European Leveraged Finance Association

BRIEFINGS

ELFA Open Letter – Summary from the Engagement Roundtables

ELFA published an open letter from our Board (the "Open Letter")[1] addressing critical issues within the European leveraged finance market. Titled "Taking Stock of Market Standards on Disclosure, Process, and Engagement in the European Leveraged Finance Market", the Open Letter outlines the current challenges faced by lenders and the broader market due to insufficient disclosure, rushed processes, and limited engagement.

The Open Letter highlights a series of practices that we believe to be detrimental to the future of the leveraged finance market and notes the work we have done to support strong standards of market practice since our inception, including best practice guidance we have published in many of the areas mentioned. ELFA continues to observe market behaviour and will advocate for high market standards and support a lightly regulated leveraged finance industry concerning the issues discussed in the Open Letter.

The aim of the roundtables was to facilitate discussion of the issues raised and hear perspectives from lenders, banks, law firms and sponsors to work towards a stronger, more efficient, and more resilient leveraged finance market. We provided a Discussion Guide to roundtable participants to facilitate a dialogue on the issues raised in the Open Letter.

Discussion Guide:

Addressing compressed timelines and complexity in leveraged loan and high-yield bond market documentation

- Rushed processes have the effect of reducing the scope for negotiation.
- The current timelines for reviewing documentation in both the leveraged loan and high-yield bond markets are too short, often leaving lenders with insufficient time to analyse and negotiate terms.
- Leveraged loan lenders frequently receive limited or draft documentation, with full documentation provided only a day before commitments are due. This rushed process is particularly evident in repricing transactions, where lenders may have as little as 48 hours to consider their decisions.
- Our best practice guidance states that a minimum of 5 days should be provided to review the long-form SFA and that a redline of the updated Syndication Term Sheet should be provided - what obstacles prevent this from being followed and how can we overcome these?

Discussion Points

- **Market Dynamics:** Market dynamics have compressed timelines over the years. The market has experienced significant changes due to conditions worsened by Covid-19 and global conflicts, leading to shorter documentation review periods for lenders. Concerns that strict measures might alienate issuers.
- **Issuer Convenience:** Timelines are often compressed to benefit issuers, focusing on pre-marketing, and managing hedging risks, which can both streamline the process and introduce challenges.
- **Refinancing vs. New Money:** While compressed timelines are more acceptable for refinancing transactions, they pose significant challenges for new money transactions where more thorough analysis and research are required.
- **US Loan Market Example:** The US loan market suggests that timelines should be adapted based on the quality of the issuer rather than adhering to a fixed period, allowing for greater flexibility and better alignment with issuer capabilities.
- **Documentation Delays:** Delays in documentation are frequently due to banks and advisers not prioritising the documentation timelines, which can lead to rushed processes and potential errors. Suggestion to provide preliminary information as soon as it becomes available, though this may cause confusion.
- **Negative Publicity:** Rushed documentation processes can result in negative headlines and investor concerns, highlighting the importance of balancing speed with thoroughness to maintain market confidence.
- **Sponsor Judgement:** The timing and release of information are based on sponsor's judgement. Discussions with sponsors are necessary to address timeline issues and improve the process.
- **ELFA Best Practices:** Suggestion to reduce the review period for long form SFA's from 5 business days to 2-3 business days.

[1] Open Letter from the Board of the European Leveraged Finance Association

Discussion Guide:

Insufficient covenant information

- There is a lack of reporting on covenant-related information, which creates potential surprises due to unexpected borrower behaviour. This lack of transparency is detrimental to all market participants.
- The Open Letter references the International Organization of Securities Commissions (IOSCO) Good Practices on Leveraged Loans and CLOs, which recommend clear disclosure of material covenants and associated terms.
- Our New Deal Disclosure Questionnaire requests information on day one Restricted Payments and Debt capacity, and ratio calculations. What obstacles prevent this information from being provided, and how can we overcome these?

Discussion Points

- **Complexity and Transparency:** Covenant-related information has become increasingly complex and less transparent, leading to higher risk aversion among lenders. The reluctance to calculate and disclose specific numbers contributes to the overall lack of transparency in covenant-related documents.
- **Advocacy for Information:** Both lenders and the International Organization of Securities Commissions (IOSCO) are advocating for more detailed and transparent covenant information.
- **Efficiency and Risk Reduction:** Providing aggregate amounts and clear breakdowns of covenant information would enhance efficiency and reduce risk aversion.
- **Covenant Flexibility and Buy-Side Demand:** Lawyers often ensure maximum flexibility in documents, making it challenging for lenders to understand covenant baskets. Sponsors are unlikely to provide detailed information without consistent demand from the buy-side.
- **Trust and Disclosure Issues:** Trust issues and violations of NDAs contribute to the withholding of information. Legal counsel and investment bankers often advise against detailed disclosures during roadshows, despite the availability of covenant information from third-party providers. Continuous disclosure of covenant capacities and usage is suggested, with sponsors being best placed to change market practices, supported by ELFA.

Discussion Guide:

Increasing restrictions on transferability

- Overly restrictive transferability conditions are hampering liquidity and negatively impacting the market's health. ELFA has been engaging with private equity sponsors to voice these concerns and is considering publishing best practice guidance on transferability.
- Documentation and operational recommendations that we made to private equity sponsors include, among others, reviewing minimum transfer amounts, waiving transfer fees in certain circumstances, reducing the deemed consent period, and all restrictions falling away in the event of default.
- We also recommended that the whitelist be circulated annually and capping the number of institutions that can be removed from the whitelist, replacing those institutions on the whitelist, and opening the secondary market much sooner post-primary allocation.
- A number of the recommendations we proposed to private equity sponsors have been made in the International Organization of Securities Commissions (IOSCO) Good Practices on Leveraged Loans and CLOs.

Discussion Points

- **Impact of Restrictive Transfer Provisions:** Increasingly restrictive transfer provisions are hampering liquidity and overall market health, making it difficult for loans to be traded freely. Additionally, agents' minimum requirements and potential transfer fees impact the market, and stringent restrictions in syndication, like 100% consent, face market pushback.
- **Sponsor Control:** Sponsors and their lawyers push for tighter documents to maintain control over loan transactions, leading to constant negotiations and reduced flexibility for lenders.
- **Market Liquidity:** Improving transferability provisions is crucial for enhancing market liquidity and attractiveness, ensuring that loans can be traded more easily and efficiently.
- **Buy-Side Demand and Constraints:** The buy-side needs to demand better provisions, but time constraints and legal/regulatory concerns in the EU limit their ability to push back effectively.
- **Incentives:** Decisions supporting market longevity may be influenced by other incentives. Engaging private equity sponsors outside of deal contexts and educating them on good governance can drive improvements.
- **ELFA's Role:** Industry bodies like ELFA are essential for navigating complex regulations and driving change. ELFA plans further engagement with private equity sponsors to address these issues and promote better market practices.

Discussion Guide:

Password-protected websites for financial information

- We have warned against the use of password-protected websites since our inception, as their use runs counter to a well-functioning public securities market.
- Recently it has come to our attention that the use of password-protected disclosure is impeding the ability of ESG rating agencies to conduct ESG analyses of leveraged finance issuers.
- Why does the use of password-protected disclosure persist, and how can we move away from this practice?

Discussion Points:

- NDAs and Transparency: It is uncertain why sponsors insist on restrictive practices since NDAs could protect sensitive information. These barriers do not prevent press access and often antagonise lenders and issuers, creating unnecessary friction. Private companies often use password protection to control access due to NDA violations, which is becoming more commonplace. From a long-term perspective, it is important that information is easily accessible.
- Aggressive Whitelisting and Password Protection: Practices like aggressive whitelisting reduce liquidity for existing bondholders by limiting who can trade the bonds. Persistent password protection, discussed by ELFA's Disclosure & Transparency Committee, remains due to concerns over competitive information. Removing these barriers would increase transparency and improve bond trading, making the market more efficient.
- Competitor concerns: While banks recommend against password-protected websites due to lower liquidity and increased volatility, issuers often use it to exclude competitors.
- Access Delays: The current wait time of 24-48 hours for access, combined with a challenging sign-up process, significantly reduce market liquidity. This delay can hinder timely trading and affect market dynamics negatively.
- ELFA's Role and ESG Engagement: ELFA's Disclosure & Transparency Committee suggests engaging with ESG providers and MSCI to create a framework for good governance. This includes addressing issues like password protection and transparency to ensure long-term accessibility and to improve market practices.

Next Steps

- ELFA will continue to engage on these issues with PE Sponsors – specifically Heads of Businesses and relevant stakeholders.
- ELFA will continue to collaborate with its Partners and Initiative Committees to educate, gather feedback and work on existing initiatives to further address issues discussed.
- ELFA will update the best practice guidance based on suggestions from the discussion.

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