The devastating shock of COVID-19 on the economy has radically changed the face of lending. With unemployment projections reaching 20% in the second quarter, interest margins contracting, and the potential for contractions in GDP exceeding those of the Great Recession, uncertainty and risk are at an all-time high.

However, the same crisis that is pummeling certain sectors presents opportunity for others. Lenders that support near-prime markets are well positioned to help consumers rebuild their credit. The federal stimulus programs have created a spike in commercial and industrial lending. Stock market uncertainty has led to heightened interest in high yield checking and savings accounts amongst consumers. A change in the landscape requires a change in strategy, and the Kessler Group (KG) is poised to help our clients (and future clients) prepare for just such a change.

First, our perspectives on the landscape:

With consumer lending down, unemployment at historic rates, and small businesses shutting down, the lending landscape has completely changed. Financial institutions and fintechs are re-examining how they are doing business, tightening credit underwriting and limiting the types of loans being offered. At the same time, federal agencies are trying to mitigate the impacts to consumers and small businesses by giving these institutions some flexibility in order to meet short-term needs. The struggle for the industry is avoiding another financial crisis while supporting consumers and business owners in need.

Beware of disparate impacts on credit quality. During the financial crisis that began in 2008, unemployment skyrocketed, and credit quality deteriorated across the board — but to a greater degree differentially, as one went higher up the credit spectrum. For example, while lower-end credit spectrum charge-off rates might have increased by a third, in some cases prime and super-prime rates doubled or even tripled.

This time, the impacts may be different depending on the composition and duration of the economic slowdown. The initial unemployment surge impacted more service workers who are comprised of lower income earners and who benefited from the government's economic stimulation efforts. The longer the crisis continues, the more profound the impact will be on higher earning people, including many small business owners, who tend to fall into the prime and super-prime categories.

- **The economy has been severely shaken by the COVID-19 crisis.** Over 30 million Americans have filed for unemployment, which is projected to reach 20% for Q2. Brick and mortar retailers are filing for bankruptcy and small business are closing down in the wake of reduced consumer spending and foot traffic slashed by social distancing measures.

- The federal government is taking measures to curb the pandemic and soften the blow on American business interests. However, a full reopening of the economy is a subject of heated debate. Certain states are beginning to relax their stay-at-home orders, attempting to find a balance of health for both consumers and businesses.
- Reuters reports that CEOs are predicting a drawn-out U-shaped recession, and many are worried that their companies might not survive the ordeal. Negative impacts on earnings could last for over a year. Publicly, however, companies remain optimistic, with a National Association for Business Economics survey showing 75% of respondents expecting to weather the crisis without federal assistance.
- Travel, hospitality, and restaurants are the hardest hit, with consumers sheltering in place without a concrete plan for resuming leisure activities.

- **Banking has been given a lifeline by the CARES Act, but earnings are still set to fall.** S&P Global Market Intelligence forecasts that earnings in the banking industry could fall almost 25%, with community banks taking over a 40% hit. However, relief efforts by the government have the potential to create significant improvements through the second half of 2020.

  - Paycheck Protection Program (PPP) loans will generate fees from 1-5% based on size, which should bolster bank earnings — especially with a second round of funding for the program taking effect in late April.

- **The CARES Act has given banks enhanced flexibility and additional tools, which they will need to react to the changing lending landscape.** Consumer lending has decreased significantly, leading to reduced credit card balances, personal loans, mortgages and HELOCs. Even so, federal regulatory agencies and state bank regulators are encouraging financial institutions to provide short-term loans and payment relief options to their creditworthy customers without fear of criticism. The various aid options introduced via the CARES act also provide other opportunities for banks to help their customers.
  - Loans through the PPP will put $660 billion on financial institutions' balance sheets in the short-term, though loan forgiveness will likely result in rapid payoffs. Smaller banks in particular are benefiting from this, showing commercial and industrial loan increases of 6.3%, as they are able to fund PPP loans faster than the larger institutions. New guidelines from the SBA that ensure smaller banks are approving a larger percentage of the loans will further support this growth.

- **The credit card market is in turmoil and marketing spend has changed to reflect this.** Between the week of March 18th and the week of April 8th, credit card lending dropped 4.7%. In addition, analysis of consumer search terms includes a heightened interest in terms such as "bad credit" and offers for subprime credit cards. Many institutions are pulling back from direct mail, email, and digital marketing spend for credit products in general, with increased focus on communicating their relief efforts. TD Ameritrade, Fidelity Investments, Charles Schwab, and Chime have all leveraged social media advertisement to promote portfolio advice.

Second, there are a variety of things that KG excels at that can potentially help our clients (and prospective clients) during times like these:

- **Evaluating our clients' portfolios** to provide an alternative and unbiased perspective on potential performance in recessionary scenarios — and potentially, in concert with this, suggesting related risk mitigation strategies. (KG's investors and partners have recently purchased several portfolios totaling in excess of $1 billion which are managed by KG's Fidem subsidiary. In this regard, we are "practicing what we preach," using our expertise and daily performance data to run scenarios on our portfolios.)

- **Working with our clients to optimize their consumer credit businesses** — including identifying and orchestrating the movement of higher risk (capital consuming) assets off balance sheet.

- **Advising fintech lenders and card issuers** — an area where we have recently added deep expertise.

- **Helping orchestrate win-win outcomes** for groups and financial institutions by helping identify, broker and orchestrate the movement of co-branded or affinity card programs and portfolios.

- **Providing pay-for-performance marketing funding** that allows our clients to do more marketing, while transferring program risk to KG. An added benefit of these programs is that acquisition expenses are incurred over time, better aligning origination costs with revenues. (To date, we have funded almost $1 billion in marketing, including for several of the top 10 banks coming out of the Great Recession.)

- **Providing marketing strategy, data analytics and reporting, creative, and marketing execution management services** across all channels. Our years of experience in direct marketing drive improved results, helping make scarce marketing dollars go farther.

To our clients, and prospective clients, we hope this is helpful. With the constant changing environment, KG has been keeping on top of new developments and is poised to help in any we that we can. For more information, please contact us at info@kessler.com.