European Leveraged Finance Association

Sabrina Fox, CEO ELFA

ELFA held its second Annual Conference in partnership with Bloomberg to bring together individuals from 62 ELFA member firms and ELFA partners across High Yield, Leveraged Loans, CLO and Private Debt. I was delighted by both the high attendance, with over 130 people joining us, and with the excellent quality of debate in all seven panels. Panellists discussed, disagreed and dissected the challenges and opportunities facing investors and borrowers in leveraged finance. Below I summarise five key take-aways from the day.

First, there was a consensus that things aren't as bad as expected this time last year at our first conference, thanks to a low default rate and an expectation that things will get better in 2025. Companies have been preparing for recession since 2022, reducing CAPEX, raising additional money (small add-ons) and therefore most will survive through to 2025. Defaults are expected to rise slightly in 2024 due to the wall of re-fi coming over the next few years but people will find a way through, mostly avoiding the conclusion of a default. Creditor-on-creditor violence, although expected to increase and arguably enabled by newly UK regulation, is not thought to become as intense as in the U.S. This is due to Europe being a smaller market where relationships matter, and local law rules on directors' duties that serve as a deterrent to management fully flexing covenant terms.

Second, ESG is now considered part of the DNA of the leveraged finance market and is integral. The market is seeing improved disclosure and transparency with ESG Fact Sheets widely adopted and more standardised reporting by CLOs. Private companies are voluntarily disclosing ESG information and across the value chain (i.e. including suppliers' carbon emissions). Meanwhile, market participants grapple with the risk of potential litigation for greenwashing and inadequate disclosure.

Third, the huge rise of private debt looks set to continue with 60% growth to $1.6tn in the last three years (according to Bloomberg) and will increase with more fundraising underway. It is popular both with investors, offering low volatility and good returns, and with borrowers for reducing complexity and time.

Fourth, inclusion can drive productivity and is therefore good for the bottom line. Diversity in the workforce is nothing without inclusion and firms must find ways to encourage diverse voices in the workforce to speak up and be engaged. Inclusion is a big word nowadays but can be approached like any business challenge – identify the business case, ROI and create a solution. Inclusion can boost margins when engaged, happy employees are more productive, they can drive targets and business.

Fifth, Artificial Intelligence (AI) is coming and brings with it new benefits and new risks. The benefits are already being seen by managers using AI for repetitive summaries and analyses of data at scale, in any language and without making mistakes. However, as AI is used for knowledge and more creative tasks, beware the risk of mistakes and hallucinations from bots and therefore human oversight is important. Also debated were the existential threats of AI hollowing out white collar jobs and creating a monopoly of power amongst big tech companies that own winning AI.

Last, I want to summarise a highlight from each panel:

- The market outlook was surprisingly positive amid challenges, with creativity and strong business fundamentals driving solutions.
- High-yield discussions focused on dealing with capital structure issues promptly to avoid defaults.
- Navigating the ESG landscape highlighted the progress made but noted challenges of inconsistency in data.
- Inclusivity discussions stressed the importance of transparency and community-building.
- Covenants discussions highlighted the decline in the quality of documents due to ample liquidity with concerns about priming in liability management situations, however, with companies still wanting to execute deals in 2024/5/6, investors will be more discerning so covenants may improve.
- Private debt discussions focused on its rapid growth and the benefits of multiple sources of debt in the market.
- CLO discussions emphasised the importance of proportional reporting and the need for transparency in cov-lite buckets.
- The closing debate on AI provided useful background for the newly created ELFA AI Committee. Just as the impact of ESG was impossible to predict when we started, so too is the impact of AI on the leveraged finance market – hence the need for a new committee to be proactive at the leading edge of developments and opportunities.