Coronavirus: Survivor Edition

by Charles B. Wendel

First, the good news. The economy has started to move forward. This Monday's *Wall Street Journal* points to positive changes: "Truck loads are growing again. Air travel and hotel bookings are up slightly. Mortgage applications are rising. And more people are applying to open new businesses." The WSJ goes on to say the economy is "slowly creeping back to life." The New York Times reports more people are accessing Apple Maps for directions. Even dog walking is picking up. That means people are going out and back to work.

If you are running a relatively new bank or expanding into a new geography, you have a great growth opportunity. With no or little significant existing loan portfolio, you can *selectively* add new clients. We have spoken with several banks in that position; they see companies coming to them in instances in which customers say their bank has gone MIA or has become hedgehog-like. Customers fleeing unresponsive lenders can bring low-cost deposits while paying higher spreads and fees than a few months ago.

At the same time as good news and business opportunities are growing, we are about to exceed 100,000 deaths, and the pandemic is harming companies, many of which will not survive or will require long recovery periods. Their banks face a struggle as they manage through current loan portfolios. A CNBC story discussed a new IMF report on bank challenges: "The fund said the Covid-19 economic downturn will 'test banks' resilience" as they face loan losses and tighter margins from low interest rates. Despite the capital and liquidity cushions banks possess, the IMF recommends ending buybacks and dividends.

Two lending groups, Fintechs and banks, need to address related but different problems.

Fintechs. At the end of a conversation with a Fintech owner last week, he said, "We need to focus on survival." Many Fintechs may be in that situation.

Banks have long claimed that, come a downturn, Fintechs would suffer from a tsunami with the inevitable negative outcome; they may have been right. Some Fintechs need to address a deteriorating loan portfolio from current borrowers, limited new loan volume opportunities, a dead securitization market, and an anxious Private Equity ownership group that may hesitate to keep investing. Many lack the liquidity and capital cushion of banks, albeit a bank's cushion may be less today than yesterday. An article on the PYMNTS.com website quotes a German banker's observation: "FinTechs typically do not have a huge balance sheet, and it can be very expensive for them to use a large amount of equity to finance their loan portfolio and keep growing." That assumes they have the equity available.

Fintechs with substantial loan books need to conduct a level of customer analysis that goes beyond the algorithms they used to approve initial loans, but they may lack that expertise and need to bring in third parties. Many have already shifted to put increased focus on providing platforms to banks, recently related to PPP lending, but the “platform” market seems oversaturated with many vendors including Core systems providers and accounting firms in this space. Platforms also make most of their revenue from loan volumes and that is likely to be reduced for months.

Consolidation with other Fintechs to broaden the product set (Consumer, Student Lending, and Business Banking) may be one option. Sale to a bank or credit union, in effect becoming their in-house digital bank, may be another, although the sale price may not be attractive and how many banks today are interested in this type of liaison? If they have the option, time, patience, and pivoting when new opportunities arise might be their best approach.

Banks. For some Fintechs the end is near, but hundreds of banks must resolve a similar existential threat.

The type and extent of loan losses differ from the past. Whole industries, some no surprise like CRE, restaurants and franchises, have been impacted, but some segments that had been highly prized have unclear futures. Are dental, medical practices, vets, plastic surgeons, and hospitals at risk? Who would have thought that? Banks need to review the makeup of their loan portfolios with three buckets in mind: recovery likely, recover possible (over what time frame and at what risk?), and recovery unlikely, thereby acting accordingly.

Many community banks performed admirably during the PPP process, we hope a one-time event. They pulled their troops together quickly, broke down internal barriers, and made fast approval decisions regarding IT partners, creating much good will. *Now what?* After 2008-2009, smart banks increased their diversification away from CRE lending; that shift needs to move much faster, ASAP, meaning that banks must find new revenue streams; easier said than done.

Banks need to *invest more in digital* to reduce costs and improve the customer experience and do so at a pace similar to their speed during PPP, but banks are often much better at creating a lengthy decision process than making a decision. How do they build a culture that encourages speed, internal cooperation, and quality decision-making? How do they focus the professional “no-ers”(often from compliance, legal, and other “support” groups) within the bank?

Perhaps the major reason hundreds of banks may disappear results from *executives unprepared or unwilling to manage through this crisis*. Management may not possess the bandwidth or desire both to manage through the loan issues and plan for the future, whether the planning involves technology, new market segments, or managing customer relationships differently than in the past.

A more self-reliant, savvy, and demanding customer requires a new approach by banks, one in which quick decision-making and an ability to pivot become essential. In some cases customers are pulling their banks into new directions rather than banks being proactive.

Using Zoom and Microsoft Teams, we have begun working on these and related issues. Despite uncertainty and in fact <u>*because*</u> *of it, all FIs need to focus on the future as they manage current portfolios and changing customer expectations.*