Hodek Committee Reform – has Creditor Corporate Governance in Israel been Improved?

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OVERVIEW & Main claims:

1. The effects of a regulation that urged institutions to invest only in corporate bonds that include restrictive and financial covenants.
2. Several years into the reform all new bond issues include several restrictive covenants and most also include financial covenants based either on rating or on accounting ratios…
3. Main contribution :

- This is the first study to document the use of covenants several years into the reform in a systematic manner

Model:

$$Y = \beta_0 + IMR + \beta_1 X + CVN + \varepsilon$$

Results:

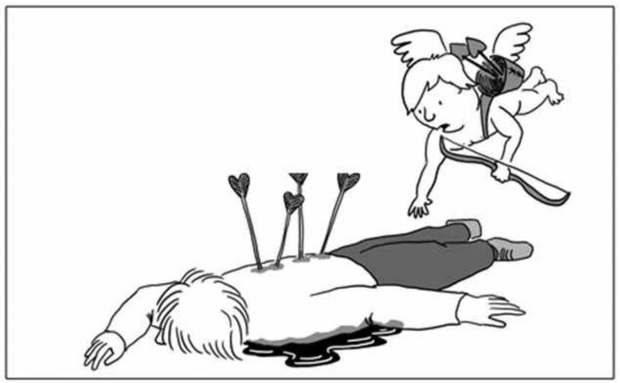
	Rating restrictive covenant	Rating interest compensation covenant	Accounting ratios interest compensation covenant
Selectivity variable	0.18	-0.09	-0.29
Price effect of covenant	-0.86^{***}	-0.78^{***}	0.40^{*}
Log(assets)	-0.33^{***}	-0.38^{***}	-0.42^{***}
leverage	1.75^{***}	1.69^{**}	1.77^{***}
Tangibility	1.36^{**}	1.63^{**}	1.50^{**}
Cash flow volatility (%)	0.34^{***}	0.34^{***}	0.33^{***}
1 year treasury rate (%)	0.73^{*}	0.71^{*}	0.69^{*}
10-year-2-year Treasury (%)	-0.72	-0.69	-0.61
Market-to-book	-0.59	-0.91^{**}	-0.67^{*}
Equity return standard deviation (%)	0.15^{***}	0.12^{**}	0.15^{***}
Equity return mean (%)	-1.13^{**}	0.15^{***}	-1.21^{***}
Year dummies	Y	-1.19^{***}	Y
Industry dummies	Y	Y	Y
Constant	8.65^{***}	9.87^{***}	10.11^{***}
Observations	231	231	231
R^2	0.47	0.46	0.44
Adjusted R^2	0.42	0.41	0.39
F Statistic	9.67^{***}	9.33^{***}	8.66^{***}
Note:	*p**p***p<0.01		

Covenants?

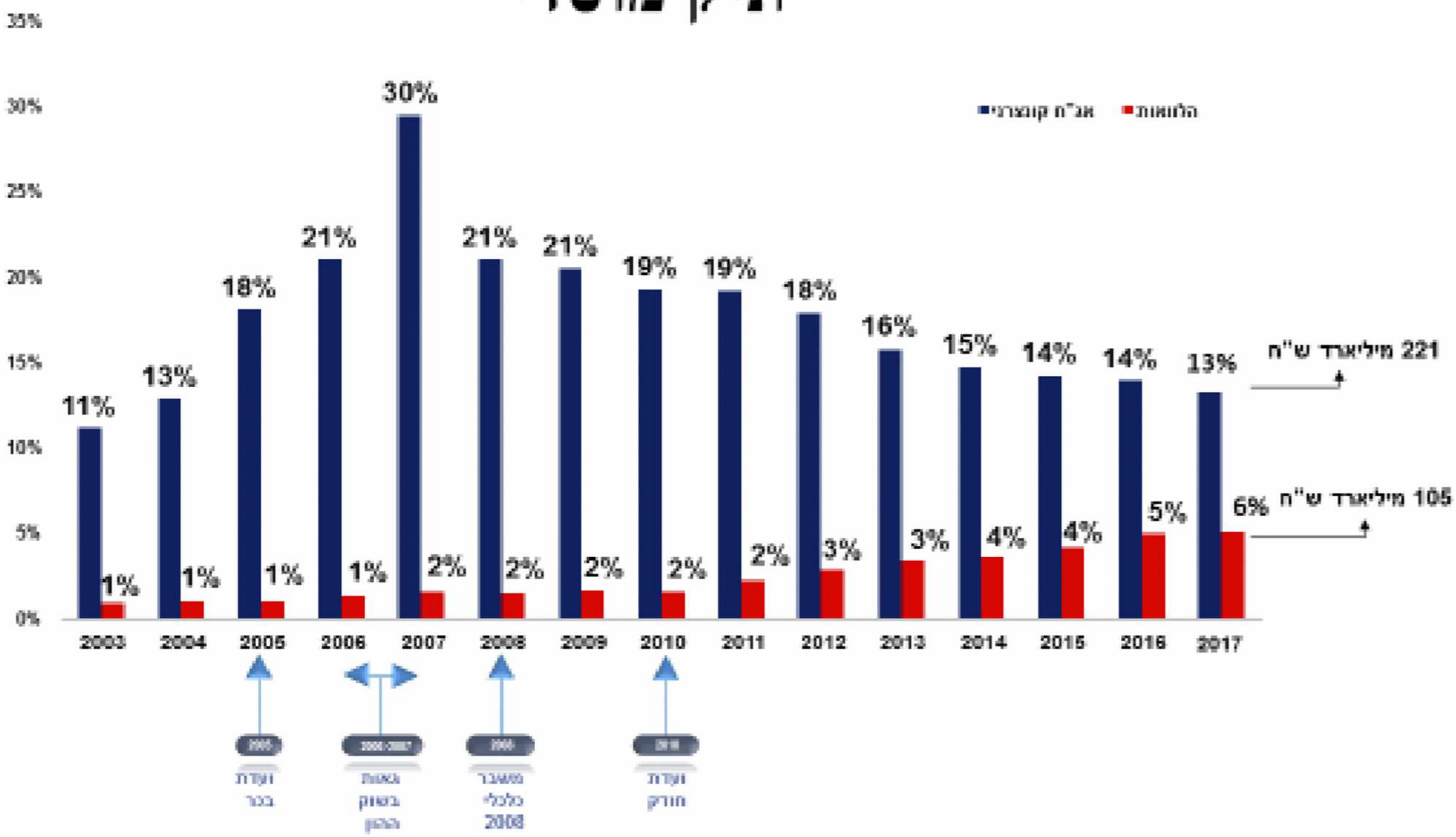
- We must be (really) sure that the covenant is real ☺

Unintended consequences?

- All new bond issues include several restrictive covenants and most issues also include either a rating or an accounting (ratios based) covenants.
- BUT… What about
  - Series Expansions (no covenants?)
  - Private Loans (no covenants?)



תיק מוסדי



רשות שוק ההון, ביטוח וחיסכון

Model:

- Not a different estimation for each covenant, but a set of dummies for each covenant
- Collateral?
- The standard errors must be clustered at a firm level

$$Y = \beta_0 + IMR + \beta_1 X + CVN + \varepsilon$$

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Recommendations

- Debt covenants literature!
- There is no control group here… hence, the results should be interpreted with care!

  [רפורמות מקיפות בממשל התאגידי הישראלי]

- Maybe series expansions & private loans could serve as a control?
- Dif-in-dif estimation, which much more convincing?

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- Abstract? To include all the findings… no rating covenants results.
- All figures must have self explanatory captions.

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- “Equity data is based on daily returns during X days before bond issue” on page 13 (I hope)…

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- Hamdani et al 2016 → Hamdani et al 2017

THANK YOU!

- I liked the paper a lot.
- Overall, it is well written.
- The paper opens several interesting policy questions.
- However, there is a WAY to go!