COVID-19 Update: Government responses

Executive Summary

- **Government responses to the Coronavirus have been swift and ample.** However, support measures announced to date are not coordinated and **vary from country to country.**
- The market does not have an immediate unified view of the situation or understanding when companies will be able to access these measures or for how long.
- **Pemberton is using their local presence in Europe to analyse the government responses through a local lens** and provide a comprehensive picture.
- **Our assessment shows broadly a timely** and adequate reaction to the immediate needs of companies in the mid-market segment with certain exceptions – in particular, the **UK's response is failing to address the area of mid-market companies.**
- **Regulators are stepping in** to provide some relief and we believe that **direct lenders have an important role in helping companies to meet short-term liquidity needs.**
- We are in **active dialogue with our portfolio companies about liquidity needs** and assessing the appropriate liquidity solution for each respective borrower.

Overall a set of timely and adequate measures

- **The packages announced by the national governments in the major European economies** we have analysed are **timely and deal with most of the main, immediate issues facing companies.**
- Governments have announced a package of measures that cover the following areas:
  - **Tax and social security deferral,**
  - **Loans and guarantees,**
  - **Employment and income support.**
- Many of these are **pre-existing programmes extended** or **made more flexible to meet the current challenge,** e.g. short-time working schemes in Continental Europe such as Kurzarbeit in Germany.
- While there are **differences of detail and emphasis** between different countries, we consider these packages to be **generally comprehensive and timely in meeting the immediate needs of companies,** particularly the **mid-market segment served by Pemberton** and other direct lenders.
- We will need to examine **how quickly these packages are implemented and the money promised reaches portfolio companies.**

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ANALYSIS AND KEY TAKE-AWAYS

Has the UK mid-market been left out?

- There are several areas where more could be done to help the mid-market. Perhaps the most notable of these is in the UK.
- There is support for investment-grade companies through the Bank of England's commercial paper purchase programme, and for SMEs through an existing loan guarantee scheme that has been extended. However, as of March 27 the UK's mid-market companies earning annual revenues in excess of £45m were missing out.
- There is a notable contrast with, for example, Germany and the KfW-backed loan guarantee programme, which is open to all companies. Although the British Treasury, Bank of England and Financial Conduct Authority issued a joint letter on March 25 urging lenders to support companies that fall outside the scope of both schemes, the government has yet to put forward a more tangible proposal to address this policy gap.
- This is important because the mid-market segment of the UK economy employs 7.6 million people, compared to 6.9 million employed by the FTSE 350. It is also a segment where direct lenders are most involved, accounting for perhaps two-thirds of their provision of acquisition finance in the UK. For many mid-market companies their "bank" is a direct lender.

Insolvency rules are being temporarily suspended

- Among the headline-grabbing measures announced so far, there are notable amendments to laws regarding insolvencies and defaults that are of importance to mid-market companies and direct lending investors.
- In Germany, lender-liability and equitable subordination risks have been abolished on recently issued loans, facilitating the provision of new capital. Furthermore, the duty of directors to file for insolvency has been temporarily suspended and a moratorium imposed on creditor-initiated insolvency petitions.
- Similar laws have been passed elsewhere, including in the UK where the government has announced a three-month suspension of the wrongful trading rules to keep otherwise healthy businesses from being forced to file for insolvency.
- In Spain, the requirement of debtors to file has been suspended while the national state of emergency is in effect, and creditor-initiated petitions for compulsory liquidation will not be allowed until two months after its end.
- In France, the Ministry of Justice issued a notice stating no insolvency proceedings should be opened for the time being, though this is partly due to the courts' currently limited availability.
- In addition, in late March the European Banking Authority clarified that the general deferral of loan payments would not automatically classify a loan as defaulted or that its credit risk significantly increased. This allows institutions to support such companies through the pandemic without the increased capital charge of a defaulted asset on their books.

Can direct lenders help meet the short-term lack of liquidity?

- We believe that there may be potential opportunities for direct lenders to help Europe's mid-market survive the liquidity constraints looming in the next few months.
- Many of the measures announced are specifically intended to help corporate liquidity - deferring taxes, paying most of employees' salaries, and suspending social security contributions. However, companies may need additional, short-term help while they are waiting for new loans guaranteed by KfW (Germany), BPI (France), CDP (Italy) etc. to flow.
- Private lending is generally well placed to help mid-market companies given that it offers locked-up, long-term capital and employs structures to make lending decisions swiftly. Clearly direct lenders cannot do this at subsidised interest rates given the return expectations of our investors.
- However, we believe that there may be opportunities to put our capital to work and help companies survive until the full force of these government programmes are felt, or more normal financial conditions return.

How are Pemberton and Pemberton's portfolio companies addressing the need for liquidity?

- As the primary/sole lender, we are in active dialogue with our portfolio companies around their liquidity needs and the potential for state aid. There will be no "one size fits all" approach and we are carefully analysing each situation to come to the appropriate liquidity solution for each respective borrower.
- We have a range of strategies that offer solutions for borrowers during these crucial times – from senior through to subordinated/mezzanine financings.
- In coordination with our peers, we are discussing with the government ways to support mid-market companies in the UK.

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OVERVIEW OF PUBLIC SUPPORT MEASURES

	UK	France	Germany
Tax	• Deferral of VAT payments for businesses and income tax payments for self-employed workers • Business rates holiday for companies in the retail, hospitality and leisure sectors and nurseries	• Deferral of social contribution payments • No-penalty extensions on certain VAT, corporate & local taxes • Selective tax and social security charge rebates	• Deferral of income and corporate tax payments, reduction of tax prepayments, and suspension of enforcement measures and penalties • Other accommodative measures for VAT, insurance, energy and air traffic taxes
Loans & Guarantees	• BBB[1] existing guarantee scheme for SMEs extended to provide 80% guarantees on loans up to £5m and to cover fees and interests payable in first 12 months • Bank of England facility committed to purchasing investment-grade commercial paper at rates prevailing in the market before the crisis • Bank of England to extend 4-year funding to selected lenders priced at or close to Bank Rate • Countercyclical capital buffer reduced from 1% to 0%	• Various support measures by BPI[2] France including 3-7-year loans to SMEs with 12-month deferred capital amortisation, 90% guarantees on new loans and overdrafts • Private sector banks undertaking to offer 1-5-year loans starting at 25 bps margin, up to an amount equivalent to 3 months of turnover with guarantee from French state between 70% and 90%	• KfW[3] existing loan program extended with state commitment to provide unlimited additional support • Maximum loan size increased from €25m to €1bn and guarantee increased from 50% to 80% for large corporates and 90% for SMEs • Pricing fixed in 1-1.46% range for SMEs and 2-2.14% range for large corporates instead of being market-driven • Economy Stabilisation Fund put in place to provide up to €500bn of loans and guarantees to large and mid-sized corporates
Employment & Income Support	• State to cover 80% of salary of furloughed workers and 80% of trading profits of self-employed workers affected by Covid-19, up to £2,500 per month • SMEs can reclaim up to 2 weeks of statutory sick pay per employee • One-off £10,000 - £25,000 grants per property made available to eligible SMEs and companies in the retail, hospitality and leisure sectors	• Companies who place staff on temporary leave may reduce their salaries to 70% and state will reimburse up to 4.5x minimum wage. Affected employees will receive 84% of net prior salary. • Solidarity fund for independent business owners forced to shut down	• Employees placed on short-work arrangements in companies where at least 10% of workforce is affected by loss of work will see 60% of net pay difference covered by the state (67% if support a child)
Others	• Some lenders have offered 3-month mortgage holidays • Residential and commercial tenants protected from eviction proceedings or lease forfeiture for at least 3 months • Suspension of wrongful trading law to minimize risk of premature insolvency proceedings • Temporary 6-month suspension of National Rail Franchises to ensure continuity of service	• Suspension of rent and utility bills for vulnerable SMEs • Banks have undertaken to defer by up to 6 months the repayment of loans or interest payments and to waive penalties on maturity extensions • Banque de France to support borrowers in negotiating a rescheduling of their loans	• Insolvency regime adapted to facilitate restructurings by relieving pressure on management to file for insolvency • Elimination of equitable subordination risk, claw-back rights, and lender liability for all new loans extended until Sep-20 • Commercial tenants temporarily protected from lease termination due to missed payments

[1]BBB: British Business Bank, British state-controlled bank, [2]BPI: Banque publique d'investissement, French state-controlled bank,
[3]KfW: German state-controlled bank.
Please note that this information has been sourced from local government websites.

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OVERVIEW OF PUBLIC SUPPORT MEASURES

	Netherlands	Italy	Spain
Tax	• Deferral of VAT, income, corporate and wage taxes and suspension of late payment penalties	• Temporary suspension of social security contributions • Deferral of tax collection and controls • Tax-based incentives to encourage corporates to sell impaired receivables	• Deferral of tax processes and payments
Loans & Guarantees	• Extension of existing guarantee scheme for large corporates, increasing available amount from €400m to €1.5bn and max loan size from €50m to €150m • Extension of existing guarantee scheme for SMEs to increase cover from 50% to 75% of eligible companies' financing needs • Guarantees for bridge loans of up to €1.2m in agricultural sector • Lowered regulatory capital requirements to free €8bn of bank capital	• CDP[4] to provide up to 80% guarantees on bank loans to corporates • Central Guarantee Fund to provide guarantees on SME loans • Freeze on revocation of SME credit facilities and loans and deferral of all loan instalments and rental payments due before Sep-20	• ICO[5] to provide loan guarantees for companies and self-employed workers covering renewals and new financings • Funding provided to Spanish export credit agency to shore up liquidity of exporters • Loans made available to SMEs to buy equipment necessary to enable employees to work from home
Employment & Income Support	• Companies affected by a 20% or more reduction in turnover can apply for a compensation of up to 90% of labour costs (based on the updated regulation initiative NOW) • Varying with the extent of turnover loss, the government will provide an advance payment of 80% of the requested amount of compensation for the company to be able to continue the payments to their workers (up to an employee's individual salary of €9,538 per month)	• Extraordinary unemployment benefits for employees of companies with reduced work • Self-employed workers granted access to National Solidarity Fund to support home mortgage payments • One-off tax-free contribution of €600 to freelance, seasonal and entertainment sector workers	• Special state benefit for self-employed workers who suffer from a loss of income • Employers exempt from paying 75% of social contributions for workers on temporary lay-offs or short-work arrangements
Others	• Some banks have offered 6-month repayment extensions on loans up to €50m • Compensation scheme under review for industries affected by governmental measures (i.e. aviation, hospitality, leisure)	• Financial contribution to enterprises to purchase personal protective equipment for workers • Damage compensation to the aviation and cruise sector • Export credit agency support to boost exports	• Utility suppliers prevented from cutting electricity, gas or water of vulnerable customers • Vulnerable customers may be eligible for a deferral of principal or interest payments on mortgages • Controls imposed on foreign direct investments involving the purchase of significant control of a company • Debtors are not required to file for insolvency while the state of emergency is in effect, and creditor-initiated filing not allowed until 2 months after its end

[4]CDP: Cassa Depositi e Prestiti, Italian state-controlled bank, [5]ICO: Instituto de Credito Oficial, Spanish state-controlled bank.
Please note that this information has been sourced from local government websites.

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APPENDIX

Country notes: UK

- Some of the measures announced in the UK help companies big and small e.g. the employment support programme covering 80% of furloughed employees' salaries up to a set limit. But in other areas there seems to be a gap that affects mid-market companies.
- There is support for investment-grade companies through the Bank of England's commercial paper purchase programme, and for SMEs through an existing loan guarantee scheme that has been extended. However, as of March 27 the UK's mid-market companies earning annual revenues in excess of £45m were missing out. There is a notable contrast with, for example, Germany and the KfW-backed loan guarantee programme, which is open to all companies.
- Although the British Treasury, Bank of England and Financial Conduct Authority issued a joint letter on March 25 urging lenders to support companies that fall outside the scope of both schemes, the government has yet to put forward a more tangible proposal to address this policy gap. This is important because the mid-market segment of the economy employs 7.6 million people, compared to 6.9 million employed by the FTSE 350. It is also a segment where direct lenders are most involved, accounting for perhaps two-thirds of acquisition finance in the UK. For many mid-market companies their "bank" is a direct lender.
- There is also an issue about how efficiently banks will be able to provide additional liquidity to mid-market corporates. Many have hollowed out their lending teams for that segment, and their lending process takes time in normal conditions. So the government measures announced will help to maintain corporate liquidity e.g. by deferring tax payments and reducing salary costs, but is there a role for direct lenders in channelling the additional liquidity that corporates will need?

Country notes: France

- The package of measures announced so far is strong and well-designed to help French mid-market companies. Speaking to our portfolio companies, we would say that it has been well received - a combination of tax and social relief, employment support and financial help. We do not see obvious big gaps.
- The employment support around temporary lay-offs (chomage partiel) is not new, but it has been made much more flexible, meaning that many more companies can apply for it. It also seems that the delay in companies being reimbursed by the State will be reduced. Already a huge number of companies are going to benefit – an estimated 150,000 companies and 1.6 million by March 27.
- The loan guarantee programme sees BPI France return to its roots. The public investment bank was set up in the Financial Crisis to support the economy and will now be guaranteeing bank lines of credit to ensure corporate liquidity.
- A big issue is how fast companies will be able to access this money. It is possible that direct lenders, with their flexibility and speed of response, could step in to provide short-term liquidity in coming months until money from the government scheme begins to flow.
- An interesting anecdotal change is the decision to suspend the rules on working hours in some sectors, allowing workers to have a working week longer than the statutory 35 hours. This is a practical consequence of strategic businesses having to increase capacities, notably in the food and healthcare sectors.
- Unlike in Germany, there has not been a change in the treatment of insolvencies, although we might expect to see greater flexibility there in the future.

APPENDIX

Country notes: Germany

- Overall the measures announced by the German government in response to the coronavirus crisis look to be sufficient for what the mid-market companies in Germany need. Highlights include tax deferral, access to liquidity, an ability to avoid short-term layoffs, and flexibility to avoid unnecessary insolvencies.
- Some of the measures introduced are well tried and tested in Germany e.g. the use of KfW (government agency) guarantees for bank loans, and short-time working (Kurzarbeit).
- The KfW programme is an extended and improved version of what has gone before. The percentage of the loan covered by the guarantee is larger, but the lending is still via a company's house bank. One issue here, however, is whether the approval process by the house bank will be fast enough to provide the liquidity that companies need.
- Could direct lenders have a role to play? Private debt is generally well placed to help mid-market companies given that it offers locked-up, long-term capital and the structures to make lending decisions swiftly. However, of course this cannot be done at subsidised interest rates given the return expectations of investors.
- Similarly short-time working schemes are a well-established part of German corporate life. This is a contrast with the situation in the UK, where the UK government's recently announced scheme to subsidise companies keeping workers on the payroll is new territory.
- In other areas, the response to the coronavirus crisis has already introduced something new in Germany. Previously, when lenders were considering providing additional loans to a company during a liquidity squeeze, they faced lender-liability issues and the risk of equitable subordination of the loans they had already extended. That has been abolished. Where the response package is introducing new concepts like this, it will be interesting to see whether these are short-lived or they become a permanent part of the corporate scene in Germany.

Country notes: Netherlands

- Overall, the Netherlands has introduced an adequate, timely programme, although some aspects of it have not been communicated very clearly e.g. whether there is a salary cap for the employment support measures. However, it is a sector-agnostic approach that aims to help a wide range of companies, including the mid-market where direct lenders operate.
- Many of these measures have existed since the Financial Crisis, but they have been expanded or made more flexible to cope with the current crisis e.g. the short-time working measures. Similarly, the loan guarantee scheme already existed but during the Financial Crisis it only applied to new lending, which proved to be a problem in cases that involved restructuring.
- It is likely that we will see further measures in areas such as insolvency to help companies get through what will hopefully be a temporary downturn.
- In many areas the measures adopted across Europe are very similar, but there are notable differences e.g. so far Dutch SMEs have not been offered cash grants as they have in the UK.
- In terms of the potential for direct lending to meet companies' needs, under the Dutch scheme banks cannot use state-aided tools to boost their competitive position, which means that they will be focussing on existing borrowers. That could leave scope for direct lenders to meet new borrowers' needs.

APPENDIX

Country notes: Italy

- So far the programme of government help has focused on SMEs – typically companies with a turnover of < €50m and under 250 employees. These will benefit from a package of measures, principally the deferral of tax, temporary suspension of loan instalments, and protection against banks withdrawing lines of credit.
- We are expecting more measures to help larger companies (such as Pemberton borrowers) during w/c March 30, but there have already been two important initiatives:
  - State financial institution CDP will be guaranteeing new loans - previously such support was targeted to a very limited number of sectors.
  - The scheme that allows temporary layoffs (Cassa Integrazione) has been vastly expanded.
- Certain sectors that have been particularly hit e.g. aviation and cruise ships, are getting additional help, as are exporters through export credit agency SACE, which is also getting extra funds.
- While France has seen flexibility in the working time directive to allow longer working hours, in Italy the move has been in the other direction to allow reduced hours for workers, and there have not been any changes to the laws on insolvencies, in contrast with Germany.
- It is early to say what role direct lending can play in supporting Italian mid-market companies through and after this crisis. There will be an increased demand for credit, but even with this package will the banks be able to meet the demand, and how quickly? There will undoubtedly be opportunities but, given that Italy is one of the economies most affected by the coronavirus crisis, direct lenders will be selective and focus on transactions with compelling risk/return profiles.

Country notes: Spain

- Portfolio companies that have to shut down stores or factories are already taking advantage of the programme for temporary lay-offs (ERTE) under which employers will be exempt from paying 75% of employers' social security contributions. As in some other countries, the ERTE system existed already but it has been speeded up and adapted to face the current challenge.
- The €100Bn programme of loan guarantees is new, and there is extra money for financial agency ICO to guarantee credit and loans to businesses. The first €20Bn tranche has already been approved and is expected to be made available to local financial institutions during the first week of April. Consecutive instalments will follow suit with high demand expected.
- We should expect to see further grants of money as well as deferral of payment as lockdown is extended and unemployment mounts. Sectors like real estate, construction, hospitality and tourism are central to the Spanish economy, and there has already been a big spike in unemployment over the last week (w/c March 23).
- We are seeing flexing in the terms of insolvency, with the time periods set for companies to restructure themselves being waived. At one level this is purely practical – the courts are closed and likely to stay that way for some time.
- As in other countries, Spanish companies will get access to some lending programmes, but there are questions about how long it will take for them to receive that money. Will banks focus on existing customers, and how closely will they keep to their traditional requirements for business plans? In this environment, there may well be potential for direct lenders to plug the gap in the short term.

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DISCLAIMER

These are just a few thoughts based on our view of the market.

We'd love to hear your opinions. So please feel free to contact our Business Development team on businessdevelopment@pembertonam.com or +44 (0) 20 7993 9300 with any questions or comments.

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