Press Release
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Study shows banks can exploit borrower adversity following short seller attacks

Companies under public scrutiny face higher loan rates even when their actual credit risk does not increase.

A new paper published last month in *Review of Finance*, led by Professor Albert Kwame Mensah, Professor Luc Paugam, and Professor Hervé Stolowy (HEC Paris), together with Professor Jeong-Bon Kim (Simon Fraser University), finds that **banks might be taking advantage of companies facing public attacks from activist short sellers by charging higher interest rates than what their actual risk would justify.**

The research examined more than 2,700 bank loans to U.S. companies between 2008 and 2018, focusing on firms targeted by activist short sellers, investors who publicly criticise companies and bet against their share prices. These critics often publish detailed reports alleging accounting fraud, business irregularities, or other corporate misconduct.

On average, banks raised loan interest rates by 8% following these attacks, even after controlling for changes in the borrowers' actual financial risk.

"*Banks appear to be taking advantage of companies when they are most vulnerable,*" said Prof. Mensah. "*Even after accounting for actual risk, some banks still charge higher rates, which indicates opportunistic behaviour.*"

The effect persists for several years and becomes even stronger when regulators later validate the short sellers' claims. Companies facing the most serious allegations, such as fraud or accounting irregularities, experience 1.5 times the impact of less serious ones. These findings reinforce the notion that banks act more opportunistically when borrowers face allegations that pose greater reputational or financial risk. Activist short sellers have mainly emerged after the 2007 financial crisis, producing forensic-type negative reports that impact financial markets. Although their reports can expose important corporate issues, they also have an unintended consequence: their attacks can limit companies' access to other sources of financing. This gives banks with existing lending relationships incremental bargaining power, allowing them to raise rates without losing business, since targeted companies are less likely to switch lenders.

The paper provides new evidence on how banks respond to public scrutiny of their clients and the ways in which relationship lenders can exploit borrower adversity.

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