European Leveraged Finance Association

INSIGHTS

Engagement

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Voting Cap Provisions are an Inappropriate Curtailment of Investor Rights

On 23 November 2020, Ancestry.com announced a new high yield bond offering in the U.S. as part of the company's buyout financing. Certain voting provisions included in the deal materially disadvantage creditors vis-a-vis the private equity sponsor and its affiliates. The European Leveraged Finance Association believes that these new covenant terms are detrimental to credit investors' best interests and opposes their inclusion in European leveraged credit deals.

The provisions in question create a "Voting Cap" such that any investor's voting power is limited to a maximum of 20% of the outstanding Notes, regardless of that investor's actual holding size. There are numerous instances in which this partial disenfranchisement of investors could be harmful. Consider, for example, "Event of Default" triggers which typically require at least 30% of Notes to be voted in order to instruct the trustees to take prescribed action. While groups of investors may theoretically act together to meet the threshold, no single investor would be able to enforce contractual protections, even in the event of a default. Capped voting power thus creates an unwelcome hurdle for creditors seeking to exercise and enforce their basic rights as creditors.

In addition to the above Voting Cap, which itself erodes investor protections, the provisions go on to allow the issuer (Ancestry.com) to 'cherry-pick' the votes it wants to count in instances where this arbitrary "Voting Cap" has been exceeded. This gives the private equity sponsor full discretion to choose which single investor may exceed this cap when it suits them. This inequality is then compounded by the inclusion of Net Short Lender provisions.

These provisions, if widely adopted, would undermine the entire principle of pari passu lending and the concept of equal contractual rights for creditors. Granting varying rights to creditors, which rights depend ultimately upon arbitrarily defined thresholds or the non-germane issue of lending vehicle ownership affiliates (with the borrower itself making the final determinations on these matters), is an attack on the very foundational principles that have come to define modern capital markets.

The above not only mutates covenant practices, which the ELFA and the buy-side industry previously have described as anti-competitive, it also looks to combine these "innovations" in a way that inflicts significant damage to investor rights. We believe that ultimately these new provisions only serve to decrease the integrity of credit markets, and we discourage their use.

About the European Leveraged Finance Association

The European Leveraged Finance Association (ELFA) is a professional trade association comprised of European leveraged finance investors from over 35 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.

Our Mission Statement:

The 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 engages with other industry professionals in order to educate and to promote best practices and transparency.

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