The economic re-boot and the impact on the business of banking

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Impacts and outlook

Analysis of the current macro-economic climate points towards a large fall in output in the second quarter of 2020. In some countries this could exceed 10%, as large sections of the economy essentially shut down.

Consumer demand will also suffer as social distancing and low confidence lead to a big drop in discretionary spending, especially for big ticket items like recreation, leisure and travel.

On top of this, investment is likely to decline as the pandemic hits business confidence and cashflow, leaving projects postponed or cancelled, and export demand limited by lockdowns elsewhere overseas.

While the short-term contraction in output is set to be large and result in some long-term scarring to the economy.

In the UK, for instance, Experian's central economic scenario projects that output will rebound swiftly in the second half of the year. The analysis assumes that the outbreak is brought under control within a predicted five-month timeframe.

Imperial College London charts a V-shaped recovery in investor, business and consumer confidence, where financial markets stabilise and tightening credit conditions prove to be relatively short lived.

What solutions could help the banking sector in the current crisis?

Though the solvency and liquidity positions of European banks are generally sound, the Covid-19 crisis will deeply impact new lending, capital requirements and the profitability of the banks. Banking operations will be influenced by increased credit, market and operational risks as well as new regulations aimed at mitigating the impact of the economic downturn.

Experience and the resulting learnings obtained from the previous recessionary cycles, in conjunction with the latest advances in technology, alternative data, advanced analytics and regulations provide banks with a wide range of solutions to assist them in facing the current economic shock.

Diversification of distribution channels and growth of digital acquisition

The current crisis has necessitated a large shift in the working habits of employees with most organisations having to adapt to working remotely. Quarantine periods and social distancing affect the behavior of consumers and their channel preferences. These trends are expected to force the adoption of technology and digital processes as well as diversification of distribution channels.

Digital transformation has been one of the key priorities for consumer banking in recent years. It is expected that this trend will continue with a large shift towards digital payments. The redevelopment of legacy systems for cloud deployment and the wholesale adoption of digital origination could emerge as a key theme heading into this recession. Reducing the cost of origination will become ever more imperative.

It is important to note that digital acquisition will not only support new customer acquisition but will also play a significant role in growing relationships with existing customers by making the process of opening a new product easier.

Bureaux, transactional and alternative data and scores will be key elements in the banks' strategies for transition to diversified distribution channels.

Fraud prevention

The rapid growth in the number of distribution channels and complexity of remote banking services creates new business opportunities for financial organisations, but also brings new fraud challenges. It is expected that economic hardship will drive increased levels of fraud. Digital channels make financial institutions even further susceptible to fraud attacks since demand for rapid response adds further vulnerabilities. Fraudsters will systematically target the diverse range of distribution channels such as call centers, web sites, mobile banking and IVR systems. Due to the anonymous nature of these remote channels and the growing variety of service offerings available through them, financial institutions face unique fraud risk challenges and are compelled to address them not only to prevent financial losses, but also to prevent erosion of end-user confidence in the payment systems.

Financial institutions must enable digital fraud prevention for acquisition and transaction monitoring to support the increased usage of digital channels and cost-effective fraud prevention.

Focus on SMEs - regulatory action to support specific customer segments

Government intervention will be one of the biggest areas of focus for the banking sector leading into a downturn. Interest rate adjustments, payment holidays as well as support packages to specific consumer segments will result in big shifts in the macro-economic environment impacting industry in various ways, as we have seen in the aftermath of the last financial crisis. Financial institutions that gain insights into the impact of macro-economic changes and in turn implement adjustments to their downstream processes will be best placed to leverage government intervention for the benefit of their customers. Recent developments indicate that most governments will take strong action to support SMEs. Consequently, the SME sector may experience high levels of economic activity in the coming period and as a result, financial institutions will benefit if they invest in their capabilities to support it. Traditionally SME banking processes have continued to be very manual in nature when compared to the consumer lending space. This could be the time for banks to invest to grow and automate the capabilities.

Growing demand is expected for solutions which will help banks to improve SME lending capabilities through credit bureaux, transactional and alternative data as well as origination models and strategies.

Reduced lending volumes and increased risk levels at the point of origination

Widescale shifts in consumer habits typically occur during downturns as both lending processes and customers adjust to changes in credit requirements. Shifts affect models and strategies built using historical data, resulting in the necessity to recalibrate underwriting models and strategies to incorporate changes in underlying risk profiles. The opportunity to make use of alternative data and strengthen the usage of ML practices in evaluating new credit applications may bring new valuable insights in segments such as SME for example, allowing for more accurate decision making through the identification of swap-sets and segments of high value customers.

Modification of application models' cut-off strategies in the new environment will be among the first critical steps which the banks must take to manage the impact of the crisis on their portfolio.

Understand and anticipate customer issues and needs

We are forecasting changes in customer needs and requirements. There will be big shifts in existing customer behavior and credit habits during a recession. Banks will have to understand these shifts and play them to their advantage. Banks may need to shift more of their attention from new lending initiatives to active management of existing customers, focusing on customer value optimisation, relationship and retention management. Monitoring of the rapidly changing environment, portfolio profile and performance as well as taking the right decisions and actions will be key requirement.

The ability to manage - proactively and reactively - significantly increased volumes of requests for payment holidays, restructuring and refinancing will be critical for the survival of the financial institutions. There is a tendency for banks to focus more closely on managing the risks in times of recession rather than the identifying and taking advantage of upsides. However, during the recession periods wealth strategy shifts in the top consumer segments and strong changes in asset allocation could result in profitable upside strategies. For example, active customer credit limit management strategies which ensure that consumer and business limits are handled at a holistic customer level rather than at a facility level could bring significant benefits.

Facilities like bank overdrafts and credit card limits tend to have peak usage in recessionary periods as consumers adapt to tougher market conditions. Therefore, an enhanced focus on pricing versus risk, in addition to the use of segmentation and optimisation tools is also a strong recommendation.

Modification of behavioural models and optimisation of customer management strategies, focusing on clients with lower-risk profiles for active credit limit management as well as cross and up-sell activities, will be among the key trends likely to be seen during the economic slowdown.

Identifying the vulnerable segments for collection treatment

During recession periods delinquency and forbearance levels may sharply increase. Forbearance impact on provisions will be significant and currently there are no clear guidelines on how to approach it. Some customer segments are likely to be more impacted than others during a downturn. Therefore, conducting a full analysis of the portfolio to identify the vulnerable consumer and business segments will be needed.

Early warning triggers and implementation of a quick yet effective triage systems to channel the customers into corresponding treatment "pools" leveraging on data enrichment packages, pre-built and custom-collection models to create treatment segments, using digitisation to better-serve the forbearance portfolio in a consistent yet cost-effective way.

Early warning systems and triggers, collection and NPL management models and supporting strategies will need much larger investment now.

Economic capital recalculations

Recent regulatory developments provide sound regulatory framework for maintaining the resilience of the banking system. The regulators will also provide extensions for some of the up-coming regulatory deadlines to help banks adjust to the new environment and reduce the impact on capital and liquidity. Recalculating economic capital to account for expected changes in credit, market and operational risks is a necessary step during a recession.

Access to capital during a downturn is wrought with difficulty. Advanced knowledge of the banks' capital coverage and liquidity standing may provide an insight as to the requirement for capital raises. Forecasting and scenario analysis to evaluate the impact of the developing situation will ensure that this is a dimension that is not missed resulting in an emergency requirement at a later date. Technological advancement in the regulatory space allows for more frequent recalculations of capital as well as detailed stress-testing and scenario planning reducing the likelihood of unforeseen events.

Regulatory models, economic forecasting, stress-testing and scenario analysis will provide the banks with crucial insights into the downturn capital requirements.

Operational efficiency within the organization

Financial organisations will have a requirement to focus in on their processes with a view to bringing in operational efficiencies, cost savings and automation. During the crisis banks are expected to face increased levels of operational risks due to closure of working space, as well as suffer capacity issues due to sickness, failures of key suppliers, higher resource demands to manage risks and on-site work restrictions. Areas such as analytics teams will come under increased pressure as they are a key competency responsible for monitoring and managing downturn impacts. Banks will benefit from review of their strategies associated with the headcount intensive side of their business and invest in nearshoring and automation of operations which are resource and IP intensive with the right mix of internal and external resources and capabilities.

Near-shoring and cloud-based collaboration platforms drive operational efficiencies in banks' key competence areas.

Summary - Commercial resilience in an uncertain world

Based on Experian's ongoing analysis for our clients world-wide, we have distilled the following 10 steps for ensuring the continued acquisition of new customers, safeguarding existing customers and upholding business quality.

1. Make the most of market insights and economic information. Despite periods of uncertainty, it's still possible to pave the way for future business growth. Companies around the world are already using economic trend analysis, credit market insights and portfolio benchmarking to best-inform their credit risk strategies. This can include everything from new business acquisition, through to customer management and debt prioritisation.

2. Develop resilient credit management strategies. While efficiency reigns in a surprise-free climate, key to navigating unpredictable waters is resilience. In these times, it's critical to safeguard customers against over-indebtedness. This means balancing customer opportunities with appropriate lending strategies by continually offering the right credit limits to the right customers. But determining the best credit limit for each customer amid evolving circumstances – both at the point of application and during a relationship – can present a minefield. But smart and scalable solutions are available to uphold decision-making and support both risk and operational objectives, whether that's warding off bad debt or minimising business exposure.

3. Update intelligence daily with real-time risk analysis. As unanticipated events unfold with every news cycle, it becomes more vital than ever to keep data at the heart of your strategies. Turning real-time information into insight and insight into action helps businesses make the right decisions for their customers across the customer lifecycle. We all know that data provides the raw understanding that fuels decisions. But it's what you do with it and where it takes you that counts.

4. Safeguard your customers with smarter fraud detection and prevention. Fraudsters are smart, relentless and indiscriminate. During uncertain times, you need make even more effort to protect your customers, your business and society from fraud. The threat of fraud is a shared one and we work closely with industry bodies and other related organisations to reduce the impact on consumers, industry and society.

5. Prepare for a changed world by protecting online transactions. In our ever-evolving digital world, consumers from all walks of life now expect fast, seamless and convenient online experiences - whoever they transact with. While digital channels offer convenience to customers, they can also provide an easy route for fraudsters - especially during periods of turbulence and stress. Consistently delivering the right customer experience while safeguarding them and your business from fraud is essential.

Summary continued...

6. Support small businesses during challenging periods. As foot traffic falls, small, independent and local businesses the world over are having to close their doors. Access to even more small business data can help ensure these closures are not permanent. Experian has already mobilised to help deliver a more complete view of every commercial customer - from SMEs, to micro-businesses to sole-traders. Our Commercial Acumen platform gathers alternative data such as Open Banking and management account information, and combines it with credit history analyses, commercial credit scores and adverse financials to generate deep-dive insights into each business. As a result, you get the information you need to identify the appropriate products and services for each customer, enabling you to make better-informed lending decisions, quickly and fairly that can help support them through this difficult time.

7. Constantly reframe your understanding of the next-best action for your customers. Identifying the right communication channel for each customer and executing it at the correct time, via the most appropriate route, with the right terms, are all critical components of any successful collection strategy. But as repayment habits are continually evolving, selecting the most appropriate action for each individual customer is growing increasingly challenging.

8. Deliver even more data-driven affordability decisions. We all rely on the ability to distinguish between hard facts and speculation. Data and insight can help you make confident decisions, so you can assess affordability quickly and easily. With a more calibrated view under a belt, we're in a better position to understand an individual consumer's ability to afford your products or services, and ensuring we provide the right product for the right customer.

9. Make way for agile customer management strategies. In a rapidly shifting landscape, automating and streamlining customer management and collections processes, will support recovery management initiatives and enable organisations to continually help rehabilitate customers, minimise the risk of exposure to bad debt and maintain revenue streams.

10. Use expert insights to forecast credit risk carefully. To help businesses interpret complex and shifting information, having advanced modelling capabilities at your fingertips becomes indispensable. Where expert opinion can differ on critical issues, combining lending policy and economic forecasts enables more forward-looking risk modelling. This union of the disciplines of credit risk and economics will help you meet continually evolving commercial and regulatory requirements and plan successful credit risk strategies.

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There's no question there's a global appetite to get through the current crisis as quickly impossible highlighted in the USA, which recently passed a US$2 trillion stimulus package, to help shore up and safeguard the economy.

While we're all facing up to short-term pain, the pandemic's impact is likely to be felt for years to come and is set to drive the way we all work from here on. Following the outbreak, there's likely to be a rethink and economic re-boot on numerous aspects of business, industry and commerce. As ever, the banking sector needs to be agile enough to support new and emerging working trends. It's worth considering the impact the following may have on your business:

- Blueprints for remote working, virtual assistants and video-tellers.
- Banking blazes a trail for one-stop shops and the emergence of consumer marketplaces.
- Scaled opportunities of greater connectivity. Even well before the start of 2020, analysts were predicting 5G's arrival would drive US$620 billion in business opportunities during the next decade. Of this, around US$200 billion is expected to come directly from video analytics and real-time automation.
- Critical and appropriate medium-term tax breaks for vulnerable sectors such as retail, e-commerce and hospitality,
- A trend towards alternating remote working with face-to-face working.
- Reduced footfall and a rapidly evolving high street as restrictions on the maximum capacity of stores are imposed, while branch networks are redesigned and strictly re-imagined on a per square metre basis.
- Greater reliance on online channels driven by the growing prevalence of 'live' performance technology.
- Revised work shift patterns for all sectors.
- Revisions to carpooling schemes or staggered commuter slots on public transport.
- Alternate opening times for commercial establishments to better suit specific demographics or key workers.
- Specific opening and operating hours set to better serve vulnerable or at-risk demographics.

How we can help

The circumstances we find ourselves in are unparalleled and changing daily. The way we prepare to weather the impact in the short term will be key to making sure its long-term effects are contained as much as possible – both for the customers in our care and for our own businesses.

If you'd like to discuss any aspect of this report or find out more about how we can support you through this crisis, please get in touch with your Experian account manager today.

While the road ahead may be rocky, and there will be new developments to navigate, we believe that by working together, and bringing you powerful data and tools, we can help you and your customers come back from this crisis strong, secure and ready for a brighter future.

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