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Borrower Private Information Covenants and Loan Contract Monitoring [☆]

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Abstract

We identify covenants in commercial loan contracts that require public borrowers to periodically disclose two types of accounting-related private information to lenders: projected financial statements for future periods and monthly historical financial statements. We hypothesize and provide evidence that: (1) loan contracts include these covenants in settings where they enhance lenders' loan contract monitoring; (2) the covenants are positively associated with the frequency of loan contract amendments; and (3) lenders trade on the borrower private information they receive in secondary loan markets. We further show that the two types of covenants have predictably different determinants and effects.

Keywords: Loan monitoring, debt contracting, debt covenants, relationship lending, private information

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