# ALAN MCINTYRE: THE NOW AND THE NEXT FOR BANKS

## AMERICAN BANKER PODCAST TRANSCRIPT

**Rebecca McReynolds:** Hi, and thanks for joining us. While every industry is being tested by COVID-19 and its economic fallout, banks are balancing dual responsibilities. First of course, they're working to serve their customers while protecting their employees and ensuring their own continuity through this pandemic. On the broader stage though, banks will also play a critical role in moderating the economic damage this crisis is expected to cause.

To help banks manage both the short-term and long-term impacts of COVID-19, Accenture has identified four key areas that banks need to be focusing on right now and is providing guidance on how we can all come out stronger after this pandemic is over. Alan McIntyre, Accenture's senior managing director for banking, is here to talk about those issues and strategies. Alan, thanks for joining us.

**Alan McIntyre:** It's a pleasure to be here.

**Rebecca McReynolds:** Well, first of all, how ready was the banking industry to cope with this crisis? It's obvious that the pandemic is a black swan but were they prepared and equipped for this amount of turmoil?

**Alan McIntyre:** I think the answer is both yes and no. Yes in that many bank business continuity plans ended up working very well. And whether it was trading floors to establishing virtual call centers, many of the banks that we deal with had 90 percent of their employees working productively from remote locations within a couple of weeks.

Now, that being said, the service levels weren't always great. We've heard a lot of stories about three-hour call center wait times and other issues as banks transitioned. But I think that the basic access to money, payments, financial planning all worked pretty well. So I think a lot of the banks were happy with that transition. I heard recently from Jamie Dimon at JPMC who commented that the bank had their single largest payments day ever with just over $7 trillion being moved, all processed by people working remotely.

So I think that's a yes answer to the question, which is the industry did transition to remote working and remote operations relatively smoothly. But the no aspect to the question is, I think that the most common response in terms of the ability to cope at this point has been regret. Regret that more progress wasn't made to becoming more digital, to be more in the cloud, to be more automated and to have higher levels of digital sales when the industry had the chance to do so. So, regret that they didn't move quicker over the last five years and that this pandemic has highlighted I think that there was things that could've been done that weren't done.

**Rebecca McReynolds:** I understand that Accenture has analyzed the likely impact on banks across the board and you've concluded that there are four key areas that will be hardest hit. The first is credit management. Why?

**Alan McIntyre:** I think there are many differences between the financial crisis of '08 and '09 and where we are today. And I think one of the principal ones was that the '08-'09 crisis was first and foremost a liquidity crisis. That's what took down Lehman Brothers. That's what triggered many of the other crisis interventions. And I think the regulators and the central banks learned that lesson. And in this crisis, they stepped in early to ensure that their liquidity dominoes didn't stop falling.

There have been some pockets of failure like highly leveraged commercial real estate investment funds where margin calls have essentially driven them into bankruptcy and foreclosure. But in general, I think the liquidity tap was turned on very quickly and effectively. And ultimately, lack of liquidity can kill a bank very quickly.

But I think the contrast with where we are now is that this crisis is going to be characterized by a multi-year credit event. So it's going to be more of the small thousand cuts as both consumers and corporates struggle to make loan repayments.

I think the other thing to highlight about this crisis versus '08-09 is that this is first and foremost a public health crisis, triggering a crisis in the real economy, rather than a financial-sector-generated crisis then following through into impaired assets.

I think you can see the credit crisis on the horizon here. You can see preparations being made. The top five US banks have taken $24 billion in new credit provisions. But I think the reality is that the real impact won't be felt for a number of quarters because some of the fiscal stimulus and some of the forbearance that's been put in place with respect to payment holidays, the fiscal stimulus checks to both small businesses and to consumers—that those are going to create somewhat of a phony war, I think, over the next couple quarters. But that is going to wear off probably in Q3, Q4.

So if you think about the economy, both consumers and businesses needing a fixed dollar amount of capital to get through this crisis, then later in the year, the onus to provide that is going to move from public to private. And I think that's why we think credit management is going to be a critical differentiator here and that credit management is very quickly rising to the top of most banks' agendas.

**Rebecca McReynolds:** So instead of waiting for government action, should banks be more proactive in providing credit extensions and similar customer support?

**Alan McIntyre:** I think that the immediate priority for a lot of banks is to be seen as good partners of the public sector and provide efficient transmission mechanisms for fiscal policy. I think a good example of that in the US is the Small-Business-Administration-backed Hero Protection program that at this point is providing over $700 billion of small-business forgivable loans.

And I think one of the things that we got right was that the incentives provided to the banks to participate in that type of program were meaningful and hence, the US banks have all went in. I think a good contrast here is with the UK, where the banks had to take on more of the risk for business continuity lines and the initial efforts were a little bit of a bust because the program wasn't attractive. But as I said, I think that while the immediate focus has been on being a good partner for the public sector, sometime later this year, that's where it's going to be game time for the banks I think in terms of picking up the emphasis on providing credit extensions and some customer support.

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And that’s where it's going to be front and center. I think one of the most interesting questions about this crisis is how surgical the banks are going to be in providing that support. In the short term, a lot of the public sector support has been broad-based but I think the reality is, post-COVID, that the economy is going to look very different. So the question of where banks provided proactive credit support versus where they maybe take a step back and say, this is a sector that’s not going to look the same post-crisis as it did last year.

I think you take commercial real estate as a good example of that. The chances are we're never going back to having the same number of people working in large offices that we did in 2019. So at some point, the commercial real estate sector will need to get restructured. So I think that the fallacy that everything will go back to the way it was before, that would lead to higher credit losses than a more nuanced approach.

So, I do think that the banks will be proactive in managing credit. But, I don’t think that we'll really see the differentiation happen bank to bank until later on this year. And I think that’s where a lot of the data and analytics firepower that the banks have developed over the last decade is going to be turned towards credit management and figuring out the right strategies to take to provide the right support to the right customers at the right time, while also trying to do the right things on a macroeconomic basis for the bank's shareholders.

**Rebecca McReynolds:** What's the upside for banks for doing all this?

**Alan McIntyre**: I think the upside is principally to be seen as heroes rather than villains, to be seen as a sector that helps moderate rather than amplify this crisis and to be perceived as advisors and supporters. I think that in times of financial stress, most consumers don’t turn to their banks for advice. We've recently done research that suggests that only 14 percent of customers look to their bank for advice in a period of financial stress. So that indicates a pretty material trust gap.

So I think this crisis, given that it wasn’t generated by the banks, provides an opportunity to close some of that gap and I think it will require an appreciation of long-term customer value rather than short-term profit maximization. I think there's upside for banks here in being good partners both for the public sector and for their own customers to help navigate this crisis and as I said, absorb some of the financial stress, rather than being a source of that financial stress.

**Rebecca McReynolds:** The second area of concern is revenue compression. We're already seeing that, right?

**Alan McIntyre:** Yes. I mean we expect, if you look globally, for banking revenues to be down 5% to 7 percent in the next year. It's probably going to be higher in Europe and it's going to be lower in Asia with North America being somewhere in the middle. And that revenue compression is coming from a couple of different sources. One is that the emergency interest rate cuts that we've seen the central banks take around the world has a compression impact on net-interest margin. Rates were already low and have gone lower, which over time is going to compress the margin.

I think another area where we'll see revenue drop meaningfully is in payments. Payments is a revenue stream that's closely correlated with overall economic activity. So our estimate is that payments revenue alone could drop by north of $100 billion globally. But again, it's going to be concentrated in certain areas like travel and dining and hospitality. So yes, we're already seeing the impact but I think really, the overall revenue impact for the banking sector may take four quarters to really be visible.

**Rebecca McReynolds:** Where else will revenue be impacted?

**Alan McIntyre:** I think we're going to see other fee income lines be impacted. I think a good example is if you look at the US banking sector is overdraft and account service fees. In a typical year, that is still $20 billion plus of revenue for US banks. Yet, in the current crisis, we're seeing a waiving of many of those charges. So again, if you look over the next 12-month period, you could be seeing a multi-billion dollar impact there. Also in things like wealth management. There's been a flight to safety. There's been a drop in the stock market, even though we're coming back. So anyone who was relying on fees driven by asset under management may have seen a 30 percent drop in the first and second quarters on those types of revenue.

**Rebecca McReynolds:** The third area of impact is customer service and advice. How is the pandemic changing customer behavior and banks' ability to respond to those changes?

**Alan McIntyre:** If you look at what psychologists say, they will tell you that it typically takes an individual 60 to 70 days to form effective new habits, like say going to the gym on a regular basis.

In the US, in most states, we're now at least 50 to 60 days into the lockdown. So new habits about how to deal with your bank are already being formed. And while many banks have kept some physical locations open, there's clearly been a surge in remote and digital interactions.

And as I said, some of those experiences haven't been great. So if you look at the lines for drive-thru teller windows, or if you look at the wait times for call centers, the banks have struggled with some of that capacity. So what's happened is that people have gone to digital solutions and they have interacted a lot more online and through apps than they might have before.

I think what it's showing is that reality is that US banking was not ready to be 100 percent digital. Even last year when we looked at research around which products for retail and commercial clients in the US could be opened end-to-end digital, it was still only around 10 percent. So over the last couple of months, a lot of banks have had to cut corners. They've had to accelerate their digital roadmaps and I think a good example of how behavior has changed is something like auto finance. If you bought a car last year, many people were still forced to go sit in that small windowless room at the back of the dealership with the finance guy, watching six feet of documents come off a printer to sign.

It's been amazing how over the last couple of months, auto finance has immediately moved online. You cannot only buy a car online, you can also do the financing online and then have that car delivered to your door. And I think that that's a good example of a process where we're never going to go back to what it looked like six months ago and where the way in which customers interact with financial institutions has been fast forwarded by at least three, if not five, years.

**Rebecca McReynolds**: Banks were already moving towards digitalization. Do they need to accelerate their digital plans now or is this something they can worry about when the crisis is over?

**Alan McIntyre**: I think one of the critical questions for banks over the coming months is how much they want to be reactive versus proactive when it comes to shaping sort of new customer-engagement models. So if you take physical branches as an example, do banks take this as an opportunity to accelerate closure programs or do they let themselves be guided by customer behavior and run the risk of having a couple of years of underutilized branches before they take action.

So I think the question of how they accelerate could either be driven by the sort of settling of the new normal of customer behavior or banks could be a little bit more aggressive about saying we've demonstrated that you can interact for most things online. Why don't we push that forward? Why don't we take the lead?

However, I think that there's also concerns about the speed at which we've moved to digitalization. And one of those concerns is about security and the robustness of many of the processes that have been put in place quite quickly over the last couple of months. I think the reality is that behind the scenes, many of them have been duct-taped together. And now that we're settling into a new normal, the industry I think is going to need to go back and look at them from a controls and a governance standpoint. I mean there's been a lot of regulatory forbearance and understanding with regulators saying, yes, do what you need to do in order to serve your customers.

I think that regulatory forbearance will begin to wear off later in the year and that those regulators are going to come back and they're going to start looking at processes, which have been accelerated to digital, and asking whether they are fit for purpose, whether they are more open to fraud and abuse, whether their lending practices have been followed. So, I do think that digitalization will have been accelerated but I think in the second half of the year, we may see a little bit of the banks walking it back a little bit to ensure that the trade-off between a digital customer experience and good security and fraud prevention is the right balance.

**Rebecca McReynolds:** All of this upheaval takes us to the fourth impact area—operating-model adjustments and cost controls. What are Accenture's projections for the banking industry once some of this dust settles?

**Alan McIntyre:** Well, as I said, I think we definitely see revenue dropping and we're probably seeing it dropping five to 10 percent. The impact on profitability is going to be more severe than that. We think globally, looking at the sector as a whole, profitability is probably going to be down 20 to 30 percent. In a market like Europe, which was already structurally less profitable, we think it could be 50 percent-plus profitability drops in most markets. And that's coming from a combination of the revenue compression and some of the higher credit costs that I talked about.

And you see that drop being baked into market valuations with banking indexes in all the major markets trailing the broader stock market indexes and banking being one of the top five sectors impacted in terms of market capitalization. So banks are going to be forced to either go to their shareholders and say you're going to need accept structurally lower profitability over the next one to two years, or they're really going to have to think quite aggressively about operating-model adjustments and cost controls. And that's where I think some of the things about being proactive in terms of maybe shrinking branch networks are going to come to the fore in order to reduce headcount and reduce operating costs.

**Rebecca McReynolds:** That's going to be a big hit to bottom lines though. How can banks prepare to absorb it?

**Alan McIntyre:** I think one of the things that we're going to see is that this year may be a little bit of a "kitchen sink" year with a lot of stuff that the banks may have wanted to do in terms of cost write-offs and adjustments being loaded into this quarter and next quarter. As I said, the big US banks took $25 billion worth of provisions during the last earnings cycle. I think the hope of many of them is that credit losses will be lower than that and that they can write back some of those provisions to improve profitability maybe this time next year.

I think you may also see a bunch of write-offs of both physical and technology assets happening where there's a recognition that they're maybe not fit for purpose in the new world. A good example, I think, has been National Australia Bank in Australia, who at their last earnings point, took a $1 billion software write-off. Because they said a lot of what we've invested in over the last few years is not going to be that useful for us going forward.

So I think that you will see banks trying to absorb a lot of the hit quickly and also try and take a lot of sort of investment decisions quickly that will better prepare them for when the economies come back and will allow the sector to rebound relatively quickly and tell a positive story maybe is no more than three or four quarters from now.

**Rebecca McReynolds:** Unfortunately, nobody has a crystal ball but looking ahead, will things ever really go back to, "normal"—and should we even want that?

**Alan McIntyre:** I think in my experience of being a banking consultant for over 30 years, this is probably one of the periods in my career where there's the most ambiguity. There's really the most uncertainty about how things may look going out one to two years. And I think that's because this isn't a typical macroeconomic cycle. This is really a public health crisis and we don't know how that public health aspect is going to play out, which is why you hear this sort of alphabet soup of what the macroeconomic outcomes might be.

I don't think it's going to be V-shaped. It may be W-shaped. It may be U-shaped and it may be L-shaped. And there is a lot of uncertainty at this point about how the macroeconomics are going to play out. I think what is clear is that we won't go back to normal in terms of either the nature of the banking workforce or the nature of customer behavior. I think we could be in a world where there's a relatively strong bounce-back if we get a vaccine.

But even at that point, I don't think that the banking industry looks like it did in 2019. I think behaviors will change. Operating models will change. And I think that even in a relatively quick bounce-back, we will, with hindsight, look at this as a period in which banking changed significantly. But there is a maybe darker scenario, where just like with the Spanish flu, there's a big second wave of infections. I think at that point, the industry may look quite different. 2021 could be a year in which we're looking at major solvency issues for many banks as they take a relatively deep set of credit losses.

The banking industry is certainly in far more robust shape from a capital perspective than it was in '08-'09. So I think under most scenarios that we've looked at, the industry is capable of absorbing the credit losses. But again, I think the real uncertainty here is not the uncertainty around the economics—it's uncertainty around the public health aspects and how they play out into macroeconomics over the next one to two years.

So I don't think we're going back to where we were before but I think the nature and the depth of the crisis will partly determine what the banking industry looks like two to three years out from now.

**Rebecca McReynolds:** Accenture has put together and extensive checklist of short-term actions banks can start taking today to buffer the impact of COVID-19. Where can our listeners find that?

**Alan McIntyre:** I think we have curated and put together on Accenture.com a wide range of COVID-related material, some of which is general in nature, like what does it mean for the future of work? What does it mean for people going back to sort of regular office employment versus working remotely? But some of it is bank-specific and we've looked at what it means for commercial banking, what it means for payments. We've looked at what it's meant for the mortgage industry.

And we've done some broader summary pieces on Accenture.com about how the banking industry is likely to respond and that's where some of the four themes that we've been talking about in this podcast have come from. So hopefully there's a lot of interesting material to access there that covers a wide range of COVID-related topics.

**Rebecca McReynolds:** Well, thanks for your time today, Alan—and stay safe everybody.

**Alan McIntyre:** Thank you. It's been a pleasure to speak to you, Rebecca.