



## **ELFA launches consultation on best practice guide for covenant transparency under high yield bonds**

*Related survey solicits investors' views on materiality of covenant capacity, incorporation with ESG frameworks*

**London, UK, 6 July 2020** – The European Leveraged Finance Association (ELFA), a trade association comprised of European leveraged finance investors from over 30 institutional fixed income managers, including investment advisors, insurance companies, and pension funds, today announces the launch of a public consultation on a draft best practice guide for covenant transparency under high yield bonds.

In an ELFA Insights report, **Increased Transparency on Covenant Capacity is Essential to Good Governance by Leveraged Finance Borrowers**, the group explains how the drastic increase in covenant complexity has made it difficult, and in some cases impossible, for investors to quantify the level of risk they are incurring via the borrower's ability to pay dividends, incur additional debt, dilute security, transfer collateral, et alia. This has troubling implications, as disclosure of material information to creditors is an essential component of good corporate governance.

The paper argues that after years of increasing complexity and bespoke drafting in covenant definitions and calculations, enhanced disclosure by borrowers on covenant financial definitions and related capacity calculations is required. Investors cannot price risks that they cannot quantify. Without substantive changes to the status quo, ELFA expects that higher uncertainty around the degree of creditor protection will lead to a higher risk premium for high yield debt.

ELFA supports greater transparency in covenant capacity calculations, and has launched a public consultation on proposed metrics and topics for disclosure in a Best Practice Guide on Covenant Transparency. These include disclosure on "EBITDA" as defined under the covenants, the amount of outstanding debt captured by the "Indebtedness" definition, Restricted Payments capacity (including back-dated build-up basket capacity), and flexibility for a borrower to disapply IFRS 16 to calculations under its covenants.

The public consultation begins today and will close to comments at 6pm on 17 July 2020. Comments should be sent to Sabrina Fox, Executive Adviser to ELFA, [sfox@elfainvestors.com](mailto:sfox@elfainvestors.com).

ELFA is also conducting a survey of investors in order to gather a broad market view on how covenant capacity impacts their decision to invest, or remain invested, in a particular instrument. If you are an investor and would like to complete the survey, click [here](#). All responses will be anonymous, and only aggregate results will be presented to the market.

Sabrina Fox, Executive Adviser, comments: "Transparency with all financial stakeholders is central to good governance. Flexibility in the calculation of covenants and the increased complexity and customisation of financial definitions have become widespread, yet disclosure on these provisions remains largely unchanged. ELFA believes that clear, transparent disclosure on these measures of a company's financial health, and information on the capacity for the company to pay dividends, incur debt, and take other material actions, is essential to good governance and should form part of an issuer's overall ESG framework."

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**About ELFA:** The European Leveraged Finance Association (ELFA) is a professional trade association comprised of European leveraged finance investors from over 30 institutional fixed income managers, including investment advisors, insurance companies, and pension funds. ELFA seeks to support the growth and resilience of the leveraged finance market while acting as the voice of its investor community by promoting transparency and facilitating engagement among European leveraged finance market participants. For more information please visit the ELFA website: [www.elfainvestors.com](http://www.elfainvestors.com).

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