

# **CovenantAI- New Insights into Covenant Violations**

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## **ABSTRACT**

This paper introduces CovenantAI, a novel artificial intelligence (AI)-powered tool that tracks SEC-reported covenant violations with improved accuracy over existing text-search methods, covering data from 1996 to 2022. It accurately identifies amendments, waivers, and technical defaults, providing a detailed timeline of covenant breaches. We use a “quasi” regression discontinuity approach to analyze the effects of these violations on key firm outcomes such as investments, employment, or credit access, revealing complex patterns and pronounced effects during economic downturns such as the COVID-19 pandemic. The changing loan market, resembling bond markets with the rise of CLOs and secondary trades, has decreased covenant reliance and violations among non-investment grade firms.