The Covid crisis: how the banking and finance industry can be part of the solution

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How the banking and finance industry responds to the Covid crisis and how it behaves in the next few weeks and months will define its relationship with government and society for the next decade. We strongly believe that capital markets have a vital role to play in supporting the economy through this crisis and in driving a recovery - and that the industry can be part of the solution.

But…it will be vital in the coming months that the industry demonstrates a clear sense of purpose and avoids the mistakes and types of behaviour that have got it into so much trouble in the past.

This is the first in a series of papers and events from New Financial on how the banking and finance industry can respond to the Covid crisis. It focuses on 10 things the industry should and should not be doing right now to demonstrate that the industry can be part of the solution. It is based on conversations with member firms, examples of how many firms in the industry have already responded in the past few weeks, emerging examples of best practice, and some of our previous work.

Here is a short summary of this paper:
Despite the huge operational challenges involved, we take as our starting point that firms should be focusing on their day job: helping companies raise capital, borrow money and manage risk, helping deliver long-term returns for investors, allocating capital, and supporting liquid and resilient markets.

1) **A clear choice:** the industry will in future be divided into firms that took advantage of it and those that supported their staff, customers and society. Which side do you want to be on?
2) **Look after your staff…:** the first priority for the industry is to look after its staff, keep them safe, treat them well and recognise that they are working hard in difficult circumstances.
3) **…but not too much:** nothing will accelerate a backlash against the industry as fast as banks and asset managers paying big bonuses when the rest of the economy is in crisis.
4) **Look after your customers:** firms should redouble their efforts to support and listen to their customers, putting their interests ahead of their own, and be as flexible as possible - particularly with smaller firms.
5) **Give, give, give:** the industry should donate or lend whatever it can spare - advice, staff, equipment, IT, time, money, real estate - to governments and charities.
6) **A longer-term view:** suspending measures that reward shareholders over customers such as dividends or buybacks and consciously stepping back from shorter-term or more questionable activities will send a powerful message to government and wider society.
7) **Collective action:** where possible the industry should work together to develop new norms and standards and start thinking about creative ways in which firms can work together.
8) **A suspension of hostilities:** the industry should not confuse temporary relief in some areas of regulation with an opportunity to use the crisis to lobby for more substantial or permanent regulatory reform or changes in tax policy.
9) **An eye on the future:** firms need to juggle firefighting the immediate crisis with keeping an eye on big issues such as Brexit, industry restructuring, and preparing to support a recovery.
10) **Don't let a good crisis go to waste:** on the other side of this crisis there will be huge demand for more investment in infrastructure, innovation and sustainability. How can the industry prepare and respond?

1) A clear choice

When the history of this crisis comes to be written, the financial services industry will be divided by public opinion into those firms that saw the crisis as an opportunity to take advantage of it and those who instead stepped up to support their staff, their customers and wider society. The question is simple: which side do you want to be on? In the coming months, the industry collectively will need to demonstrate that it has moved on from the culture and behaviours that helped feed the last crisis and which caused the wave of scandals in the industry over the past decade.

One approach will be for firms to refocus on their underlying purpose and to think of the 'optics' of everything they do. The late Dan Tully, the former head of Merrill Lynch in the mid-1990s, had a good maxim for how companies and their staff should behave (that he didn't always manage to keep): that you should never do anything today that you wouldn't be proud for your mother to read about on the front page of the newspapers tomorrow.

Of course, there are many aspects of banking and finance that will inevitably look 'unsavoury' to politicians, the media and the public on the other side of this crisis. Investment banks are likely to see a big increase in sales and trading revenues, many hedge funds will make a lot of money from short-selling, and many companies will inevitably go under because banks were unable to lend them money or investors were unwilling to support them. Firms will need to prepare their response to these issues now and in the meantime avoid do anything that could trigger any further backlash.

2) Look after your staff…

For an industry where the most important assets go up and down in the lift every morning, the immediate priority for firms is to look after their staff, listen to them, and be kind. Many of them will feel anxious, remote and disorientated, and will be working in stressful conditions in kitchens, spare rooms and home offices with sub-optimal IT, while juggling work with childcare or home schooling. Those employees who are still working in the office will need an additional level of support and protection. Firms should be as flexible and accommodating as possible in terms of working hours, holidays and time off, and responsibilities for caring for vulnerable relatives and friends.

While this crisis will have an economic impact on the industry in the short to medium term, firms should avoid wherever possible making staff redundant to save money: if necessary, they can use the UK government's job retention scheme and top up the 80% of salary in full even if they don't feel able to guarantee people's jobs for the rest of the year (as a number of banks have already done). Contractors and suppliers - particularly those on lower incomes such as cleaning or security staff - will be apprehensive about their future and ideally should still be paid even if they are not working.

Many staff will need a different, more personalised and more intensive (perhaps 'better') style of management through this period. Managers will need more training and will need to set more realistic targets and expectations. A lot of lower paid staff in the industry on the front line will also have acute financial concerns and a particularly stressful workload. A number of firms such as Bank of America and JP Morgan have set a good example by offering small upfront payments to them. Firms with a strong shared culture and a clear sense of purpose will be in a stronger position to support their employees and will likely benefit from that support in future.

3) …but not too much

Firms should be wary of supporting their staff - particularly their highest paid employees - too lavishly. Nothing will accelerate a backlash against the industry as surely as banks and asset managers paying big bonuses at a time when the rest of the economy is in crisis. Any argument that these rewards are based on performance or retaining talent is likely to fall on deaf ears and may be counterproductive. Regulators and policymakers will also take a dim view of any imaginative attempts by firms to get around the 'requests' from supervisors to show restraint with bonuses.

Any firms that use public support - such as the job retention scheme or, if the crisis deepens, any form of bailout - should significantly reduce what they were thinking of paying their senior executives this year: a useful rule of thumb might be to think of a much smaller number than last year and halve it. A good example to follow might be Santander, where Ana Botin has taken a 50% pay cut and will donate the rest to a Spanish medical charity.

The same approach should be taken to bonuses more broadly. The Bank of England and ECB have already called on banks to show restraint with bonuses to preserve capital. While a lot of firms will have seen a boom in their sales and trading revenues from the increase in volumes and volatility, they should resist the temptation to pay out 'business as usual' bonuses for this year and brace themselves for a bumpy political and media ride in a year's time. In the longer term, this crisis may be an opportunity for firms to reflect on the bonus culture in the industry, rethink how they measure and reward performance, and reassess the relative value and reward they apply to different roles.

4) Look after your customers

It is imperative that the industry supports its customers in every way possible and puts their interests ahead of its own. This is not about preserving unviable businesses but ensuring that any company that was viable before the crisis can access the emergency funding it needs to survive through this crisis. Wherever possible, firms should be reaching out to customers proactively to discuss their concerns, listen, and help address them. This should not be confused with an opportunity to sell them more products. Any sense that firms are taking advantage of customers' distress by changing existing agreements, pushing products, setting unfair terms or hiking fees will shoot the industry in the foot.

While many firms in the industry are facing economic challenges of their own (from lower activity, lower asset values or higher default rates and loan losses) they should try to balance this with being as flexible as possible with their customers. This might include payment or fee holidays; temporarily reducing fees, lowering hurdles or accelerating standard processes; forbearance on debt and flexibility on any covenants or guarantees. A loyal customer in future will be more valuable than an angry one today. Despite the early teething problems, banks should actively support government-backed schemes (such as the CBIL small business lending scheme and CCFF scheme for larger companies).

This is particularly acute for smaller firms and individuals, many of whom are facing an existential crisis: big firms can weather a crisis for a few months but many smaller companies may be wiped out. Few things (apart from paying big bonuses) will be more corrosive for the industry than headlines about SMEs being hung out to dry.

5) Give, give, give

The banking and finance industry should step up a gear with its philanthropy and CSR initiatives in response to this crisis. Firms should donate anything that they can spare that may be of any help to governments, healthcare systems and charities: for example, providing free advice and feedback to governments and regulators; staff with time on their hands could be seconded remotely to government departments or charities that could benefit from their expertise; firms with supplies of disaster recovery equipment can donate it (BNP Paribas has donated half a million masks to the French government) or buy it for them on their behalf (see Apple). Charities will be desperately worried about their future and in need of cash, supplies and support.

Any firms with empty real estate could offer them up them as temporary shelters for the homeless, the sick or people in need of social care. In particular, firms could redouble their support for local communities near their offices, where schools may need laptops or IT support to provide online schooling, or where vulnerable and elderly people may need deliveries or just a phone call.

6) A longer-term view

If firms haven't already done so, they should cancel any proposed dividends and any plans for share buybacks in the foreseeable future (as the Bank of England, ECB and BIS have already requested for banks) and advise their clients to do the same. This is not just to conserve capital and enable the industry to play as active a role as possible in supporting the economy, but to avoid the negative 'optics' of prioritising shareholders over customers when the economy is in crisis. While share prices will be punished in the short-term if firms cancel dividends or buybacks, they are likely to be punished more in the long-term if they don't.

Firms should consciously step back from a short-term approach, try to ignore short-term measures of performance (Q1 and Q2 results and fund performance rankings are going to make for unpleasant reading), and actively commit to focusing more on the longer term. They might also pause for thought before engaging in or facilitating practices that might be perfectly legitimate in a 'normal' environment - such as short-selling - but which smell funny in the current climate. Now might not be the best time to launch an activist campaign on a company or a hostile takeover. As Andrew Bailey, who has probably had the most lively first few weeks in a new job since Harry Truman, said: "Anybody who says, 'I can make a load of money by shorting' which might not be frankly in the interest of the economy, the interest of the people, just stop doing what you're doing."

7) Collective action

The banking and finance industry is fiercely competitive but where possible (and within the constraints of competition law) the industry should work together through this crisis. For example, individual firms and trade associations have an opportunity to quickly develop new industry norms and best practice on everything from staffing and working practices, to dealing with customers, transparency, bonuses and fees. While these measures may only be temporary, they will help reinforce the view that the industry is behaving responsibly and reduce the burden on individual firms of trying to reinvent the wheel and cope with the pressures of this crisis on their own. This approach will also help isolate and identify outliers: on the other side of this crisis it will be important for the industry to avoid exposing itself to any collective criticism of its behaviour.

In the medium term, the industry might take a more creative approach; for example, the Business Growth Fund, which provides growth equity funding to small companies that fall between the cracks of venture capital and private equity, was created in 2011 as a joint venture between the big five UK banks (albeit with a big nudge from the government). The industry could apply similar thinking to regional or sector-specific lending and investment funds - some regions and sectors of the economy will be hit far harder than others - or to the highly political issue of bank branches in smaller towns (perhaps through a jointly owned utility to provide open banking branches).

8) A suspension of hostilities

Regulators and supervisors have demonstrated an admirable degree of flexibility in delaying the implementation of certain aspects of incoming regulations (such as changes to loan loss provisions), postponing consultations on new rules, or relaxing existing rule (such as pre-emption on raising equity) and allowing firms to use their capital buffers. But the industry should beware of confusing temporary relief with an opportunity to push for more permanent and substantive changes at this time.

Every firm has a particular piece of regulation or tax policy that they love to hate and would love to see abolished or reformed. However, any attempts for the foreseeable future to use this crisis as an occasion to lobby for the reform of the long list of policies that have been put in place over the past decade (regardless of the intrinsic merit or otherwise of those policies) is likely to not only fall on deaf ears but provoke a backlash against the industry. Equally, any efforts to find imaginative ways round new or temporary rules will likely backfire.

A better approach for the next few months and years will be to focus on demonstrating how the industry played a vital role in supporting its customers and the economy through the crisis, and how it can help drive a recovery in future. Given the huge amount of debt that governments (also known as 'the public') have taken on, there is likely to be raft of new and higher taxes in the next few years to pay for it. While the industry may not like it, it may be best to take it on the chin for now.

9) An eye on the future
One of the biggest challenges in any emergency is getting the balance right between firefighting the immediate crisis and thinking about the medium and longer term. Big issues like Brexit, the Balkanisation of regulation or ESG are not going to go away and firms will need to keep half an eye on some of the following issues and be ready to swing into action at short notice to address them.

- **How to support the recovery:** the crisis provides a political imperative and political opportunity for the industry to demonstrate that its core role is to support the wider economy and help drive the recovery that will be urgently needed. What can the industry do to fuel this recovery? Where should it focus its efforts and how should it prepare?

- **Brexit still means Brexit:** with every day it seems more likely that the UK's exit from the transition period at the end of December will be delayed. The chief negotiators on both sides have contracted Covid-19, the negotiating teams won't be able to meet face to face for months, and national governments and regulators are rightly focused on this crisis. Firms will need to continue to prepare for the worst-case scenario on January 1st, which will be complicated by the fact that it may be impossible to relocate staff for the foreseeable future.

- **Bracing for change:** like all crises, this one is likely to accelerate reform and change. Established business models and practices are likely to come under increased scrutiny - such as fees in asset management, quarterly reporting, share buybacks and short-selling - and the crisis is likely to trigger a rethink of financial orthodoxy on issues such as capital efficiency, measuring and valuing sustainability in its broadest sense, the differential tax treatment of debt and equity, and the issue of pay and bonuses. Better to get on the front foot and start thinking about these issues now than to hope that they will blow over.

10) Don't let a good crisis go to waste
You should never let a good crisis go to waste: amid the economic and market turmoil there are a number of factors that should help the industry demonstrate its value: capital markets have already shown how they can help setting a new record for investment grade corporate bond issuance last week as companies rushed to raise cash and in the recent flurry of rights issues.

In particular, there will be huge demand in future for more investment in infrastructure, innovation and sustainability (in the widest sense of the term) that capital markets can help meet. This will collide with some existing trends that are already making capital markets more relevant to people's every day lives. First, under auto-enrolment in the UK, more than 80% of people now have some form of workplace pension and while the value of defined contribution assets from auto-enrolment is relatively small (and will have taken a big dent in the past few months) they will grow into trillions of pounds over the next few decades.

And second, sustainable finance had already been catapulted up the agenda by the climate emergency (the E in ESG). This crisis is likely to inject more urgency in the S in ESG (social issues such as how companies treat their employees, customers, suppliers and communities) and accentuate the G (governance and how companies are run). Asset managers should keep a close eye on how the companies in which they invest are responding to this crisis and investment banks should apply tougher social and environmental filters on their clients. Capital markets will have an even more important role than before in helping finance the transition to a more sustainable economy.