FRQ enjoy smaller loan spreads relative to borrowers that do not improve their FRQ (***H1***).

- Improving FRQ decreases loan spreads only when high PR borrowers:
  - *do not* have prior lending relationships (high information asymmetry) (***H2A***);
  - have high financial risk (***H2B***).
  - have (a) high amounts of goodwill on their balance sheet, (b) R&D expenses, or (c) high cash flow volatility.

- Overall, banks reduce the loan prices of high PR borrowers ***before*** the public disclosure of financial reports.

Contributions (1)

- **Lit. on the role of accounting information in debt-contracting**: FRQ *improvements* "shelter" borrowers exposed to high PR from paying higher loan prices.

- **Lit. on the debt-market relevance of private information**: spread-reducing effect for the improvements in the FRQ of high PR borrowers *before* the public release of borrowers' financial reports.

- **Lit. on PU**: we focus on borrowers' exposure to overall PR (rather than economy-wide measures of PR), but also to different political related topics.

Contributions (2)

- The closest studies to our paper:
  - Gad et al. (2022): Lender PR is transmitted to borrowers via lending relationships;
  - Kim (2019): Lender PR is transmitted to borrowers with high financial risk.

- Our paper brings together the findings of these two studies:
  - Lending relationships *do not* bring loan spread benefits to high PR borrowers that improve their FRQ (consistent with Gad et al. 2022);
  - The negative incremental effect of borrower financial risk is mitigated by FRQ improvements (extension of Kim 2019).

Effects of PR in the literature

- Higher stock market volatility (Boutchkova et al. 2012; Pastor and Veronesi 2012), underinvestment (Julio and Yook 2012), lower aggregate expenditure and employment growth (Baker et al. 2016; Gilchrist et al. 2014; Giavazzi and McMahon 2012).

- The effect of PR on firms' information environment is subject to debate:
  - FRQ deteriorates because managers either make more discretionary reporting choices or because it is more difficult to predict future cash flows (Chen et al. 2018a; Dhole et al. 2021; Nagar et al. 2019);
  - FRQ improves due to investor demand (El Ghoul et al. 2021; Wynne 2022).

- From a debt-market perspective, banks react to PR by increasing loan spreads (Francis et al. 2014; Gad et al. 2022; Kim 2019), recognizing more loan loss provisions, and incurring higher loan charge-offs (Ng et al. 2020).

H1: *The increase in loan spreads due to borrowers' exposure to political risk is lower for firms that improve their FRQ after loan initiation relative to firms that do not do so*

- PR negatively impacts credit supply and borrowers' ability to repay their loans (Kim 2019 ; Gad et al. 2022).

- PR affects borrowers' operating and investment decisions, which increase their default risk (Jens 2017; Chen et al. 2018).

- Lenders charge higher interest rates as PR rises because of the higher credit risk (Kim 2019; Francis et al. 2014; Gad et al. 2022).

H1: *The increase in loan spreads due to borrowers' exposure to political risk is lower for firms that improve their FRQ after loan initiation relative to firms that do not do so*

- Lenders reward borrowers with better FRQ by reducing the cost of borrowing (Bharath et al. 2008; Costello and Wittenberg-Moerman 2011; Graham et al. 2008).
- Improving FRQ is a **mechanism** that assists lenders in the estimation of credit risk.
- Lenders use non-public information shared by borrowers in loan pricing (Plumlee et al. 2015; Hope et al. 2023).
- In our setting - two potential effects:
  - Improving FRQ reduces information asymmetry ➡ expected to reduce spreads.
  - Private (and unaudited) information might have reduced reliability ➡ might not be priced at loan initiation.

H2A: *The weakening effect of future FRQ improvements on the positive association between political risk and loan spreads depends on the level of ex-ante information asymmetry*.

- Information asymmetry worsens loan-contracting features because borrowers are perceived as being riskier and harder to value (Hasan et al. 2012).

- Past lending relationships are valuable in environments with uncertainty and information asymmetry (Coase 1937, 1988).

- Overall, relationship lending generates valuable information about borrower credit quality above and beyond the readily available public information.

H2A: *The weakening effect of future FRQ improvements on the positive association between political risk and loan spreads depends on the level of ex-ante information asymmetry*.

- For high PR borrowers, FRQ improvements are likely less relevant when lending relationships exist because the information gathered from past interactions already assist lenders in estimating the borrowers' credit risk.

- We expect that the improvements in FRQ at the end of the fiscal year are more likely to be priced by new lenders (i.e., no lending relationships).

H2B: *The weakening effect of future FRQ improvements on the positive association between political risk and loan spreads depends on the level of ex-ante financial risk.*

- Financial risk is generally associated with unfavorable lending terms because of the increased probability of default (Graham et al. 2008).

- Financial risk may exacerbate the negative effect of PR on credit quality (Kim 2019).
  - In times of PR, lenders extend more expensive loans to borrowers who are riskier (higher downside risk).

H2B: *The weakening effect of future FRQ improvements on the positive association between political risk and loan spreads is contingent on the level of ex-ante financial risk.*

- Banks' screening process is mainly based on hard information, where accounting numbers are used for contracting purposes (Bharath et al. 2008; Holthausen and Watts 2001).

- We argue that, for high financial-risk borrowers, the benefits of improving FRQ mitigate (at least partly) the increasing cost of debt associated with the borrowers' exposure to PR.

- Positive changes in FRQ are a "hedge" against PR.

Data and sample

- 11,195 syndicated loan facilities granted to U.S. non-financial firms during the 2002-2017 period (from Dealscan).
- Quarterly firm-level political risk indices from Hassan et al. (2019).
- Financials from Compustat North America.

Empirical model (1)

$$Spread_t = \delta_0 + \delta_1 \, Political \; Risk_{t-1q} + \delta_2 \, Loan\text{-}Specific \; Controls_t + \delta_3 \, Borrower\text{-}$$

$$Specific \; Controls_{t-1y} + Year \; and \; Borrower \; Fixed \; Effects + \varepsilon_t \qquad (1)$$

DV

Spread is the "all-in-drawn" spread over LIBOR for syndicated loans.

Test variable

Political Risk is the natural log. of the overall firm-level political risk or the natural log. of the firm-level political risk related to one of the eight political topics, in the quarter before loan initiation (Hassan et al. 2019).

The political topics are: "economic policy & budget," "institutions & political process," "health care," "security & defense," "environment," "trade," "tax policy," and "technology & infrastructure."

Results

Table 4
The Effect of Political Risk
Panel A: Overall Political Risk

Variables	Dep Var: *Spread*
Political Risk	**0.019****
	[2.06]
Year & Borrower FE	*Yes*
Observations	11,195
Adjusted R^2	0.604

A one std. dev. increase in borrowers' exposure to PR increases loans spreads by 3 basis points.

Panel B: By Type of Political Uncertainty

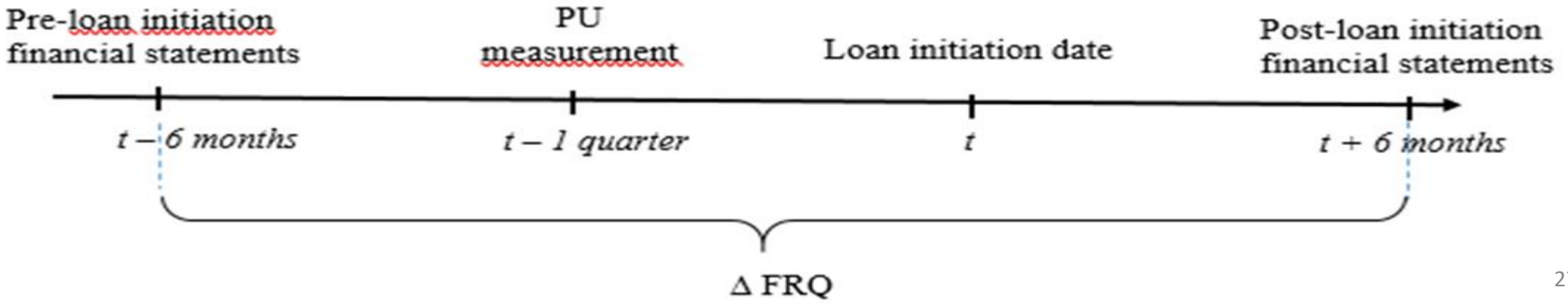
	Dep Var: *Spread*							
	Political Uncertainty							
	Economic Policy & Budget	Institutions & Political Process	Health Care	Security & Defense	Environment	Trade	Tax Policy	Technology & Infrastructure
Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Political Uncertainty	**0.022****	**0.020****	**0.025*****	**0.022****	0.013	0.012	**0.020****	**0.023****
	[2.38]	**[2.24]**	**[2.60]**	**[2.43]**	[1.37]	[1.36]	**[2.22]**	**[2.46]**
Year & Borrower FE	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Observations	11,022	10,963	10,981	11,022	10,987	10,751	10,914	10,923
Adjusted R^2	0.605	0.605	0.605	0.605	0.605	0.607	0.604	0.605

Empirical model (2)

$$Spread_t = \delta_0 + \delta_1\ Political\ Risk_{t\text{-}1q} + \delta_2\ Increase\ FRQ_t + \delta_3\ Political\ Risk_{t\text{-}1q}\ x\ Increase\ FRQ_t + \delta_4\ Low\ ExAnte\ FRQ_t + \delta_5\ Loan\text{-}Specific\ Controls_t + \delta_6\ Borrower\text{-}Specific\ Controls_{t\text{-}1y} + Year\ and\ Borrower\ Fixed\ Effects + \varepsilon_t \quad (2)$$

Test variable: *Political Risk x Increase FRQ*

Increase FRQ is an indicator variable equal to 1 if the absolute value of total abnormal accruals (Kothari et al. 2005) decreases at the end of the year after loan initiation relative to the year before, and 0 otherwise.



Results (H1)

	Dep Var: *Spread*			
	Main Model	Alternative Measure of *Political Risk*	Entropy Balancing	PSM
Variables	(1)	(2)	(3)	(4)
Political Risk x Increase FRQ	**-0.048*** **			
	[-2.89]			
Political Risk	**0.042*** **			
	[3.62]			
High Political Risk x Increase FRQ		**-0.113*** **	**-0.099*** **	**-0.110** **
		[-3.06]	**[-3.53]**	**[-2.09]**
High Political Risk		**0.065** **	**0.049** **	**0.061***
		[2.52]	**[2.46]**	**[1.65]**
Increase FRQ	-0.026	0.004	0.005	0.015
	[-1.42]	[0.21]	[0.29]	[0.42]
Low ExAnte FRQ	0.018	0.019	0.013	0.021
	[0.91]	[0.96]	[0.75]	[0.69]
F-test p-value: *Political Risk x Increase FRQ* + *Political Risk* = 0	0.61	0.09	0.02	0.21
Year and Borrower FE	*Yes*	*Yes*	*Yes*	*Yes*
Observations	11,195	11,195	11,195	5,266
Adjusted R^2	0.605	0.604	0.691	0.644

Improving FRQ reduces loan spreads by 7 basis points for each std. dev. increase in borrower-level PR.

Results (H1)

Panel B: By Type of Political Uncertainty

	Dep Var: *Spread*							
	Political Uncertainty							
	Economic Policy & Budget	Institutions & Political Process	Health Care	Security & Defense	Environment	Trade	Tax Policy	Technology & Infrastructure
Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Political Uncertainty x Increase FRQ	**-0.040****	**-0.045*****	**-0.042****	**-0.039****	**-0.042****	-0.022	**-0.041****	**-0.032***
	[-2.38]	**[-2.72]**	**[-2.48]**	**[-2.32]**	**[-2.43]**	[-1.32]	**[-2.40]**	**[-1.88]**
Political Uncertainty	**0.042*****	**0.042*****	**0.046*****	**0.041*****	**0.033*****	**0.023****	**0.040*****	**0.038*****
	[3.54]	**[3.60]**	**[3.68]**	**[3.48]**	**[2.71]**	**[2.01]**	**[3.36]**	**[3.21]**
Increase FRQ	**-0.031***	**-0.031***	-0.029	**-0.030***	-0.030	**-0.033***	**-0.033***	-0.029
	[-1.68]	**[-1.70]**	[-1.58]	**[-1.65]**	[-1.64]	**[-1.79]**	**[-1.79]**	[-1.60]
F-test p-value: *Political Uncertainty x Increase FRQ + Political Uncertainty = 0*	0.91	0.84	0.80	0.85	0.51	0.96	0.95	0.65
Year and Borrower FE	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Observations	11,022	10,963	10,981	11,022	10,987	10,751	10,914	10,923
Adjusted R^2	0.605	0.606	0.606	0.605	0.606	0.607	0.605	0.606

Results (H1)

Robustness Tests

Panel A: Alternative Measures of Political Risk

	Dep Var: *Spread*	
	Political Risk	
	Military Conflict	News-Based EPU
Variables	(1)	(2)
Political Risk x Increase FRQ	**-0.410*** **	**-0.029***
	[-3.03]	**[-1.69]**
Political Risk	0.164	**0.050*** **
	[1.41]	**[2.69]**
Increase FRQ	-0.025	-0.026
	[-1.40]	[-1.42]
F-test p-value:		
Political Risk x Increase FRQ + *Political Risk* = 0	0.00	0.25
Year and Borrower FE	*Yes*	*Yes*
Observations	11,195	11,195
Adjusted R2	0.604	0.604

Results (H1): Robustness tests

- Two alternative measures of PR:
  (1) the likelihood of extending a loan in a period with a military conflict where the U.S. is involved, and
  (2) the EPU index from Baker et al. (2016).

- Controlling for the economy-wide level of PU (EPU index).

Results (H2A)

The Incremental Effect of FRQ Improvements and Relationship Lending

	Dep Var: *Spread*	
	Relationship Lending	
	No	*Yes*
Variables	(1)	(2)
Political Risk x Increase FRQ	**-0.083****	-0.022
	[-2.33]	[-1.15]
Political Risk	**0.047***	**0.027****
	[1.95]	**[1.97]**
Increase FRQ	-0.051	-0.023
	[-1.35]	[-1.06]
F-test p-value: *Political Risk x Increase FRQ* + *Political Risk* = 0	0.18	0.77
Test for differences in *Political Risk x Increase FRQ* c^2-test p-value: *No* (1) = *Yes* (2)	0.04	
Test for differences in *Political Risk* c^2-test p-value: *No* (1) = *Yes* (2)	0.33	
Year and Borrower FE	*Yes*	*Yes*
Observations	5,618	5,577
Adjusted R^2	0.574	0.669

The loan spread benefits of improving FRQ by high PU borrowers accrue to firms **without** relationship lending.

Results (H2B)

The loan spread benefits of improving FRQ by high PU borrowers accrue to firms with **high** ex-ante financial risk.

Table 6

The Incremental Effect of Financial Reporting Quality and Financial Risk

	Dep Var: *Spread*							
	Bankruptcy Probability		*Credit Ratings*		*Zscore*		*Leverage*	
Financial Risk =	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*
Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Political Uncertainty x Increase FRQ	**-0.238***	**-0.046*****	**-0.069*****	-0.019	**-0.083*****	-0.033	**-0.049***	-0.022
	[-1.94]	**[-2.83]**	**[-2.64]**	[-0.92]	**[-2.69]**	[-1.64]	**[-1.86]**	[-0.94]
Political Uncertainty	**0.176****	**0.041*****	**0.066*****	0.023	**0.051*****	**0.041*****	**0.041****	**0.038****
	[1.99]	**[3.57]**	**[3.72]**	[1.60]	**[2.63]**	**[2.74]**	**[2.42]**	**[2.14]**
Increase FRQ	**-0.301****	-0.023	-0.026	**-0.049****	**-0.076****	-0.009	-0.029	-0.012
	[-2.19]	[-1.32]	[-0.94]	**[-2.29]**	**[-2.36]**	[-0.43]	[-1.05]	[-0.49]
F-test p-value: *Political Uncertainty x Increase FRQ + Political Uncertainty = 0*	0.48	0.69	0.89	0.77	0.21	0.58	0.69	0.35
Test for differences in *Political Uncertainty x Increase FRQ*								
χ^2-test p-value: *High = Low*	0.02		0.05		0.07		0.30	
Test for differences in *Political Uncertainty*								
χ^2-test p-value: *High = Low*	0.04		0.02		0.60		0.89	
Year and Borrower FE	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Observations	931	10,264	6,624	4,571	4,977	6,218	5,593	5,602
Adjusted R^2	0.586	0.621	0.525	0.655	0.580	0.621	0.596	0.623

Mechanism

Improving FRQ reduces loan spreads only when borrowers are exposed to high PR both before and after loan initiation.

Table 7
Mechanism: Persistently High Political Uncertainty and Relationship Lending

	Dep Var: *Spread*					
	Persistently High Political Uncertainty		*Persistently High Political Uncertainty = Yes*		*Persistently High Political Uncertainty = No*	
			Relationship Lending		*Relationship Lending*	
	Yes	*No*	*No*	*Yes*	*No*	*Yes*
Variables	(1)	(2)	(3)	(4)	(5)	(6)
Political Uncertainty x Increase FRQ	**-0.098***	-0.018	**-0.221***	-0.018	-0.060	-0.002
	[-1.94]	[-0.75]	**[-1.87]**	[-0.29]	[-1.08]	[-0.07]
Political Uncertainty	**0.064***	**0.031***	0.158	-0.017	0.037	0.028
	[1.72]	**[1.90]**	[1.63]	[-0.33]	[1.07]	[1.48]
Increase FRQ	0.010	-0.004	0.065	-0.022	-0.028	-0.013
	[0.18]	[-0.19]	[0.48]	[-0.29]	[-0.53]	[-0.43]
F-test p-value: *Political Uncertainty x Increase FRQ* + *Political Uncertainty* = 0	0.38	0.51	0.44	0.44	0.58	0.26
Test for differences in *Political Uncertainty x Increase FRQ*						
χ^2-test p-value: (1) = (2)		0.05				
χ^2-test p-value: (3) = (4)				0.02		
χ^2-test p-value: (3) = (5)					0.07	
χ^2-test p-value: (5) = (6)						0.18
Test for differences in *Political Uncertainty*						
χ^2-test p-value: (1) = (2)		0.26				
χ^2-test p-value: (3) = (4)				0.01		
χ^2-test p-value: (3) = (5)					0.06	
χ^2-test p-value: (5) = (6)						0.76
Year and Borrower FE	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Observations	3,340	7,855	1,680	1,660	3,938	3,917
Adjusted R^2	0.654	0.612	0.664	0.749	0.576	0.669

Mechanism

Improving FRQ reduces loan spreads only when borrowers are exposed to high PR both before and after loan initiation.

Further, this result holds only for newly formed lending relationships.

Table 7

Mechanism: Persistently High Political Uncertainty and Relationship Lending

	Dep Var: *Spread*					
	Persistently High Political Uncertainty		*Persistently High Political Uncertainty = Yes*		*Persistently High Political Uncertainty = No*	
			Relationship Lending		*Relationship Lending*	
	Yes	*No*	*No*	*Yes*	*No*	*Yes*
Variables	(1)	(2)	(3)	(4)	(5)	(6)
Political Uncertainty x Increase FRQ	**-0.098***	-0.018	**-0.221***	-0.018	-0.060	-0.002
	[-1.94]	[-0.75]	**[-1.87]**	[-0.29]	[-1.08]	[-0.07]
Political Uncertainty	**0.064***	**0.031***	0.158	-0.017	0.037	0.028
	[1.72]	**[1.90]**	[1.63]	[-0.33]	[1.07]	[1.48]
Increase FRQ	0.010	-0.004	0.065	-0.022	-0.028	-0.013
	[0.18]	[-0.19]	[0.48]	[-0.29]	[-0.53]	[-0.43]
F-test p-value: *Political Uncertainty x Increase FRQ* + *Political Uncertainty* = 0	0.38	0.51	0.44	0.44	0.58	0.26
Test for differences in *Political Uncertainty x Increase FRQ*						
χ^2-test p-value: (1) = (2)		0.05				
χ^2-test p-value: (3) = (4)				0.02		
χ^2-test p-value: (3) = (5)					0.07	
χ^2-test p-value: (5) = (6)						0.18
Test for differences in *Political Uncertainty*						
χ^2-test p-value: (1) = (2)		0.26				
χ^2-test p-value: (3) = (4)				0.01		
χ^2-test p-value: (3) = (5)					0.06	
χ^2-test p-value: (5) = (6)						0.76
Year and Borrower FE	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Observations	3,340	7,855	1,680	1,660	3,938	3,917
Adjusted R^2	0.654	0.612	0.664	0.749	0.576	0.669

Conclusions

- High PR borrowers improving their FRQ after loan initiation benefit from incrementally smaller loan spreads relative to borrowers that do not do so.

➡ Banks access and use private information on future improvements in FRQ to set loan prices.

- The effect we document is contextual ➡ FRQ increases are associated with loan spread benefits only when borrowers have:
  - *no* lending relationships or
  - high *ex-ante* financial risk.

The University of Manchester
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Thank you very much for your comments!

Table 2
Descriptive Statistics

Variable	N	Mean	Median	Std. Dev.	Min.	P25	P75	Max.
Spread	11,195	214.840	175.000	143.014	15.000	125.000	275.000	800.000
Political Uncertainty	11,195	118.127	64.693	162.597	2.278	30.097	133.030	1,064.754
Increase FRQ	11,195	0.473	0.000	0.499	0.000	0.000	1.000	1.000
Low ExAnte FRQ	11,195	0.430	0.000	0.495	0.000	0.000	1.000	1.000
NCovenants	11,195	1.346	1.000	1.319	0.000	0.000	2.000	5.000
Facility Amount ($ millions)	11,195	516,700	250,000	673,600	1,000	100,000	600,000	3195,000
Maturity (months)	11,195	52.521	60.000	19.116	5.000	42.000	60.000	177.000
NLenders	11,195	8.836	7.000	7.142	1.000	4.000	12.000	35.000
Relationship Lending	11,195	0.498	0.000	0.500	0.000	0.000	1.000	1.000
Secured Loan	11,195	0.542	1.000	0.498	0.000	0.000	1.000	1.000
Term Loan	11,195	0.302	0.000	0.459	0.000	0.000	1.000	1.000
Investment Grade	11,195	0.308	0.000	0.461	0.000	0.000	1.000	1.000
Total Assets ($ millions)	11,195	7,877.104	2,020.121	20,520.428	8.351	724.009	6,031.241	349,493.000
ROA	11,195	0.034	0.045	0.097	-0.562	0.011	0.079	0.250
Leverage	11,195	0.286	0.255	0.217	0.000	0.134	0.392	1.220
Tangibility	11,195	0.284	0.204	0.233	0.009	0.099	0.423	0.904
Loss	11,195	0.204	0.000	0.403	0.000	0.000	0.000	1.000
Negative Equity	11,195	0.046	0.000	0.210	0.000	0.000	0.000	1.000
Zscore	11,195	3.292	2.674	3.000	-4.303	1.601	4.168	19.575
Market-to-Book	11,195	3.045	2.285	4.277	-10.983	1.424	3.717	24.310

Table 3
Correlations

	Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)
(1)	*Spread*																			
(2)	*Political Uncertainty*	**0.05**																		
(3)	*Increase FRQ*	0.004	-0.01																	
(4)	*Low ExAnte FRQ*	**0.05**	**-0.03**	**0.39**																
(5)	*NCovenants*	**-0.04**	0.01	0.01	0.004															
(6)	*Facility Amount*	**-0.35**	-0.01	**-0.02**	**-0.06**	**-0.11**														
(7)	*Maturity*	**0.11**	-0.01	-0.004	-0.01	**0.05**	**0.05**													
(8)	*NLenders*	**-0.32**	0.01	**-0.02**	**-0.08**	**0.09**	**0.52**	**0.05**												
(9)	*Relationship Lending*	**-0.17**	0.002	-0.01	-0.01	-0.01	**0.20**	0.02	**0.15**											
(10)	*Secured Loan*	**0.42**	**0.02**	-0.0004	**0.05**	**0.25**	**-0.23**	**0.23**	**-0.18**	**-0.08**										
(11)	*Term Loan*	**0.36**	0.001	**-0.02**	**-0.02**	-0.01	**-0.06**	**0.24**	**-0.08**	**-0.05**	**0.26**									
(12)	*Investment Grade*	**-0.37**	**-0.02**	**0.02**	**-0.04**	**-0.18**	**0.35**	**-0.21**	**0.27**	**0.05**	**-0.49**	**-0.19**								
(13)	*Firm Size*	**-0.23**	-0.002	-0.003	**-0.10**	**-0.30**	**0.63**	**-0.08**	**0.42**	**0.16**	**-0.32**	**-0.03**	**0.54**							
(14)	*ROA*	**-0.29**	-0.01	**-0.05**	**-0.07**	**-0.03**	**0.18**	**0.04**	**0.12**	**0.04**	**-0.23**	**-0.05**	**0.24**	**0.13**						
(15)	*Leverage*	**0.24**	-0.01	**0.03**	-0.01	**-0.05**	**0.09**	**0.12**	0.01	**0.08**	**0.22**	**0.24**	**-0.19**	**0.13**	**-0.19**					
(16)	*Tangibility*	0.01	**0.02**	-0.0001	-0.0003	**-0.02**	**0.10**	0.001	**0.06**	**0.04**	-0.0001	**-0.04**	-0.01	**0.12**	**-0.06**	**0.20**				
(17)	*Loss*	**0.30**	0.01	**0.04**	**0.10**	**0.02**	**-0.17**	**-0.03**	**-0.17**	**-0.05**	**0.24**	**0.06**	**-0.22**	**-0.14**	**-0.68**	**0.20**	**0.08**			
(18)	*Negative Equity*	**0.15**	-0.01	0.01	**0.03**	**-0.03**	**-0.02**	**0.03**	**-0.09**	-0.01	**0.13**	**0.09**	**-0.12**	**-0.04**	**-0.11**	**0.50**	**0.03**	**0.14**		
(19)	*Zscore*	**-0.22**	-0.01	-0.01	**0.02**	**0.05**	**-0.09**	**-0.04**	**-0.07**	**-0.08**	**-0.16**	**-0.11**	**0.12**	**-0.21**	**0.43**	**-0.55**	**-0.19**	**-0.29**	**-0.20**	
(20)	*Market-to-Book*	**-0.10**	0.01	0.003	**0.02**	-0.01	**0.06**	**-0.04**	**0.03**	0.01	**-0.08**	0.005	**0.10**	0.02	**0.16**	**-0.08**	**-0.07**	**-0.10**	**-0.40**	**0.24**

APPENDIX
Definitions of Variables

Test variables	
Political Uncertainty	The natural logarithm of the overall firm-level political risk or the natural logarithm of the firm-level political risk related to one of the eight political topics, in the quarter before loan initiation (from Hassan et al. 2019). The political topics are: "economic policy & budget," "institutions & political process," "health care," "security & defense," "environment," "trade," "tax policy," and "technology & infrastructure;"
Dependent variable	
Spread	The interest rate that a borrower pays in basis points over LIBOR or LIBOR equivalents (spread all-in-drawn from Dealscan);
Loan-specific controls	
Facility Amount	The natural logarithm of the amount of a loan facility (from Dealscan);
Maturity	The natural logarithm of loan maturity measured in months (from Dealscan);
NCovenants	The total number of financial covenants of a loan facility (from Dealscan);
NLenders	The total number of lenders in each loan facility (from Dealscan);
Relationship Lending	An indicator variable equal to 1 if in the last five years the current lead lender granted a loan to the borrower where he was also a lead lender, and 0 otherwise (from Dealscan);
Secured Loan	An indicator variable equal to 1 if the loan is secured, and 0 otherwise (from Dealscan);
Term Loan	An indicator variable equal to 1 if the loan is a term loan, and 0 otherwise (from Dealscan);

Borrower-specific controls	
Firm Size	The natural logarithm of total assets in year *t-1* (from Compustat);
Investment Grade	An indicator variable equal to 1 if the credit rating of the borrower in year *t-1* is at least "BBB-," and 0 otherwise (from Compustat);
Leverage	The ratio of total debt to total assets in year *t-1* (from Compustat);
Loss	An indicator variable that equals 1 if net income is negative in year *t-1*, and 0 otherwise (from Compustat);
Market-to-Book	The ratio of market value of equity to book value of common equity in year *t-1* (from Compustat);
Negative Equity	An indicator variable equal to 1 if total assets are lower than total liabilities in year *t-1*, and 0 otherwise (from Compustat);
ROA	The ratio of net income to total assets in year *t-1* (from Compustat);
Tangibility	Net property, plant, and equipment divided by total assets in year *t-1* (from Compustat);
Zscore	Altman's Z-score in year *t-1*, computed as follows: 1.20 x Working capital/Total assets + 1.40 x Retained earnings/Total assets + 3.30 x ROA + 0.60 x Market value of equity/Book value of debt + 1.00 x Sales/Total assets (from Compustat);

Additional variables used in the cross-sectional tests

Financial Risk	Financial risk is high if either (*i*) probability of bankruptcy (Hillegeist et al. 2004) is above 0; (*ii*) S&P credit rating or leverage is below the sample median; or (*iii*) Altman's Z-score is below the yearly median, and it is low otherwise (from Compustat);
Increase FRQ	An indicator variable equal to 1 if the absolute value of total abnormal accruals (based on Kothari et al. (2005)) decreases at the end of the year after loan initiation relative to the year before, and 0 otherwise (from Compustat);
Low ExAnte FRQ	An indicator variable equal to 1 the absolute value of total abnormal accruals (based on Kothari et al. (2005)) at loan initiation is above the industry-year median, and 0 otherwise (from Compustat).
Persistently High Political Uncertainty	PU is persistently high if: (a) in the quarter before loan initiation, it is above the yearly-industry median and (b) its average of the four quarters ending at the fiscal year-end after loan initiation is also above the yearly-industry median, and it is not persistently high otherwise.