FIVE ACTIONS FOR CORPORATE BANKS

In response to COVID-19

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Coronavirus (COVID-19) is already having a profound effect on people's lives and the economy. Corporate and commercial banks have a central role to play in supporting the global economy during the crisis, and in facilitating a rapid and sustained recovery afterwards. On top of normal commercial lending, banks will play a key role in implementing many of the government's policies to support SMEs and corporates.

This short paper identifies five actions corporate banking leaders should take to improve the resilience of their businesses and support the real economy. It draws on our live experience supporting banks on the COVID-19 response in Asia and Europe, and on broader crisis management experience from the financial crisis.

THE CHALLENGE

COVID-driven travel restrictions and social distancing have had an immediate and dramatic impact on the cashflows of many corporates and SMEs, from airlines to retailers to restaurants. Banks are already being inundated with requests for credit and must make urgent and "distressed" credit decisions. This flow will increase in the coming weeks as cash reserves run down and clients look to banks to deliver the hundreds of billions of lending support that the government has promised. Near-term bank decisions on how to respond to clients' financing needs will have a huge impact on the economic consequences of the crisis, including whether companies survive and continue to employ staff.

Exhibit 1. Summary of policy interventions for corporates and SMEs

Bank-supported lending	Fiscal levers
Small business and consumer forbearance programs Lenders and insurers volunteering/forced to suspend or reduce credit or insurance payments, waive late fees, suspend reporting or foreclosures	**Government forbearance schemes** Suspending or postponing tax payments
Large corporate forbearance programs Lenders suspending credit repayments and not classifying overdue corporate loans as bad debt for struggling companies	**Direct fiscal stimulus – borrow and spend** Direct investment packages for affected industries (e.g. shale, tourism, retail, food services and transport) and payroll tax cuts
Funding for lending schemes Loans/guaranteed for banks to lend to corporates in specific portfolios (e.g. SMEs)	**Subsidy for employment cost** Government providing a subsidy to temporarily cover the cost of employees who would otherwise made redundant in the most affected industries
Liquidity Changes to collateral policy, short-term repos, longer-term lending instruments for banks, additional quantitative easing programs	**Increasing sick leave allowance** Extend sick leave for those that have some, allow for some sick leave for those that don't have any. Sick leave for family care
	Extension of unemployment benefits Government extending the standard length of unemployment benefits for the duration of the crisis

Source: Oliver Wyman analysis; central banks; national governments

A “business as usual” approach based on largely manual processes, expert judgement and existing underwriting criteria will not work. It cannot cope operationally and it cannot be relied on to consistently deliver the best decisions. Many client requests will be triggered by rapidly declining revenues and a poor financial outlook, which would fail normal underwriting criteria at the first hurdle. Underwriting criteria will therefore need to be adjusted to enable lending to companies that are viable and should return to health after the effects of COVID-19 have dissipated. But banks must not relax criteria so far that they lend to companies that were unsustainable before the crisis and will never be able to repay.

THE RESPONSE

In responding to the crisis, corporate banks’ management will need to make difficult decisions that trade-off doing what is right for clients and society (and minimizing reputation risk) against protecting the bank’s balance sheet and medium-term shareholder returns by structuring and pricing credit exposures for increased risk.

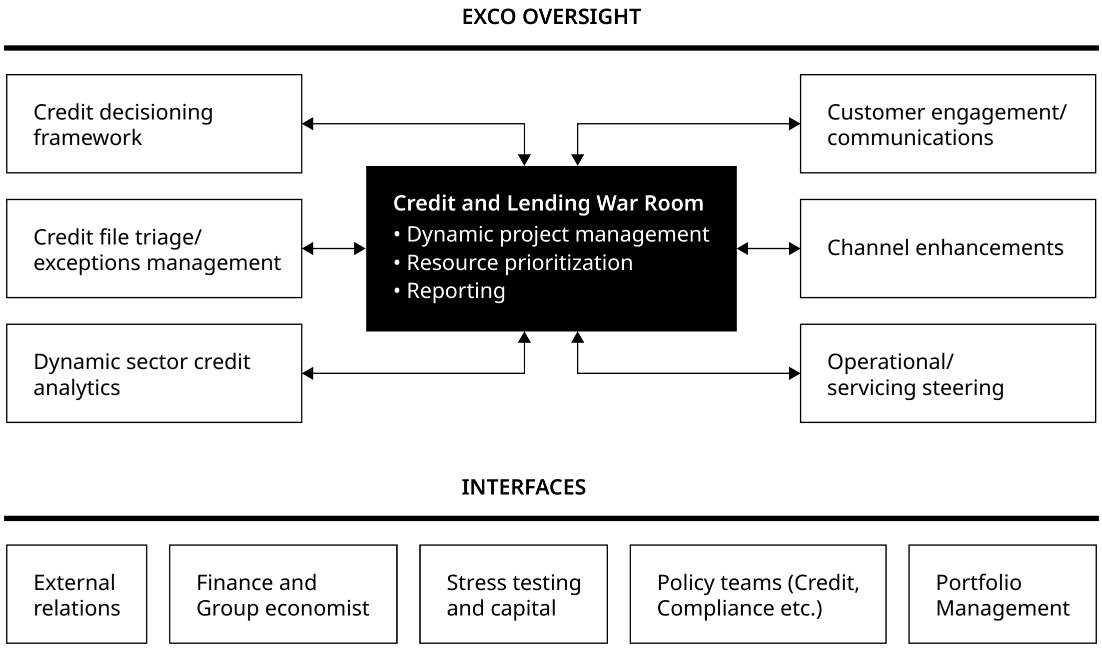
Getting this trade-off right and making the right decisions will be difficult. To give themselves the best chance, we think the management of corporate banks should have five priorities, each detailed in the following sections:

- Mobilize a “credit war room” to coordinate the bank response
- Build a dynamic credit decisioning framework
- Stand up operations to manage increased volumes
- Proactively engage with clients
- Understand the economic impact on the existing loan portfolio

MOBILIZE A “CREDIT WAR ROOM”

While the circumstances of the COVID-19 response are unprecedented, lessons can be learned from other periods of extreme distress. In previous crises we have seen a “Credit War Room” play a key role in dealing with rapidly changing and uncertain situations. Typically, this is a small and experienced team at the nerve-center of the organization, steering, coordinating, adapting and prioritizing work executed in the normal functions. This team is supported by a range of other specialist capabilities which, if not already available, the team is mandated to resource quickly.

Exhibit 2. Credit War Room structure



Source: Oliver Wyman analysis

The Credit War Room is responsible for setting and operationalizing the credit strategy in response to crisis-driven events and works closely with the Exco. It is typically a multi-disciplinary team, including representatives of the business, risk, finance, legal and compliance teams. It aims to ensure a consistent and coherent response across all aspects of the lending operating model.

The responsibilities of the Credit War Room include:

- Identifying and prioritizing the issues requiring action, driven by clients, colleagues, regulation and political or reputational expectations
- Understanding where there is already a Group position to enable decisions and actions to be taken
- Determining how open issues should be resolved, either by requesting and securing input from accountable functions or by mobilizing additional resources as required
- Coordinating and driving rapid convergence across teams to deliver solutions
- Documenting when, how and why decisions were taken and implemented
- Identifying what is not working and moving rapidly to provide a remedy
- Tracking and reporting progress and results

Many decisions will need to be taken on the basis of imperfect information, meaning the team must draw on experience and take an “80:20” approach. Sometimes more information may be required before a decision can be made. But it is important to remember that in rapidly changing environments even a few days delay may render decisions irrelevant.

PROACTIVELY ENGAGE WITH CUSTOMERS

Supporting customers as they navigate unprecedented challenges to the viability of their businesses will be a unique opportunity to deepen relationships with them. And failing to do so could be a uniquely effective way of damaging client relationships and the bank's reputation.

We see three priorities here. The first is driving Relationship Manager (RM) outreach and feedback. This means creating messages for RMs to deliver to clients and then systematically capturing responses as feedback to help inform the decisions of the credit war room.

A second opportunity is to help SMEs and mid-market corporates understand their position. Many lack a finance department equipped to run cashflow forecasts and scenarios, and therefore may not have robust projections on which to base their decisions. Banks can help their customers forecast cashflows under different macro scenarios and thereby understand their funding runway and the timing of mitigating actions. Some banks are looking to adapt existing cashflow forecasting tools for this purpose, and a number of fintech solutions that already exist could be also adapted for this purpose. Such analytics can also be used in the bank's own credit decisioning.

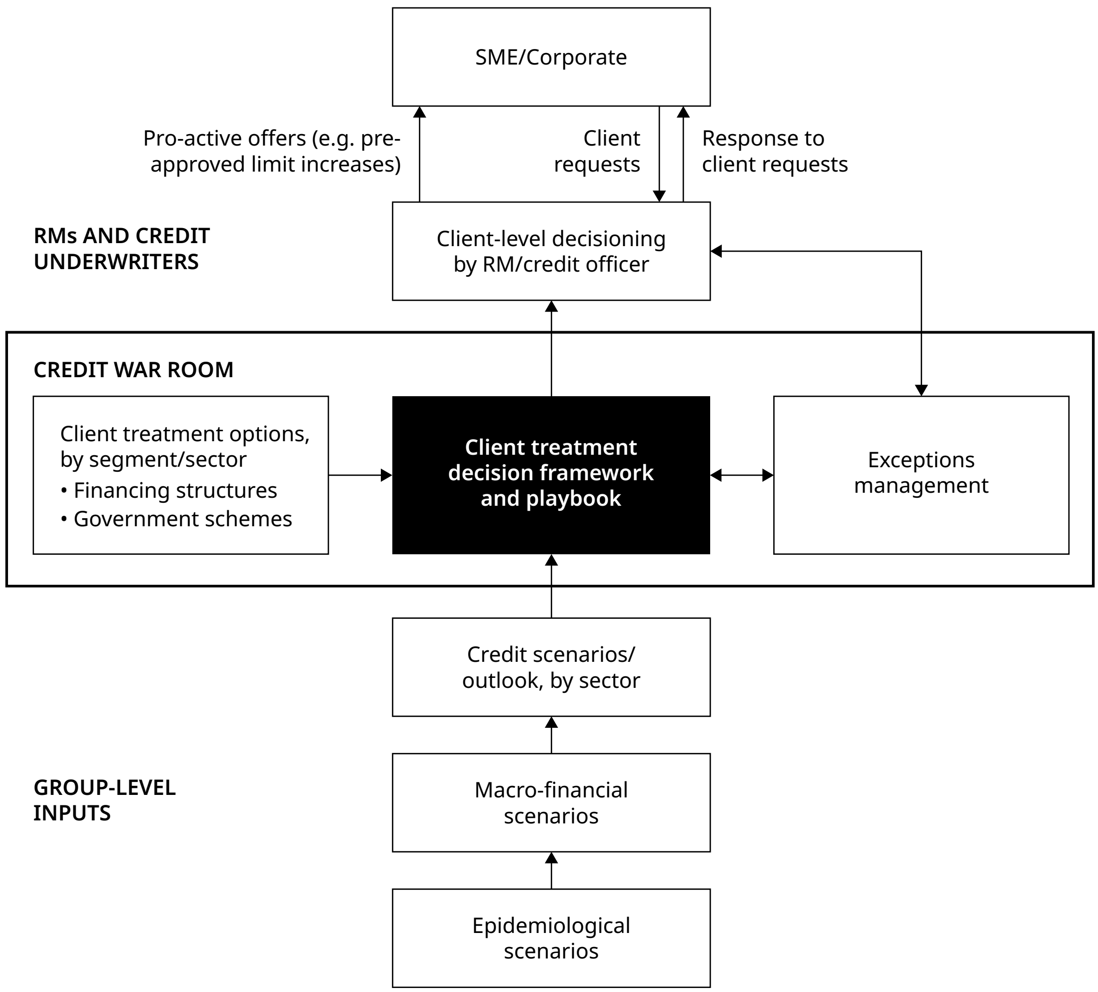
The third priority should be helping clients navigate the funding and restructuring solutions available to them. These range from claims for COVID-related grants through to government lending schemes and payroll subsidy schemes. Beyond near-term funding, there will be opportunities to support customers in restructuring their businesses (e.g. advisory, debt structure, divestments).

Consistency when engaging with clients will be necessary to avoid relationship and reputational damage, while advice must be continually updated to reflect the latest government policies and customer feedback. Ensuring that everyone is on message and behaving in line with the engagement strategy will be challenging. There may be a case for establishing a dedicated restructuring taskforce to coordinate and manage RM communications and directly support customer discussions.

BUILD A DYNAMIC CREDIT DECISIONING FRAMEWORK

A core role of the Credit War Room will be to adjust and codify the credit decisioning framework to deal with the rapidly evolving situation. In some areas, the new lending criteria could be fully codified, allowing for automated decisions. In others, they will provide a common foundation for expert-based decisions to be prudently simplified and triaged to cope with extraordinary volume of applications.

Exhibit 3. Example role of credit decision framework for manually underwritten credits

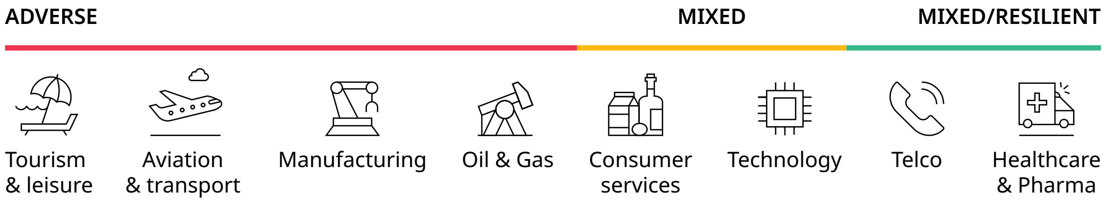


Source: Oliver Wyman analysis

The foundation of the decision framework will be a central scenario for how the crisis will play out and alternative scenarios. These comprise **epidemiological scenarios** (how will the pandemic play out), **macro-economic scenarios** (the effects on GDP, inflation, sector performance, etc.) and **credit scenarios** (how the economic effects will translate into company performance, default probabilities, collateral values, etc.). These scenarios will need to be updated as the situation evolves and, ideally, they should be Group-wide to ensure consistency across business decisions, with the Credit War Room being a "user".

In parallel, a comprehensive set of **client treatment strategies** should be developed. These could include increased limits, renewals of existing facilities, additional invoice finance facilities, interest payment holidays and principal repayment holidays. They should also include options created by government policy initiatives, such as government-backed lending, business rates relief, and sick pay support.

Exhibit 4. Common view of crisis impact by sector



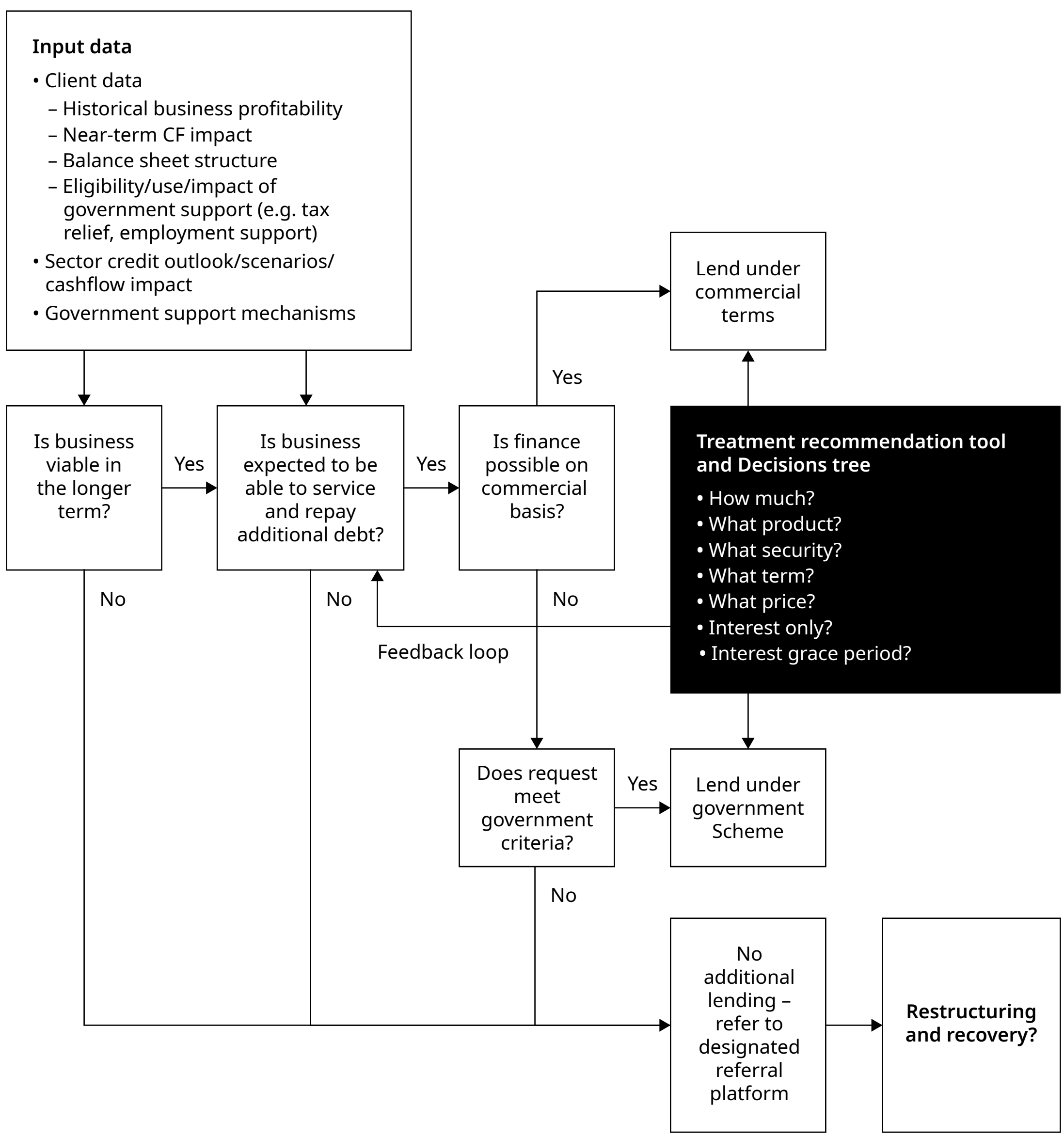
MARKET IMPLIED INPUT IS ONE WAY TO INCORPORATE MICRO-ECONOMIC NUANCES

Equity market impact Sector[1] total return index (Feb 21 – Mar 10)		CDS impact Sector[2] 5Y CDS index mid price (premiums)	
Top 10 most affected			
Oil, Gas, Coal	-30,8%	NA Oilfield Mach. & Prod.	403,0%
EBA' 2020 Adv.S. 1Y	-25,0%	NA Airlines	347,4%
Aerospace & Defence	-21,2%	EBA'2020 Adv.S. iTraxx 1Y	281,0%
Industr. Met. & Mining	-20,3%	EU Oil & Gas	255,3%
IB and Brokerage	-19,7%	NA Oil & Gas	212,8%
Travel and Leisure	-18,7%	NA Containers	202,7%
Mortgage REITS	-17,4%	UK Beverage/Bottl.	181,8%
Consumer Services	-17,1%	Asia Utilities	167,8%
Chemicals	-16,1%	EU Leisure	136,0%
Automobiles & Parts	-16,1%	NA Home Builders	132,3%
Industrial Transportation	-16,1%	NA Food & Drugs	123,2%
World Market	-14,1%		
Gas, Water, Utilities	-11,0%	NA Veh. Parts	28,3%
Tech. Hardw & Equip.	-10,2%	NA Healthcare	3,8%
Telcommunications	-9,9%	NA Beverage/Bottl.	3,2%
Retailers	-9,6%	NA Pharma	0,6%
RE Investment Services	-9,4%	NA Lodging	0,0%
Food Producers	-8,7%	NA Textile/Apparel	-1,4%
Health Care	-8,5%	Asia Railroads	-5,7%
Leisure Goods	-8,1%	Asia Retail Stores[3]	-11,7%
Pharma & Biotech	-7,9%	NA Info/Data Tech.	-24,6%
Personal Care, D & G	-7,4%	Asia Auto Manuf.	-51,8%
Top 10 least affected			

1. Sector level 3
2. Subsector
3. Asian sectors within "champions" due to sharp recent China improvement
Source: Datastream, Oliver Wyman analysis

The **credit decisioning framework** will provide a decision logic that recommends treatment strategies on the basis of the client's situation, distinguishing between those that were healthy pre-crisis and are not in a hard-hit sector, those that were previously healthy clients but in hard-hit impacted sectors, and clients that were already struggling pre-crisis. An important task in the near-term will be to build in client eligibility criteria for government-backed schemes, and combine this with the bank's existing underwriting criteria. For example, under the UK Coronavirus Business Interruption Loan Scheme (CBILS), the bank must determine that the customer is "considered viable in the longer-term" and will be required to underwrite 20% of the loan.

Exhibit 5. Decision-tree approach to determining most appropriate customer treatment options



Source: Oliver Wyman analysis

In some cases, the decisioning logic can be embedded within existing automated decision engines and processes. In other cases, it will need to be provided to RMs and credit officers in rapidly developed tactical tools and systems.

The Credit War Room would then support RMs and credit officers in interpreting and implementing the decision framework in live client situations, dealing with exceptions and, where necessary, feeding back into the decisioning framework. The Credit War Room would also continually adapt the bank's response as the crisis unfolds, the economic impact and outlook develops, and further government policy initiatives are launched.

STAND UP OPERATIONS TO MANAGE INCREASED VOLUMES

Much of the challenge will be operational. Many banks are reporting loan application volumes that are eight to 10 times their typical level and likely to grow further as awareness of government-supported loan schemes increases. This is well above operational capacity, especially given remote working and sickness-related resource constraints. The difficulty is exacerbated by the complex underwriting challenge in a fast-moving environment and the specific process requirements of national guarantee schemes which, given their novelty, remain manual for most banks.

Immediate solutions will usually need to include temporary resource augmentation to handle manual applications in contact centers and credit teams, perhaps by redeploying staff doing non-urgent work elsewhere in the bank. Allowing exceptions to current policies regarding data requirements and process steps will also be expedient when doing so does not create undue risk – for example, where existing data can be relied on. And, of course, wherever possible, client requests should be diverted to online channels.

Over the coming weeks, banks will also need to establish a more sustainable approach to processing the surge in lending applications. This should include electronic channels to manage COVID-19 related loan applications (either as a separate channel or as a separate track within existing channels) and the extension of automated credit decision-making to as many applications as possible, allowing manual credit underwriting to be focused on exceptions and higher risk cases. This automation may require some banks to increase their API connectivity to data sources and to the government agencies involved financial support schemes. The increased use of electronic signatures and pre-approval of credit limits for existing clients (based on a sector-specific view of distress) can also expedite credit processes.

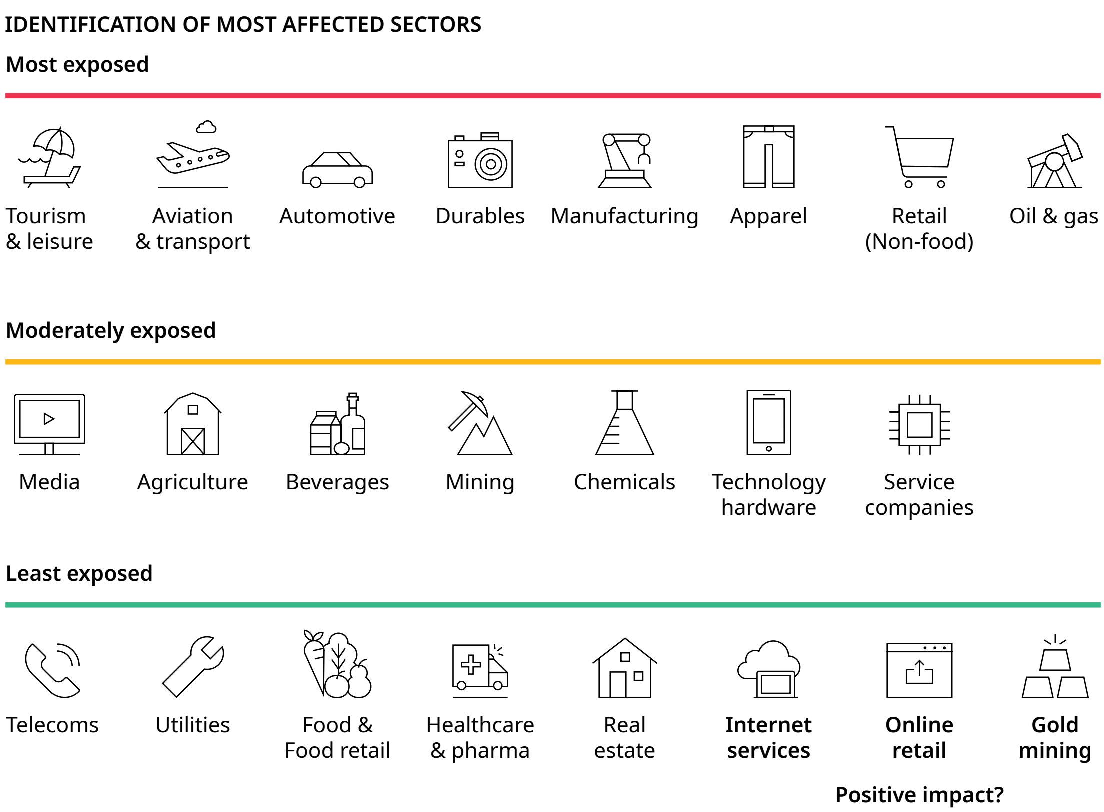
UNDERSTAND THE ECONOMIC IMPACT ON THE EXISTING LOAN PORTFOLIO

In parallel with dealing with inbound requests for additional finance, banks will need to understand the impact of the crisis on their existing loan portfolios. They will inevitably suffer credit losses that reduce the profits of the corporate banking businesses, as well as its capital and lending capacity.

Understanding the portfolio impacts will require a joint effort between the business and credit analytics teams to identify stressed sectors and clients, through a combination of expert judgment, early warning signals and public data such as equity and CDS prices. This information can then inform projections of credit losses and IFRS9/CECL provisions under the various scenarios mentioned above, which should include mitigation from governmental support initiatives.

The business, together with Risk and Finance, will then need to use the output of the this analysis to refine near-term lending capacity, strategy and capital allocation decisions.

Exhibit 6. Link between sector analytics and provisioning impact



Source: Oliver Wyman analysis

SECTOR/GEOGRAPHY-LEVEL ANALYSIS

Covid19 – top-down credit impact simulator

Geographies

× **Level 1**

1. Micro SME
2. SMEs
3. Small Corporate
4. Mid Corporate
5. Large Corporate
6. Project Finance
7. Real Estate Dev
8. Fis/NBFIs/P.S.
9. Retail Mortgages
10. Consumer Fin.

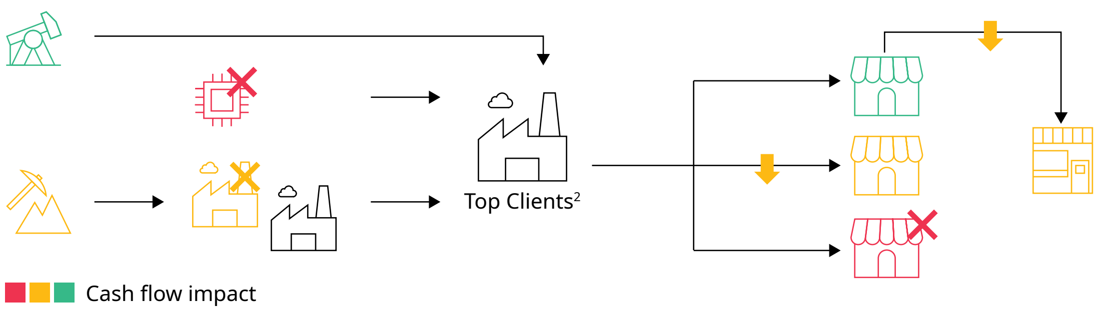
× **Level 2/3 subportfolios**[1]

Industry	Sub-sector	...
Region L1	Region L2	...
Rating	LTV	...

BOTTOM-UP ANALYSIS FOR TOP EXPOSURES

Supply
Supplier business disruption and cost/time to substitute

Demand
Disruption of customer demands, shift in revenues and bearability of delay



IFRS9 PROVISION IMPACT	
"ECB gives banks further flexibility in prudential treatment of loans backed by public support measures • Classification as … 'unlikely to pay' • Loans under Covid19 moratoriums • NPLs under public guarantee" "ECB encourages banks to avoid excessive procyclical effects in bank models when applying the IFRS 9 international accounting standard" *European Central Bank, March 20th 2020*	"Given the little information available, reliable forecasts are very challenging" "PRA expects firms to reflect the temporary nature of the shock … the significant economic support measures" "Mortgage repayment holidays should not automatically be a sufficient condition to move participating borrowers into S2" "Further guidance to firms next week" *Bank of England, March 20th 2020*

1. ~3,000-4,000 portfolio subclusters
2. Credit officers involved in vulnerability analysis & credit triaging
Source: Oliver Wyman analysis

CONCLUSION

Despite government guarantees for (some) corporate borrowing and more direct help in covering staff costs, many businesses will fail as a result of the COVID-crisis, and many that survive will be financially damaged. The banks that lend to them are sure to suffer not only credit losses but forgone revenues from the collapse in business activity.

But this is not a reason for fatalism. Such crises can be managed better or worse, not only in minimizing the losses that result from it but in positioning for success once the effects of the crisis have subsided. Corporate banks that can succeed in the five areas we have prioritized will give themselves the best chance of getting through this crisis and prospering on the other side.

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