
Press release

AFME: Equity and hybrid markets hold solution to European COVID-19 corporate recapitalisation

19th January 2021

A report by the Association for Financial Markets in Europe (AFME) and PwC reveals that an equity shortfall of up to €600bn threatens Europe's economic recovery despite the significant public support measures and private capital made available across Europe to support economies during the pandemic. AFME calls on the European Commission and members states to introduce measures to bolster Europe's equity and hybrid markets and expand funding avenues for businesses, further enabling Europe's economic recovery

In a report published today (19th) in partnership with PwC, AFME warns that Europe needs to bridge a gap of €450-600bn¹ in equity needed to prevent widespread business defaults and job losses as COVID-19 state support measures are gradually reduced. The report **Recapitalising EU businesses post COVID-19** reveals that despite the support provided by governments and the private sector since the start of the pandemic, 10% of European companies have cash reserves to only last six months. The pan-European trade association is calling on authorities to explore and develop further short-term measures to support Europe's equity and hybrid markets and accelerate the Capital Markets Union to help fund the recovery. Unless urgent action is taken, a spike in insolvencies could start as early as this month and threaten the EU's recovery prospects, AFME warns.

The report presents insights from interviews with businesses and private sector investors from across the continent to propose solutions to Europe's emerging funding gap. The findings reveal that many mid-size and SME corporates do not wish to give up control of their business but are willing to pay a premium not to dilute their voting rights, as well as are willing to distribute a share of profits to investors. Hybrid instruments are ideally suited to address these needs. In order to bolster capital markets to support businesses in the recovery phase, AFME is outlining the following recommendations:

- Proposing a new EU-wide hybrid instrument designed specifically for the corporate sector. This could be in the form of a new preferred shared instrument, which is state-aid compliant, to build scale and liquidity, and which ideally could be developed to comply with social investment objectives to attract maximum investor interest.
- Scaling up existing EU-wide recovery support schemes such as the EIF European Guarantee Fund tailored to the needs of SMEs, particularly the smallest companies.
- Replicating existing member state best practices on hybrid instruments, as well as raising awareness of the range of capital markets instruments available to mid-caps and SMEs who may be unaware such options exist
- Exploring further use of innovative instruments, such as dual class shares to address the control concerns of companies as well as debt for equity swaps to reduce leverage.
- Recalibrating state aid rules for a systemic crisis.

¹ Excluding any equity provided by EU promotional banks.

- Accelerating equity investment measures under the Capital Markets Union project.

Adam Farkas, AFME's Chief Executive Officer, said:

"While additional debt and state support have provided the short-term rescue to businesses across Europe, we now need to move beyond the short-term bridge finance and to focus on long-term repair and recovery.

"As European businesses strive to recover from the economic crisis, alternative types and sources of funding will be required to help mitigate their mounting debt burden while also allowing them to invest in their future. This is where hybrid and equity markets can play a key role in supporting Europe's recovery.

"The size of the challenge calls for urgent action. With a shortfall of up to €600bn threatening Europe's recovery, we are calling on policymakers to work with the private sector at the national and EU levels to implement solutions to ensure midcaps and SMEs in particular have the resources they need to recover post-COVID-19."

Nick Forrest, leader of PwC's economics consulting practice, said:

"The Covid-19 crisis risks leaving a long-term scarring effect on the economies of Europe. This means restoring the equity capital base of European corporates is essential for them to drive investment, innovation and growth."

"The unwinding of Government support and anticipated release from Covid lockdown measures with a successful vaccination programme means that now is the time to put in place the equity and hybrid financial capacity, and infrastructure to drive recovery of the European economy."

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Notes:

1. AFME (Association for Financial Markets in Europe) promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities

Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: www.afme.eu.

2. Follow us on Twitter [@AFME_EU](https://twitter.com/AFME_EU)
3. Key features of the proposed Covid-19 preference share:
 - Low fixed basis preferred dividend to provide investors with some cash flow certainty.
 - The preferred dividend could be combined with an increasing profit-sharing element (based on a step-up scheme) that would allow investors to benefit from an upside and provide corporates with an incentive to redeem these shares later on (and providing investors with an exit mechanism).
 - Like a typical preference share, this instrument would not entail voting rights to address companies' reluctance to cede control at least in the short-term.
 - To sharpen the incentives for companies to take appropriate action to restore profitability as quickly as possible, this could after a certain time period be convertible into equity, or to provide investors with some say over the running of the company if investing for the long-term.
 - To incentivise investors, the investment could be made tax deductible or be exempt from capital gains taxes in the first 5 years.
4. The full proposals for the Commission and member states to accelerate recapitalisation in the EU are:
 - **Develop a Covid-19 recapitalisation instrument:** agree a common, standardised recapitalisation instrument to be deployed in conjunction with a corporate education programme
 - **Scale up existing recapitalisation schemes:** scale up the European Guarantee Fund and replicate existing initiatives at member state level.
 - **Develop public-private working groups:** develop public-private forums to develop new schemes and run corporate education programmes.
 - **Develop a EU-wide public-private investment fund:** develop a private-public scheme with pricing support by the public sector and private sector support with scheme administration and investment
 - **Introduce investor incentives:** introduce time-limited capital gains tax exemptions and temporary adjustments to regulatory capital and solvency requirements
 - **Lower the cost of public equity issuance for businesses:** equity raising in public markets is much more costly than debt finance and can be prohibitive for smaller corporates. This cost could be reduced through grants or subsidy schemes and regulatory simplification in the capital raising process.
 - **Simplify state aid rules:** broaden state aid eligibility criteria, extend repayment periods and link EU RRF funding to establishing recapitalisation schemes in member states
 - **Deliver on CMU and Banking Union:** develop SME pan-European exchanges, remove structural and regulatory obstacles to bank leveraging