Equity: the key to unlocking a sustainable economic recovery

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The Covid-19 pandemic has had tremendous effects on our societies. The loss of lives and the health crisis in general has been devastating.

Secondary to this, as societies closed down to limit the spread of the disease, economic activity ground to a halt. As a result, we may be facing the most severe economic crisis since the Great Depression. This crisis also creates an opportunity to revisit and improve economic policy and create a better and greener future for Europe.

Representing various actors in the financial system, **Accountancy Europe, CFA Institute, FESE and EBRD** firmly believe that capital markets can play a crucial part in mitigating some of the economic fall-out. Together, in 2019, they re-launched the European IPO Task Force , which in its report highlighted and promoted the need for more equity financing to support the European economy. In light of the present crisis, this is more urgent than ever.

During the crisis, markets experienced extreme volatility. In the critical days, equity markets stayed open to ensure orderly and well-functioning pricing of assets and provision of liquidity. Despite extreme trading conditions, Exchanges continued offering safety, integrity and fairness in the trading place. A significant increase in trading volumes was observed and trading volumes gravitated towards transparent Exchanges, whereas bilateral and less transparent venues were often unable to provide immediate executions. Equity markets worked seamlessly, while fixed-income markets (as during the financial crisis) very often proved to be very illiquid.

Various solutions for monetary and fiscal stimulus packages are being discussed at both European and national level. In the short-term, credit and liquidity enhancements will be important to support businesses that are struggling with a lack of liquidity due to a situation where the economy has been temporarily put on ice.

While the banking system can help ensure immediate liquidity, to stabilise and ensure a sustainable and solvent European economy, equity recapitalisation will be needed. Companies need to have available financing options to ensure employment and wealth creation in Europe.

RECOMMENDED MEASURES

- A revamped CMU which balances between private and public markets is a must.
- The proposed fund for EU IPOs should be pan-European and support both IPOs and secondary issuances, while contributing to relaunching IPOs.
- To re-equitise the economy, a concrete proposal for the fund through public/private partnerships should be drafted.
- The various stimulus packages should include specific bridge financing for viable SMEs/growth companies that were planning IPOs when the Covid crisis hit.
- Measures to address taxation issues:
  - Call on the EU and member states to address the existing debt-equity bias on taxation. This invariably will require measures to strengthen equity investments over measures that favour debt.
  - A pan-European framework for withholding taxes in order to foster cross-border investment.
  - To encourage and facilitate access to growth finance in the aftermath/recovery phase of the Covid crisis, a tax alleviation for companies that go public/do an IPO could be considered.
  - For the bridge financing and tax benefit proposals above, emphasis should be given to the E-part of ESG: green investments and fund raisings that are aligned with the green criteria of the EU taxonomy, as well as, the S-part of ESG: for companies that have made financial sacrifices in order to protect jobs.

Equity Markets are crucial to restore the solvency of companies, as:

- Listed companies can raise fresh equity capital via secondary offerings in the market;
- IPOs will continue to enable an important source of capital to innovative growth companies, despite challenging market conditions;
- European and national developmental banks and governments should provide equity participation to companies with a sustainable post-crisis business model that are experiencing solvency issues due to Covid-19.

The EU Capital Markets Union (CMU) should become the focal point for all efforts into recapitalising the European economy and ensuring EU citizens can participate in the economic returns from the rescue funds provided. There is currently a large amount of cash in the banking sector that bears no interest and, so far, has not been mobilised to finance the EU real economy. Policy makers need to mobilise attractive investment possibilities for EU end-investors into equity to rebuild the economy. Smaller entities and growth companies are disproportionately affected by the Covid crisis and need to be supported. We also believe that synergies between CMU, sustainable finance and SME financing agendas is the key to creating the long-term and green recovery that Europe's economy needs.

As part of President von der Leyen's strategy to help SMEs' access to finance, bridging the missing gap for SMEs, who are currently bank-financed, to ensure they are able to grow and be nurtured up to the IPO stage and beyond is vital. In support of this, a potential pan-European equity fund could be formed by the EU to attract cross-border investors. This fund will need to be truly pan-European and have an attractive set-up for institutional and retail investors.

The post-crisis world will be built upon the choices we make now. Therefore, we call for the following:

- A revamped CMU which balances between private and public markets is a must. CMU will also be key to implement the European Recovery Fund and build a sustainable and resilient EU economy;
- The proposed fund for EU IPOs should be pan-European and support both IPOs and secondary issuances, while contributing to relaunching IPOs;
- To re-equitize the economy, a concrete proposal for the fund through public/private partnerships should be drafted. For investors outside the EU this would provide them with an opportunity to get an EU wide perspective on their investment. We are ready to engage in further dialogue on this instrument to ensure its ultimate success;
- The various stimulus packages should include specific bridge financing for viable SMEs/growth companies that were planning IPOs when the Covid crisis hit. This bridge financing would help to finance their growth stage for the next few months and facilitate the relaunch of their IPOs. Once equity markets stabilise again, EU financing could possibly be maintained or partially converted into equity to provide stability in the uncertain times;
- EU institutions and Member States will need to sit down and address the elephant in the room – taxation. We recommend the following measures:
    - The COVID crisis has confirmed that highly leveraged companies are at higher risk of failure, and indeed were amongst the first ones to fail. We need a more diverse financing of companies in Europe and allow all companies, and in particular smaller businesses, to strengthen their balance sheets by reducing their reliance on external debts. Thus, we call on the EU and member states to address the existing debt-equity bias on taxation. This invariably will require measures to strengthen equity investments over measures that favour debt.
    - A pan-European framework for withholding taxes in order to foster cross-border investment.
    - To encourage and facilitate their access to growth finance in the aftermath/recovery phase of the Covid crisis, a tax alleviation for companies that go public/do an IPO could be considered. This tax arrangement should be limited to small issuers/SMEs/growth companies.

- For the bridge financing and tax benefit proposals above, emphasis should be given to the E-part of ESG: green investments and fund raisings that are aligned with the green criteria of the EU taxonomy, as well as, the S-part of ESG: for companies that have made financial sacrifices to protect jobs.

Investing in equity markets, and in particular in the smaller business section, carries risks for investors, for which they are normally rewarded higher returns. However, we believe that the measures outlined above will help to mitigate these risks as well as overall equity volatility caused by the COVID crisis. They will foster long-term and sustainable growth, and safeguard against excessive indebtedness of businesses. This could be stimulated by, amongst others, allowing investors to benefit from certain tax alleviations to offset some of that increased risk taking.

We strongly support an ambitious and innovative renewed CMU for investors and users and aim at significantly increasing equity financing. This will be key to creating an equity culture for both institutional and retail investors

More financing through equity markets helps achieve higher levels of growth and risk-sharing, diminishing systemic risk. In addition, securing the right equity market structure is key to avoid liquidity crises turning into solvency crises. Transparency in equity markets must be reinforced to allow robust liquidity and price formation.

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