The European Leveraged Finance Alliance: A study on the use of password-protected websites by European high yield bond issuers, and its impact on investors' credit analysis and investment decisions.

- Despite investors' continued frustration with, and previous attempts to curtail, the use of password protected websites by issuers to distribute financial information, the practice persists.
- According to Bloomberg, out of 162 private issuers in the European high yield market (that is, those without publicly listed equity), over a third (56) use a password-protected website to distribute financial information, and a further six require investors to make certain representations prior to accessing information.
- The protections take different forms – including, most recently, a requirement that investors provide NDA-style commitments to keep the information confidential.
- The resulting creation of a significant cohort of investors without access to financial information has negative implications for market liquidity; however, an issuer's creation of informational asymmetry in a public securities market is far more concerning.
- The regulatory framework is blurry at best, and the applicable rules of the main European exchanges on which high yield bonds are listed (Euro MTF, GEM, and TISE) do not restrict the use of password-protected websites.
- ELFA surveyed over 50 investors on the use of password-protected websites and the results reveal a significantly negative view of the practice – nearly half of respondents have ruled out an investment due to the issuer's reliance on the practice, and 85% indicated that the practice sours their perception of an issuer's business.
- Following a review of these points, we make specific recommendations on the practice for market participants to consider when deciding how to approach the practice of using password-protected financial disclosure.

Introduction

According to data on European high yield debt compiled by Bloomberg, almost 40% of private issuers in the high yield market rely on the practice of distributing periodic financial information by way of password protected websites or other means that require investors to make representations by way of a "click-through" disclaimer prior to receiving financial information on the issuer.

The protections take different forms – while all require interaction with management or Investor Relations (IR) to unlock, some also require a request for a password, and others seek an additional level of confirmation, including proof that the investor holds a position in the bonds (the so-called "information piece").

The most problematic permutation is the requirement by some companies that investors commit to keeping the financial information they receive confidential before providing investors with access to it – a practice that is akin to requiring them to sign a non-disclosure agreement (NDA).

Bloomberg Data on the Prevalence of Password-Protected Websites

According to data on European high yield debt compiled by Bloomberg, out of 162 private issuers in the high yield market (that is, those without publicly listed equity), over a third (56) use a password protected website to distribute financial information, and a further six require investors to agree to a restrictive disclaimer prior to accessing financials. In the case of nine other issuers, it was unclear how an investor could find financial information, whether via their website or a stock exchange.

Bloomberg reported that these companies include some recent, well-known debut issuers. French and German firms make up largest proportion of issuers using password-protected websites, with ten issuers in each country adopting the practice.

On average, private companies with password protected websites are rated B, whilst private companies with public access to quarterly earnings are rated B+.

The Implications to Investors of the Practice

The most basic issue with password protected financial disclosure is the resulting delay for a prospective investor in gaining access to information on a company, slowing his or her ability to make an informed investment decision. Indeed, our investor survey (presented on page 4) revealed that it may cause investors to decide not to invest at all.

Therefore, the market cannot act efficiently, as trading is delayed while the investor obtains access to the issuer's information or, alternatively, the investor has to acquire securities with an informational disadvantage.

The resulting creation of a significant cohort of investors without access to financial information has negative implications for market liquidity. Even more concerning, however, is the creation of informational asymmetry in a public securities market where should have equal access to publicly available information. Informational advantages should not be created by the restriction of information to a subset of investors even if such restrictions are time-limited. (While investors can avail themselves of information in the offering document published at the time the bonds are marketed and sold, this information obviously becomes quickly dated.)

Depending on the reason the issuer is using the practice, the period of time when this quasi-public market persists will vary. If the practice is used as a way of mapping holders, then the delivery of a password will likely be faster, such that the information disparity period is shorter. However, if the company uses the practice to effectively create white or black lists (investors who will not receive a response or not be successful in obtaining a password), then this period of information inequality is likely to persist for longer.

The more onerous level of information gathering, namely requiring investors to provide proof of a security's ownership, creates an impossible situation where an investor must risk compromising his or her own due diligence standards in order to invest. Essentially, secondary market investors must risk capital on an uninformed purchase in order to gain access to the information that enables them to assess the risks of what they have just bought. This also prevents research analysts and financial press from accessing information which, again, impedes the dissemination of information to the market.

The requirement that investors make representations with respect to their status or their use of the information by way of a "click-through" page presents other issues. For example, one issuer's website requires investors to represent that they "will keep such information confidential and will not communicate the information to any [Person]…," which in our view has as similar effect to asking the investor to sign an NDA. This may cause the investor to determine that the information disclosed by the issuer is not public, a troubling result in what is ostensibly a public securities market.

Investors asked to sign a formal NDA typically must follow standard in-house checks that often require engagement of their firm's legal or compliance team. This practice may be appropriate in distressed scenarios, but it is entirely inappropriate when an investor is seeking information on a non-distressed company or immediately after issuance of a bond.

Key Points: Implications to Investors

- **Delay in accessing information slows the ability of investors to make informed investment decisions, resulting in market inefficiency and inhibiting liquidity**
- **The practice creates a quasi-public market due to informational asymmetry, which is incompatible with a properly functioning public market**
- **Investors required to provide proof of ownership must risk capital to assess an investment**
- **The practice impedes dissemination of information by research analysts and financial press**
- **A "click-through" page requiring NDA-style representations of confidentiality may require engagement of legal and compliance**

> "*While it doesn't preclude us from investing, it makes it more challenging to invest and monitor, and makes it more difficult for the bond to be covered in the wider market which sometimes hampers liquidity and sell-side coverage.*
>
> ***-- Respondent to ELFA's investor survey***"

The Regulatory Framework

Whether password protected financial disclosure is prohibited by applicable regulations or listing rules is widely misunderstood.

The EU Market Abuse Regulation 596/2014 (MAR), which became effective on July 3, 2016, sets out requirements relating to disclosure of inside information and market manipulation, in addition to insider lists and insider dealing, among other things. MAR imposes significant on-going obligations on companies to ensure compliance with its rules.

MAR is applicable to all EU exchanges, including the Luxembourg MTF (Euro MTF) and the Irish Global Exchange Market (GEM). This feature in particular caused many high yield issuers to consider listing on The International Stock Exchange (TISE), which is headquartered in the Channel Islands, a move that would cause them to fall outside of MAR's regulatory reach.

The Euro MTF last year introduced an option for issuers who prefer a European listing but do not wish to be subject to MAR. Bonds on their Securities Official List (SOL) are listed but not admitted to trading, bringing them outside of MAR. While this option may not work for all issuers (there would be no eligibility for UK withholding tax exemption, for example), several large issuers have listed their bonds on the SOL.

While MAR does not contain an explicit prohibition against issuers publishing financial information on password-protected websites, the practice is considered by many market participants to be incompatible with the spirit of MAR's obligations to ensure the public disclosure of inside information.

As MAR is not applicable to TISE or securities listed on SOL, issuers and their advisors will not have to face the potential EU regulatory implications of posting periodic financial reports behind a password-protected website in the context of a listing on these exchanges.

Listing Rules

Since MAR does not explicitly prohibit the use of password protected websites, it should come as no surprise that the Euro MTF and GEM do not restrict or reference the use of password-protected websites in their respective listing rules or related guidance. TISE also does not restrict password protected financial disclosure in its listing rules.

However, TISE does address the use of password-protected websites for the distribution of information in their High Yield Bond Frequently Asked Questions, which are available on their website. The FAQ states that "[i]t is the policy of the Authority to permit the use of such password protected websites, subject to all information being made readily available to any qualified investor likely to deal in those securities. It is the expectation of the Authority that qualified prospective investors who are interested in acquiring the securities of the issuer will be granted access to all relevant information, upon request to either the issuer or their advisers, without restriction or delay."

We spoke with Fiona Le Poidevin, CEO of the The International Stock Exchange Group who noted that the TISE listing authority always engages in a discussion with prospective issuers about their intention to use the practice, and emphasises the guidance set out above.

In our discussions with the Euro MTF, GEM, and TISE, each was receptive to working with ELFA to provide guidance on the potential implications of using password protected websites to distribute information. ELFA hopes that this will be useful in reducing reliance on the practice.

Key Points: Regulatory & Listing Rules

- **The applicability of regulations and listing rules to the use of password-protected websites is widely misunderstood.**
- **The EU Market Abuse Regulation (MAR) does not explicitly prohibit issuers from using password protected websites to distribute financial information, the practice is considered incompatible with the spirit of MAR's obligations to ensure public disclosure of inside information.**
- **MAR is not applicable to The International Stock Exchange or securities listed on the Euro MTF's Securities Official List (SOL).**
- **Neither the Euro MTF nor the Irish Global Exchange Market (GEM) restrict the use of password-protected websites in their respective listing rules.**
- **TISE addresses the practice in its High Yield Bond Frequently Asked Questions, noting that issuers must make all information readily available to any qualified investor likely to deal in their securities "without restriction or delay".**
- **ELFA plans to with the listing agencies to draft guidance for issuers on the potential implications of using password-protected websites to distribute financial information.**
- **ELFA believes that this guidance will be useful in reducing reliance on the practice, as issuers will be able to weigh investors' experience into their decision.**

The Experience of Investors

We surveyed over fifty European high yield investors on their experience with the practice and found that it has a deeply negative impact on their investment decisions and credit analysis.

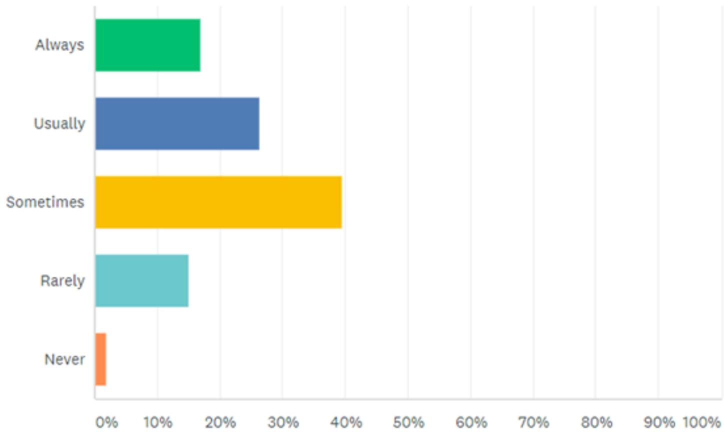
- Nearly half reported that they had ruled out an investment due to the request for a password.
- Almost 65% said they had ruled out an investment in an issuer requiring proof of an existing position in the issuer's bonds.
- Eighty five per cent. of respondents said that an issuer's reliance on the practice changes their perception of the issuer in a negative way.
- Over 98% reported that an issuer's use of the practice has caused them to perceive a difference in performance or credit quality – indeed, over 17% indicated that it always does, and almost 27% answered that it usually does.
- Over 98% reported that the use of the practice has triggered a heightened level of due diligence with respect to their investment decision, with 25% indicating that it always does, and 48% indicating that it usually does.
- Two-thirds of respondents have shared with issuers their concerns about their use of password-protected websites.
- Despite this, almost two-thirds of respondents have perceived an increase in the number of issuers using the practice in the last five years.

Some investors noted that the information might be available from other sources, including colleagues, which further exacerbates the information asymmetry created by password protected disclosure. Others said that it made investing and monitoring their investments more challenging by delaying their investment, hampering liquidity, and limiting sell-side coverage.

According to one investor, "There's little upside to the issuer as it's clearly negative in terms of market awareness and education about their company and I've never understood why companies take this approach. It's genuinely not in their best interests."

The solution is simple, according to another investor: "This practice should be stopped for issuers wishing to access the public markets."

Do you perceive a difference in performance or credit quality amongst issuers who demand that investors request a password and/or require proof of holdings as compared to those who have freely available information?

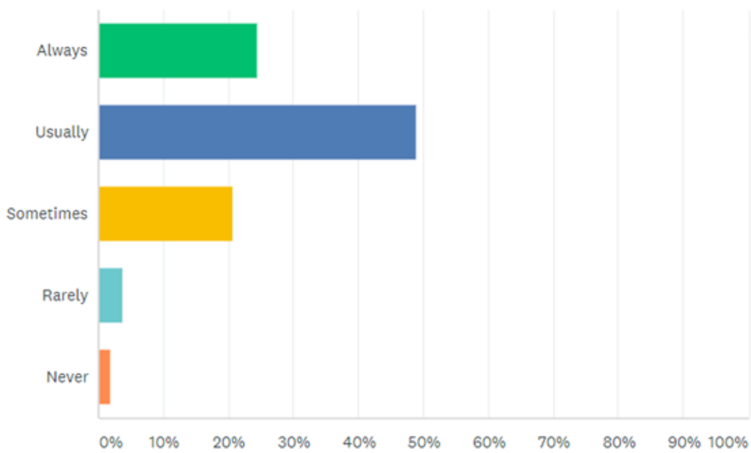


" There's little upside to the issuer as it's clearly negative in terms of market awareness and education about their company and I've never understood why companies take this approach. It's genuinely not in their best interests. "

" Improved disclosure will improve the efficiency of the industry and ultimately reduce the cost of debt, benefitting the whole industry. "

-- Respondents to ELFA's investor survey

Does an issuer's reliance on this practice trigger a heightened level of due diligence in respect of your investment decision?



" [Password protected financial disclosure] just adds useless steps for investors and always triggers the question "what do they have to hide?". "

-- Respondent to ELFA's investor survey

The Utility to Issuers of the Practice

We also sent a survey to issuers using password protected websites. Since only a few issuers responded to our survey, it is difficult for us to know for sure what their primary motivations are for adopting the practice.

What we know anecdotally is that some companies may be concerned about divulging sensitive information to their competitors. Others may have adopted the practice on the advice of their private equity owners or advisers. Given that it is not explicitly prohibited under MAR, some issuers may adopt the practice because they do not perceive a downside to doing so.

Some of these companies might discontinue the practice if they were aware of the detrimental impact on the liquidity of their bonds, the perception of their business by investors, and their ability to access a diverse investor base.

Indeed, out of the small sample of issuers who responded to our survey, a majority said that they would be *very likely* to eliminate the requirement if they were aware that the practice detrimentally impacts the trading price for their bonds, or that it might hamper their ability to access the capital markets in the future.

Our Recommendations

We believe that the practice of restricting investor access by way of a password or other requirement is incompatible with a properly functioning public market.

Issuers should make information freely available on their websites without any form of password protection or "click-through" requesting that investors make representations about their holdings, or requiring investors to commit to keeping the information they receive confidential.

Issuers wishing to track investors in order to interact with them can simply request contact details to add to a mailing list. This could then be used to highlight upcoming results release dates, conference calls, and other corporate events.

We will continue to engage with existing issuers directly and through their advisers to ensure that management is fully aware of the costs and investor perceptions of using the practice so that each company can make an informed decision about whether it is appropriate for their business.

-- The European Leveraged Finance Alliance
May 2019

About the European Leveraged Finance Alliance

Our Mission Statement:

ELFA seeks to create a more transparent, efficient, and resilient leveraged finance market while acting as the voice of its investor community. To that end, our diverse forum of investors engage with other industry professionals in order to educate and to promote best practices and transparency.

The Benefits of Being an ELFA Member:

- Quarterly educational seminars for member firms with leading industry professionals
- A forum to share ideas for improving the leveraged finance market, which can be reflected in the initiatives that emerge from ELFA
- Participation as a thought-leader to develop industry guidelines and standards to promote transparency and establish industry best practice
- Educational initiatives to assist member firms in discovering risk in documentary provisions

Upcoming Events:

15 May: ELFA Members' Forum

Join the Executive Committee, the Board of ELFA, members and prospective members to discuss what ELFA has achieved so far, and to set priorities for the coming months. The Forum will be followed by a drinks reception.

Representatives from ELFA will participate in the following upcoming events:

21-23 May: *Commercial Finance Association's 13th Annual International Lending Conference (10% discount for ELFA Members)*

22 May: *S&P Global Ratings 18th Annual Leveraged Finance Conference*

5 June: *Alternative Credit Council Global Summit 2019 (Discount available for ELFA Members)*

Find out more: www.elfainvestors.com