

# PerspectivesReport

Exclusively for Members of the Strategic Leadership Series by Sievewright & Associates



## New Realities in Financial Services

### It's a Different World

The world has changed dramatically since I published Perspectives Report #15 back in February. Tragically, many human lives are being lost as the coronavirus (COVID-19) continues to spread rapidly across the globe, and we owe an enormous debt of gratitude to the medical professionals and first responders who are working tirelessly to save lives.

While a pandemic scenario had been raised in many Strategic Planning sessions over recent years, I doubt that any of us had a meaningful

sense of what it would be like and how it would impact our lives. Today, we live in a different world - one which has presented us with a set of "New Realities". This Perspectives Report provides insights on some of the key aspects of this new environment with a focus on the primary economic, business, financial and operating impacts that Credit Unions will need to deal with. Future Perspectives Reports will drill-down on some of these themes and explore them individually.

# Expected Economic and Financial Impacts of COVID-19

## How Bad is the Economy?

COVID-19 is devastating economies worldwide as it inflicts high (and rising) human costs. As a direct result of the pandemic, the global economy is projected to contract very sharply. These facts we know: the more pertinent question, perhaps, is “How bad will it (the economy) get?”.

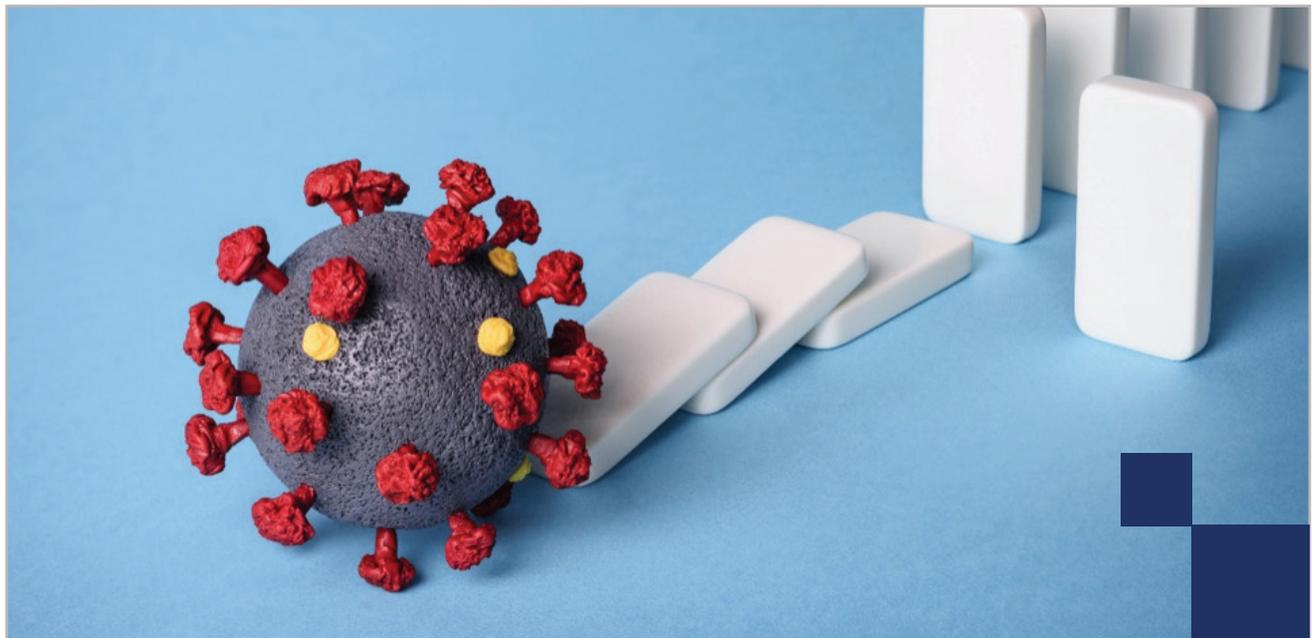
To gain direct insight into the likely answer to this question, I have read myriad economic studies and reviewed multiple data points. Here’s what I’ve concluded:

- The **global economy** will contract to a *negative* 3.0% GDP decline in 2020 (compared with a 2.9% gain in 2019)
- The **U.S. economy** will contract to a *negative* 6.0% GDP decline in 2020 (compared with a 2.3% gain in 2019)
- Other key economies are likely to be impacted as follows:
  - **China’s** GDP growth will decline from 6.1% growth in 2019 to 1.2% growth in 2020
  - **India’s** GDP growth will decline from 4.2% last year to around 2.0% this year
  - The **European Union’s** GDP will decline by 7.1% compared with 1.7% growth in 2019

## The U.S. Economy

The economic challenges posed by the coronavirus pandemic are especially acute for the poorest Americans, according to a new **Federal Reserve** survey released at the time of writing this Perspectives Report. Many Americans came into the nationwide lockdown with limited savings, despite gains made over the course of a record-long economic expansion. At the end of 2019, 3-in-10 adults said they could not cover three months’ worth of expenses with savings or borrowing in the case of a job loss, indicating that they were not prepared for the current financial challenges.

To date, 36.5 million Americans have applied for unemployment benefits since the pandemic took hold. Furthermore, 1-in-5 people who were working in February reported that they lost a job or were furloughed in March or the beginning of April, and that economic pain was highly concentrated among low earners. Fully 39% of former workers living in a household earning \$40,000 or less lost work, compared with 13% in those making more than \$100,000.



## ***How Might Credit Unions be Impacted?***

By any standard, the economic forecasts described above are remarkable (in a bad way) and make last decade's Financial Crisis look quite mild by comparison. While acknowledging that many Credit Unions have seen record growth in loans and deposits, I expect the Movement's collective 5300 Call Reports over the next four quarters to reflect **substantially lower RoA** (perhaps trending close to zero during that timeframe).

Of course, rising unemployment increases the risk of **widespread borrower defaults**, which is why I expect that over the next 12 months, Credit Unions (and banks) will experience **loan loss provisions of at least double the level of 2019**.

Additionally, I expect that **card-based interchange** and **net interest income** will be adversely impacted with the result that **card-based revenues could decline by 8%-10% this year**.

Also, I believe that the **industry consolidation** trend we have witnessed for decades **will accelerate** and it is almost certain that the pandemic will cement a previous forecast I made that, by 2030, the U.S. will have a Movement made up of a healthy 2,500 to 3,000 Credit Unions.

The financial and operational impacts of the pandemic will result in two powerful trends:

- *A strategic drive for scale* (which will trigger larger mergers, including more "mergers of equals").
- *The inability of some Credit Unions to remain viable and independent.*

## ***Are Certain Members More Vulnerable Than Others?***

Recently, **Credit Union Journal's Managing Editor, Jackie Stewart**, sourced me on a story relating to COVID-19's impact on the Movement and she discussed with me how the pandemic is hitting Millennials' finances the hardest. According to **TransUnion**, 69% of Millennials (people between the age of 26 and 40) said that their income had been negatively impacted compared with 58% for other demographic cohorts. Further, 22% of Millennials reported that they had lost their jobs and almost 50% said their work hours had been reduced.

In other research, **JD Power** revealed last month that the pandemic's financial impact has strong ethnicity bias. The findings show the following groupings in the range of those financially devastated or severely hurt by the pandemic:

- Native American: 47%
- Black/African American: 41%
- Latino/Hispanic: 40%
- Asian/Asian American: 35%
- White/Caucasian: 24%

Overall, 71% of respondents in JD Power's research said that the COVID-19 crisis has impacted their financial situation on a scale ranging from "Somewhat hurt my financial situation" to "Devastated my financial situation".

Also, the same research shows how consumers have been getting by using a combination of savings (44%), credit cards (15%), withdrawals from a retirement account (7%) and/or getting a loan (5%). Other sources – apart from unemployment benefits - included loans from family members or friends.

## ***When Might Things Get Better?***

Looking forward, there is extreme uncertainty around the global economic outlook because there are so many dependencies including the course of the pandemic, progress in the wide availability of a vaccine, tightening in global financial markets (and credit), employment gains, shifts in consumer spending patterns, behavioral changes, consumer confidence, commodity prices.....the list goes on. Being an economist in this era is tough duty.

We know that any improvement in global (and regional) economic outlooks for 2021 will depend heavily on how well countries contain the spread of COVID-19 and, ultimately, when an effective vaccine becomes available and can be distributed in mind-boggling volumes. The **International Monetary Fund (IMF)** believes that global GDP growth could rebound to close to 6% next year. We have to look back to 2010 to see a similar reversal of fortunes when the global economy grew by 5.4% compared with a decline of 0.1% in 2019. Can history repeat itself? Let us hope so.

## Digital-First Member Experiences

Recently, **CU Ledger's CEO, John Ainsworth** and I co-hosted a series of Zoom sessions with Credit Union leaders. I was very happy that many of my Strategic Leadership Series clients were able to participate and the discussions were incredibly valuable in understanding not only what Credit Unions have done to adapt to the impacts of the pandemic but, also, how they are adapting their strategies especially in the digital banking and payments arenas.

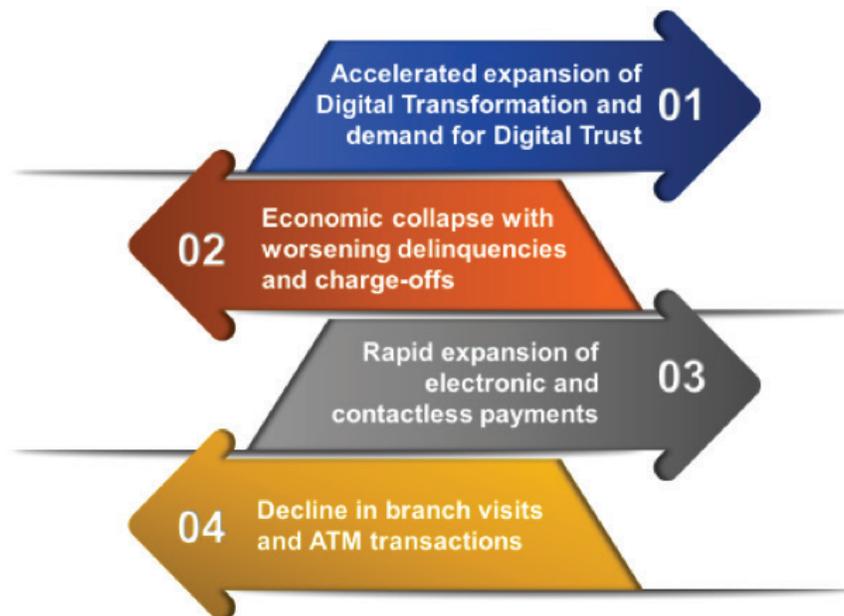
We were fortunate to have **PSCU's CEO, Chuck Fagan**, participate in all four of the sessions and one of Chuck's many helpful insights was this: "*The Future is Now*". His point was that many of the future digital banking trends and related strategic initiatives Credit Unions were focused on (and preparing for) were being "fast-tracked" to today. Chuck's views meshed perfectly with one of the key slides that John and I presented to the four groups (see below).

Like Chuck, I believe strongly that the pandemic will create a permanent shift in the financial behaviors of many consumers and small businesses, especially in their **increased use of digital banking solutions and the rapid rollout of "touch-less" payments capabilities** like contactless cards and mobile payments (which can be completed without needing to touch a retail point-of-sale device). In fact, at the time of writing, the use of contactless and mobile payments is surging.

Many large retailers have already responded to the opportunity:

- **Wal-Mart** tweaked its self-service checkout system to a completely contactless process when shoppers use **WalMart Pay** (this new process uses a QR code which can be read on your phone). Interestingly, Wal-Mart sales are surging. The retailer posted a 10% increase in sales for the last quarter, including a 75% jump in e-Commerce business.

### FUNDAMENTAL UNDERLYING TRENDS ARE ACCELERATING AS A RESULT OF THE COVID-19 PANDEMIC



- **Publix Super Markets** accelerated its transition to contactless payment terminals so that all stores can now accept mobile payments (**Apple Pay**, **Google Pay**, etc.) at the checkout.
- **Burger King** and other fast food outlets are actively encouraging customers to use their “order-ahead” mobile apps to pay at drive-thrus.
- **Square** quickly rolled-out ways for its **restaurant owners** to offer pickup and delivery options.



Also, **Samsung** announced its plans to launch a debit card in the U.S. this summer following the lead of **Apple** which launched its credit card almost a year ago, and **Google** which announced plans to offer Checking Accounts later this year.

Additionally, person-to-person payment networks, **Zelle** and **Venmo**, have reported increased instances of consumers sending money to loved ones to pay for things like prescriptions and groceries as they follow stay-at-home stipulations in many states.

Consumers are also using their phones to use mobile apps tied to payments, such as **Amazon Prime Now**, to place delivery or pickup orders for groceries and meals. The **Treasury Department** even allowed people without Credit Union or bank accounts to receive their economic relief checks via mobile payment services. According to a survey sponsored by the **Electronic Transactions Association (ETA)**, close to 30% of small businesses have seen an increase in customers using mobile payment services.

## WFA - Work From Anywhere

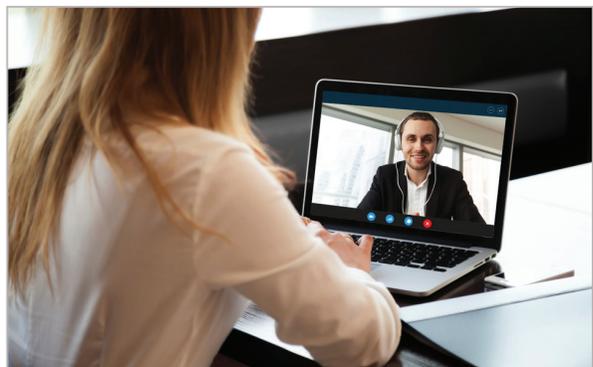
Before the pandemic, only 7% of American workers had access to a “flexible workspace” benefit (or telework) according to the **Pew Research Center**. Today, almost 50% of workers who previously did not work from home are doing so according to a recent **All-America Economic Survey** report.

Credit Unions moved astonishingly quickly to “virtualize” their respective workforces, and close or limit access to their branch lobbies as they worked to adapt their branch environments to “self-service” modes supported by digital banking solutions.

It was clear from those recent Zoom sessions I mentioned earlier that many Credit Unions believe some of these changes in the workplace will become permanent ones. The same is true for other companies, too. Recently, **ServiceNow CEO, Bill McDermott** commented that the COVID-19 crisis has “pulled companies into the

world of virtual work rapidly”, and they will now “lean into a permanent transformation”.

ServiceNow forecasts that \$7.4 Trillion will be invested by 2023 in the digital transformation of business operations. Additionally, research shows a company’s Return on Investment in adapting to virtual business operations will be at least 5X the amount it invests in any given year, and most will see a payback in less than a year.



# Credit Unions as “Financial First Responders”

As stated previously, the financial impact of current economic conditions has been devastating for many millions of Americans. But, as Financial First Responders (credit to **CUNA CEO, Jim Nussle**, for that term), Credit Unions are doing incredible things to help members through these unprecedented times.

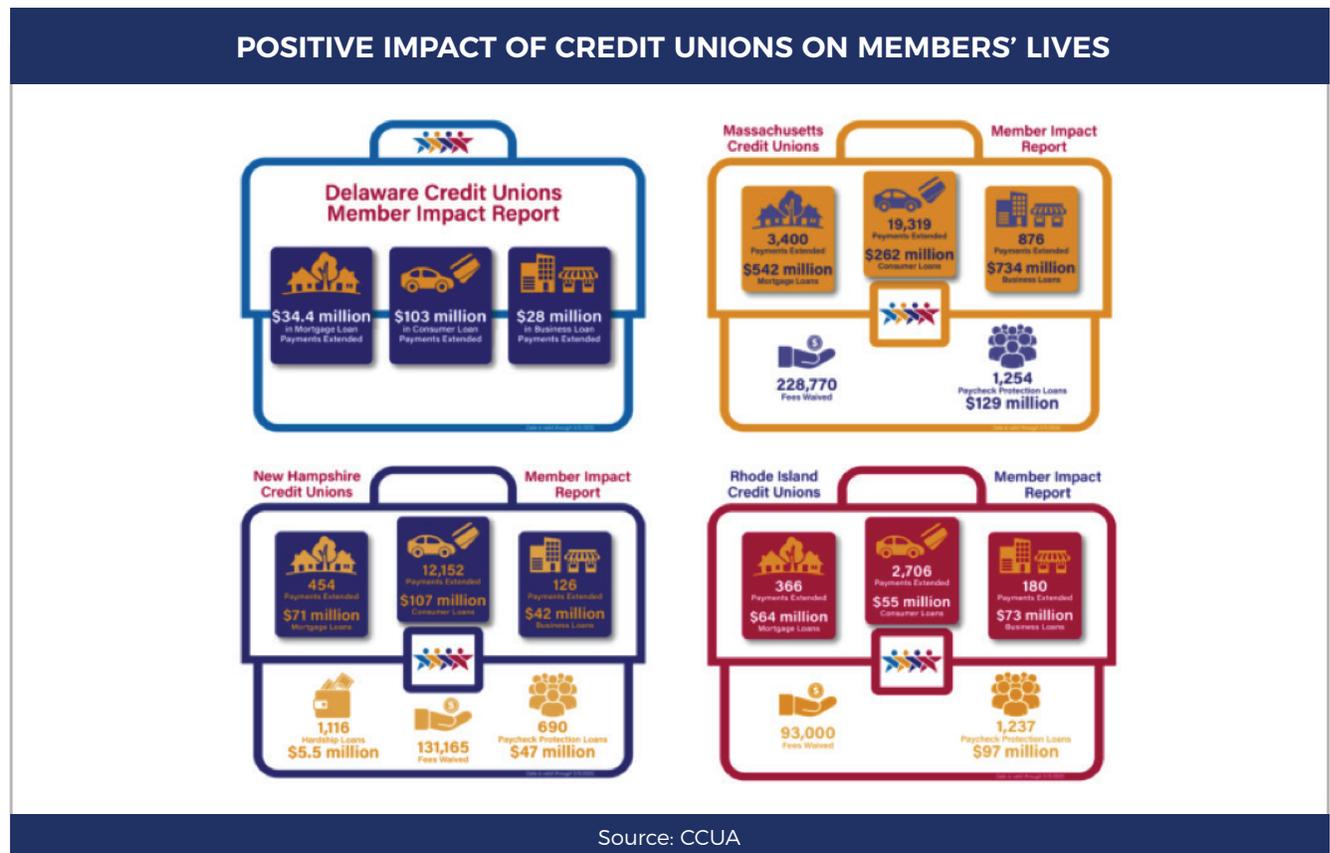
Across the country, Credit Unions are stepping-up to support their members with actions and programs like these (which come without any negative impact to members’ Credit Scores or Credit Files):

- **Skip-a-Pay Programs:** members have the option to skip payments for certain eligible loan types for up to 90 days.
- **Mortgage Forbearance:** members have the option to request a payment deferral on their mortgage for up to 4 months in some cases.
- **Credit Card Payments Deferred:** members have the option to have zero minimum payments due for up to 90 days.

- **Payroll Protection Program (PPP) Loans:** some Credit Unions have provided small businesses with access to these SBA-backed loans often when those same small businesses could not access them through their bank.
- **CD Penalties Waived:** members’ funds being made available for withdrawal now, penalty-free.

Additionally, many Credit Unions accelerated and/or enhanced their Digital Banking and electronic payments solutions making it easier for members to access, manage and move their money without the need to visit a branch.

Credit Unions are not turning their backs on their members and are (potentially) creating another “Bank Transfer Day”-type moment in the history of U.S. financial services. As they did in the Financial Crisis, Credit Unions have continued lending and are working closely with those members facing financial challenges. These moves will be remembered by America’s consumers



and small businesses: they will prove to be not only the right ethical moves but also the right business moves. Just recently, **Ron McLean, President/CEO of the Cooperative Credit Union Association (CCUA)** which supports Credit Unions in Massachusetts, New Hampshire, Rhode Island and Delaware, published

information showing how Credit Unions in these four states have positively impacted members' lives. This one region is indicative of the outstanding work done by America's Credit Unions across the country. (see previous page)

## A “Carpe Diem” Moment for Credit Unions?

Unquestionably, the U.S. financial services industry is at the end of the beginning of one of the most challenging periods in its history. Credit Unions across the country have to be prepared to operate under extremely adverse circumstances. As stated earlier, through their powerful and empathetic responses, Credit Unions are, collectively, exposing themselves to (potentially) billions of dollars of credit losses as they help their members - consumers and businesses - through these very challenging times.

Notwithstanding this, can Credit Unions turn this situation into a *Carpe Diem* moment? I believe they can. Financially strong, well-capitalized Credit Unions can redefine their business and operating models with an intense focus on the execution of digital transformation initiatives and the restructuring of their branch (and, if applicable, call center) operations. Additionally, they can re-think the workplace and make permanent some of the remote working initiatives they've implemented because of the pandemic crisis.

Finally, through their collective actions, Credit Unions have emphasized “the Credit Union Difference”. The unique nature of the Credit Union philosophy must be shouted from the rooftops!

This is a time for financially strong Credit Unions to play offense and strengthen their relevance and share-of-business with America's consumers and small businesses. *Carpe Diem!*



## Strategic Insights & Trusted Advice



### About Siewwright & Associates

Siewwright & Associates is uniquely focused on providing credit unions with valuable strategic insights and trusted advice to drive business growth, effectively and efficiently.

