Working together to transmit stimulus - action for today

COVID-19

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Introduction

In recent weeks, we have observed incredible efforts to combat the coronavirus pandemic – medically through the response of healthcare professionals, scientifically through the efforts being made to counter the virus, and politically through the efforts to delay, contain, research and mitigate. Through those various efforts the coming together of people and societies, recognizing collective responsibility, has been heartwarming.

In this paper we consider how we can collectively combat the economic impacts. The stimulus measures that have been announced are simply incredible, they are war time in nature and scale, and show significant innovation on the part of governments. However, our collective imperative now is to ensure that stimulus is transmitted successfully, and quickly, to the real economy. This paper is designed to explore how governments, authorities, banks and business leaders can think about doing just that.

We consider we have 5 major, collective, objectives, to:

1. **Act with purpose:** Be clear and consistent on the public interest objective, keep actions based in and fully aligned in this. Deftly embed stewardship of this purpose into design of interventions, in the background begin to consider what this means when the "reboot" begins as the crisis eases.
2. **Swamp the business cashflow deficit and financing chasm:** Avoid major short-term cashflow contraction (due to demand or financing issues); protect "good businesses" preferably outside but especially if entering formal insolvency processes.
3. **Maintain employment, mitigate harm to individuals, avoid exacerbating health system stress:** In particular, minimize job losses keeping labour employed, support the vulnerable, self-employed and temporary workers, mitigate self-isolation and where possible enable labour to redeploy to match short-term demand shortages.
4. **Build business resilience and enable timely recovery:** Assist businesses to adapt to changes in demand, regulation and supply chains, stimulate demand and leverage the role of Government as a customer.
5. **Ensure the financial system remains resilient and able to support medium term "reboot":** Firstly take action collectively or individually as governments to ensure more than sufficient sovereign finance is in place long-term. Secondly, while using the banking system as a transmission mechanism create transparency on risk and ensure banking and insurance markets avoid long term impairment, act purposefully reflecting stewardship principles.

Getting it done: We believe there are several imperatives that need to be adopted, within the constraints of biosecurity but not prevented:

- Recognize the "Purpose" imperative– build public interest stewardship into the design upfront.
- Create an evolving coherent strategic program to act widely with complementary interventions .
- Ensure simple intervention design enabling rapid, sufficient development and deployment avoiding unnecessary execution risk.
- Create multi-skilled execution teams with strong leaders, empower action, remove excessive constraints (e.g., regulation) but do build in sufficient control and compliance.
- Innovate to overcome biosecurity and other constraints; A must do "anything is possible" mindset is needed to breakthrough some constraints.
- Recognize the security and cybersecurity threat.

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Stewardship

A collective, purpose-led response?

The 2008 crisis, its aftermath and the subsequent dialogue have demonstrated the opportunity (and necessity) to address Purpose, Public Interest and Stewardship in major crisis interventions.

Extreme levels of public finances and potential hardship are involved and many topics present a stewardship challenge:

- Allocation and related mechanisms for funds across sectors, regions, segments etc.,
- Shareholder vs. employee benefit (e.g., Private Equity vs. Pension Funds).
- Conduct and governance of those supported.
- Care for key workers and most vulnerable e.g., for single working parents in zero hours employment.

Purpose, Public Interest and Stewardship can itself be part of the problem:

- Inadvertent impact of prudential regulations and accounting standards.
- Excessive reporting and other requirements complicating execution and diverting resource.
- Lender approach to cash flow support, distress and recovery (especially vulnerable groups).
- Insurers handling of claims, risk acceptance, coverage & premiums (e.g., pandemic risk).

...and ideas for how to be purpose led at this time

- Ground all work in the public interest with common purpose of winning the COVID-19 battle, sustaining the economy and mitigating harming, and rapidly rebooting as the crisis passes.
- Root all communication, strategy and design as simply as feasible with this purpose and mind and "boundaries" consistent with it.
- Encourage reallocation of corporate resources to assist the common purpose - to sectors / teams in need, to fight the healthcare battle with COVID-19.
- Shape focus on those most at harm and doing the most for common good but recognize everyone needs support.
- Ensure where appropriate the public interest is "paid back" in the right way.
- Design stewardship of this purpose into interventions in the simplest manner excessive complexity leads to delay and further harm.
- Champion corporate values, and related actions
- Identity critical areas of likely concern – e.g., fraud, misuse of funds.
- Be prepared to challenge norms that may be causing unintended adverse affects.

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Stimulus measures announced – high level overview

A three-way stimulus

- Central banks have lowered interest rates, offered cheap funding to banks for Small and Medium-sized Enterprises (SME) credit extension as well as funding schemes that go direct to corporates. There is a clear message from central banks that liquidity will not be an issue and banks have a vital role in offering credit.
- Governments have offered fiscal incentives to those transmitting stimulus, with unprecedented levels of open financial support on offer. The EU has also made clear that any state guarantees by national governments to support banks, while unlikely to be needed, would not be seen as state aid.
- Regulators have offered several forms of regulatory forbearance, including removal of Counter-Cyclical Buffers and deferral of stress tests, which will all help to provide the playing field on which banks can extend further credit. We have also seen welcome moves to scale back more routine regulatory interactions to allow firms to focus on supporting customers. In spite of this, there is still an expectation from regulators that firms will consider increased and new fraud risks as their operating models evolve. This will enable them to interact with their customers more remotely than previously in this new environment.
- We can expect further interventions if regulators, governments and central banks feel it necessary. For example, the PRA has already started to address concerns around the impact on IFRS9 and the possible impact on banks' capital and ability to lend.

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The stimulus transmission challenge

Our transmission framework

On the following page we set out a framework that considers the breadth of stimulus measures, and their transmission mechanisms to the real economy. In doing so we identify some of the impediments to smooth, effective, fast transmission

Transmission via banks

- We have seen truly co-ordinated action on a range of stimulus measures for the real economy, much of which is targeted at ensuring the banking system plays a central role.
- In order for banks to play a central role they need to be strong themselves. Operationally and financially. Capital levels are materially higher than 2008, with lower debt levels and less reliance on short-term funding. That said, the scale of this event has put significant pressure firstly on liquidity (particularly via the widespread drawing of undrawn credit lines) and pressure on capital will follow.
- The actions that central banks and prudential regulators have taken to introduce liquidity, provide capital relief and significantly reduce the supervisory burden on banks has acknowledged balance sheet distress and is in anticipation further significant demands.
- While banks are a key conduit in transmitting liquidity into the economy, they are also corporations with boards that have fiduciary responsibilities. There is therefore a delicate balancing act that banks must manage.
- We can expect to see more focus in the weeks ahead on how the banking sector is supporting the real economy. As we saw in the aftermath of 2008, there will a high level of reputational and regulatory scrutiny in the way banks deal with citizens, SMEs and large corporate customers. The sector has already made positive steps, such as offering mortgage holidays for three months, and ringfenced funds to support SMEs. We have also seen some corporates already fully draw down on their credit lines.
- There are however a number of challenges in transmitting the stimulus to corporates, SMEs and citizens.
- It will be a challenging next few weeks and months, but if done right, banking could regain much of the trust lost post 2008.

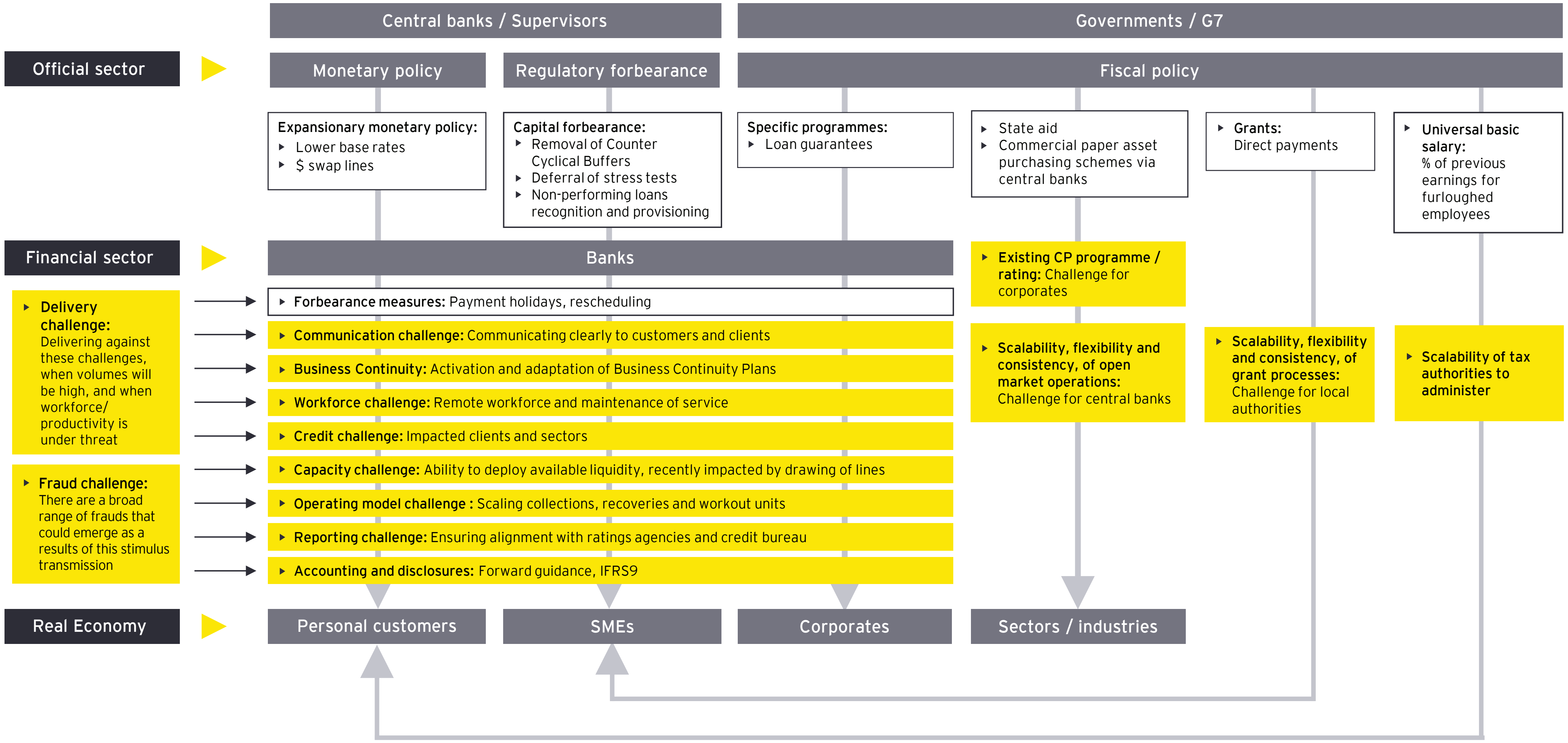
Transmission via authorities

- Schemes which are not to be transmitted via banks typically intend to leverage existing operations. For example, central banks for corporate commercial paper purchasing, local governments for SME grants and tax authorities for salary underwriting. These operations will need to scale fast to cope with demand.
- New capabilities may also be required, for example open market operations teams at central banks may need to start to look and feel like limited scope corporate banks.
- For the federated operations (e.g., via local governments, or via various central banks in the case of the ECB program) consistency of delivery will be a challenge.
- All schemes will also need to protect against fraud, and will need to balance this with delivering at pace.

Ey stimulus transmission framework:

- Seeks to show the range of stimulus measure that we have observed
- How they are transmitted; and importantly
- Identify the impediments to smooth, effective, fast transmission

We can apply this framework, together with our domain knowledge of banking, government operations, central banking operations, corporate treasury operations to help develop practical solutions to impediments.



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A focus on citizens

Ideally stimulus measures for citizens will be limited as a result of the success in transmission of corporate and SME stimulus measures.

To date the main stimulus measure that benefits citizens is the Job Retention Scheme. While benefiting citizens, this is initiated/led by corporates and SMEs.

Additionally however, there is significant expectation for banks to support citizens and a good start has been made with banks announcing forbearance measures on a wide basis, covering payment holidays, and ability to amend products (e.g., withdraw term deposits ahead of term) without incurring fees / penalties.

Like with the SME forbearance measures banks will need to consider the most appropriate operating model for impacted citizens and may well leverage existing approaches for vulnerable customers (insofar as these operations can be adequately scaled). Banks should ensure that adequate fraud prevention and detection controls are in place which address fraud risks.

Example schemes:
UK direct from government (via employers): Coronavirus Job Retention Scheme. HMRC will reimburse 80% of furloughed workers wage costs, up to a cap of £2,500 per month.

UK via banks: Various forbearance measures

Europe: Governments in mainland Europe have deployed a mixture of tax moratoriums, payment extensions on social charges, loan guarantees and wage subsidies for workers who cannot work or move to part-time roles.

Given the breadth of forbearance measures, and the pace of their implementation, fraud risk is likely to be heightened. Banks should consider this fraud risk, while trying to maintain pace and volume of stimulus.

Policy and operations within banks will be moving fast to accommodate impacted customers. As a result there is significant potential, for imperfect customer interactions. Getting those interactions right, now, will not only help support the customer, but will also help to avoid a future remediation program.

Key actions for banks

- Determine policy / criteria for impacted citizens.
- Understand the front to back journey for those seeking stimulus and forbearance, to ensure customers get the right experience.
- Considering leveraging existing processes used for vulnerable customers.
- Understand the incentive set (KPIs, performance management) to ensure it doesn't inhibit financing stimulus.
- Ensure bureaux reporting is accurate and reflects the conversation with the customer.
- Identify new and evolving fraud risks and ensure adequate fraud prevention and detection controls are in place.

Key actions for governments re:citizens

- Encourage citizens to understand what their employers intentions are with respect to the Job Retention Scheme.
- Encourage citizens to talk to their bank about forbearance options.
- Encourage citizens to make sure their credit reporting is consistent with that agreed with their bank.
- Encourage citizens to consider the trade off between short-term liquidity and long-term indebtedness.
- Make it easy for citizens to keep up to date with stimulus announcements.

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A focus on SMEs

Currently financing stimulus packages for SMEs are only available to SMEs via bank lenders (in the UK at least) and therefore as a starting point SMEs should understand their relationships with funders and the extent to which they will have stimulus measures at their disposal.

Ahead of seeking financing stimulus, seeking forbearance on existing commitments may well be the starting point. A good start has been made with banks announcing significant SME forbearance measures.

That said a new operating model is required by the banks to make this happen – to identify the eligible SMEs and then deliver forbearance in a way which means their business as usual collections, recoveries, and credit file reporting operations don't kick in.

The banks will also need to ensure that incentives will work appropriately – existing performance management, and financial KPIs will likely drive banks towards caution in extending forbearance, and financing stimulus and therefore solving these will be important.

For some SMEs obtaining financing stimulus may be the right, and necessary, thing to do. Others may want to consider whether amassing an additional debt is required and should balance it against future indebtedness.

Banks should therefore set themselves up to have a well rounded, affordability based discussion with its clients.

Key actions for banks

- Understand all the levers available to SMEs around rent, rates and other items to advise them on their best course of action.
- Understand the front to back journey for those seeking stimulus and forbearance, to ensure customers get the right experience.
- Understand the incentive set (KPIs, performance management) to ensure it doesn't inhibit financing stimulus.

Example schemes:
UK direct from government: COVID-19: support for businesses link. Including grants (£10k and £25k)

UK via banks: Term Funding Scheme with additional incentives for lending to SMEs (TFSME) – enabling banks to borrow cheaply for lending to SMEs link. Business interruption loans (up to £5m, with guarantee to lender of up to 80%).

Italy: Frozen loan repayments by small and medium-sized companies until 30 September. A state guarantee fund for small and medium enterprises will be boosted by €1 billion and state lender Cassa Depositi e Prestiti will be allowed to guarantee at least €10 billion in loans through a new-set Treasury fund.

SME lending in the UK

The schemes are designed to operate via banks. However, SMEs in the UK are served by a broad community of non-banks as well as banks. In the UK, EY's survey of just 17 non-banks SME lenders identified:

Over **£10bn** of lending balances to SMEs outstanding

£8bn of lending in the last 12 months

>420,000 SMEs served

Key actions for SMEs

- Understand existing banking relationships.
- Keep up to date with stimulus announcements given taking many forms.
- Understand local authority process for grant applications.
- Ahead of obtaining a grant, or bank loan, consider the trade off between short term liquidity and long term indebtedness.

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A focus on corporates

Transmitting stimulus to corporates is such an important step – if corporates can be more confident that liquidity is available then they can be more assertive about communicating with their employees, and their suppliers regarding their ability to maintain employment and supply.

Those with commercial paper programs in both the UK and across Europe should be able to tap stimulus quickly by issuing paper to central banks who have the mandate to purchase it under stimulus schemes.

For those without existing commercial paper programs there is a short-term challenge:

- Either – those corporates will need to put commercial paper programs in place.
- And/or - central banks administering asset purchase schemes will need to underwrite and accept applications from those without existing commercial paper programs.
- Alongside meeting rating requirements and having a commercial paper program, corporates will typically need to demonstrate their contribution to their economy (this is a pre-requisite alongside a commercial paper program).

Example schemes:
UK: Covid Corporate Financing Facility (CCFF) link. £330 billion when combined with other loan facilities being offered.

Europe: Pandemic Emergency Purchase program (PEPP) link. €750 billion (19 March), in addition to €120 billion (12 March). Together = 7.3% of euro area GDP

France: A scheme to provide State guarantees to banks on portfolios of new loans for all types of companies. Expected to mobilize more than €300 billion.

Germany: The German government is providing €500 billion to support the economy through state-owned KfW business development bank.

Commercial paper – quick facts

Commercial paper is a form of short-term debt security. It is typically issued with a maturity of less than 1 year. Corporates who issue commercial paper are Rated.

In order to extend stimulus central banks will need to be able to purchase commercial paper from Dealers (eligible counterparties, per FSMA 2000), and the commercial paper will need to be capable of being cleared through Euroclear or Clearstream (which can be arranged by an Agent).

Given the need to appoint a Dealer and an Agent and achieve a Rating it is typical for it to take 4-6 weeks to create a commercial paper program.

Key actions for corporates

In order to best prepare for discussion with authorities, and banks, around current, and potential future stimulus schemes, we consider gathering the following portfolio of information to be a necessary step

- Historical financial track record (3 year income statement and balance sheet)
- Rating opinions or NAIC rating if available
- Legal entity structure
- Shareholder base
- Existing liability structure (seniority)
- Cash burn
- Any asset encumbrance
- Purpose statement
- Values statement
- Number of employees last three years
- Estimate of total number of employees within its broader supply chain
- Total tax contribution (VAT, PAYE, NIC and corporation tax)
- Key suppliers - list of top 10
- Key customers - list of top 10
- Carbon footprint
- Gender pay gap and how moved
- Examples of recent innovation
- Examples of contribution to government objectives (e.g., Northern Powerhouse, Infra programmes)

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