The European Leveraged Finance Alliance calls for greater accessibility, consistency and content in reporting by borrowers.

- The European Leveraged Finance Alliance strongly believes that the European High Yield market would benefit from greater consistency and increased content in reporting by borrowers.
- This reporting must also be freely accessible by investors to support decision making and boost transparency in the market to benefit all stakeholders.
- We believe this standard is not being consistently met and is illustrated well by the continued restrictive access to financial information through password protected websites.
- In this paper, we discuss how and why investors should proactively engage with issuers to push for improvements in this field.

For years, investors in the European high yield market have called for more accessible, consistent, and comprehensive company reporting, as well as improved covenant disclosure. After all, both of these are essential to investors' efforts to price credit risk and make effective investment decisions.

While such transparency might seem like a fundamental principle of governance in public capital markets, there are several areas in which the market falls short of acceptable norms. Practices such as burying complex and risky covenant provisions in dense offering documents, barring discussion of such provisions in roadshow presentations, keeping periodic financial information behind password-protected websites, and using nebulous and inconsistent financial definitions in covenant calculations are inconsistent with, and ill-suited to, a functioning public market.

Against this backdrop, the newly-formed European Leveraged Finance Alliance (ELFA) has stepped forth as an advocate for better and broader disclosure as well as greater transparency in the European high yield market. ELFA believes that overdue improvements in the quality, quantity and availability of public information can both improve secondary market liquidity and enhance investor confidence in the European high yield asset class, thereby benefitting both issuers and investors alike.

ELFA believes that the first steps for achieving these aims are:

- broadening the accessibility of issuer financial reporting and investor presentations,
- more consistency in financial definitions and disclosures, and
- enhanced content in company reporting in order to adapt to ESG requirements.

Accessibility

Since the most recent global financial crisis, the European high yield market has grown significantly in both volume of debt and number of issuers. According to LCD, an offering of S&P Global Market Intelligence, 441 bonds have been issued by debut issuers since 2011. At the same time, according to the BAML ICE Index, the market has grown from nearly 175 bonds outstanding in 2010 when the market capitalisation was €82 billion, to over 415 outstanding bonds at the start of 2019 with a market capitalisation of nearly €230 billion. This trend has coincided with a broad-based reduction in regular research coverage of issuers, leaving the market with an even greater vacuum of information than existed in the past.

Much more now than at the beginning of this credit cycle, investors must sign up for and request financial information through direct requests to companies and through password-protected websites.

There are two primary weaknesses related to password-protected websites:

- Irregular or inconsistent release of news into the market; and
- Onerous hurdles for potential new investors to be able to freely access the necessary information, creating an inefficient market.

There is a meaningful consequence to companies that issue bonds while only granting access to company financial information through a password-protected website.

According to 9fin, in the last twelve months password protected issuers experienced higher levels of volatility and were more likely to trade at "stressed" or "distressed" levels than issuers who make their information readily available.

	2018-2019 YTD		As at 15-Mar-19 % trading below			
Reporting type	Avg Price	Avg Std Dev	100	95	90	80
Public	97.7	2.66	36%	17%	12%	6%
Password Protected	94.46	3.23	51%	25%	15%	9%

Source: 9Fin Data

Content

We believe that high quality disclosure should be a constant through the cycle and not only part of the new issue process or of an investor relations reparation strategy. Furthermore, investors' growing demand for mandates that incorporate ESG criteria will impose specific disclosure requirements that are largely absent from bondholder communications at the present time.

The UN PRI's 2018 annual report notes that just under 2,000 asset owners accounting for just under $90 trillion of AUM are now signatories to the principles. Nearly $31 trillion of this AUM relates to fixed income, of which the majority lies in active management strategies. We anticipate that such mandates' ownership of high yield assets will be dependent upon issuers' willingness to provide additional content and sufficient disclosure on ESG-related topics.

However, the growth of ESG investing should not be the sole motivation for more comprehensive content in investor communication. Companies will need to improve the depth and transparency of financial information if they want to retain access to capital markets in more difficult funding environments.

Consistency

Financial trend analysis becomes more challenging if companies are changing the basis of calculating or the format of reporting key financial metrics.

A good example of this is the use of "earnings before interest, taxes, depreciation, and amortisation" (EBITDA) as a proxy for operating cash flow.

Construction of EBITDA varies widely, resulting in instances of surprisingly broad scope, when as much as 30% of the number can be from add-backs calculated at management's discretion. EBITDA can mean anything from one company to the next, and it has become an illusory number that undermines the credibility of covenants and fails to reflect the economic reality of a company.

We would recommend investors engage during roadshows to negotiate robust reporting provisions that will provide increased transparency through the life of the bond, including provisions incorporated into the covenants.

This could be achieved in a number of ways, including through comprehensive reporting covenants and caps on EBITDA add-backs. The reporting covenant could require prompt delivery of disclosure on segment or regional contributions, quarterly (versus semi-annual) reporting, and regular reporting of similar data provided during the roadshow for the bond.

Since the start of last year European capital markets have operated under the Markets in Financial Instruments Directive II (MiFID II), which seeks to improve investor protection by imposing greater transparency on European securities markets. We think that the aforementioned objectives are in the spirit of this new regime.

Conclusion

ELFA urges borrowers and their advisors to push for improvements to market standards for financial, operational and covenant disclosures. This entails the provision free and open access to financial reports, consistency in metrics and quality of financial reporting, while bearing in minds the increased requirements of ESG-related initiatives.

Those companies best equipped to meet investor requirements on transparency will likely have a better chance of obtaining access to European high yield capital markets and a lower cost of capital when we make it through to the other side of the cycle.

ELFA is a trade association comprised of European leveraged finance investors that seeks to create a more transparent, efficient, and resilient leveraged finance market while acting as the voice of its investor community. Find out more about ELFA at www.elfainvestors.com.