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CAPTURE NEXT WAVE OF GROWTH IN BANKING : A POST COVID-19 ROADMAP

An Infosys Consulting Perspective

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INTRODUCTION

The COVID-19 outbreak and subsequent lockdown and travel restrictions have already caused significant impact to the global economy, with stock prices tumbling across indices and exchanges.

Banks have been affected in varying degrees; for example, those with exposure to the worst hit industries (travel, retail, manufacturing etc.) have been impacted more than those with exposure in consumer goods and healthcare.

Right now, there is an expectation to return to economic growth over the next two to three quarters thanks to economic stimulus, China's revival and learnings from current pandemic responses. However, the pace of the economy will depend on multiple factors, including restoration of global supply chains, effectiveness of the lockdown and speed of medical advancements.

With so many variable factors, banks will need to not only address their immediate needs, but also maintain enough flexibility to drive growth through both an economic downturn and the eventual recovery.

This paper looks at the impacts of COVID-19 on the financial sector, as well as outlining the key remedial actions that banks should take in the short, medium and long-term in order to survive.

COVID-19 Global Impact

The health crisis created by COVID-19 has seen widespread economic impact across the world.

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Normal economic activity has been disrupted on an unprecedented scale in peacetime, as the patterns of everyday life are upended. Governments are intervening to try to stave off the collapse of companies and livelihoods, and most economists are predicting a major recession. There are three key factors contributing towards the severity of the global impact:

1) Reduced economic activity

Not even during the second world war did the bulk of economic activity literally shut down as it has in China, the US and Europe today. Lockdowns and travel restrictions have impacted multiple sectors, and the International Monetary Fund (IMF) has warned that the world faces its worst recession since the Great Depression of the 1930s.

2) Rising job losses

The International Labor Organization (ILO) has predicted that the pandemic could cause the equivalent of 195 million job losses. The four hardest hit sectors, according to the ILO's report, are accommodation and food services, manufacturing, retail and business services, and administrative activities. [1]

3) Stock market decline

Dow Jones Industrial Average, FTSE, and the Nikkei have all seen huge falls since the outbreak began on 31 December 2019. Dow, FTSE and Nikkei declined 24.1%, -28.8% and -22.2% respectively in March 2020 period. However, several important factors, including long-term market psychology and smart investor behavior, suggest that this bear market has not yet seen its low point. [2]

External Factors vs Systemic Risk

Despite the magnitude and speed of collapse in activity, there are indications that banks are better prepared for the current economic crisis than they were during the 2008 recession.

> The 2020 economic downturn is due to external factors rather than inherent systemic risks within banks, and, as a result, they may be able to weather the storm.

Pandemics are inherently temporary events that do not cause long-term structural damage to productive capacity. This means that the 2020 economic downturn is due to external factors rather than inherent systemic risks within banks, and, as a result, they may be able to weather the storm and ride out the impending slump. That said, the current economic conditions are putting increased pressure on banks across all these dimensions.

Capital adequacy

The capital adequacy ratio of the banks was just 9.7% during the 2008 crisis. This has a seen a steady increase over the decade and is at a much higher value of around 13%. Furthermore, the liquidity ratio has witnessed a significant upward trend post the initial recovery of 2008 and stands at nearly 36%.

Bank structure

Banks have improved on their asset quality since 2008 and, at present, appear to be in a much better shape. NPAs have been on a declining trend since 2010 with being almost at par with prior to 2008 value.

Regulations

Following the 2008 recession, the US introduced Dodd Frank Act to promote financial stability in the system by bringing in more accountability and transparency in the entire financial sector. The Act required banks with an asset base greater than $250 billion to conduct annual stress tests, aiding in undertaking course correction measures for safeguarding the banks.

A return to growth?

Policymakers are also playing their part. In the US, the CARES Act has authorized businesses more than $2 trillion to battle COVID-19 and its economic effects on individuals. The European Commission has approved a £50 billion (approximately €57 billion) umbrella UK scheme to support small and medium-sized enterprises and large corporates affected by the coronavirus outbreak.

With the unprecedented stimulus from global policymakers, experiences from past epidemics, China's ability to counter the pandemic and the steps being taken by countries to contain the spread, economists believe there is good probability of economic revival within next two to three quarters.

Bank Exposure Varying by Industry

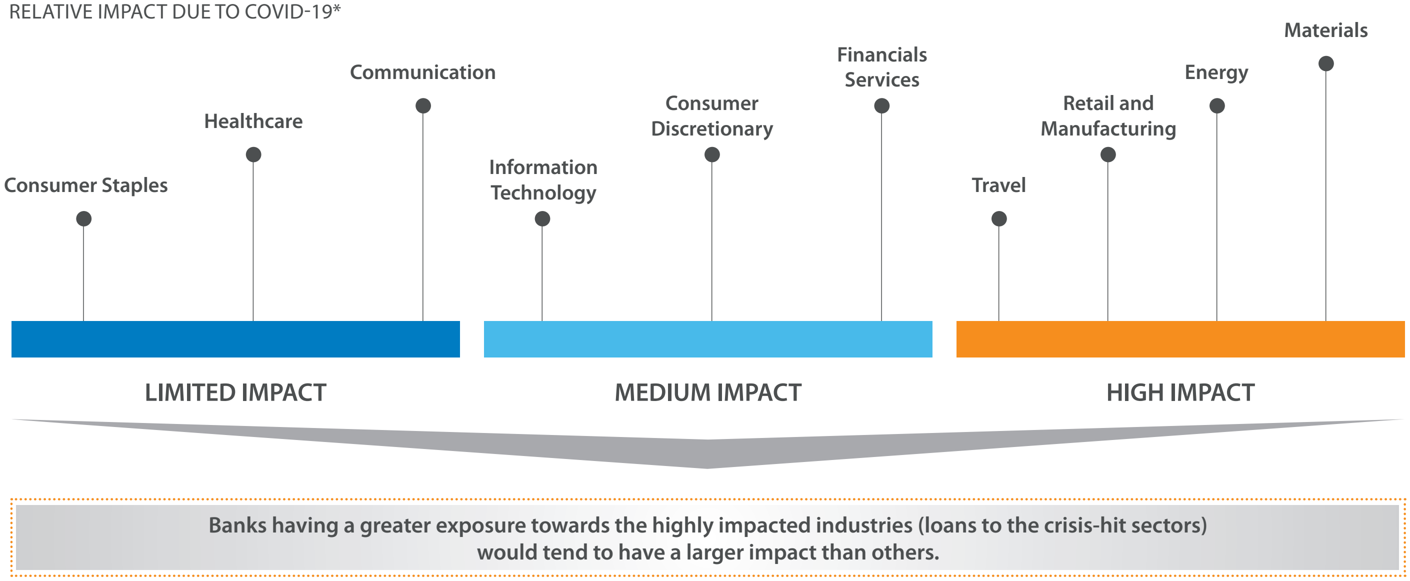
Despite the positive expectation of return to growth within the next two to three quarters, not all banks will face the same challenges from COVID-19.

The sudden onset of the nationwide lockdown, with no time to prepare, will likely trigger a wave of business failures and loan delinquencies that have a snowball effect on lenders. Those with a greater exposure towards the highly impacted industries (loans to the crisis-hit sectors) will undoubtedly be hit hardest. Figure 1 demonstrates the relative impact on banks due to the current pandemic. [3]

In addition, there are other factors that will impact the speed of recovery of banks.

Industries have seen varying levels of impact and banks with exposure to specific industries have been impacted disproportionately

RELATIVE IMPACT DUE TO COVID-19*



*Source: Dow Jones Feb-Mar Performance, Infosys Analysis

Digital maturity

Banks with multi-channel onboarding and servicing capabilities are better placed than those with significant dependence on offline processes. Banks with branch presence, especially in severely hit areas, will be impacted more in terms of reduced loan offtake and reduced customer service.

Type of risk products

Banks engaged in collateral backed lending will face less impact on their profits than those engaged in unsecured lending.

Diversification of revenue streams

In the US, the net interest margins of banks are under pressure due to the 150-bps rate cut by the Federal Reserve System. Diversified revenue streams will help banks protect their topline.

Geographical exposure

Since the pandemic has hit all continents, global banks are expected to feel the brunt of the disruption.

Roadmap for Success

Given the scale and the magnitude of the slowdown, banks need to take measures across multiple dimensions while navigating this journey.

Due to the changing nature of the pandemic and the global economy, each bank will have its own challenges and successes over the coming months. We have identified three key initiatives that banks can take to navigate the short, mid and long-term effects of COVID-19.

A. Engage clients and enhance value:

Address immediate financial needs, streamline and automate processes, and enhance product and digital capabilities.

B. Strengthen workforce and internal operations:

Leverage AI, automation, digital and cloud capabilities to build flexibility and resilience.

C. Ensure financial stability:

Take measures to address liquidity, capital adequacy and risks.

A Banks need to support and enhance the value proposition to clients

IMPACT AREA	IMPACT FROM COVID-19	INITIATIVES
FINANCIAL NEEDS	Customers facing **financial difficulties** may find it difficult to make payments on time	! **Proactively reach-out and support customers** impacted by the economic downturn helping them model and customize hardship offers
	Customers will **need help from banks** to rebuild their life and business	! **Assess the sector & regions being impacted** the most, extend temporary help and support to the clients, examine the loss provisions under loans
CUSTOMER ONBOARDING & SERVICING	**Longer onboarding times** due to closure of bank branches and overwhelemed call centers	**Automate the end-to-end digital lifecycle,** by enabling straight through processing of applications and real time decisioning to reduce call volumes
	Reduced availability of the field sales teams for customer support & service	**Enhance omni channel digital experience** to reduce dependence on the physical infrastructure (branches, field sales, etc.)
PAYMENT OPTIONS	Increase in **online purchases** compared to physical stores	**Review existing and enhance customer value proposition** by envisioning curated products and solutions
MARKET PLACE	With decrease in overall business activity, sellers will find it **difficult to attract buyers**	**Enable businesses to sell** in this environment by hosting a marketplace by bringing buyers and sellers together

! Act **Immediately** | **Accelerate** Ongoing Projects | **Ideate** on New Initiatives

B Banks need to align and sustain changes to internal operations to ride out COVID-19 and beyond

IMPACT AREA	IMPACT FROM COVID-19	INITIATIVES
MARKETING	**Messaging needs to be altered** to meet the changing requirements	! **Refine the marketing messages** to address the need of the clients impacted by COVID-19 situation
CUSTOMER SERVICING	Increased **call wait time** due to surge in call volume to customer service	! **Automate digital servicing experience.** For e.g. implement conversational chatbots, self-service options, customer training measures, etc.
COLLECTIONS	Increase in delinquencies and loan defaults due to **job losses and reduced business**	! Reimagine **credit and collection** processes to proactively identify loans that can turn delinquent and implement remedial measures
PROFITABILITY	Banks will have **fewer avenues to sell their products** as clients would be less inclined to start any new ventures	! **Assess risk & profitability to existing products and segments** and align product value and pricing accordingly
COST AND SCALE OF OPERATIONS	Increase in **operational cost** in short-term as banks are responding to COVID-19 situation	! **Review cost heads** and identify opportunities to streamline processes, technology and resources
	Surge in **business demand** as the economy is reviving after COVID-19 situation subsides	Plan for **long term flexibility** and ensure the necessary capabilities will be in place to cater to the increase in demand leveraging cloud capabilities
GOVERNANCE	Disruptive nature of the market situation calls for **crisis management**	! **Establish crisis response team** and create/revisit roles to handle governance of initiatives to manage the crisis
BCP	Businesses and revenues are **affected** despite the presence of BCP plan in many cases	**Review** current **BCP plan** and **re-baseline** to make it more suitable to post COVID-19 situation

B Banks should prepare for workplace changes that will sustain in the long run

IMPACT AREA	IMPACT FROM COVID-19	INITIATIVES
COLLABORATION	Employees **not able work from office** due to branch and office closures, illness and lockdown	Act Immediately: **Enable employee flexibility** through work-from-home, tele-commuting and video-conferencing options
COLLABORATION	Companies may **allow employees to continue to work remote** as the COVID-19 situation eases	Ideate: Enable **long term sustainability** for distant collaboration
PRODUCTIVITY	**Reduce dependency** on company issued devices to improve employee efficiency	Accelerate: Enable **secure anywhere, any device** access by ensuring strong virtual protection for identity, device, data, apps and email
PRODUCTIVITY	Increase in remote work would warrant new ways to **track employee efficiency and productivity**	Ideate: Establish new metrics to **measure efficiency and productivity** of the tele-commutinag employees
ENGAGEMENT	Increased **stress and anxiety** levels due to lockdown and remote working	Act Immediately: Support employees through **constant communication and employee engagement**
EMPLOYEE SERVICE	**Consumer-grade experiences** for employee service will become an inevitable eventuality	Ideate: **Reimagine and design experiences** based on each employee's motivations, psychological traits and context
EMPLOYEE SERVICE	Increase in pressure on support teams as remote workers accessing existing and new systems at **unusual times**	Ideate: Enable **intelligent self-service,** for employees, to drive service capacity higher and cost per service-request lower

Act **Immediately** | **Accelerate** Ongoing Projects | **Ideate** on New Initiatives

C In addition, Banks need to take measures to address liquidity, capital adequacy and improve risk management

IMPACT AREA	IMPACT FROM COVID-19	INITIATIVES
LIQUIDITY MANAGEMENT	The repayment of assets might be **sluggish** but consumers would want to withdraw their deposits This possesses a **higher probability** of a liquidity crunch	Accelerate: Closely **monitor and review the daily liquidity stress testing** reporting, limit/threshold. Analyze impact of the stress testing results.
CAPITAL MANAGEMENT	Risk Weighted Assets (RWA) may be **impacted** with increase in volatility and higher counterparty risks Greater exposure to products with higher RWA would tend to have a **larger impact**	Accelerate: **Revisit and recalculate valuation of the assets** Additional **stress tests with scenarios related to impact of COVID-19** can be added while calculating risk associated with an asset
RISK ASSESSMENT	A dip in the interest rates accompanied by the current volatility in the market may expose banks to the **market, credit and operational** risks eventually leading to losses	Act Immediately: **Revisit the internal models capturing market risk** and account for potentially higher correlation **Assess Credit Risk Models** based on changing market and customer profiles **Evaluate and Monitor Operational Risk** aspects like fraud, business continuity management and information security
REGULATORY COMPLIANCE	With the **CARES Act** and other measures being undertaken, banks would be required to comply to new regulatory requirements in addition to the present standards	Act Immediately: **Review the impact** and **prepare for compliance** to the new regulatory standards, reporting requirements etc.

Conclusion

Looking to the Future

It won't be an easy journey to recovery post-COVID-19. Policymakers are providing unprecedented support to households, firms and financial markets, and, while this is crucial for a strong resurgence, there is considerable uncertainty about what the economic landscape will look like when we emerge from lockdown.

However, due to the temporary nature of the pandemic and lack of inherent systemic risk, banks are likely to be able to ride out the disruption to their operations. To do this, they must take initiatives across multiple dimensions to mitigate their risk and emerge stronger in the post COVID-19 world.

By engaging clients and enhancing their value proposition, strengthening workforce and internal operations, and taking measures to ensure financial stability, banks can drive growth through both an economic downturn and the eventual recovery.

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