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Bank CEO inside debt and loan contracting

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Abstract

Contrary to the theoretical prediction that CEOs with large debt-based compensation take lower levels of risk, we find that banks with higher CEO inside debt compensation extend syndicated loans with smaller number of lenders, lower spread, less covenant, and higher maturity. Using two-stage selection models, we reconciled these seemingly counter intuitive results of inside debt leads to less conservative loan contracting terms by incorporating banks selection effect. We find that the mechanism of inside debt limit bank risk-taking in loan contracting is through making loans to safer borrowers in the first place, but not through tighter loan terms. These results are consistent and robust to instrumental variables and structure models that control for the endogeneity of relationships.

Keywords: Inside debt, Loan contracting, Bank Executive, CEO Compensation, Risk-taking, syndicated loans

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