EY/OMFIF Covid measures transmission podcast and transcript

Welcome to this discussion with EY on the economic response measures to the Covid crisis. We are looking at transmission mechanisms, specifically via the commercial banking sector. How are banks dealing with the government supported lending they have been asked to do? Beneath the headline numbers is a mass of new credit work to process, for example. Where have we seen difficulties and how have they been remedied? What are the success stories so far and what will be the long-term impact on their business models? Joining us to discuss this is Jan Bellens, global banking and capital markets sector leader at EY, who has been working with bank executive teams for 20 years.

JO: Jan, please let us know what your role means on a day to day basis?

JB: Well, like many of you I’m spending my days on long conference and video calls, staying in touch with our clients, discussing their priorities and then connecting our teams across the different service lines that we offer with our clients, such as assurance, tax, transaction services, and consulting.

JO: How you feel the banking sector is handling the Covid crisis and how does it compare to the financial crisis we had a decade ago?

JB: I think this is a very different crisis from a decade ago. This is really a global health crisis. The previous crisis was mostly a financial one and that also means that the response of the banks is different. The first priority has been very much around operational resilience, making sure that customers have access to banking services and that employees are safe and can actually do their job. The banking system has held up in that respect very well and overall, bank boards and executive committees can be happy with how banks have been making sure that people can make payments, access loans, and their bank accounts.

JO: Take me through some of the schemes that have been set up by government requests that have been transmitted through the commercial banking system and how they are being implemented.

JB: Banks have been supporting customers and the broader economy by measures they have taken on their own account, which include fee waivers and forbearance measures. In many jurisdictions, banks have been called to transmit government stimulus into the economy, mostly, but not exclusively, towards small businesses. This has gained most visibility.

JO: Take me through some of the schemes that been implemented so far and what has worked very well.

JB: It is important to note that when governments design schemes to get money into the economy, directly to customers and businesses, the implications for these institutions must be well thought out. We have seen a massive effort by the banks to get that money quickly out in the market. One example is Switzerland, where a scheme was co-designed with the top banks and a package of over Chf20bn of SME stimulus was very quickly distributed into the market. A relatively simple process designed mostly on a digital basis – with the aim that an SME applicant would be funded in 30 minutes – did not quite work as expected. But most SMEs that requested the loan were able to get their funding in a few hours, or at least in a day. So, a lot of SMEs in the Swiss market have been funded very quickly.

JO: How did they get that right? What contributed to that scheme being designed and then executed well?

JB: One of the key success factors was that it was really thought through from an end-to-end perspective. When the government was thinking about this programme, it solicited advice from the banks in the market on how to do it right, and so the process was designed principally around online processes. The form itself is used as the credit contract and is signed, scanned and sent by email or snail mail. The banks’ checks for risk purposes were also relatively limited. So overall, the processes were designed in tandem with the design of the aim of the scheme.

JO: Which schemes have not worked as well, and how could they be remedied?

JB: It is important to ensure that the money goes to those businesses and customers that are most in need, while ensuring a the same time that there are no fraud or money laundering issues, particularly when banks are the entities responsible for that transmission. In the US, for example, the first wave of bank lending schemes with payment protection for small businesses was $376bn, followed by a second wave of $310bn. With these volumes being put into the market, institutions need a lot of checks to ensure the funding goes to those most in need, and that all conditions are met. Given this complex exercise, there has been a bit of a scramble to make sure that the banks can leverage technology solutions accordingly.

JO: Where have the challenges been with the Paycheck Protection Programme? Are they due to the sheer scale of it?

JB: There's the scale, and the fact that banks are cautious to ensure they are checking off all the conditions. Banks do not want to be held accountable for handing out funds to customers that didn't justify it, and are also very keen to avoid fraud challenges. Banks have to really tread a fine line between speedy action and making sure they don't trip up over government conditions for eligibility.

JO: People tend to make mistakes when they're rushing. You're saying the US banks are especially mindful of that and trying to avoid future legal – and other – liabilities by rushing through processes at this stage?

JB: It is a fine balancing act and correctly so. The banks are keen to support the economy and its SMEs while also looking out for fraud risk, KYC or anti-money laundering risk.

JO: Are there lessons there in terms of process from the Swiss example you mentioned earlier, such as form designs and processes which could make this work more quickly?

JB: A lot of the banks and government institutions have realised that there was still an awful lot of paper shuffling in some of these processes. They have now seen that, even in a matter of days or weeks, they can put in place technology-based and data-based solutions which improve process. A number of executives have reported that work that normally takes six to 12 months to digitise can be done in a week. This is quite a wake-up call for some of the banks when the urgency is there. Overall, we will see much accelerated digitisation of some processes and the administration.

JO: One bank chief executive told me his digital plan advanced more in the first four weeks of lockdown than in the preceding four years of his tenure at that bank. What are you seeing in terms of the digitisation of banking business plans? Presumably, some will start to speed up the rationalisation of their branch networks, so it might become more profitable to be a universal bank, for example. How has the digital side of bank business models been propelled by this crisis?

JB: Banks at this stage are looking at how the return to their physical offices will pan out, what their workforce will look like post-crisis and how it will operate. The digital acceleration and their digital plans will be driven by what we can observe in terms of consumer and employee behaviour, and how those evolve. There is a discussion going on about real estate. But nobody has really pulled the trigger yet. We recently did a consumer survey across five large markets, UK, France, Germany, US and Canada, where 24% of those consumers said that they would bank more online, even after the crisis. This is lower than the number of consumers who would shop or seek health services online. Banks will definitely continue to invest heavily in terms of their digital transformation, but they will not be closing those branches as of yet.

JO: Indeed, some bank chief executives think that branches are the best place to cross sell products. Onto the medium-term: are their broader lessons from the credit analysis and credit disbursement work that is taking place on these government-guaranteed schemes?

JB: This is a big topic among several boards. One of the board members mentioned that the risk teams are giddy with excitement about the different scenarios that they can develop in terms of how the book will evolve. This is also a real challenge due to the degree of uncertainty in terms of duration of the crisis as well as the economic uncertainty. This translates into how much risk is supported by government funding and government stimulus and how much of it is not. Boards and CEOs are genuinely concerned about the so-called ‘day of reckoning’. The massive global government stimulus of $10tn that has been put into the markets has been tremendous. But this has serious implications if the crisis continues for longer and banks have to walk a fine line in lending to small business in this time. If for example, after six months, this is still not resolved and the SMEs can no longer be sustained, that debt could turn into non-performing loans for the banks. How would that be dealt with? There is quite a lot of concern about taking on these loans at the moment, correctly so. Governments are clearly doing the right thing for customers and for the economy but at the same time it is difficult to assess that risk from SMEs and midsized corporations.

JO: EY is already advising banks on the medium term with respect to how to think about and deal with NPLs. How banks are preparing for them?

JB: Banks have learned from the previous crisis, they are well capitalised and continue to stress test their books. They have a pretty solid view on where the different risks are in the balance sheet and are preparing to look at loan restructuring, credit workouts, schemes to operate certain assets with special purpose vehicles and how to get traditional investors into those assets to operate them in these challenging times. People with skills and expertise in capital restructuring of corporates will be critically important in the next year.

JO: How are regulators and supervisors helping? To what extent are they offering forbearance to banks being put under strain at the moment?

JB: The regulators have learned a lot through the last decade and from the previous crisis. Regulators have also been proactive to make sure that banks can play their role in supporting the economy at this crucial time. Some of these include postponing stress tests and supervisory actions, as well as providing some relief for risk limits. There has been close contact and communication between regulators and bank boards, and some regulations have been eased to release some of the immediate pressure, where regulators feel it's safe and secure to do so.

JO: How are banks managing to balance their social duty with their fiduciary duty to protect profitability?

JB: Bank boards are very actively thinking about this. They are well aware that they didn't have the best record in society coming out of the previous crisis, and even going into this crisis. They know that playing a supportive role for the economy and their customers, socially-responsible banking, is the way to improve their reputation. At the same time it’s a fine balancing act between providing a loan to those who need it but also taking care of the medium to longer term when it might not be fully clear whether that business is actually going to survive this crisis in the first place, or whether it was viable. That has also been demonstrated by the fact that quite a lot of banks in the US and Europe have made formal or informal commitments not to lay off staff in this calendar year, or to put certain restructuring programmes on hold.

JO: Some banks, particularly in Europe, have been waiting for a while for interest rates to eventually rise to help them with net interest margin. But that looks even further away. Is this crisis putting bank business models under strain again through the very ‘low for even longer’ interest rate environment?

JB: It certainly puts the return on equity targets under strain because of the credit provisions and then also because of the interest rate environment. There's a lot of uncertainty in the overall economy, banks are well capitalised, so they do have good staying power. But it remains to be seen what happens over the next six to 12 months to see how overall bank profitability will evolve.

JO: What will be some of the long-term lessons – and even benefits – from the crisis for the banking sector?

JB: I would certainly hope for the reputation of banks to actually increase through this crisis where banks really play their role as a facilitator for the economy and for customers going about their business. It would be good for banks that have purpose in mind, that think about responsible banking across ESG targets to come out of this crisis stronger in terms of reputation, but also with growth prospects. This was confirmed by our consumer survey where we found that the majority of customers put very high premium on those institutions which seem to be doing the right thing during this crisis. Secondly with the digital acceleration, banks can become much more agile in a very short period of time and can leverage technologies, artificial intelligence, and other innovations to serve customers better. Hopefully this will prepare banks better for the next decade.

JO: Despite the very difficult challenges, socially, health-wise, and economically, it sounds like there is some benefit for the banking sector, potentially, in terms of how it is regarded, and indeed how it operates, compared with 10 years ago. Thank you very much for talking to us today, Jan.