Partisan Professionals: Evidence from Credit Rating Analysts

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University of Chicago Booth
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Political Economy of Finance, October 2019
Introduction

- Political polarization and partisanship are on the rise
  - “Partisan perceptual screen” (Campbell et al. (1960))
  - Partisan perception in the formation of economic expectations (e.g., Gerber and Huber (2009) and Mian et al. (2017))
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- **Question:** Does partisan perception affect *economic decisions*?
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○ So far, no evidence on economically sophisticated individuals in high-stake environments
Introduction

- **This paper**: Does political alignment with the president affect decisions by finance professionals?

- **Setting**: credit rating analysts

  1. We can link credit rating decisions to individual analysts (Fracassi et al. (2016))

  2. Credit ratings matter for firms’ cost of capital, financing and investment policies (e.g., Kisgen (2006, 2009), Almeida et al. (2017))

  3. Requires *long-term* forecasts of credit risk

  4. Multiple analysts rate the *same firm* at the *same point in time*
Introduction

What do we find?

Analysts who are not affiliated with the president's party downward-adjust ratings more around the Trump election.

Firms rated by misaligned analysts lose 0.52%–0.62% more of their market capitalization over a single presidential term.

Mechanism:
belief disagreement

Conducted online survey of credit rating analysts. Effect is larger for cyclical firms, and when views of economic conditions are more politically polarized.
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Part I: Rating actions on all U.S. corporate debt issuers between 2000Q1–2018Q1
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Rating actions:
- Moody’s: Moody’s DRD
- Standard & Poor’s: S&P RatingXpress
- Fitch: Mergent FISD
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Rating actions:
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Match to a press release that contains the name(s) of the analyst(s) covering the firm
- Usually contain two names, the lead analyst and the rating committee chair or secondary analyst
Part II: Data on party affiliation

Source: Voter registration records from NYC, New Jersey, and Illinois

Voter registration data cover a larger part of the population relative to financial contributions

Final sample: 557 analysts covering 1,984 firms (match rate of 46%)
○ Part II: **Data on party affiliation**

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- **Final sample:** 557 analysts covering 1,984 firms (match rate of 46%)
Data Descriptives

Kempf and Tsoutsoura
Partisan Professionals

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<th></th>
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<th>Mean</th>
<th>Std. Dev.</th>
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<tbody>
<tr>
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<tr>
<td>Rating change</td>
<td>72,732</td>
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<td><strong>Partisan Bias</strong></td>
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<td></td>
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</tr>
<tr>
<td>Ideological mismatch</td>
<td>76,969</td>
<td>0.370</td>
<td>0.483</td>
</tr>
</tbody>
</table>

- Rating change = difference (in notches) between rating at the end of the calendar quarter and rating at the beginning of the quarter
  - Ratings transformed into cardinal scale, starting with 1 for Aaa and ending with 21 for C
  - I.e., positive change = downgrade

- Ideological mismatch = 1 if party affiliation does match the president’s, 0 otherwise
Empirical Strategy

○ Has to address the following issues:

- Non-random matching of analysts to firms
- Agency differences in rating methodologies
- Time-invariant characteristics of analysts with different affiliations

Solution:

\[
\Delta R_{\text{ift}} = \alpha_{ft} + \alpha_p + \beta \text{Ideological mismatch}_{it} + \gamma' X_{it} + \epsilon_{ift}
\]

- Additional fixed effects (e.g., agency × quarter f.e.)

- Why changes instead of levels?

- Analysts may respond gradually rather than instantly
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- \(\alpha_p\): party affiliation f.e.
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Results

Univariate

Kempf and Tsoutsoura Partisan Professionals
<table>
<thead>
<tr>
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<th>(1)</th>
<th>(2)</th>
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<tbody>
<tr>
<td>Ideological mismatch</td>
<td>0.0168</td>
<td>0.0170</td>
<td>0.0134</td>
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<tr>
<td></td>
<td>(4.18)</td>
<td>(4.26)</td>
<td>(3.79)</td>
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<tr>
<td>Tenure</td>
<td>0.0001</td>
<td>-0.0006</td>
<td>-0.0004</td>
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<tr>
<td></td>
<td>(0.03)</td>
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<td>(-0.15)</td>
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<tr>
<td>No. of firms covered</td>
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<td></td>
<td>(-0.10)</td>
<td>(0.05)</td>
<td>(-0.02)</td>
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<td>Observations</td>
<td>49,792</td>
<td>49,792</td>
<td>49,790</td>
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<tr>
<td>$R^2$</td>
<td>0.804</td>
<td>0.804</td>
<td>0.808</td>
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<tr>
<td>Firm $\times$ Quarter FE</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
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<tr>
<td>Agency FE</td>
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<td>No</td>
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<td>Agency $\times$ Quarter FE</td>
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<td>Yes</td>
</tr>
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<td>Agency FE</td>
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<td>No</td>
<td>No</td>
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<tr>
<td>Agency × Sector FE</td>
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<td>No</td>
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- Analysts who are not affiliated with the president’s party on average downward-adjust more by **0.013 notches per quarter** (0.21 notches over four years)
## Results

### Robustness

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<th>Coeff</th>
<th>$t$-statistic</th>
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### Panel A: Alternative dependent variables

- Rating change indicator: 0.0110, $t$-statistic: 3.88
- Downgrade: 0.0064, $t$-statistic: 3.24
- Upgrade: -0.0046, $t$-statistic: -2.21

### Panel B: Alternative definitions of ideological mismatch

- Use only party affiliation from presidential elections: 0.0144, $t$-statistic: 2.75
- Add party affiliation from political contributions: 0.0135, $t$-statistic: 4.36

### Panel C: Estimation

- Triple-cluster standard errors (analyst, firm and quarter): 0.0134, $t$-statistic: 4.33
- Firm-agency level: 0.0298, $t$-statistic: 3.82
- Weighted least squares: 0.0125, $t$-statistic: 3.35
- Add Analyst FE: 0.0108, $t$-statistic: 2.40
- Agency $\times$ Sector $\times$ Quarter FE: 0.0087, $t$-statistic: 2.82
- Add NBER Recession $\times$ Party affiliation FE: 0.0150, $t$-statistic: 4.03
We conduct an event study around the 2016 presidential election.
We conduct an event study around the 2016 presidential election

Unique setting:
2016 Presidential Election

- We conduct an event study around the 2016 presidential election

- Unique setting:
  - Unexpected outcome
  - Candidates had very different views on economic policy (Meeuwis et al. (2018))
  - Election date did not overlap with other major economic events
2016 Presidential Election

- Does the rating behavior of Democratic and Republican analysts change around the election?
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Price Effects

- Price effects of analysts’ partisan perception:
  - Estimate abnormal stock returns around rating-change announcements
  - Stock prices do not react differently to rating adjustments by aligned versus misaligned analysts
  - Overall effect: replacing an aligned analyst with a misaligned analyst leads to a negative cumulative abnormal stock return of $0.52–0.62\%$ over 4 years
  - Corresponds to a USD-difference of $89–107$ million for the average firm
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Accuracy

- Results so far imply that analysts who are not aligned with the president’s Party are more likely to downward-adjust ratings.

- Who is right and who is wrong, or are aligned and misaligned analysts equally wrong?

- Look at rating accuracy:
  - \( \text{Accuracy}_{ift} = \Delta R_{ift} \times \Delta s_{f,t+h} \)
  - \( i \): analyst
  - \( f \): firm
  - \( t \): quarter
### Accuracy

<table>
<thead>
<tr>
<th></th>
<th>1Q (1)</th>
<th>2Q (2)</th>
<th>4Q (3)</th>
<th>8Q (4)</th>
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<tr>
<td>Ideological mismatch</td>
<td>-0.0014</td>
<td>-0.0017</td>
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<tr>
<td></td>
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<td>(-1.41)</td>
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<td>(-0.45)</td>
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<tr>
<td>Observations</td>
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<td>14,627</td>
<td>11,832</td>
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<tr>
<td>R²</td>
<td>0.070</td>
<td>0.086</td>
<td>0.109</td>
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<td>Agency FE</td>
<td>Yes</td>
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<td>Sector × Quarter FE</td>
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<td>Firm Characteristics</td>
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Main results show that analysts’ political alignment with the president affects credit ratings.

Possible mechanisms:

1. Online survey of credit rating analysts
2. Effect driven by firms and industries with high market betas
3. Effect is stronger when political polarization in views of economic conditions is high
Main results show that analysts’ political alignment with the president affects credit ratings.

Potential mechanism: belief disagreement.
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Suggestive evidence:

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Kempf and Tsoutsoura
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Conducted survey of 91 current and former credit rating analysts (57 valid responses)

40% Democrat, 27% Republican, 33% Independent
○ Conducted survey of 91 current and former credit rating analysts (57 valid responses)

○ 40% Democrat, 27% Republican, 33% Independent
  
  – “How would you rate economic conditions in this country today — as excellent, good, only fair, or poor?”
  
  – The responses to the question are converted into a numerical scale that ranges from 1 (poor) to 4 (excellent)
Conclusion

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One of the first studies to document diverging economic behavior of Democrats and Republicans around the Trump election
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- Suggests partisan perception may have real effects