BOSTON CONSULTING GROUP

White Paper

How Should Financial Institutions Navigate the COVID-19 Crisis?

Kilian Berz, Gwenhaël Le Boulay, Simon Bartletta, Yann Sénant, Sam Stewart, and Anna Zakrzewski

March 2020

There are of course many unknowns surrounding the COVID-19 crisis, the first of which is the ultimate impact on human health across the world. At this juncture, it's still impossible to say how far and wide the epidemic will spread before it runs its course and begins to abate.

Yet there are at least two certainties amid all the questions: the crisis has prompted companies in virtually all industries to seek an optimal way to navigate their way through — both until and after light appears at the end of the tunnel — and has thrown global financial markets into a state of high volatility. Financial institutions (FIs), in particular, need a strategy to help maximize their level of resiliency and prepare for any macroeconomic and financial scenario.

First, it's clear that the global economy is facing a triple shock: on the supply side (e.g. electronics, automotive); on the demand side (e.g. airlines, hotels); and in market confidence as evidenced by the VIX index, which recently hit 55, not far from the highest-ever level of October 2008. Central banks such as the People's Bank of China and the US Federal Reserve have already taken measures to anticipate a potential economic slowdown by lowering interest rates — yet, with a direct impact on financial institutions' bottom lines. Such measures could lead FIs into unchartered territory given the fact that interest rates are either at historic lows or negative in a number of geographies. Indeed, Europe and Japan have been dealing with negative interest rates for some time, but US markets are starting to price negative rates for US dollars.

In our view, it is critical for FIs to take specific steps both for the short term and the medium term. We have identified ten key action points to be addressed, encompassing both time frames.

The Impact of the COVID-19 Crisis on FIs

As in other industries, financial institutions are facing a broad range of operational issues because of COVID-19. These include how to operate branches if client traffic

significantly slows (owing to official local restrictions or to fears of contracting the coronavirus in a public place); how to operate trading floors (especially when recovery sites might also be hit by restrictions); how to manage market and credit risk, which is likely to rise (notably for SMEs); how to optimize investment management in volatile and bearish markets; and how to cope with the profitability hit caused by lower interest rates.

Moreover, specific types of clients have specific needs, such as asset reallocation in wealth and asset management, and new lines of credit in corporate banking (to offset potential treasury shortages). Further, specific business and product lines are facing potential consequences. These include trade finance (related to new trade flows or failures that may arise from the supply side), and transaction banking (as online payments rise, benefiting acquirers, and in-store and cash payments decline).

There is an additional overall risk for incumbent players, as disruptors — such as pure retail digital players and new trade-finance entrants— may be well-positioned to gain market share. Perhaps most foreboding, the possibility of a true recession, with the COVID-19 crisis acting as a trigger event, would reduce demand for most FI products and services.

Short-Term Actions for FIs

In the short term, financial institutions must essentially take six actions to navigate the COVID-19 crisis: protect staff and ensure business continuity, respond quickly and thoughtfully to clients, manage physical networks and promote alternatives, deploy agile and highly-reactive stress testing to anticipate diverse scenarios, launch or accelerate efficiency programs, and engage in active dialog with public stakeholders, supervisors, and governments. A number of FIs globally have already deployed these or similar measures, particularly in Asia. (See the Exhibit below).

Measures implemented by Financial Institutions in the last weeks

Protecting staff and business continuity

Work from home policies

New health measures, e.g.,
- Partnerships with health care companies to supplement health advice to employees
- Temperature screening
- Provision of masks and sanitizer

Business-related travel restrictions

Supporting clients

Debt repayment solutions, e.g.,
- Moratorium on mortgage repayment
- Extended maturity on trade loans

New debt packages, e.g.,
- New working capital financing solutions focused on SMEs

New relief-focused products, e.g.,
- Ad-hoc relief insurance for customers

Asset allocation advice, e.g.,
- Proactive and personalized communication to wealth management clients

Managing physical network and alternatives

Suspension of branch operations and/or temporarily relocating offices

Promotion of digital channel, e.g.,
- Trade Finance and Working Capital products fully digitalized

Focus on digital channel growth, e.g.,
- Free debit transactions to reduce cheque usage
- Digital channel training for employees

1. **Protect staff and ensure business continuity.** This initiative includes reviewing business-continuity plans and optimizing internal communication to accurately and regularly inform staff — as well as to reassure them that their well-being is foremost in management's mind. It also includes accelerating the deployment of new ways of working (such as telecommuting and virtual meetings), and familiarizing staff with the right tools. Along these lines, some FIs have recently begun offering medical consultations and temperature screening for staff, rotating groups of home-working staff within specific teams, separating critical teams in two locations, and preparing management continuity if a senior leader is forced to self-quarantine.

2. **Respond quickly and thoughtfully to clients.** FIs need to communicate clearly (and often) with clients on how the crisis is impacting both overall financial markets and their own personal savings. When appropriate, for example in wealth management, FIs should provide advice on how clients themselves (with the FI's help) can navigate these turbulent times, and suggest specific products and asset allocations that may be relevant. For example, one Asian bank recently proposed a six-month principal moratorium on property loans, and another FI

extended the maturity period for trade loans. Still another FI implemented export trade fee rebates. Moreover, FIs should not hesitate to communicate on the regional and global status of the crisis from a health perspective — taking the opportunity to connect with clients in a more meaningful way. They should make the interaction a “moment of truth” that clients won’t forget. Banks should proactively engage with sectors of the economy that are most severely impacted (for example, automotive, electronics, energy, travel and leisure) and discuss innovative financing solutions with their clients.

3. **Manage physical networks and promote alternatives.** FIs should prepare a scenario plan for a region or even an entire nation that goes under “lockdown” — meaning that clients have no access to retail branches, business centers, or to any site where a physical meeting with a representative from the FI could take place. In Asia, a number have banks have closed a significant proportion of their branches, stopped teller services, and the like. FIs should carefully review and promote alternative channels, as well as accelerate deployments of the needed functionalities in apps and digital platforms.

4. **Deploy agile and highly-reactive stress testing to anticipate diverse scenarios.** Given the unpredictability of the range and speed at which the coronavirus may spread, FIs should set up rapid and frequent stress testing and scenario analysis — aiming for results in days as opposed to weeks — in order to set new limits and make credit and market decisions. FIs will need to understand the primary impact of the COVID-19 event, but also grasp the secondary-order impact on monetary and fiscal policy, as well as the sector-specific implications — for example, the secondary impact of negative interest rates on money market funds and US Treasury repo markets. The crisis also presents an opportunity to accelerate the use of data science in stress testing, typically in anticipating SME credit risk.

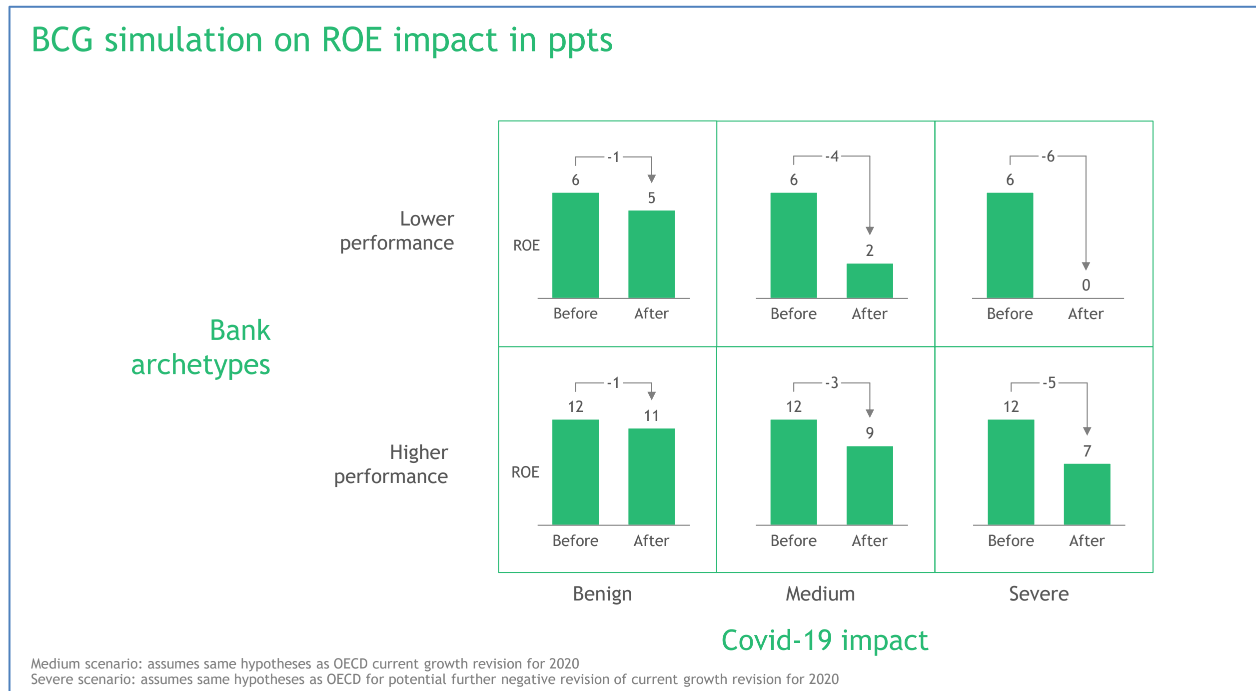
5. **Launch or accelerate efficiency programs.** FIs should prepare for a potential downturn and lower revenues. They should communicate their cost reduction

ambitions — typically targeting at least 10% of net cost impact — to the markets, and launch immediate, high-return initiatives with medium- to long-term time horizons. This is particularly urgent for players with low to medium profitability performance.

6. **Engage in active dialog with public stakeholders, supervisors and governments.** FIs should work on government-backed programs to lend funds to firms that are suffering, as they did during the 2007-2009 financial crisis. China is currently urging banks to show flexibility with delinquent borrowers, and it is clearly in the interest of lenders globally to show forbearance toward borrowers facing a cash squeeze— much as banks did with public-sector employees during the US government shutdown in 2018-19.

Medium-Term Actions for FIs

Currently, there is an open and ongoing debate among economists on the question of whether COVID-19 will trigger a significant economic slowdown — even a full-blown recession — or, under a sunnier scenario, fade away within a few weeks or months permitting a rapid rebound. Yet regardless of how the crisis plays out, it is safe to say that 2020 revenues and ultimately profitability, factoring in the cost of risk, are very likely to suffer — a direct consequence of lower interest rates and of at least six months of reduced economic activity in base cases. We have developed three scenarios on the length and severity of the crisis, simulating their impact on two bank archetypes, a high-performing institution and a lower-performing one. (See the Exhibit below).



Moreover, for a number of incumbent institutions, the crisis represents an added burden atop already lower-than-expected profits (e.g. return on equity and price-to-book ratios) stemming from the effects of disruptors — such as digital attackers in retail banking, principal trading firms, and new payments giants.

Overall, in the medium term, FIs must take four additional actions to navigate the crisis: accelerate the move toward digital sales and service, reinvent models, prepare for new opportunities, and rethink planning for low-probability/high-impact risk events.

7. **Accelerate the move toward digital sales and service.** FIs must accelerate both retail and wholesale client migration to online channels and online platforms, as well as foster new ways of working and interacting between relationship managers and clients (such as via phone and video channels). Many banks have already launched initiatives in this direction, seizing the opportunity (and necessity) to accelerate progress toward becoming a truly "bionic" institution.

8. **Reinvent models.** FIs should also accelerate discussions and decisions on their portfolio of activities — for example, selecting asset classes with a "right to win" in capital markets. They should also speed up analysis and decisions related to deconstructing the value chain, which could lead to white-label approaches — determining which parts of the value chain to keep (e.g. client fronting), and which parts to outsource (e.g. trading, back office and IT).

9. **Prepare for new opportunities.** Economic shocks, difficult as they may be to navigate and endure, can also bring unforeseen opportunities. During this crisis, FIs should carefully search and screen potential consolidation opportunities — looking to strengthen themselves for the long term and bearing in mind that the next economic shock may be even more difficult. They may benefit from lower acquisition prices amid the present conditions.

10. **Rethink planning for low-probability/high-impact risk events.** Finally, FIs should rethink their perspectives on low-probability/high-impact risk events. In the aftermath of the 2002-2004 SARS outbreak, most FIs had identified pandemic flu as a key risk event that could have an adverse impact on their balance sheets and business models. However, in the interim years, this possibility gradually dropped from the risk inventory — until the advent of COVID-19. FIs need a more robust framework and state-of-readiness for low-probability/high-impact (or "black swan") events. This will not be the last time the industry is tested.

* * *

It goes without saying that the action steps described above may vary widely by the type of financial institution in question, and by the region in which it is located. Moreover, there may be further specifics based on different areas of FI activity, such as retail banking, wholesale banking, wealth management, and asset management.

Much, of course, is still to be done. And a stark reality remains: FIs must act now, and decisively, not only to weather the present COVID-19 crisis but also to strengthen their resiliency and thrive in the post-crisis landscape.

Kilian Berz
Gwenhaël Le Boulay
Simon Bartletta
Yann Sénant
Sam Stewart
Anna Zakrzewski

About the Authors

Kilian Berz is a managing director and senior partner in the Toronto office of Boston Consulting Group. Gwenhaël Le Boulay is a managing director and senior partner in BCG's Paris office. Simon Bartletta is a managing director and senior partner in the firm's Boston office. Yann Sénant is a managing director and partner in BCG's Paris office. Sam Stewart is a managing director and partner in the firm's Sydney office. Anna Zakrzewski is a managing director and partner in BCG's Zurich office.

You may contact the authors by e-mail at:

berz.kilian@bcg.com
leboulay.gwenhael@bcg.com
bartletta.simon@bcg.com
senant.yann@bcg.com
stewart.sam@bcg.com
zakrzewski.anna@bcg.com

About BCG

Boston Consulting Group partners with leaders in business and society to tackle their most important challenges and capture their greatest opportunities. BCG was the pioneer in business strategy when it was founded in 1963. Today, we help clients with total transformation—inspiring complex change, enabling organizations to grow, building competitive advantage, and driving bottom-line impact.

To succeed, organizations must blend digital and human capabilities. Our diverse, global teams bring deep industry and functional expertise and a range of perspectives to spark change. BCG delivers solutions through leading-edge management consulting along with technology and design, corporate and digital ventures—and business purpose. We work in a uniquely collaborative model across the firm and throughout all levels of the client organization, generating results that allow our clients to thrive.