



Europe vs. the U.S.: A new look at the syndicated loan pricing puzzle[☆]



Aurore Burietz^a, Kim Oosterlinck^{b,*}, Ariane Szafarz^c

^a IÉSEG School of Management, 3 Rue de la Digue, 59000 Lille, France

^b Université Libre de Bruxelles (ULB), SBS-EM, CEB and CEPR, 50 Av. Roosevelt, CP114/03 1050 Brussels, Belgium

^c Université Libre de Bruxelles (ULB), SBS-EM, CEB and CERMI, 50 Av. Roosevelt, CP114/03 1050 Brussels, Belgium

HIGHLIGHTS

- The syndicated loan pricing puzzle points out lower-priced loans in Europe than in the U.S.
- We solve the puzzle using region-specific credit ratings.
- Differences in local accounting standards compromise the uniformity of credit ratings.

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ABSTRACT

According to the syndicated loan pricing puzzle (Carey and Nini, 2007) interest rates charged to corporate borrowers are lower in Europe than in the U.S. Our investigation suggests that controlling for region-specific credit ratings makes the Europe–U.S. gap insignificant, and solves the puzzle. We speculate that the puzzle originates from the lack of uniformity of accounting standards.

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1. The puzzle

A syndicated loan (SL) is a credit granted by a group of lenders, mostly banks. With a SL, the issuer selects one or several lead arrangers to structure, arrange, underwrite, and administer the loan (Dennis and Mullineaux, 2000). The lead arrangers charge

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* Corresponding author.

E-mail addresses: a.burietz@ieseg.fr (A. Burietz), koosterl@ulb.ac.be (K. Oosterlinck), aszafarz@ulb.ac.be (A. Szafarz).

a fee for their services. It should be noted that the SL market is huge. Recent statistics from Thompson Reuters (<http://dmi.thomsonreuters.com>) and the Bank for International Settlements (<http://www.bis.org>) indicate that syndicated lending attracts around 50% of corporate debt issuance in the US, and some 20% in Europe. Fig. 1 shows the evolution of the market between 1992 and 2014.

The so-called SL pricing puzzle emerged from the work of Carey and Nini (2007), henceforth C&N, showing that, all else equal, credit in the European SL market is significantly cheaper than in its US counterpart. Subsequent articles provided partial clues to the puzzle by emphasizing that ratings alone are insufficient to account for the riskiness of SL contracts. Gaul and Uysal (2013) blamed unobservable volatility differences between US and European firms. That explanation solved the puzzle, but only for listed borrowers. Berg et al. (2016) underscored that loan category matters, and showed that the puzzle vanishes for syndicated credit lines, which account for 70% of their full sample.

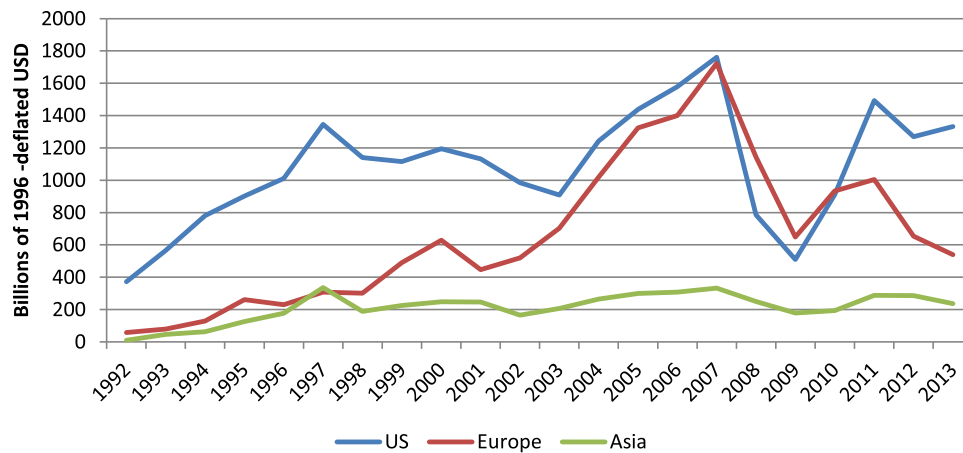


Fig. 1. Syndicated loan market: Issuance volume 1992–2014. Source: Loan Pricing Corporation's DealScan database, authors' computations.

Table 1

Descriptive Statistics: 1992–2014. The spreads are expressed in basis-points (1 bp = 0.01%); the rating is either the Standard & Poor's or the Moody's rating (when only one of the two is available), or the lesser rating (when both are available); *** significant at 1%, ** significant at 5%, * significant at 10%.

All-in spread	Europe		U.S.		T-test for equal means
	Mean	SD	Mean	SD	
Total	127	133	222	164	12.88***
Investment grade					
A+	39	28	43	39	0.98
A	56	63	47	50	0.99
A–	42	37	69	58	5.12***
BBB+	49	40	80	54	5.75***
BBB	73	46	102	62	5.43***
BBB–	90	62	136	79	5.24***
Speculative grade					
BB+	200	183	169	83	0.65
BB	245	106	208	94	1.99**
BB–	233	84	238	103	0.34
B+	315	181	293	127	0.82
B	255	178	371	175	2.98***
B–	303	67	376	184	3.24***

Stressing that ratings are based on accounting ratios (Campbell and Taksler, 2003), which depend on standards that vary across jurisdictions, this paper shows that using region-specific ratings solves the SL puzzle, not only over the period covered by C&N, but also for a larger sample of SLs.

2. Data and methods

Analyzing the SL puzzle requires first comparing the all-in spreads – the spread to LIBOR, plus fees – of deals arranged in the US with those observed on the European market. C&N capture the Europe–US difference by introducing a dummy variable for European loans in the OLS regression explaining the all-in-spreads. They control for a number of variables, including the borrower's credit rating. This econometric design relies on the assumption that, for lenders, the informational content of credit ratings is uniform across jurisdictions. We lift this assumption by introducing Europe-specific credit ratings through interaction terms into the regression.

Our data are retrieved from Loan Pricing Corporation's DealScan database. They concern 25,078 SLs granted over the period from January 1992 to December 2014. Like C&N, we selected USD-denominated SLs issued in Europe and in the US, for which the

borrowing firms are located in OECD member countries, Hong Kong, Singapore, or Taiwan. When ratings from both Standard & Poor's and Moody's were available, C&N used the lower of the two. They furthermore discarded borrowers rated above A+ and below B-.¹

3. Results

Table 1 shows descriptive statistics for all-in spreads over the 1992–2014 sample. T-tests for equal means reject the null both for low ratings in the investment-grade category (A–, BBB+, BBB, BBB) and for half of the speculative ratings (BB, B, B–). The results are possibly due to the fact that loans in Europe and the US have different characteristics. The regressions reported in Table 2 control for these characteristics. They explain the all-in spread over two sample periods: the full period (1992–2014) and the period studied by C&N (1992–2002). For the latter, we consider two specifications depending on whether the European dummy is single or split into two sub-periods (1992–1998 and 1999–2002), as in the original model. In each case, we replicate the global-rating approach used by C&N (2007) and compare it to our region-specific rating model, which includes interaction terms between the regional dummy variable and rating classes.²

Our findings suggest that the SL pricing puzzle can be solved by acknowledging the possibility that rating agencies' assessments are region-dependent. A rationale for this stems from the fact that accounting ratios depend on the standards used in different regions. Despite harmonization measures taken by the European Union since 2005, a significant gap still exists between the reporting conventions of US and non-US firms (Barth et al., 2012). Leuz (2010), who groups countries according both to regulatory frameworks and to reporting practices, puts continental Europe and the US into separate groups for both criteria. Cascino and Gassen (2015) document differences in compliance with International Financial Reporting Standards (IFRS). Likewise, Nobes (2006) and Kvaal and Nobes (2012) argue that accounting rules are persistent, so that pre-IFRS local specificities continue to influence practices even after the standards have been adopted. In addition to firm's characteristics, tax motives and enforcement schemes contribute

¹ The sample used by Gaul and Uysal (2013) is made of rated loans of listed firms only. Berg et al. (2016) use all the rated loans.

² For the sake of clarity, we show only the coefficients of rating-related explanatory variables. Full results are available upon request.

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