Extension of the PEPP for solid companies

The Pandemic Emergency Purchase Program (PEPP) corporate securities

In March 2020, as a reaction to the Covid-19 pandemic, the European Central Bank (ECB) initiated the Pandemic Emergency Purchase Program (PEPP) of bonds of public and private debtors to counter the pandemic-induced risks for the monetary policy transmission mechanism and to improve the economic prospects of the Eurozone. In April 2020, the ECB also announced a package of temporary measures for loosening securities. Until the end of June 2021, the Eurosystem plans to purchase assets totaling 1,350 billion euros.

All assets may be acquired that are approved in the existing program for the purchase of assets (Asset Purchase Program, APP), this means covered bonds, asset-backed securities, public sector securities as well as corporate sector securities. Since March 2020, non-financial commercial papers are also eligible for purchases, in order to help companies to overcome short-term liquidity needs. The purchase of corporate sector securities is regulated in the Corporate Sector Purchase Program (CSPP), which was launched in June 2016.

Corporate bonds will be purchased from six national central banks of the Eurosystem, among them from the German Central Bank. The central banks may purchase on the primary market – in case of a reissue – as well as on the secondary market. The duration must be between six months and 30 years, for commercial papers at least 28 days and must exhibit a sufficient credit rating. This includes all ratings within the range of “investment grade”. The corporate bonds may be admitted for trading in an accepted market (e.g. the STEP market, listing on a regulated or another accepted market like the German “Freiverkehr”).

In the past five years, the circulation volume of domestic corporate securities has increased by 50 percent to 368 billion euros. This growth underlines the meaning of corporate bonds for the funding of the corporate sector.

Increased Refinancing Requirement – and Costs due to Corona

Corporate bonds from all industries have been devalued by leading rating agencies due to the Covid-19 pandemic, among them also medium-sized and larger automotive suppliers, which are responsible for around 75 percent of the added value of a car and employ more than 1.3 million people in the EU.

Many corporate securities, which at the end of 2019 were still rated “investment grade”, have been downgraded to “sub investment grade” since the outbreak of the pandemic in the beginning of 2020 (“Fallen Angels”). From now on, these corporate securities automatically drop out of the PEPP, liquidity of the companies decline, and their costs increase. Additionally, many companies think about a rating to face prospective challenges and to finance themselves on the capital market. During the current period, during which companies have been impacted severely by the crisis and in the case of the automotive industry must also finance an unprecedented transformation, there must not be further restrictions but rather appropriate regulation to support liquidity and companies’ access to the capital market.

Moreover, an intercontinental imbalance in supporting the economy is at work and further exacerbates international competition. Effective April 9th, 2020, the Federal Reserve System (FED) has modified the terms for local purchasing bonds programs. Since then, bonds from “sub investment grade"-issuers with a rating up to Ba3/BB- may be purchased, provided these were rated at least Baa3/BB- before. This new regulation had an immediate effect on the stock exchange listing of the pending USD-bonds, and it facilitates the financing of locally traded corporate bonds.

Representatives of European companies demand that the consequences of the pandemic are reduced with regards to monetary policy and that an international level playing field must be created. Therefore, the PEPP should be modified as follows:

1. If available, the rating on the reporting date December 31st, 2019 should serve as the basis.

2. Solidly rated companies with recent ratings up to Ba3/BB- should be included in the purchasing program.

Regarding non-financial commercial paper purchased under the CSPP, the "accepted market" requirement should be dropped, as a listing does not reflect German common market practice and investor demand for corporate commercial papers, while causing unnecessary costs.

Berlin, November 10th, 2020,

Supporter:

VDA | Verband der Automobilindustrie

Deutsches Aktieninstitut