European Leveraged Finance Association

1 July 2024

Open Letter from the Board of the European Leveraged Finance Association

Taking Stock of Market Standards on Disclosure, Process, and Engagement in the European Leveraged Finance Market

- ELFA's best practice guidance contains governance standards designed to support an efficient, fair and transparent leveraged finance market from the perspective of lenders.
- Adherence to the leveraged finance offering process practices reflected in ELFA's guidance would contribute to a better functioning market.
- The market as a whole would benefit if lenders were afforded more time to review documentation. Timelines for both the leveraged loan and the high yield bond marketing process are currently very fast, leaving very little time for analysis and negotiation.
- Leveraged loan lenders often receive limited or draft documentation and full documentation only one day prior to commitments.
- Final loan agreement terms become the basis for any related bond offering, leaving bondholders with little ability to negotiate stronger terms during a rushed 24- to 48-hour marketing period.
- No covenant capacity calculations and very little other covenant-related information is reported to lenders.
- Increased exploitation of weak lender protections is generating negative news headlines for the asset class as a whole, which could reduce investors' appetite for leveraged credit to the detriment of all market participants.
- Restrictions on transferability persist and are increasing, which is detrimental to the liquidity and the health of the market.
- ELFA intends to host a series of roundtables to explore these issues with other market participants.

The European Leveraged Finance Association (ELFA) was founded by lenders with a mission to support the strength and resilience of the European leveraged finance market. In furtherance of that mission, this open letter from ELFA's Board takes stock of where the market stands in 2024 with regard to disclosure, process and engagement in the leveraged finance offering process.

We set out issues below that hamper lenders' ability to negotiate terms, have a negative impact on liquidity, and contribute to a lack of transparency - none of which is in the best interest of the industry. We highlight the guidance we have published in support of strong market standards and recommend closer adherence to this guidance for the benefit of the market as a whole.[1]

Rushed process in the leveraged loan market reduces scope for negotiation

Lenders rely on information provided by borrowers during the marketing period to make an investment decision, and the nature of the information provided in the leveraged loan market and high yield bond market is very different.

Leveraged loans are marketed on a pricing term sheet, a much shorter and less detailed document than the syndicated facility agreement, which is distributed very close to the time of syndication. In contrast, bonds are marketed with fulsome disclosure presented in a comprehensive preliminary offering memorandum, with the final offering memorandum updated for pricing terms and documentation changes, if any.

[1] See the ELFA / LMA Best Practice Guide to Term Sheet Completeness and the Best Practice Guide to Syndication Process. See also the New Deal Disclosure Questionnaire.

Furthermore, the timeframe provided to consider terms is very different in these respective markets. Leveraged loan lenders are often asked to provide commitments in a leveraged loan deal based on that short preliminary term sheet, without access to final documentation (also known as commitments "subject to docs").

When documentation is provided, it is delivered shortly before the window to submit commitments is closed, depriving lenders of the ability to comprehensively review the multi-hundreds page documents. This is most conspicuously the case in repricing transactions, when lenders get as little as 48 hours to consider their decision without access to the full amended credit agreement.

The leveraged loan and high yield bond markets are often interlinked, such that a given borrower frequently will seek capital from both markets. Where this is the case, the arranging banks will market the syndicated loan first before marketing the high yield bond.

As a result, leveraged loan investors set the deal terms, which are subsequently incorporated into any related bond offering, making it very difficult for bondholders to negotiate stronger protections during their own, often rushed offering process.

ELFA has previously published with the Loan Market Association a *Best Practice Guide to Term Sheet Completeness* in order to address some of these issues. Adherence to this resource would resolve many of them.

Insufficient covenant information provided during marketing and after completion

Borrowers rarely report covenant-related information, such as built-up capacity under Restricted Payments carveouts or covenant-calculated secured debt capacity, to lenders, despite terms having become considerably more complex. The absence of this information creates the potential surprise for due to unexpected borrower behaviour, which is detrimental for all market participants.

The International Organization of Securities Commissions (IOSCO) recently published its Good Practices on Leveraged Loans and CLOs (Good Practices). Measure 5 of the Good Practices relates to transparency on covenant limitations, stating: "It is good practice for material covenants and associated terms contained in term sheets and loan documentation to be written and presented in a clear, concise and effective manner that can be readily understood by the contracting parties…Borrowers /sponsors are also encouraged to provide clear disclosures of the quantity of incremental debt (i.e., on day one / at issue) and associated baskets that can be raised as well as the ability to move assets beyond the reach of the lender group."

IOSCO also encourages market participants to consider relevant best practice guidance, including the ELFA/LMA *Best Practice Guide to Term Sheet Completeness*.

Further, ELFA's New Deal Disclosure Questionnaire includes several questions on covenant capacity, including a question on Restricted Payments builder basket capacity. If this information were provided to lenders, surprises would be few and far between. ELFA recommends that market participants utilise this resource to enhance transparency and foster stronger engagement on covenant terms.

Restrictions on transferability persist and are increasing, thereby hampering liquidity

IOSCO's Good Practices also includes the following point in Measure 8 – "Reducing restrictions on transferability of loans: Transferability of loans within a pool of potential investors should be as broad as possible to support a liquid secondary market."

We have previously commented on the detrimental impact of overly onerous transfer restrictions on secondary liquidity in the leveraged loan market, and the resulting negative impact on the proper functioning of the market as a whole.

We therefore have engaged directly with private equity sponsors to voice our concerns, and will continue to do so. We also will consider publishing best practice guidance on transferability to support and encourage better loan market liquidity.

ELFA will continue to observe market behaviour and lobby for high market standards

Regulators recently have shown interest in processes, transparency and disclosure in the leveraged finance market. As noted above, IOSCO has published their Good Practices, with several recommendations pertaining to issues described in this letter.

ELFA will continue to support a lightly regulated leveraged finance industry in respect of the issues discussed in this open letter, and would encourage market participants to reference the resources we have developed to support best practice. We will continue to engage with the relevant market participants to seek adoption of these tools.

About ELFA

ELFA is a trade association comprised of European leveraged finance investors from over 60 institutional fixed income managers, including investment advisers, 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 ELFA's website: www.elfainvestors.com.

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