THE REPUTATION EFFECT ON SYNDICATED LOAN PRICING

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ABSTRACT

This paper analyzes the reputation effect of the lead arranger on syndicated loan pricing. To exclude the effect of the financial crisis of 2007-2009 on our study, we focus on syndicated loans lent to non-financial U.S. firms from 1994-2006. Theory suggests that the reputation/spread relationship should generally be positive because more reputable lenders usually employ more costly loan screening and monitoring techniques and therefore must be compensated with a higher spread. After controlling for endogeneity in lender-borrower matching, the empirical results show that the reputable arrangers charge a "reputation premium" for monitoring and due diligence, and a commitment against extracting an information rent from borrowers. The results also show that the less-reputable arrangers offer a "reputation discount", since the market competition from both the loan market and bond market makes it more difficult for less reputable arrangers to sustain a reputation mechanism. In addition, the reputation effect on pricing becomes less significant when the borrower enters a repeat loan relationship with a prior or existing lender.

Keywords: *Reputation Effect, Syndicated Loan, Loan Spread, Competition Effect, Information Asymmetry*