

Initial Impact of COVID-19 on European Capital Markets

April 2020

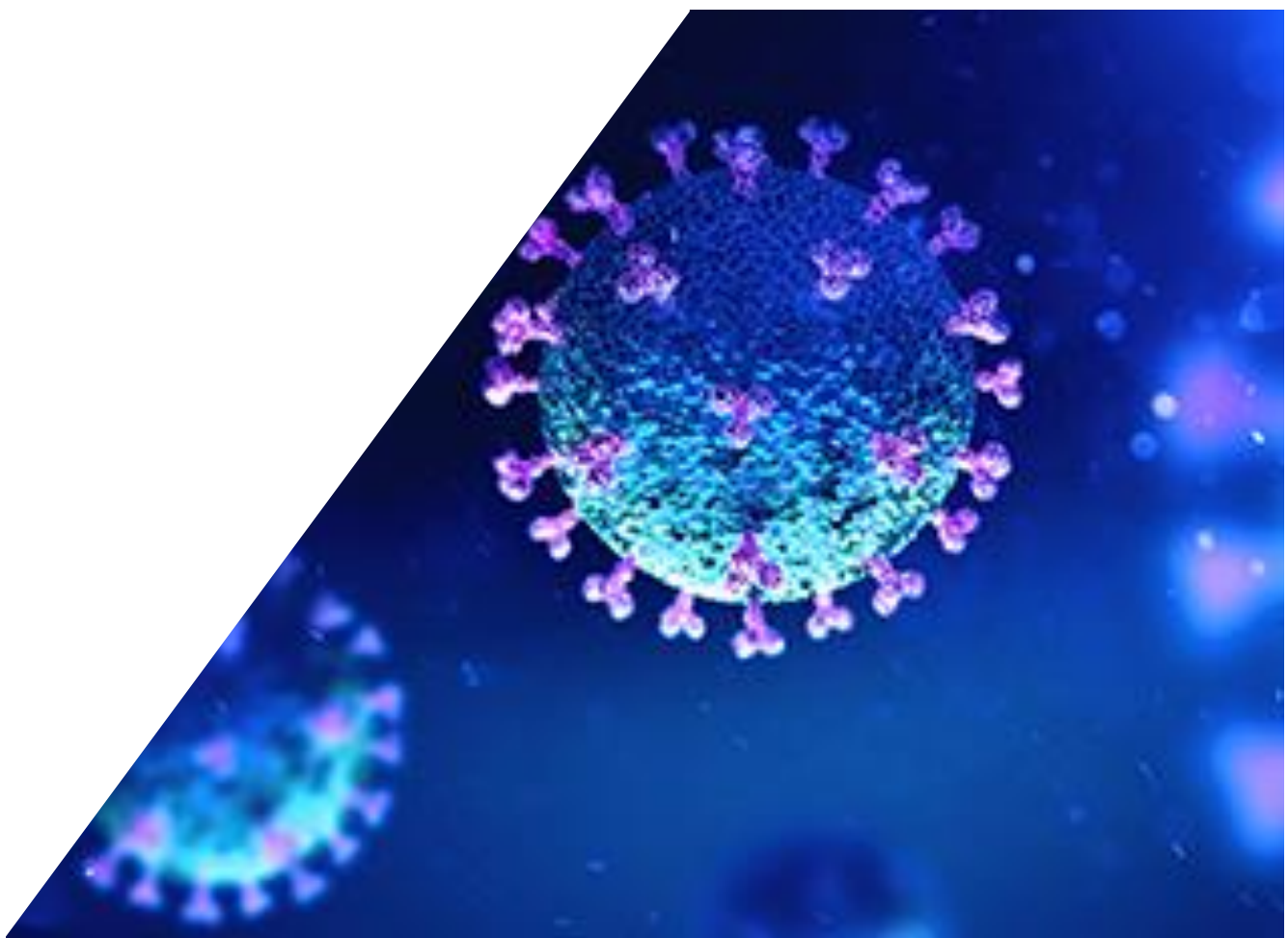


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Executive Summary

During these unprecedented times in light of the COVID-19 outbreak, European capital markets have continued to intermediate market liquidity and facilitate risk management for corporates and investors.

The purpose of this report is to provide a snapshot of the initial impact of COVID-19 on European capital markets activity.

“Banks interacting in the European market are well-positioned from a solvency and liquidity perspective to support households and businesses during this period of abnormal economic pressure”

Capital markets resilience

As this report shows, European capital markets have continued to operate well and serve their function during times of stress.

- **While working remotely, issuance of investment grade corporate bonds surpassed 50bn EUR in the first week of April; this was also the highest weekly amount ever issued in Europe.** French companies have been particularly active.
 - **Non-financial corporates have also rapidly increased secondary equity offerings** in an effort to raise cash buffers and withstand business closure for several weeks.
 - **Markets are more volatile than a few months ago, which has made it costly for some companies to list through IPOs.** IPO issuance on European exchanges has declined 83%YtD compared to a year ago.
 - **Encouragingly, markets have continued to play their role in providing liquidity, price formation, timely clearing and settlement procedures, capital allocation and helping investors manage their portfolios.** Equity trading rose 94% YoY in March-20, corporate bond trading increased 31% YoY in Q1 2020, and FX spot trading rose 61% YoY in March-20. Settled transactions at the ECB’s T2S platform have increased to over 1 million on average per day since 24 February from a 600,000 daily on average in 2019.
- The rapid increase in securities trading and post-trade activity has been carried out without any major disruption from a business continuity perspective.
- **Securitisation secondary markets have, however, suffered disproportionate reductions in liquidity** due to central bank support which is more limited in scope and slower and more difficult to access than for other fixed income sectors.

“While working remotely, issuance of investment grade corporate bonds surpassed 50bn EUR in the first week of April; this amount was also the highest weekly ever issued in Europe”

“The unexpected economic consequences of the COVID-19 outbreak are testing the coordination and speed of response of European and national institutions”

COVID-19 is stress-testing the entire financial system and its institutional architecture

The unexpected economic consequences of the COVID-19 outbreak are testing the coordination and speed of response of European and national institutions: monetary policy coordination, fiscal response, financial supervision, as well as global prudential and markets regulatory coordination.

The COVID-19 shock is also a real time test of the resilience of the banking sector to absorb simultaneously, a wide variety of shocks: credit risk, market volatility risk, and operational business continuity, while still supporting the real economy.

As section 7 of this report shows, banks interacting in the European market are well-positioned from a solvency and liquidity perspective to support households and businesses during this period of abnormal economic pressure, although with ongoing profitability concerns for some market participants which pre-date the current COVID economic environment.

AFME’s approach to COVID-19

COVID-19 has had significant implications for our members globally with many having to reallocate resources to focus on managing business continuity issues.

AFME remains engaged with policy makers across Europe, ensuring we are communicating on the wide set of policy and operational issues our members are facing in the current environment.

As summarised in section 8, AFME is working together with our members and regulators to ensure that markets remain open, well-functioning and liquid in light of the market impact of COVID-19.

AFME will continue to assess the implications of COVID-19 for our members and to engage with authorities across Europe.

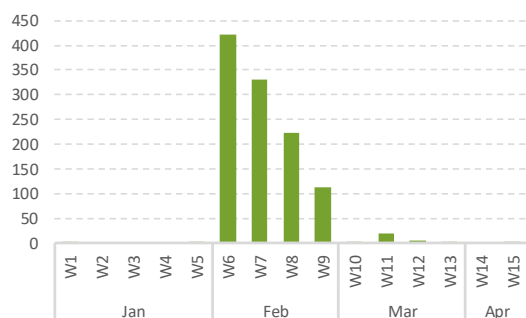
Selected market spreads and indices

| Spreads | 31-Mar | 1-Jan | bps Chg |
|------------------------------------|--------|-------|-------------|
| Corporate | | | |
| European AAA | 136 | 53 | +84 |
| European High Yield | 866 | 308 | +558 |
| Sovereign | | | |
| 5Y German CDS | 22 | 9 | +13 |
| 5Y Italian CDS | 177 | 122 | +55 |
| 5Y UK CDS | 41 | 19 | +23 |
| Securitisation | | | |
| 3-5Y AAA PanEurope CMBS | 126 | 93 | +33 |
| 1-4Y AAA PanEurope Auto ABS | 60 | 17 | +43 |
| 1-4Y AAA PanEurope Credit Card ABS | 131 | 79 | +52 |
| 5-8Y AAA Spanish RMBS | 192 | 55 | +137 |
| 3-5Y AAA Dutch RMBS | 42 | 17 | +25 |
| 3-5Y UK RMBS (Prime) | 99 | 77 | +22 |
| 1-4Y BBB PanEurope credit card ABS | 354 | 251 | +102 |
| 3-5Y BBB PanEurope CMBS | 322 | 247 | +75 |
| 5Y AAA US CMBS | 268 | 152 | +116 |
| US ABCP | 7 | 9 | -2 |
| Banks | | | |
| T1 CoCo | 674 | 316 | +357 |
| HY CoCo | 683 | 335 | +348 |

| Indices | 31-Mar | 1-Jan | % Chg |
|-----------|--------|--------|---------------|
| STOXX 600 | 314.88 | 416.17 | -24.3% |
| FTSE 100 | 5672 | 7604 | -25.4% |
| DAX | 9936 | 13386 | -25.8% |
| CAC40 | 4396 | 6042 | -27.2% |
| FTSE MIB | 17051 | 23836 | -28.5% |
| S&P 500 | 2585 | 3258 | -20.7% |
| VSTOXX | 49 | 13 | 283.5% |
| VIX | 54 | 12 | 329.4% |

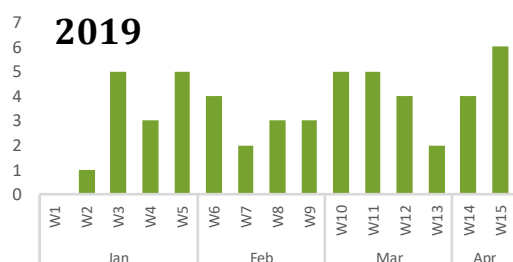
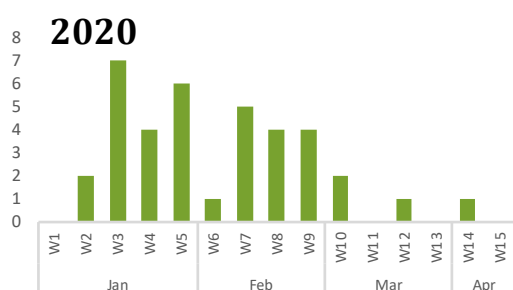
Source: Bank of America, Barclays, Eikon, IHS Markit, Trepp, Federal Reserve, CBOE, STOXX

1.1 European IPO issuance: 2020YtD (EURmm)



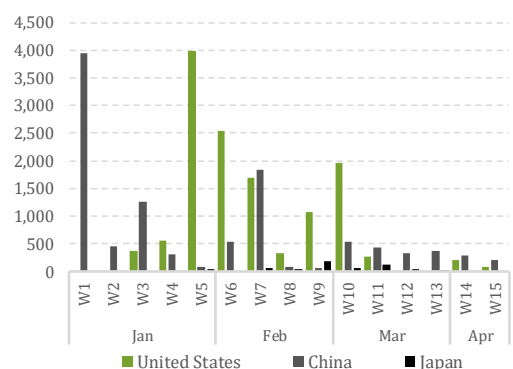
Source: Dealogic

1.2 Number of IPOs announced on European exchanges: 2020 and 2019



Source: Dealogic

1.3 Global IPO issuance: 2020YtD (EURmm)



Source: Dealogic

1. Equity Market

Primary Market

Subdued IPO market

The Initial Public Offerings (IPO) market in Europe has been virtually inactive since early March.

Only 7 IPOs were launched on European exchanges¹ between early March and mid-April, accumulating a total of €26.2mm in proceeds compared with €6.4bn issued in the same period of 2019 — a 99.6% YoY and a 83% YtD decline. See chart 1.1.

The current market environment makes it costly for companies to list and raise fresh capital. European equity share prices have abruptly declined 20-26% which, in addition to the rapid increase in equity market volatility, has resulted in an increase of c300bps² in the cost of equity.

4 of the 7 IPOs originated between 1 March and 13 April were issued on junior markets: First North Finland, Borsa Italia AIM, London NEX, and the Stockholm Spotlight market. The 3 remaining IPOs were small listings on the LSE main market (Mining Minerals & Metals plc), the Warsaw main market and the Sofia SE.

The IPOs that originated between March-April 2020 were announced on average 40 days prior to the date of issuance, suggesting that these deals had been in the pipeline a long time and investors were already well informed on the fundamentals of the newly listed companies following the company road shows. For the deals issued in the same period of 2019 it took a median of 22 days between announcement and issuance date.

Only four new IPOs have been announced since early March, which contrasts with 26 deals announced in the same period of 2019. See chart 1.2. Additionally, 2 deals of €500m in proceeds have been formally withdrawn due to the current market conditions.

In the rest of the world, the IPO market has also decelerated. In the US, IPO issuance between 1 March and 13 April totalled €2.5bn compared with €6.9bn during the same period a year ago. A similar trend has been observed in Japan (€188mm vs €399mm in 2019). See chart 1.3.

Active secondary equity offerings

The subdued IPO market contrasts with the active market for secondary equity offerings.

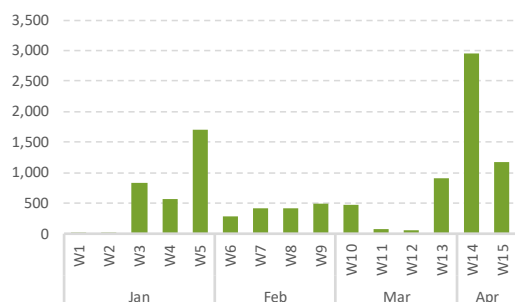
A total of €10.3bn in secondary offerings have been issued on European exchanges³ year-to-date (as of 14 April) just below €11bn issued in the same period of 2019.

¹ EU27, UK and Switzerland

² See A. Damodaran (2020) 4/1/20 ERP market update.

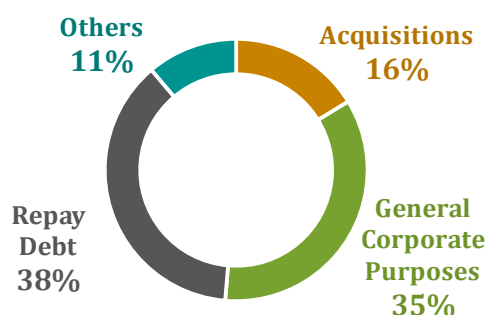
³ EU27, UK and Switzerland

1.4 Follow-on issuance: 2020 YtD (EURmm)



Source: Dealogic

1.5 Use of proceeds of European follow-on offerings (March-April 2020)



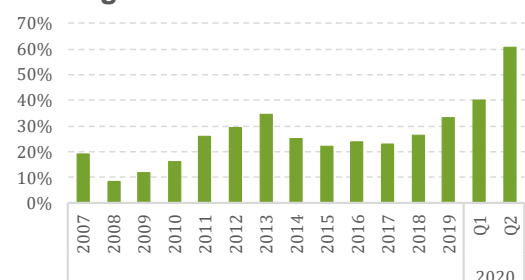
Source: Dealogic

1.6 Total follow-on issuance and COVID-related follow-ons by nationality of exchange. March-April 2020 (EURmm)

| | Total Follow-ons | Explicit COVID-19 use of proceeds |
|----------------|------------------|-----------------------------------|
| United Kingdom | 2066.18 | 1383.42 |
| Switzerland | 1650.65 | - |
| Spain | 802.65 | 802.65 |
| Sweden | 606.22 | 0.32 |
| Denmark | 378.43 | - |
| Germany | 111.11 | 65.00 |
| France | 26.56 | - |
| Ireland | 1.35 | - |
| Finland | 1.33 | - |
| Total | 5644.48 | 2251.39 |

Source: Dealogic

1.7 % of follow-on offerings marketed overnight



Source: Dealogic. Q2 2020 as of 14 April

In the first two weeks of April, and despite the Easter bank holidays, the market for secondary offerings saw a rapid increase with 52 deals for a total of €4.1bn raised. See chart 1.4.

Currently, listed companies have issued equity as a way to navigate the COVID-19 crisis. According to Dealogic, the main use of proceeds for the secondary equity offerings was for repayment of debt and general corporate purposes (including working capital). See chart 1.5.

Close inspection of companies' offering documentation reveals that about €2.5bn of the €5.6bn capital raised between March-April 2020 was explicitly attributed to COVID-19 use as a need to raise cash in the current market environment, for debt repayment, for working capital or to explore potential opportunistic M&A transactions.

The majority of equity offerings have been raised on UK and Swiss exchanges, followed by Spanish, Swedish, Danish and German exchanges. Nothing has been raised on Italian exchanges.

60% of the secondary offerings issued in April were marketed overnight. In an overnight offering, a company sells its securities overnight (typically to a reduced group of investors) after the market has closed, reducing the risk that the market will short the company's share price as the secondary offering may signal management concerns on future earnings or the quality of the company's balance sheet.

Industry-led initiatives

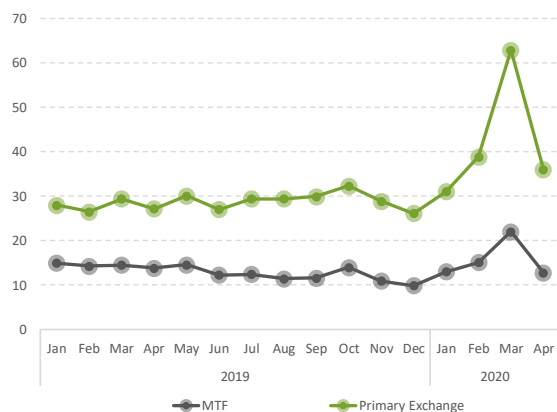
As shown earlier, listed companies have needed to raise capital quickly in limited market windows.

The UK guidelines relating to pre-emption, as published by the UK's Pre-Emption Group (PEG), give existing shareholders of listed companies first refusal to take up offers to purchase additionally issued shares and only invite new investors to apply for shares if the current shareholders decline them.

As a response to the abnormal market circumstances, the UK's Pre-Emption Group (PEG) temporarily relaxed the guidelines relating to pre-emption so that listed companies can issue up to 20% of their issued share capital on a non-pre-emptive basis during this period of unprecedented market turbulence.

This follows an initial suggestion by AFME's Equity Capital Markets group to the Pre-Emption Group to take a pragmatic and flexible approach regarding the fact that certain companies will likely need to raise capital very quickly, and within limited marketing windows. AFME has recommended its members follow the guidance in the PEG statement.

1.8 European equity trading by venue (Average daily, EURbn)



Source: BigXYT

Equity trading

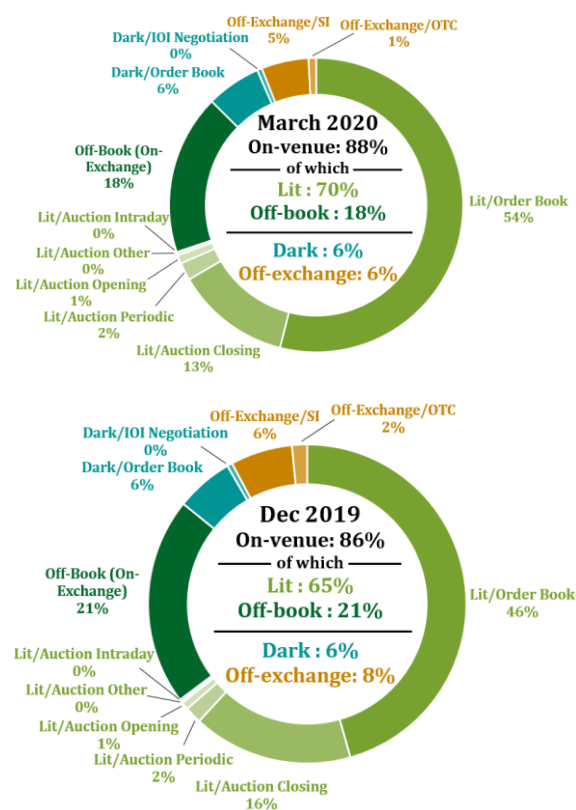
By venue

Equity average daily trading volume⁴ traded on European MTFs and exchanges increased 94% YoY in March 2020 to €84.9bn per day when market turnover peaked (vs. €43.8bn in March 2019). Preliminary data in the first trading week of April 2020 suggests a partial normalisation of trading volumes at €48.7bn per day. See chart 1.8.

The increase in trading activity during Q1 2020 can be observed across all but one venue in AFME’s analysis⁵. Larger venues, which have higher average daily trading volumes, experienced a greater relative increase in activity.

The percentage of total on venue trading conducted via primary exchanges increased to 74% in March 2020, the largest split during the period analysed and 7 percentage points greater than in March 2019, where 67% of equity trading volumes took place in primary exchanges.

1.9 European equity trading by type: March-20 and Dec-19



Source: BigXYT

By type

Lit market share of trading has risen from 65% in December 2019 to 70% of total value traded in March 2020, as can be seen in chart 1.9. This is likely to be due to market participants seeking immediacy of execution (as opposed to minimal price impact) during periods of heightened volatility as markets reacted to the COVID-19 pandemic

The market share of trading taking place off-book and off-exchange has decreased by 3% and 2% respectively over the same period and the amount of liquidity in dark trading has remained consistent at 6%.

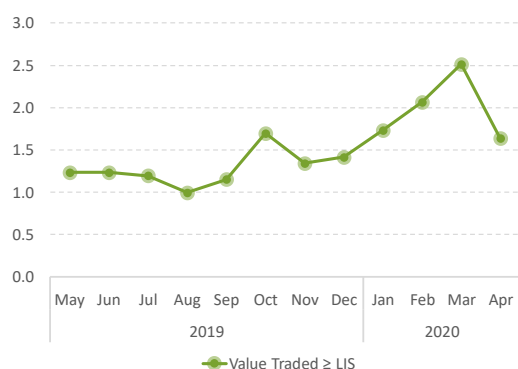
Within lit trading, there was a slight decrease in the proportion of trading conducted in the closing auction, with most of the growth in market share stemming from an enlargement of the lit order book throughout Q1 2020. The amount of trading conducted on-venue— an aggregate of lit and off-book (reported on-exchange)— has increased slightly from 86% to 88% over the same period.

Our preliminary analysis of data since the COVID-19 outbreak shows also a slight decrease in the proportion of OTC/SI trading compared to the levels of continuous lit trading.

⁴ Addressable trading only.

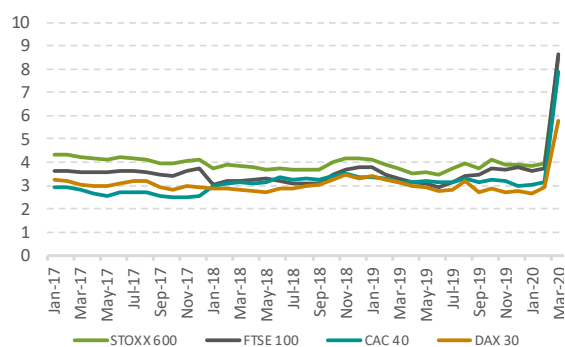
⁵ Venues in the analysis include Aquis Exchange, Athens Stock Exchange, Bolsa de Madrid, Borsa Italiana, Cboe BXE, Cboe CXE, Cboe DXE, Cboe LIS, Equiduct, Euronext Amsterdam, Euronext Brussels, Euronext Lisbon, Euronext Paris, Instinet Blockmatch, Irish Stock Exchange, ITG Posit, Liquidnet, LSE, Nasdaq Nordic, Oslo Bors ASA, Prague Stock Exchange, Sigma X MTF, SIX Swiss Exchange, Turquoise, Turquoise Plato Uncross, UBS MTF, Wiener Borse AG, WSE, Xetra

1.10 Blocktrading volumes across selected European venues (average daily, EURbn)



Source: Big XYT

1.11 Bid-ask spreads for selected European indices (bps)



Source: Refinitiv

Blocktrading

There was also a spike in average daily large in scale (LIS) trading throughout the first quarter of 2020, with traded volumes above the ESMA LIS threshold increasing 91% from December 2019 to March 2020.

Similar to overall equity trading, activity seems to have normalised somewhat based on data accounting for the first trading week of April.

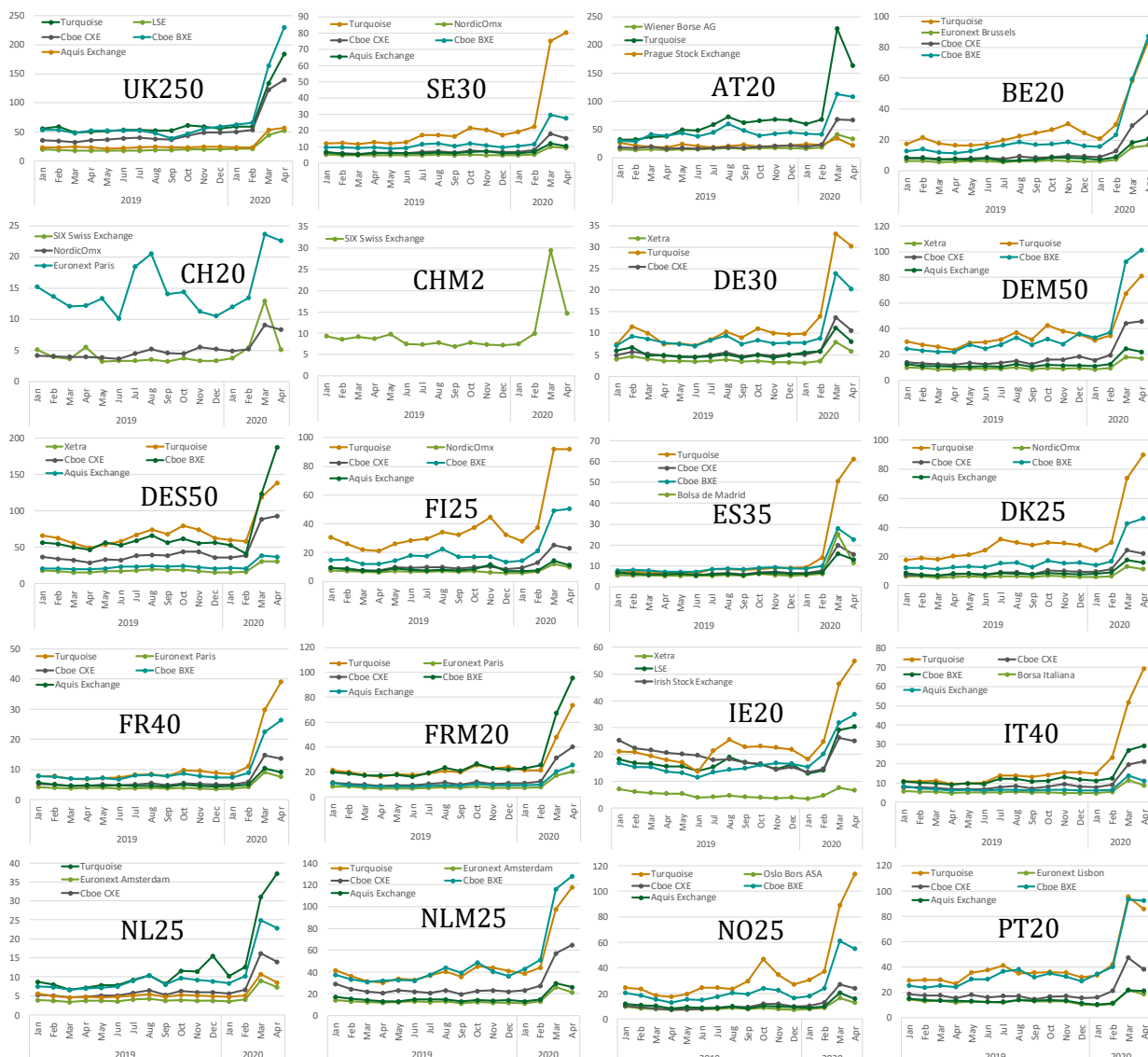
Bid-ask spreads

Equity spreads for most venues have widened significantly from February to March 2020 across all major European stock indices, as the uncertainty caused by COVID-19 led to volatility in price discovery. See chart 1.11 and additional detail on the next page.

This is supported by further index-level analysis shown on chart 1.12 on the next page which also shows equity spreads widening significantly from mid-late February to March 2020 across all major European stock indices. Initial data for the beginning of April suggests spreads for the primary exchange of each index have reached a ceiling or have stabilised, at spreads roughly double where they were pre-crisis.

1.12 Bid-ask spreads for selected European indices: primary exchange and selected venues (bps)

KEY Primary Exchange → More liquid venue → Less liquid venue



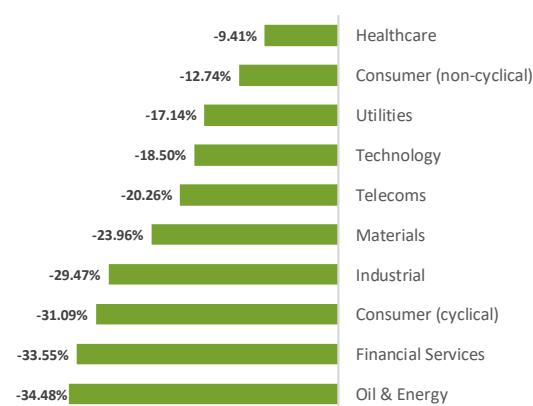
Source: Big XYT

1.13 Price indices YtD variation (as of 8 April)

| Europe | YTD% |
|-------------|---------|
| STXE 600 | -21.44% |
| FTSE 100 | -24.72% |
| DAX | -22.01% |
| CAC 40 | -25.68% |
| FTSE MIB | -26.06% |
| SMI | -11.16% |
| AEX | -17.18% |
| IBEX | -27.20% |
| OMXS 30 | -15.37% |
| Asia | |
| JPNK 400 | -16.69% |
| S&P/ASX 200 | -22.10% |
| HANG SENG | -14.97% |
| Americas | |
| S&P 500 | -15.06% |
| BOVESPA | -32.05% |
| MXSE IPC | -20.82% |

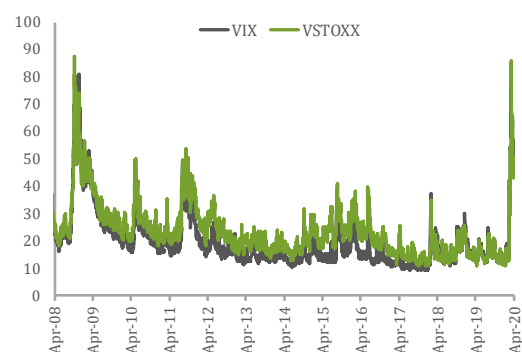
Source: Eikon

1.14 European equity shares YtD variation by sector



Source: Dealogic, AFME, SIFMA

1.15 Equity market-implied volatility: VSTOXX (Europe) and VIX (USA)



Source: CBOE and STOXX

Equity valuations

Company valuations have significantly declined over the year as result of the sudden change in the economic outlook and the uncertainty around the medium and long-term financial repercussions of the crisis for the corporate sector.

Share prices of blue-chip index constituent companies have declined between 20-30% in Europe, Asia and the Americas. In Europe, the declines have varied across countries with YtD declines of between 11-26% (at the time of writing this report). See chart 1.13.

By industry, the oil & energy sector has led the decline in share prices as consequence of the fall in oil prices to a 17-year low due to the abrupt deterioration in global demand and the subsequent “price war” between large oil producers.

The financial services sector is also among the industries hardest hit by the crisis. For banks, this follows concerns regarding future loan losses and regulatory measures aimed at freezing dividend distribution to preserve capital and support lending into the real economy. See chart 1.14.

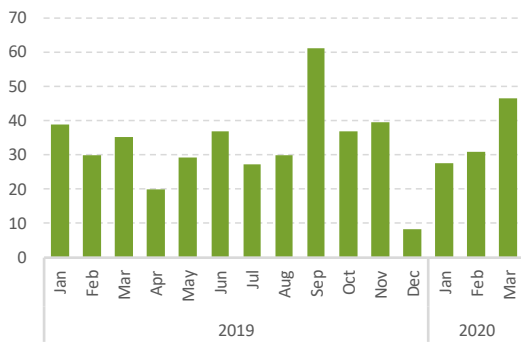
Market volatility reaches levels observed in 2009

Market volatility of European and US equity shares has rapidly increased to levels seen during the 2008-09 financial crisis. See chart 1.15.

European market-implied volatility of equity shares increased from 11bps in early January to a maximum of 86bps by mid-March. By mid-April however, it had stabilised at levels close to 50bps.

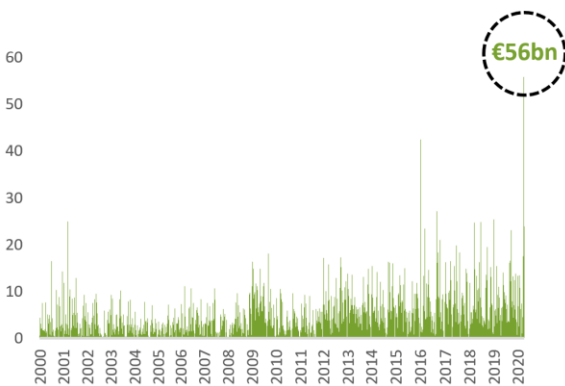
The uncertainty around the length of the lockdown measures: the evolution of the pandemic across the world; the monetary support announced by the ECB, Bank of England (BoE), other European Central banks and the U.S. Federal Reserve (FED); and the policy measures announced by national and EU bodies, have all contributed to the daily variation in investors’ risk perception about the equity market.

2.1 Non-financial corporate investment grade bond issuance (EURbn)



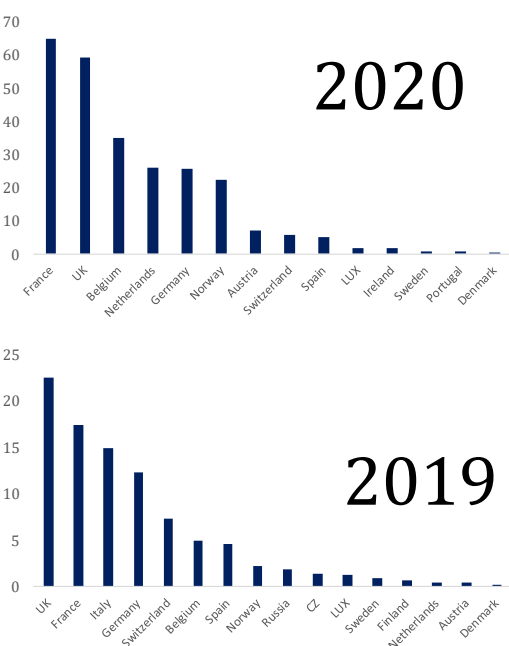
Source: Dealogic

2.2 Weekly NFC IG bond issuance (EURbn)



Source: Dealogic

2.3 NFC IG bond issuance by company nationality (EURbn): March-mid April



Source: Dealogic

2. Corporate Bond Market

The corporate sector is facing unprecedented pressure as a consequence of the economic restrictions imposed to stop the spread of the COVID-19 virus.

European corporates are currently seeking to position their balance sheets strategically for the abrupt change in the economic outlook while facing the short-term cash constraints derived from the sudden stop in business activity. Capital markets play a fundamental role in assisting businesses in this time of need.

Primary market

Rapid increase in investment grade (IG) bond issuance

IG borrowers raised a record amount of corporate debt from markets during recent weeks.

The amount of European IG bond issuance between 1 March and mid-April totalled €110bn, a 131% increase compared to the same period of 2019. In the first week of April 2020 alone, European IG bond issuance totalled €56bn, an all-time weekly record amount. This volume is remarkable given the large number of financial market participants working from home during this period.

A similar trend has been observed in other regions. Between March and mid-April, US corporates raised €231.7bn equivalent in IG bonds, an increase of 226% from the same period in 2019.

The increase has been driven by a large demand from corporates to increase their working capital, to build-up buffers to protect against economic uncertainty, and increase liquid assets to navigate a sudden fall in revenues. According to Dealogic, of the IG bond issuance between 1-March and mid-April, 86% was intended for general purposes (including for working capital), with just 2% for acquisitions and 12% for refinancing.

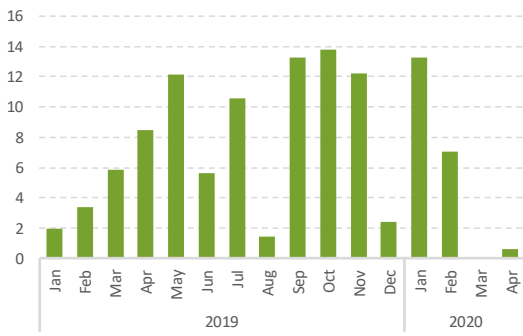
IG bond issuance has been led by the largest countries in Europe, with French, British and Belgian corporates leading with €65bn, €59bn and €35bn issued respectively between early March and mid-April. Italian corporates have not issued IG bonds over the same period.

Average deal values were in the range of €700-800mm which is almost twice the average deal size observed in 2019FY.

The increase in bond issuance has been notwithstanding an increase of 58bps in IG corporate spreads (see page 14).

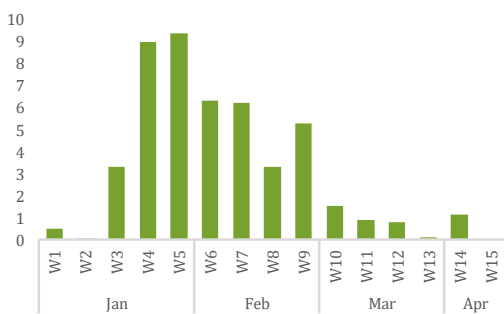
The large asset purchase programmes announced by the main European central banks have also supported the surge in IG issuance. The ECB has provided a new temporary asset purchase programme (the Pandemic Emergency Purchase Programme or PEPP) of private and public sector securities of €750bn across euro-area fixed income asset classes and

2.4 NFC High Yield bond issuance (EURbn)



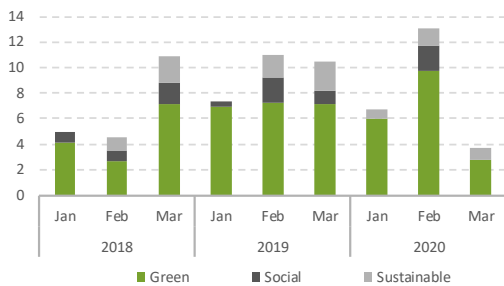
Source: Dealogic

2.5 European leveraged loan issuance (EURbn)



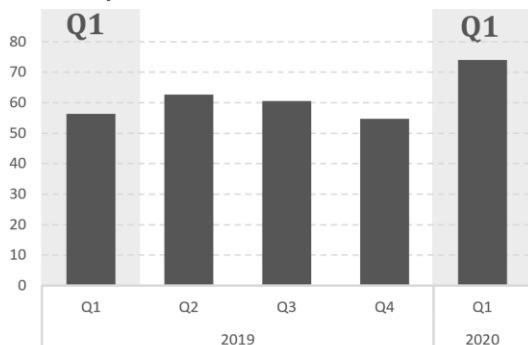
Source: Dealogic

2.6 EU green bond issuance: Q1 (EURbn)



Source: Dealogic

2.7 European credit trading (quarterly trading volumes, average daily, EURbn)



Source: Traxx, a MarketAxess company

the BoE will increase its holdings of UK government bonds and sterling non-financial IG bonds by £200bn to a total of £645bn. This is in addition to the purchase programmes that were ongoing prior to the COVID crisis.

High Yield (HY) bond and leverage finance

The rapid increase in IG bond issuance contrasts with the subdued performance of the high yield and leveraged finance markets as investors price in potential credit losses of low-rated corporate debt.

Between 1 March and mid-April, a total of €701mm in high yield debt has been issued in Europe, a 93% decline compared to the same period of 2019.

Leveraged loan issuance has also declined during the COVID-19 crisis as markets continue to reflect concerns about credit quality and highly leveraged companies. Leveraged loan issuance totalled €4.5bn between March and mid-April 2020, a decline of 86% from €31.8bn issued in the same period of 2019.

Sustainable bonds

In Q1 2020, green, social and sustainable bond issuance was 19% lower compared to Q1 2019 but 16% greater than Q1 2018.

It is too early to ascertain any visible trends in the sustainable bond market, although March 2020 represented the lowest volume in the month of March since 2017. See chart 2.6.

Credit trading

According to Traxx data, European corporate bond trading increased 31% compared to Q1 2019 and 35% compared to Q4 of 2019. See chart 2.7.

Data is not readily available to breakdown total bond trading activity between High Yield and Investment Grade bonds. However, according to ING with EPFR data⁶, the IG bond market experienced fund outflows of €3.5bn per week while the HY bond market experienced outflows of €3bn per week. The cumulative outflows between late February and late March represented 12% of the European HY AuM and 6% of the European IG AuM, according to the ECB⁷.

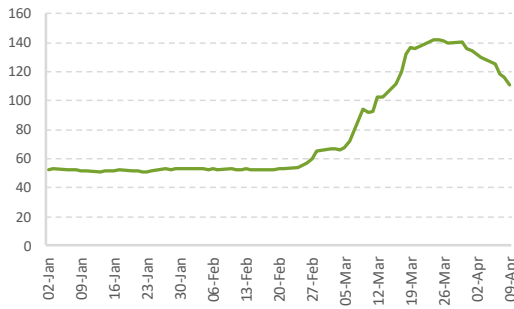
Industry research⁸ indicates that the US high yield market also experienced cumulative outflows of c6% of high yield AuM YtD (as of mid-March).

The outflows have been mostly re-directed to money market funds, sovereigns and, more broadly, liquid low-risk instruments. US government bond funds, for example, experienced an increase in inflows of 10% of AuM, while US money market funds saw increased flows by 6% of AuM.

⁶ See ING: "Massive mutual fund outflows" [here](#).
⁷ See ECB blog on CP purchases [here](#).

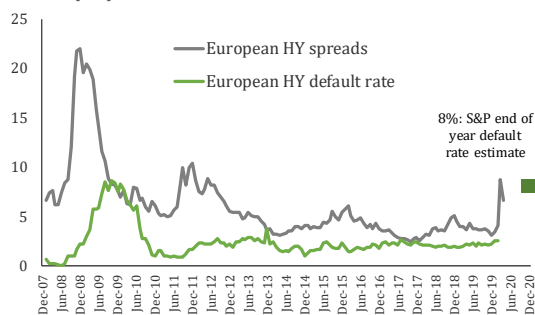
⁸ EPFR data referenced by the FT [here](#).

2.8 European AAA corporate spreads (bps)



Source: Barclays

2.9 European HY spreads and default rate (%)



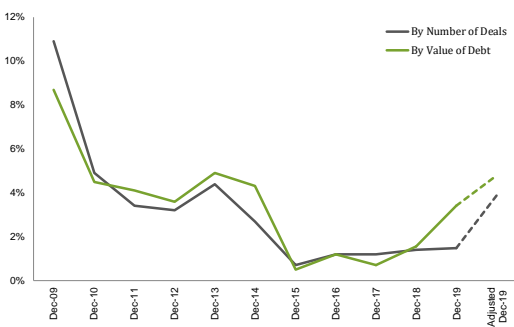
Source: S&P, BofA

2.10 European leveraged loan price index (Euro Lev Top 40)



Source: Refinitiv

2.11 European leveraged loan default rates



Source: Fitch

Credit quality

CDS, High Yield spreads, OAS

Markets are already pricing some degree of stress and credit losses in the corporate bond and loan markets.

IG spreads have risen 58bps YTD as of mid-April, with a recent decline that coincided with the announcement of the large asset purchase programmes by the ECB and the BoE. See chart 2.8.

European high yield spreads rose from 300bps in January 2020 to a maximum of 866bps reached at the end of March. Most recently, however, high yield spreads have declined to 658bps in mid-April 2020.

In the past, sustained changes in high yield spreads have been correlated with increases in high yield default rates. Based on historic performance, S&P forecasts an 8% default rate for European high yield bonds at the end of 2020 compared with 2.2% in December 2019 and 4% at the peak of the euro crisis in 2013. See chart 2.9.

In the US, the FED has also committed to supporting the high yield bonds market by purchasing debt of companies recently downgraded to non-investment grade ratings (i.e. “fallen angels”). The monetary support has contributed to a recent tightening in US high yield spreads.

Leveraged loan prices

Markets are also pricing some degree of elevated stress in the leveraged loan market.

European leverage loan prices declined roughly 20 per cent with a partial recovery of circa 7 per cent reflecting the significant volatility in the market. See chart 2.10.

Fitch analysis produced prior to COVID-19 estimated an increase in European leveraged loan default rates from an observed 3.4% in December 2019 to an expected 5% assuming that outstanding debt from c and cc rated issuers will default. See chart 2.11.

Recent regulatory initiatives

Changes to business insolvency proceedings

Some European countries have recently amended their local business insolvency rules as a measure to support businesses economically affected by the COVID-19 crisis.

Germany, the UK and Spain have temporarily changed their corporate insolvency filing obligations and/or enforcement of debts for companies affected by the current economic crisis as another measure of policy support.

The measures include issues related to stay periods, non-admission of filings for insolvency proceedings for 2 months (in Spain), and suspension of wrongful trading law measures which prevented businesses from carrying on business whilst insolvent (in the UK).

3. Securitisation

Primary market

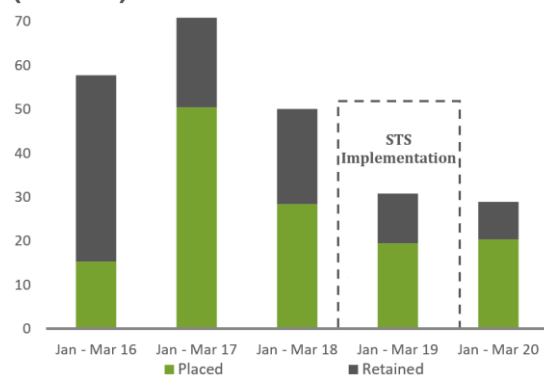
ABS, CMBS and RMBS

European primary market securitisation issuance totalled EUR 28.9 bn during January to March 2020, 6% lower than the issuance volumes observed in the same period in 2019, which in itself was already a record-low volume due to the complications the market faced during the first months of the then new STS regime. Compared with the same period in 2018, primary market issuance was 42% lower.

With the onset of the COVID-19 crisis, public new issues ceased almost completely.

Faced with worsening market fundamentals, such as declining economic growth forecasts and projected increases in unemployment, the market for placed issuance is likely to contract over 2020. However, liquidity remains the key challenge; credit concerns remain both contained and confined to certain defined sectors and the relatively new STS regime (in force since January 2019) provides a global “best in class” framework for qualifying transactions to be well placed to withstand economic stress.

3.1 European securitisation issuance (EURbn)



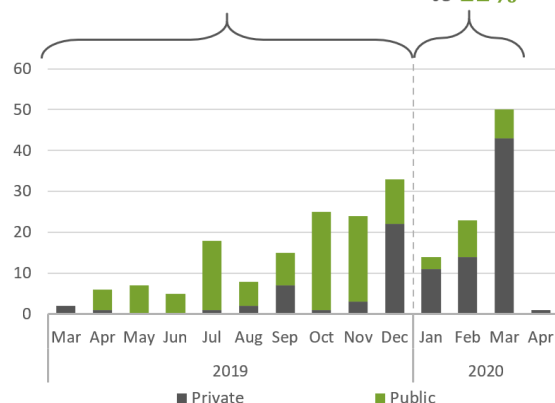
Source: BofA Global research

“There has been a notable decrease in the number of public deals for which there have been STS notifications”

3.2 Number of STS notifications

In April to YE2019, **73%** of STS notifications were for **Public** transactions

In Q1 2020, this has fallen to **22%**



Source: ESMA

Simple transparent and standardised (STS) securitisation issuance

The STS market continues to develop although, even prior to COVID-19, the take-up has not proven to be transformative and many such deals would have been issued anyway. ESMA received 87 STS notifications within the first quarter of 2020. This is slightly (6%) higher than the number of STS notifications received during Q4 2019.

However, there has been a notable decrease in the number of public deals for which there have been STS notifications, with only 19 public deals in Q1 2020, compared to 56 in Q4 2019. Moreover, the proportion of total public deals labelled STS was just 22% in Q1 2020, compared to 68% in Q4 2019 and 73% over the period from April 2019 (when the STS market opened) to YE 2019.

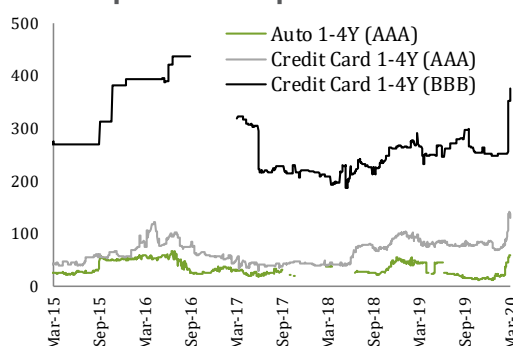
This suggests that issuers are opting to utilise private markets for STS securitisations, due to the stressed liquidity conditions in public markets. This movement of securitisation market activity from the public to private space has also taken place in previous crisis periods.

3.3 European CMBS spreads



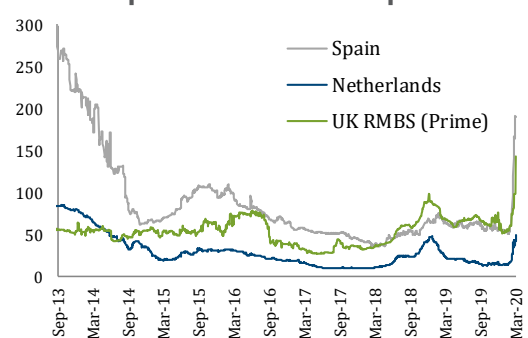
Source: IHS Markit

3.4 European ABS spreads



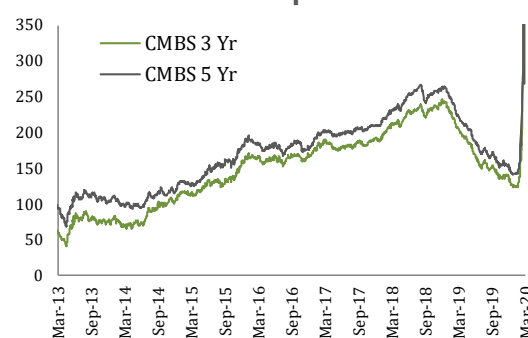
Source: IHS Markit

3.5 European AAA RMBS spreads



Source: IHS Markit

3.6 US AAA CMBS spreads



Source: Trepp

Credit quality and valuations

Spreads

There has been significant widening in European securitisation spreads during 2020 year-to-date, which has affected all asset classes.

As of 2 April 2020, European 3-5 Yr CMBS spreads have widened 127bps YtD for AAA tranches, to 221bps, and 75bps YtD for BBB tranches, to 322bps. In the US, spreads on AAA rated CMBS tranches increased 132bps YtD for 3Y and 116bps YtD for 5Y with both reaching 268bps, on 27 March 2020, compared to 2 January 2020.

With regards to European ABS, spreads on AAA rated Auto 1-4Y tranches widened 43bps YtD between 2 January 2020 and 2 April 2020, to 60bps, while spreads on credit card 1-4Y have increased 52bps YtD, to 131bps, for AAA tranches and 125bps YtD, to 376bps, for BBB tranches over the same period.

For European AAA rated RMBS, spreads of tranches whose assets are domiciled in Spain widened by 135bps YtD, to 190bps. For tranches domiciled in the Netherlands, there was a 33bps YtD increase, to 50bps. Meanwhile, for UK RMBS (Prime) AAA, spreads have increased 66bps YtD to 144bps.

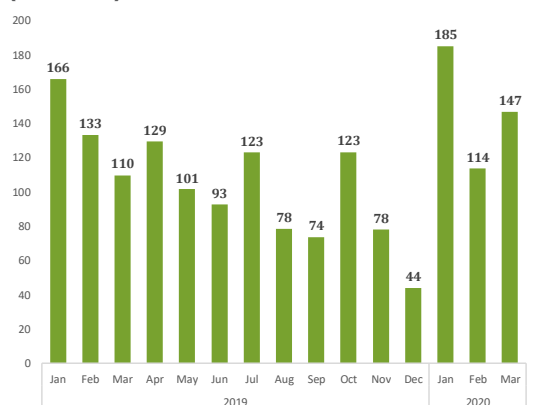
In the near-term, while central bank intervention may lead to some improvement of liquidity conditions in the market, as with all markets the wider long-term effects of COVID-19 on securitisation will be closely linked to the fiscal and wider response of European governments. That is to say, the performance of many tranches, specifically in RMBS, will be impacted by the severity of the economic downturn, the magnitude of the increase in unemployment, and how both of these factors translate into arrears and defaults in the underlying pools of loans. To date, credit concerns remain both contained and confined to certain defined sectors.

ECB's PEPP asset purchase programme

While the ECB's announcement of the Pandemic Emergency Purchasing Programme (PEPP) has already had a positive effect in government bonds and other fixed income sectors this has not yet been observed in the securitisation market; indeed spread widening and pressure on liquidity in securitisation has been disproportionate compared with other fixed income sectors. We see a direct correlation between central bank support and improved liquidity conditions. Support for securitisation under both the ABS PP, PEPP and ECB repo operations (Eurosystem) remains limited in scope, slower to access and subject to much heavier eligibility criteria, both theoretically and operationally. While the 7th April reduction by the ECB of haircuts (across all sectors) is helpful to some extent, the relatively harsh treatment of securitisation compared with other fixed income sectors remains entrenched – one obvious example is that there is no recognition of the STS label.

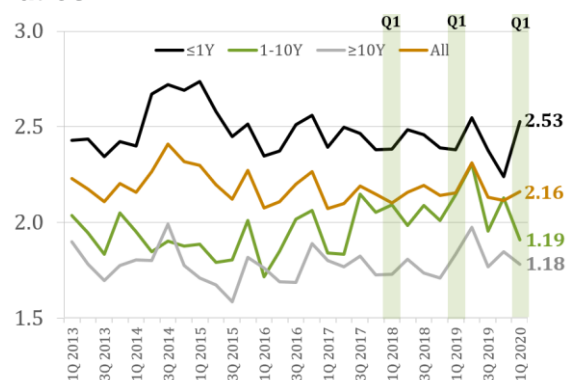
4. Government Bonds

4.1 EU Government bond issuance (EURbn)



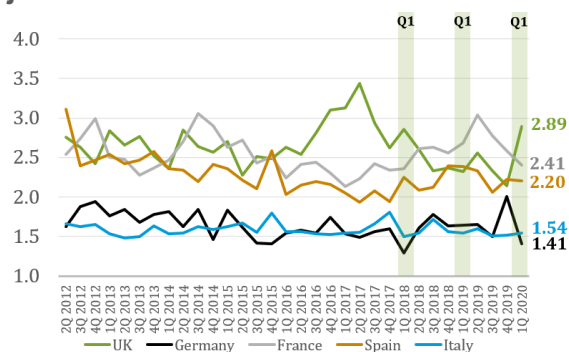
Source: Eikon

4.2 Government bonds bid-cover ratios



Source: Eikon

4.3 Average bid-cover ratio by jurisdiction



Source: Eikon

Primary market

Bonds and bills issuance

European government bond issuance (EU27 and UK) totalled EUR 445.7bn in Q1 2020, representing an 82% increase compared with Q4 2019 and a 9% increase compared with Q1 2019.

While issuance volumes have recently increased, it is too early to assess the magnitude of the crisis on the size of government bond auctions.

The broader implications of COVID-19 on the sovereign bond market are anticipated to become more evident throughout 2020. The magnitude of the changes in the primary issuance market are likely to be impacted by the extent of the fiscal and other measures taken by EU governments to help mitigate the impact of the COVID-19 crisis.

In the UK, however, the BoE announced that will directly finance UK government's spending on a temporary basis. The policy measure seeks to give more short-term fiscal space for the government to address the economic consequences of the COVID crisis. The measure is in addition to the significant increase in the UK DMO funding programme following an "exceptional revision" of its issuance plan in which intends to raise £45bn from the gilts market in April 2020.

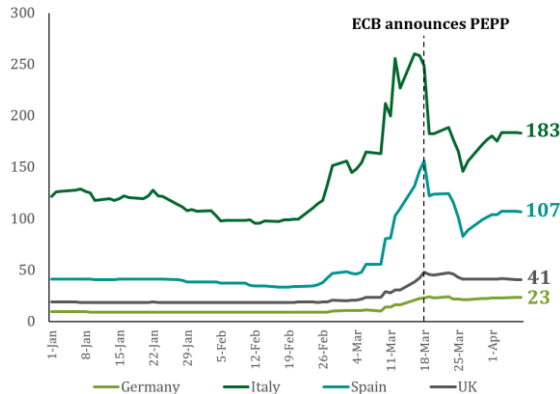
Bid-cover ratios

The average EU sovereign bond bid-cover ratio increased slightly during Q1 2020 to 2.16, a 2.2% increase from Q4 2019 and equal to Q1 2019.

Demand for sovereign securities remains robust with average bid-cover ratio by jurisdiction in Q1 2020 within average levels observed in recent quarters. See charts 4.2 and 4.3.

As with sovereign primary issuance, the near-term future path of EU bid-cover ratios depends on the extent of the fiscal response to the crisis, and the corresponding market appetite for issuance volumes.

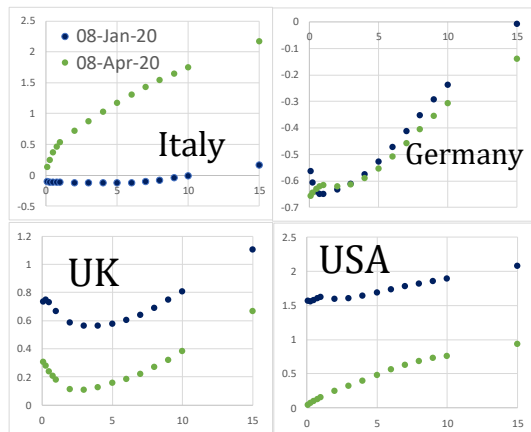
4.4 European 5Y sovereign CDS spreads (bps)



Source: Eikon

“The disruption posed by the COVID-19 crisis has increased the price volatility and risk premia of European sovereign bond markets”

4.5 Sovereign yield curves: Jan-2020 and April 2020 (%)



Source: Eikon

Credit quality

Upgrades and downgrades

In 2020 to date, there has been one credit rating action affecting a European sovereign issuer.

On 27 March 2020 Fitch downgraded the UK credit rating by one notch to AA- (from AA) with a negative outlook. This was due to a deteriorating fiscal stance caused by the effects of COVID-19 and a “fiscal loosening stance” following the stimulus measures announced in the budget on March 11 before the scale of the crisis became apparent.

While credit rating actions caused by the effects of COVID-19 seem limited at present, some credit rating agencies⁹ have announced that further actions affecting EU countries credit ratings are likely in the near-term due to the expected increase in fiscal expenditure to address the economic consequences of the crisis, and a general decline in tax revenues as a consequence of the significant deterioration in economic activity.

CDS and sovereign yield curves

The disruption posed by the COVID-19 crisis has increased the price volatility and risk premia of European sovereign bond markets.

As of 7 April 2020, and compared to 1 January 2020, 5Y CDS spreads have increased 22bps in the UK, 14bps in Germany, 66bps in Spain and 61bps in Italy.

5Y CDS spreads peaked in all European jurisdictions just before the PEPP was announced by the ECB on 18 March 2020. This policy announcement calmed market expectations, lowering CDS spreads thereafter, albeit to a higher level than pre-COVID conditions.

For sovereign yield curves, the effect of COVID-19 on the market can be observed in the steepening of the Italian curve, and the downwards shift observed for both the UK and US sovereign markets.

⁹ See Fitch press note [here](#).

4.6 EU government bond trading (quarterly trading volumes, average daily, EURbn)



Source: Traxx, a Market Axess company

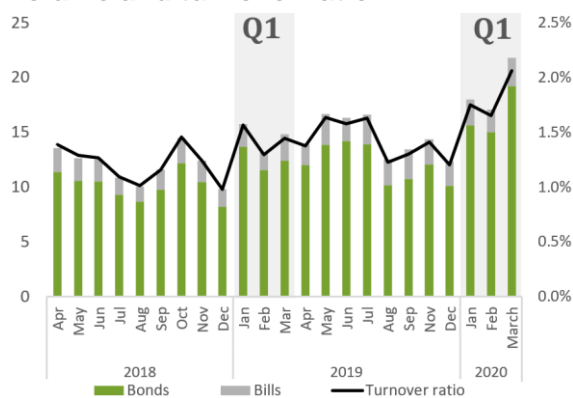
Government bond trading

According to Traxx, EU Government bond trading rose to EUR 79.1 bn during Q1 2020, representing the highest quarterly trading volume since Q1 2017.

Trading volumes in Q1 2020 were up 26% compared to Q4 2019 although representing a discrete annual increase of 4% compared to Q1 2019. See chart 4.6.

As shown on page 21, repo turnover of European government bonds cleared on LCH reported in March 2020 a similar annual increase of 2% but with large monthly variations, particularly of euro area government debt.

4.7 Spain: Average daily trading volume and turnover ratio



Source: BME Market Data and Tesoro Público de España

Country-specific findings

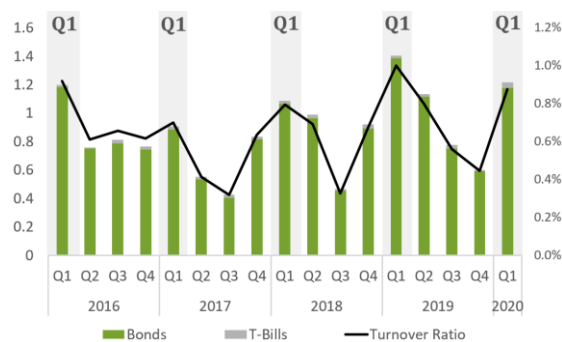
There is some country-specific evidence of substantive changes in trading activity in Q1 2020.

In Spain, the three largest average daily trading volumes in our records were observed for January, February and March of 2020.

In Hungary and Greece, Q1 2020 represented multi-year highs in quarterly trading volumes. The increase in Greek turnover may be due to the recent return of Greece to EU capital markets for funding and the inclusion of Greek sovereign debt as eligible for the ECB's PEPP programme.

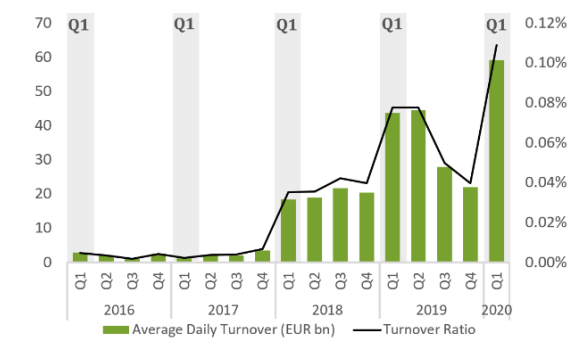
In both Ireland and Bulgaria, changes in trading were in line with recent trends.

4.8 Ireland: Average daily trading volume and turnover ratio



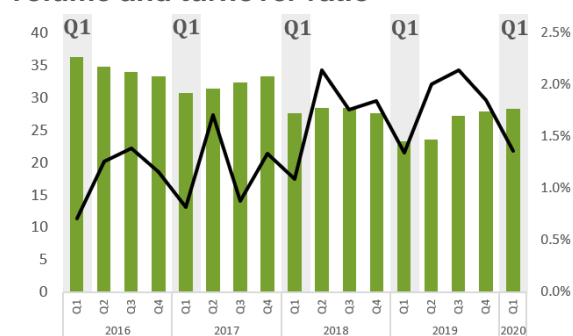
Source: Irish Stock Exchange and ECB

4.9 Greece: Average daily trading volume and turnover ratio



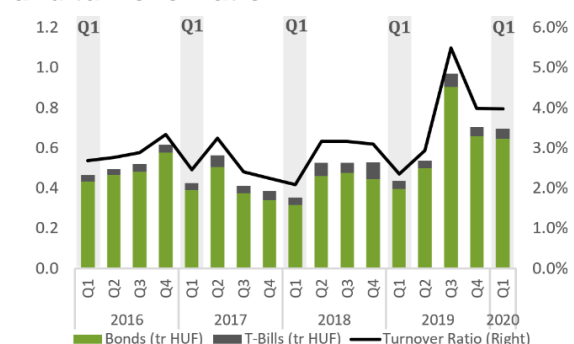
Source: Bank of Greece and ECB

4.10 Bulgaria: Average daily trading volume and turnover ratio



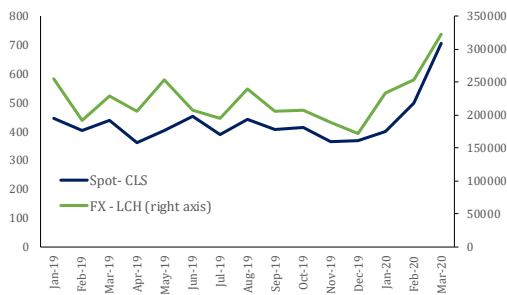
Source: Ministry of Finance of the Republic of Bulgaria

4.11 Hungary: Average daily trading volume and turnover ratio



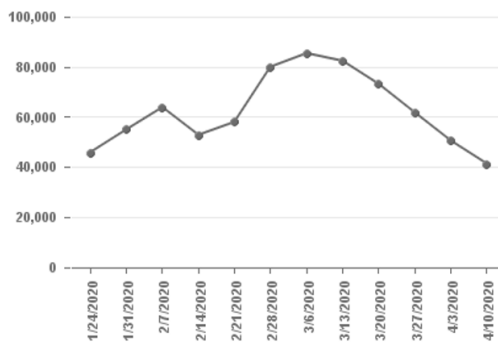
Source: ÁKK

5.1 FX NDF trades cleared on LCH and FX spot turnover settled on CLS (\$bn)



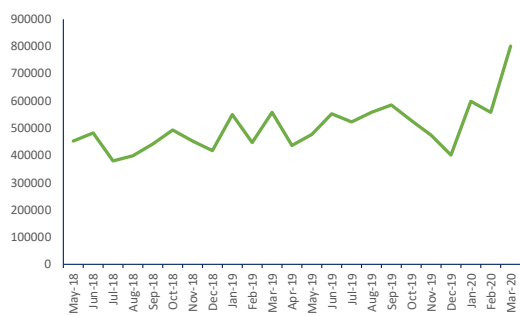
Source: LCH, CLS

5.2 Weekly FX NDF trades cleared on LCH: January-April 2020



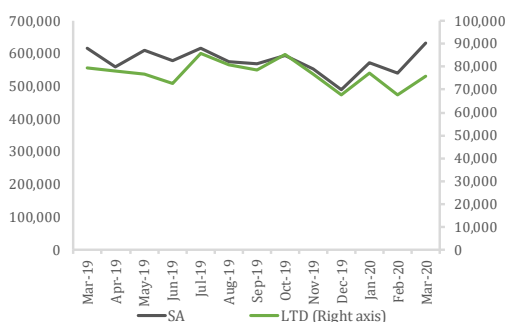
Source: LCH

5.3 Swaps clearing on LCH (monthly trades registered)



Source: LCH

5.4 REPO clearing on LCH SA and LCH LTD (monthly cleared traded sides)



Source: LCH

5. FX, Derivatives and REPO

Turnover

61% increase in FX spot turnover

The rapid increase in market volatility; the large cross-border monetary support; recent changes in central banks' policy rates; abrupt changes in market yields; and more broadly, the unexpected change in asset prices and the functioning of the real economy, have contributed to the rapid increase in FX turnover.

CLS, who provide settlement services to the wholesale FX industry, indicated an increase in the average daily traded volume submitted to CLS of 61%YoY in FX spot, an increase in FX swaps of 4% YoY, and an increase in outright forwards of 11%. See chart 5.1.

FX non-deliverable forwards (NDF) cleared on LCH increased from 250,000 trades in February 2020 to 332,000 trades in March 2020 (or the equivalent of above 80,000 trades per week). See chart 5.1. Most recently, LCH data suggests normalisation in trading activity with an average of 40,000 trades cleared on the second week of April. See chart 5.2.

43% monthly increase in swap trading

Swap clearing including IRS, OIS, and forward rate agreements increased 43% between March and February of 2020 and 44% between March 2020 and March 2019. This is as corporates seek to manage their balance sheets risks and investors hedge their portfolios against expected changes in yield fluctuations. See chart 5.3.

17% monthly increase in European REPO transactions

Repo transactions of European government bonds cleared on LCH SA and LCH LTD accumulated in March a monthly increase of 17%, but only a 2% increase against March of 2019.

By country of issuance¹⁰, some significant monthly variations have been observed in March 2020, particularly of high-grade euro area government debt. This has been predominantly of French government debt (38% MoM), Austrian (60% MoM), and Belgian (33% MoM), and to a lesser extent in Germany (18% MoM), Portugal (7% MoM), the Netherlands (17% MoM), Finland (20% MoM), Spain (20% MoM) and the UK (10% MoM).

¹⁰ See LCH weekly repo report [here](#).

6. M&A

Deal making

The announcement and completion of new M&A transactions has been materially postponed with some companies revaluating or abandoning takeover deals as they address material business disruptions faced from the COVID pandemic.

Companies finalise deals close to completion

The value of completed M&A transactions totalled €174bn in the first quarter of 2020, a 25% decline from the same period of 2019. Most recently in April, the value of completed deals has stood relatively unchanged compared to the weekly deal value observed earlier in the year.

It takes around 100 days to complete M&A between announcement date and completion¹¹. It is expected that deals that have been announced for several months and pending only final operational and closing procedures, are completed over the next months.

Going forward, however, it is possible that European M&A may take longer to finalise. For example, the European Commission as a special measure¹², due to coronavirus, has requested interested merger parties to delay notification of mergers where possible. Although it is still accepting merger filings, especially where competition issues do not arise.

Abrupt decline in announced M&A transactions

The value of announced deals has abruptly declined to below €2bn per week compared to weekly averages of €15-20bn in the first months of the year. See chart 6.2.

Some transactions may also require bond or equity financing to be profitable for interested parties, which in current circumstances, may be too expensive for the completion of a successful merger transaction.

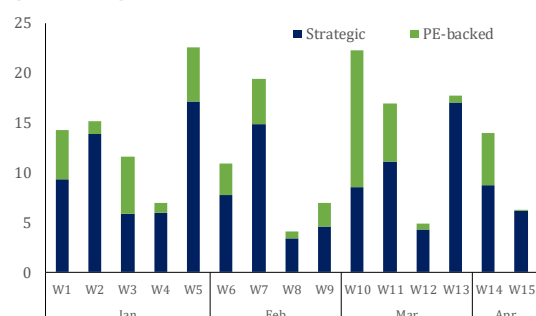
Going forward, however, there could be a prospect for opportunistic M&A transactions whereby businesses that are vulnerable can be the object of a takeover.

Price multiples

It is difficult to assess if the decline in valuation multiples of targeted companies is explained by the current economic environment. See chart 6.3.

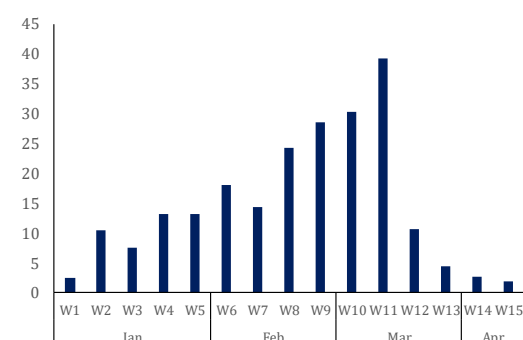
Valuation multiples of completed deals during Q1 2020 stood below the 2006-19 averages, continuing a declining trend of the last two years. The median Enterprise Value to EBITDA ratio (EV/EBITDA) of targeted firms stood at 8.8x in Q1 2020 below the annual average of 11.2x in 2006-19.

6.1 Completed European M&A (EURbn)



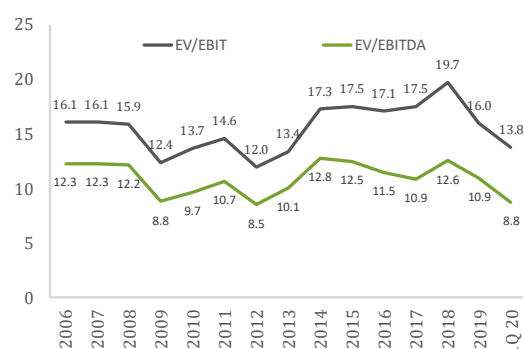
Source: Dealogic

6.2 Announced European M&A (EURbn)



Source: Dealogic

6.3 Price multiples of M&A transactions



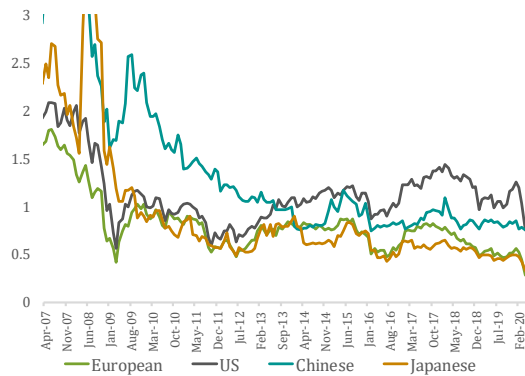
Source: Dealogic

¹¹ AFME Q1 2017 Equity Primary markets and trading report

¹² See EC announcement [here](#).

7. European Banks

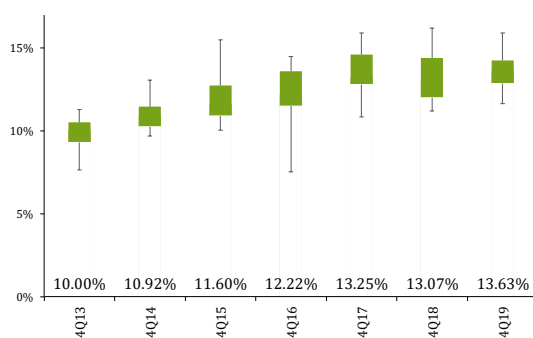
7.1 Price-to-book ratio of large banks by geographical location



Source: Eikon. GSIBs by region.

“European banks enter these challenging times with high levels of quality resources.”

7.2 EUGSIBs CET1 ratio



Source: EU GSIBs earnings reports

The global pandemic has had significant consequences on the economic outlook and the balance of risks faced by banks. In Europe, IMF estimates indicate a decline of 6.5% in GDP growth in Europe in 2020FY and 20-40% decline on the Q2 of 2020 which is more severe than stress scenarios modelled by the EBA in 2016 and 2018.

However, as this section shows, European banks are well positioned from a solvency and liquidity perspective to support households and businesses during this period of abnormal economic stress.

The banking sector can continue to provide market liquidity, mobilise resources between economic agents, and facilitate risk management for corporates and investors.

Decline in banks' valuations

European banks' share prices have declined 38% Ytd (as of early April) compared to a market decline of 20-30%.

There are several factors behind the faster decline in banks' share prices compared to the market: (1) depressed economic activity; (2) expected loan losses and foregone interest on a rising level of defaulted loans; (3) rising bad debt provisions; (4) a relatively less flexible cost base; (5) recent regulatory measures requesting banks to cut dividend distribution.

The COVID-19 economic shock led to a decline in banks' price-to-book (PB) ratios across the world.

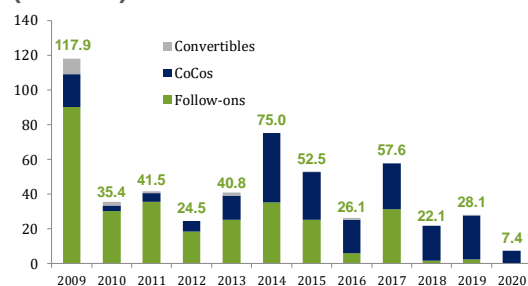
For European banks, price-to-book ratios have reached a level closer to that observed during the 2008-07 financial crisis. Low price-to-book ratios have been around for several years now and long before the recent elevated concerns over bank credit quality emerged. To date, these depressed ratios have primarily reflected the struggle that banks have had to earn their cost of capital with, more recently, dividend cuts further lowering valuations. European banks, however, enter these challenging times with high levels of quality resources to endure such unexpected economic shock.

Robust capital ratios

Banks interacting in the European market consistently built up their capital and liquidity buffers over recent years through a combination of internal restructuring, profit generation and external capital raising.

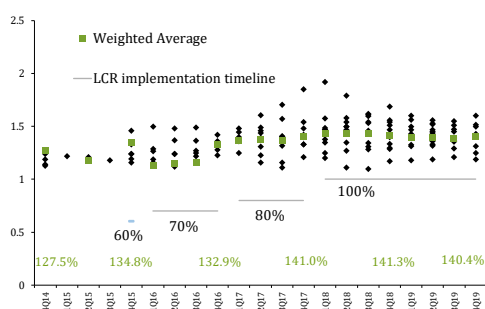
For example, since December 2013, the average end-point CET1 ratio for Europe's largest banks (EU GSIBs) accumulated an increase of 363ps, from 10% to 13.63% in December 2019. This ratio represented the highest quarterly solvency ratios in AFME's database (since 2013). See chart 7.2. Banks headquartered in the Americas, some which with significant presence in Europe, have also continued to improve their CET1 ratios from an average of 9% CET1 ratio in 2013 to 13% in 2018 (BIS).

7.3 Fresh capital raised by EU banks (EURbn)



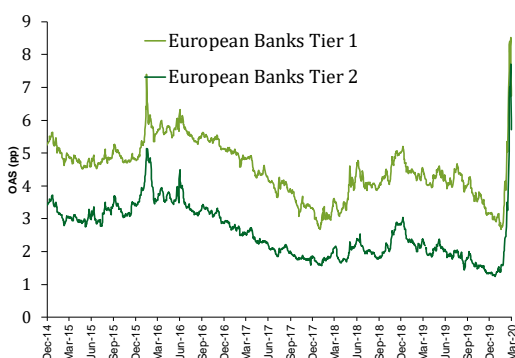
Source: Dealogic

7.4 EUGSIBS Liquidity coverage ratio



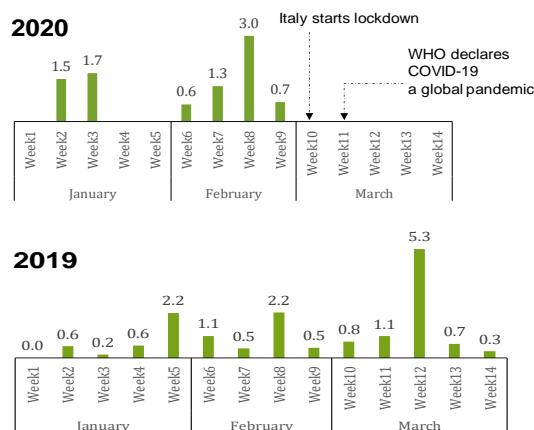
Source: EU GSIIBS earnings report

7.5 CoCo option adjusted spreads (OAS)



Source: Barclays

7.6 CoCo issuance: Q1 2019 and Q1 2020



Source: Dealogic

In 2019, EU banks reported a total €1,705.5bn in CET1 capital which, according to the EBA, was a substantial increase from €496.7bn in 2005¹³.

The total 2005-19 CET1 increase since pre-crisis of roughly €1.2tn (€1.7tn-€0.5tn) was built up through an increase in external capital of €530bn according to Dealogic (see chart 7.3), €410bn in state recapitalisation¹⁴ and around €260bn through profit retention.

Additionally, EU banks have improved the quality of their capital with additional billions in loss-absorbing resolution capital in the form of own funds (CET1, T1, T2) and other additional eligible liabilities.

Liquidity

The weighted average liquidity coverage ratio (LCR) finalised 2019 at 140.4%, marginally below the average ratio at the end of 2018 (141.3%). CRDIV requires banks to have a sufficient level of High Quality Liquid Assets (HQLA) to withstand a stressed funding scenario of 30 days. HQLA relative to total net cash outflows over a 30-day time period must be greater than or equal to 100%.

CoCo and capital issuance

CoCo OAS

CoCo risk premia has increased by 365bps YtD, from record lows observed during the first two months of the year. Markets are likely pricing the potential repercussions of COVID-19 on banks' earnings and their capacity to fulfil CoCo coupon payments.

CoCo issuance

The increase in CoCo spreads was mirrored by a sudden stop in CoCo issuance by European banks. As shown on the left panel charts, a total of €8.7bn in CoCos were issued in the first nine weeks of 2020, €1bn above the amount issued the first nine weeks of 2019.

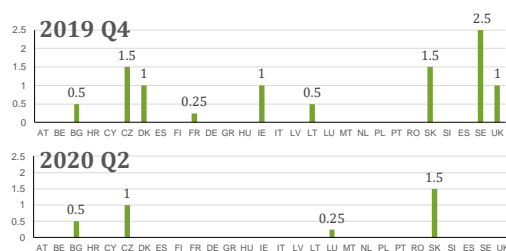
The rising spreads implied a substantial increase in the cost of CoCo debt which makes it uneconomical to raise that form of capital in current market conditions.

European authorities have responded to the current crisis with several prudential and supervisory measures.

¹³ See European Commission on state aid report [here](#).

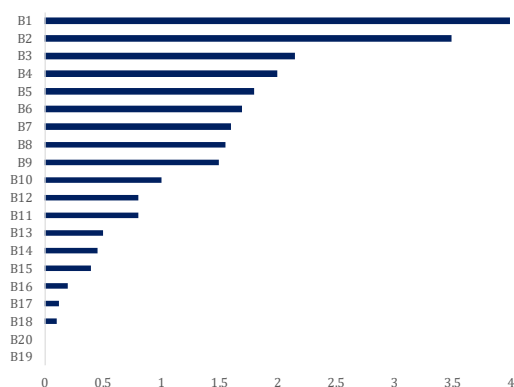
¹⁴ See European Commission on state aid report [here](#).

7.7 CCyB rates by country (%)



Source: ESRB

7.8 Estimated dividends suspended for selected euro area large banks (EURbn)



Source: Bloomberg estimates based on shares outstanding multiplied by next scheduled dividend payment

“Taken together, the euro area’s banks could postpone €30bn in dividend payments and around €57bn for all banks in Europe”

Recent initiatives

Financial regulators, supervisors, central banks and international bodies have issued several measures to help banks support funding to the real economy during the economic stress. Some of the most relevant measures and impact estimates are summarised in this section.

Capital buffers relief

The ECB will allow banks to operate temporarily below the level of capital defined by the Pillar 2 Guidance (P2G), the capital conservation buffer (CCB) and the LCR.

In the euro area, market reporting indicates a total of €120bn will be freed up for lending as a result of this measure¹⁵.

Reduction to zero in CCyB in most member states

In response to the COVID-19 pandemic, most of the national prudential authorities have cut to zero the local CCyB or reversed planned increases expected to be implemented in 2020. See chart 7.7.

According to S&P, the CCyB policy measures will free up capital for lending of €8bn in France, €5bn in Germany, €4.1 in Sweden, and €361mm in Bulgaria.

The CCyB seeks to encourage banks to accumulate capital when cyclical systemic risk is judged to be increasing and help smooth excessive credit growth during the upswing of the financial cycle.

Dividend payments postponement

The ECB and the BoE requested Euro Area and UK banks to stop their planned dividend distribution to preserve capital and support lending into the real economy in the current crisis.

According to market analysis¹⁶, taken together, the euro area’s banks could postpone €30bn in dividend payments and around €57bn for all banks in Europe¹⁷.

The regulatory request, however, further contributed to the YtD decline in European banks’ share prices.

Basel implementation postponed

The Basel committee announced on 27 March the deferral of Basel III implementation by one year to 1 January 2023, “to increase operational capacity of banks and supervisors to respond to COVID-19”. The accompanying transitional arrangements for the output floor have also been extended by one year to 1 January 2028.

At the European level, the European Commission welcomed the global deferral of Basel III implementation and is currently reassessing the policy timeline for 2020. The BoE and the HM Treasury also welcomed the deferral and “will continue to work towards a UK implementation timetable that is consistent with the one year delay”.

¹⁵ See FT estimates.

¹⁶ See FT and Bloomberg market reporting [here](#)

¹⁷ See market commentary [here](#).

8. AFME's approach to COVID-19

COVID-19 has had significant implications for AFME members globally with many having to focus resources on managing business continuity issues.

AFME is working together with our members and regulators to ensure that markets remain well-functioning and liquid in light of the market impact of COVID-19.

Over the past weeks, we have further strengthened our high-level engagement with senior policy makers in Europe, ensuring we are communicating on the wide set of policy issues our members are facing in the current environment. In close conjunction with members, we are assessing the implications of COVID-19 for firms' operations and priority areas for AFME. To date, our key focus has been on the following areas:

Contingency planning and compliance

We are assessing implications for members' contingency planning, including trading and compliance. This has included work on issues related to short selling, understanding EU-wide designation of employees as "essential workers", the transition to risk-free rates, the UK senior managers regime, IFRS 9 accounting policy and DAC6 Tax.

Markets/Regulatory implementation challenges

We are identifying challenges related to upcoming regulatory implementation deadlines.

We welcome the measures undertaken by European regulators with regards to the implementation of changes to the tick size regime, the first wave of reporting obligations under the Securities Finance Transactions Regulation, as well as the deferral of final implementation phases of the margin requirements for non-centrally cleared derivatives announced by the BCBS and IOSCO.

In early April, AFME approached the UK Pre-Emption Group (PEG) requesting the temporary relaxation of their guidelines relating to shareholder pre-emption in certain share issuances by listed companies. This would allow listed companies to issue up to 20% of their issued share capital on a non-pre-emptive basis under certain conditions. The PEG announced it would permit a temporary disapplication of the relevant pre-emption guidelines until 30 September 2020.

"AFME is assessing the implications of COVID-19 for firms contingency planning."

"An overview of key regulatory announcements and AFME public responses can be found on our COVID-19 web page which is regularly updated"

“On the AFME website we have also published our COVID-19 podcast updates on Markets, Compliance and Prudential areas.”

Consultation timelines

We welcome the extensions of consultation deadlines as announced by the European Commission and ESMA. The new consultation deadlines should be kept under review to ensure that participants are given sufficient time to provide robust and detailed responses.

Prudential Regulation/Supervision & Resolution

Our aim is to ensure that member firms are able to maintain their ability to serve clients and finance the economy. Our focus to date has been on utilising capital and liquidity buffers, the implications of national payments moratoria and forbearance provided to clients, the need to address MREL requirements, and review annual contributions to the Single Resolution Fund.

Securitisation

AFME is engaging with the EU authorities to explore further the potential of the EU framework for STS securitisation, and how it should be more widely recognised in liquidity and capital regulation so as to achieve the original ambition of a safe and vibrant securitisation market which can provide funding for the real economy and support the EU banking system, particularly during any post COVID-19 economic recovery. We are also engaging on specific COVID-19 issues affecting securitisation, including how central bank purchase and repo frameworks can be made more widely available and easier to access.

AFME will continue to assess the implications of COVID-19 for our members and to engage with authorities across Europe.

An overview of key regulatory announcements and AFME public responses can be found on our COVID-19 web page which is regularly updated.

On the AFME website we have also published our COVID-19 podcast updates on Markets, Compliance and Prudential areas.

Annex

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