OLIVER WYMAN

THE REAL CREDIT CRISIS

How governments and financial services can work together to speed economic recovery

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EXECUTIVE SUMMARY

The Global Financial Crisis of 2009 was dubbed by many as the Credit Crisis. In retrospect the term was used to describe what was primarily a mortgage mispricing and real estate leverage crisis. What we face today is rapidly becoming the real credit crisis of our times: a situation in which many households and companies, already highly leveraged, are taking on more debt; a situation in which many firms across industry sectors are unlikely to be able to sustain this debt; a situation in which governments and the financial system have to be poised to work together to absorb some of the financial losses, keep good businesses alive, and help speed the economic recovery.

The stimulus response by public authorities worldwide to COVID-19 has been massive and for the large part well targeted to prop up the dramatic liquidity risks. Now significant risks are growing in the economy due to credit misallocation, increased solvency risks for corporates and small and medium-sized enterprises (SMEs), and the risk of spill-over into failures in parts of the financial system.

The global economy is going to emerge from this crisis in desperate need of growth. Public authorities must work in tandem with the financial services system to address these issues in order to speed the economic recovery. The stimulus must be spent wisely — governments are not a source of unlimited funds. Policymakers need a more targeted approach to credit provision and will rely on banks' expertise to achieve it at scale. Banks' expertise in restructuring troubled companies will become increasingly important, as well as their critical function in traded debt and other financial markets.

Authorities can improve banks' ability to play these crucial roles, and to support growth, with a series of actions that fall into the following categories:

Course-correct on credit provision to small and midsized businesses: Much of the lending stimulus today is not getting to the right businesses. Fixing this requires an assessment of credit availability and the operational capacity of the banking system and finding fast solutions. When necessary, authorities must simplify existing measures or extend their scope to address blind spots.

Prepare to manage a potentially large corporate solvency crisis that will arise after the initial liquidity support: Managing forbearance in retail lending poses a major challenge, but we face an acute risk of deep damage to the economy through corporate insolvencies. Authorities will need to assess the preparedness of their bankruptcy systems and the potential impact of credit losses on their banking systems, and make strategic decisions on how and where to stimulate equity capital support to troubled businesses that can drive future growth. New restructuring vehicles are likely to be required.

Prepare to intervene in parts of the financial system as second-order financial stability issues arise: Good decisions have been made on the use of capital buffers and forbearance. But the risks are rising that some financial institutions will remain structurally weak or even fail. Authorities will need to be ready for intervention. Resolution planning efforts carried out in the last 10 years may come to a real test for the first time in several countries.

Planning loss absorption for future outbreaks: Systemic risks are rising relative to diversifiable risks, and this means greater government steering of loss absorption is here to stay and needs planning. Specifically, to stimulate confidence in the right growth credit and capital now, we believe a better-designed sharing of loss absorption between government, business, investors, banks, and insurers is required. The urgent priority today is to put in place a systemic solution to pandemic re-insurance.

Across all four actions, authorities and banks need to work together with co-ordinated action. Planning needs to be scenario-based, and further serious COVID-19 outbreaks need to be included in the medium-term scenarios. Our COVID-19 Pandemic Navigator Toolkit is the most comprehensive set of decision-steering tools being used today by governments, health organizations, and financial institutions.

The decisions authorities make and the actions they take in the coming weeks and months to address these four issues will have significant, long-term ramifications for how economies emerge from this crisis, and for years to come.

SUMMARY OF KEY ISSUES AND POTENTIAL SOLUTIONS

Imperative	Specific challenges	Potential solutions
Course-correct on credit provision to small and midsized businesses	• Lack of financial information • High credit risk and capital requirements for banks • Large number of demands to process • Fraud risk	• Pooling of SME financial information • Increased government guarantee coverage or subsidies for private capital injections • Simple and easily checked eligibility criteria
Prepare for a corporate solvency crisis	• Sustainability of debt levels at macro and micro levels	• Consider extending liquidity support in time to avoid refinancing wall
	• Large number of bankruptcies clogging up court system • Bankruptcy law leading to large number of liquidations even for firms with positive operating income	• Simplify bankruptcy procedures • Incentivize voluntary restructuring (such as with tax breaks) • Incentivize private equity investment to lower debt-equity ratios • Government funded equity investment for strategic situations
Prepare to intervene in the financial system to protect financial stability	• Monitor liquidity for systemic non-bank players on real estate market that could lead to foreclosures and fire sales • Monitor credit losses and banks' solvency • Monitor hot spots in the financial system	• Liquidity support to critical players • Extend scope of moratoriums to debt repayments and MBS funding • Impose moratorium on foreclosures • Set up a national bad bank or push for creation of private bad banks • Consider conditions and timing of intervention for banks or other financial institutions
Plan for loss absorption in future outbreaks	• Lack of confidence from investors due to the lack of business interruption insurance covering future COVID-19 waves or other pandemics	• Develop pandemic reinsurance options to allow coverage by regular business interruption insurance • Offer subsidized insurance and reinsurance for pandemic business interruption and consider making it compulsory
	• Lack of operational and financial preparedness of some systemic businesses	• Impose minimum solvency requirements and resolution planning for systemic firms beyond financial institutions

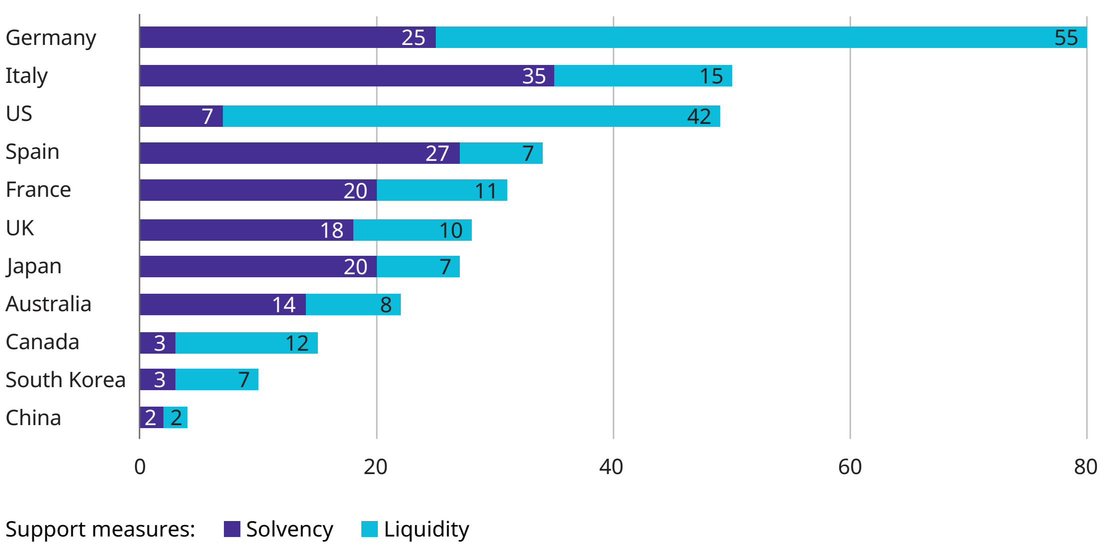
COURSE CORRECT ON CREDIT PROVISION TO SMEs AND MIDSIZED CORPORATES

Authorities worldwide have announced aggressive steps to address the most immediate threats to the global economy from the COVID-19 shutdown. Total solvency measures announced across the 15 largest economies have surpassed $6 trillion as of early May, while liquidity support measures have exceeded the $13 trillion mark. Governments' responses have mostly revolved around access to liquidity, financial relief for the most vulnerable and impacted individuals and businesses, and broader measures to stabilize financial markets. These necessary steps have been understandably blunt and will undoubtedly leave blind spots and have unintended consequences.

The financial system, and banks in particular, play a key role in complementing those measures and carrying them out. The large drops in output are already translating into significant liquidity needs for corporates. Thanks to the steps taken after the global financial crisis and the liquidity support of central banks, a strong banking sector has been able to support most of the immediate credit demand by corporates. Companies drew in cash to shore up their balance sheets, both through drawing down existing credit lines and issuing debt. In the United States alone, investment-grade bond issuance reached $257 billion in March[1], 2.5 times greater than the same month in recent years. According to our analysis, US banks extended an additional $300 billion of lending, a six percent increase over the first quarter.

Exhibit 1. Economic support announcements

As of early May, 2020, percent of GDP



Note: Eurozone and EU-level announcements added proportionally to each member state's GDP
Source: IIF Oliver Wyman Analysis

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But here is the catch. While at this stage there is probably sufficient credit available in the aggregate between government programs and banks, the task of ensuring the sectors that need the liquidity receive it in time remains a challenge. Provision of credit to non-investment-grade corporates and SMEs has proven especially difficult. Our analysis indicates that the largest businesses received more than two-thirds of lending to corporate clients by banks in the first quarter, driven in large part by their available drawdown facilities. Smaller companies do not have these large drawdown or revolving facilities, and do not have access to public markets to raise debt.

The largest businesses received more than two-thirds of recent new lending to corporates; smaller companies do not have the same credit access

While governments have announced a raft of new policies such as the Paycheck Protection Program and the Main Street Lending Program in the US, there have been material challenges in implementing those quickly due to operational constraints, credit risk, fraud management, and sometimes inadequate sizing of the programs. Distributing government-sponsored credit to SMEs in particular has turned out to be especially difficult operationally and potentially costly for governments. The banking sector has had difficulty processing a high number of demands in a short time. Most programs leave banks with the responsibility to navigate complex, highly manual, and sometimes unclear application processes, sometimes with a level of credit risk exposure they were not comfortable with as governments provided only partial guarantees. The operational rollout of the programs in most countries has therefore been difficult, and rarely able to keep up with demand. Smaller companies with strong pre-existing banking relationships were able to receive more and earlier support.

IDEAS 1: COURSE CORRECTING ON CREDIT PROVISION PROGRAMS TO SMES

Authorities should consider several steps now to course-correct and work with the banking system to improve the efficiency and efficacy of these programs. First, they should align credit underwriting criteria between banks and those embedded in government guarantees. Second, they should set eligibility criteria that are simple to document and verify, to remove operational roadblocks while reducing fraud risk. Third, they should review credit-guarantee criteria or levels to be more effective and attractive to banks and more targeted to SMEs that need it. This could include increasing the coverage level, providing loss protection to banks at a portfolio level, and providing debt forgiveness in certain specific cases in which the economic cost of business failures justifies it. Fourth, development banks are a significant channel to help mobilize these programs, but doing so effectively requires support for these institutions to pivot towards smaller corporates; many of them are geared up for international development programs or infrastructure investment. Finally, authorities should complement these fiscal relief programs with targeted capital support to the most-impacted businesses through grant or state-funded furlough programs, or through tax incentives for equity investments (see Ideas 2).

Fraud risk management has also been a burden, and in at least one instance has led to the suspension of a national grant program after a major fraud scheme was unveiled. Several countries have had to or will have to increase the amount of public support, as illustrated by the oversubscription of the Paycheck Protection Program in the United States.

The experience from this first wave of programs shows the importance of designing a simple process in which conditions for government support are clearly laid out and easily verifiable, credit risk left to banks is minimal, and funds provided by the government are sufficient.

PREPARE FOR A CORPORATE SOLVENCY CRISIS

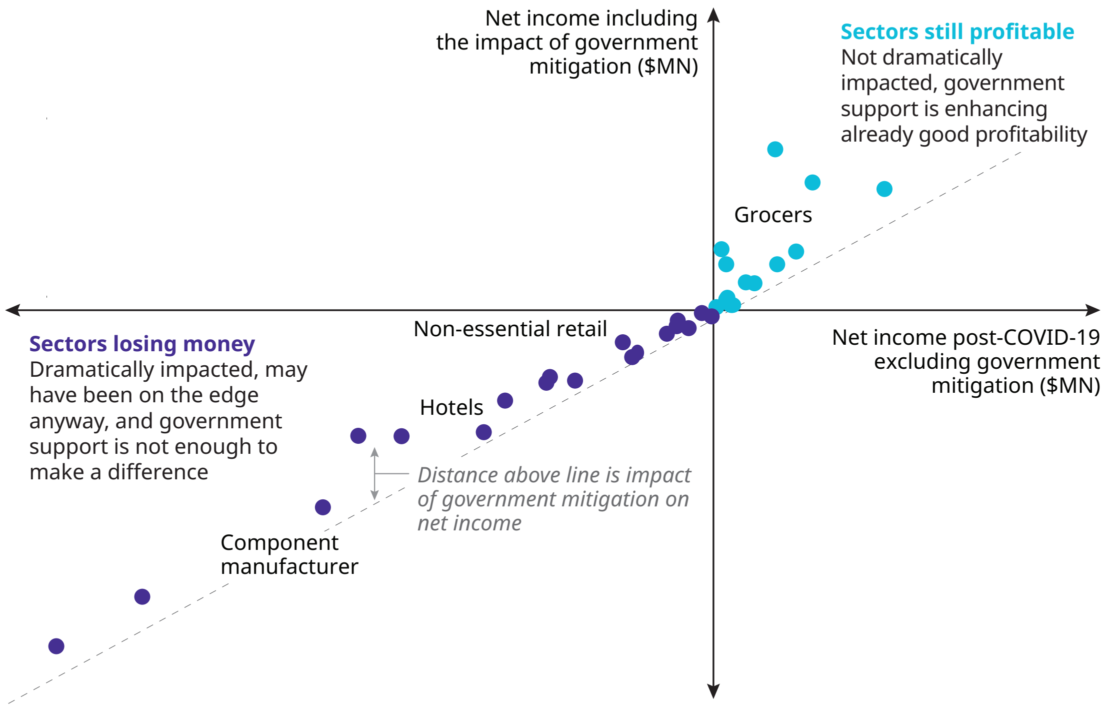
We are very concerned about retail lending, and stresses in the retail payments system.
With unemployment spiking dramatically and widespread cancellations of direct debits, there is going to be a huge challenge to rebuild good credit practices and manage forebearance. At the same time we focus on corporates due to the potential for further widespread economic damage through a solvency crisis.

Corporates in particular, entered the COVID-19 crisis with relatively high debt levels. Corporate debt pre-COVID-19 was close to 140 percent of GDP across the largest economies (the G7 plus China), a record in recent history and nearly 10 percent greater than in 2008. We estimate as of today, the debt to GDP ratio could be higher than 150%. And governments, corporates, and, to a lesser extent, households, will come out of the crisis with reduced revenue and increased debt. Exacerbating the problem: much of the new debt will come due in the next two years, presenting major refinancing challenges for the economy in 2021 and 2022. We expect this to be particularly critical for corporates, which are driving most of the credit demand and may need additional financing to restart and adjust their operations.

Corporate debt coming into the COVID-19 crisis was a record 140% of GDP across the largest economies, nearly 10% higher than in 2008; we estimate this ratio has now risen to 150%

Policymakers should begin planning for the medium and long terms and consider ways to manage the economic risks of this debt burden. They should consider the need for extending the maturity of debts accumulated through the crisis or facilitating their refinancing to avoid a massive drag on household spending and corporate investments. Tax deferral programs might have to be partially adjusted into tax breaks to avoid the combination of fiscal and financial blows to the economy in 2021 and 2022. Liquidity support to the economy is also likely to be needed for a longer period.

Exhibit 2. Sub-sector level net income post-COVID-19 versus net income post-mitigation
Industry size: Medium (50-250 employees), three months impact for single economy



- The economic shock caused by COVID-19 and social distancing restrictions has had widely different impacts on sectors of the economy, and their ability to mitigate through cost reductions varies greatly
- Our analysis across different sectors of the economy for different sized companies demonstrates the average offset we see for different sectors

Source: Oliver Wyman analysis

In economies we have analyzed, up to 60 percent of corporates are in sectors that are sustaining losses through the lockdown despite government support, and government support is expected to offset less than one-third of the decline that the private sector is experiencing

Our analysis of large advanced economies, based on company data for different sectors and different sized companies, shows that while governments have committed significant sums of money, many companies will still suffer losses through the period of the lockdown. In fact, we estimate from some countries we have analyzed in depth, that up to 60 percent of corporates are in sectors that are sustaining losses through the lockdown despite government support, and government support is expected to offset less than one-third of the decline that the private sector is experiencing. Depending on their strength heading into the crisis and the speed of the rebound, these companies could need substantial support. Meanwhile close to 30% of government stimulus is directed to companies that don't in fact need it, and would be much better deployed to stave off insolvency elsewhere.

Policymakers will need to consider a range of solutions to address the solvency issues after the crisis. First and foremost, good and viable companies will need more equity capital relative to the amount of debt. Authorities could play a crucial role in incentivizing capital investments in corporates and SMEs — there are a range of steps we explore in Ideas 2 below. Authorities will need to assess how and where to Incentivize or provide strategic capital support to the economy. As they do so, policymakers might want to direct investment to support strategic objectives such as mitigating climate change, reaching national self-sufficiency for strategic sectors, or directing investments toward sectors geared for future growth.

In any case, authorities also need to assess their bankruptcy system's preparedness and consider ways to facilitate restructuring of overly leveraged but otherwise viable companies. While some countries may have favorable regimes, such as Chapter 11 of the bankruptcy code in the United States, others will need to consider plans to encourage fast voluntary restructuring, perhaps through government subsidies, tax incentives, co-investments, or the provision of cheap funding. Even the United States risks a flood of bankruptcies that could choke its bankruptcy court system. In some jurisdictions the role of directors' duties in relation to insolvent trading may get in the way of restructuring suggested, and needs to be addressed, if needed for example with temporary Safe Harbor measures.

Regulators will also need to ensure banks deploy sufficient resources to play their role in finding workout solutions that minimize burdens on the bankruptcy courts and reduce costs for them and their customers. A specific but potentially very widespread challenge is going to be how government guarantees will be handled in default situations, which has already become a problem in the UK.

IDEAS 2: MEASURES GOVERNMENTS SHOULD CONSIDER TO INCENTIVIZE RECAPITALIZATION OF CORPORATES

Removing fiscal and administrative barriers to capital raising:

- Simplify regulations on equity issuance and reduce associated costs
- Remove tax advantages to debt vs. equity (for example, by making certain dividends tax-deductible)
- Increase tax deductibility of capital losses on investments

Providing incentives for capital investments in corporates and SMEs:

- Make some investments partially tax-deductible
- Provide government subsidies or dividends to investments in certain sectors or under certain conditions (See Ideas 3)
- Co-investing with the private sector in certain industries with high capital shortfalls

Facilitating and encouraging workouts of debt-ridden businesses and corporates:

- Provide tax incentives for conversion of debt into equity
- Set up a government-sponsored restructuring fund
- Provide regulatory and tax incentives or subsidies for debt holders to participate in voluntary restructuring (See box entitled Bolster Bankruptcy and Other Restructuring Systems)

IDEAS 3: GOVERNMENT SUBSIDIES FOR CAPITAL INVESTMENTS

Governments could go further and directly subsidize investments in midsized firms or in favored sectors of the economy that otherwise will struggle to raise equity or that support specific strategic objectives. For example, the government could agree to provide an annual dividend or a partial tax credit on the original investment for some period of time. It might or might not make sense to require a minimum holding period for the initial investor.

A variation would be to give the government warrants with high strike prices so that taxpayers share in the upside if companies do well. Another option would be to simply have the government buy such warrants upfront. The price of any warrants the government buys would need to be substantially above what private sector investors would pay; otherwise, there would be no economic subsidy to encourage investment by others.

The big advantage of subsidies over direct government equity purchases is that it puts the pricing and business decisions in the hands of the private sector, which has greater expertise. In fact, the government might wish to have minimum requirements for the investors, to ensure they are likely to bring true expertise to bear.

IDEAS 4: BOLSTER BANKRUPTCY AND OTHER RESTRUCTURING SYSTEMS

Authorities should encourage fast, voluntary restructuring programs in countries where bankruptcy laws are problematic, or the bankruptcy system will be overwhelmed. There have always been voluntary restructuring agreements between debtors and their creditors in some of the cases in which an involuntary restructuring would destroy more value. When possible, it would be advantageous to standardize and streamline such agreements. Governments might need to provide some subsidy or cheap funding for qualifying restructurings in order to encourage sufficient, swift action in this area. Regulatory or tax adjustments to reduce the immediate hit on bailed-in debt holders could provide further incentives. For instance, bailed-in creditors may be allowed to deduct 100 percent of the bailed-in amount rather than just the markdown.

PREPARE TO INTERVENE IN THE FINANCIAL SYSTEM TO PROTECT FINANCIAL STABILITY

Most of the Financial System is significantly more resilient than it was a decade ago. The financial sector is and should be a mechanism for loss absorption — this is its function. But every crisis tests us in new ways. Some parts of the banking system have far higher relative exposure to Oil or Transportation or Tourism than others. Added to this, there will be unintended consequences on the financial system of policy actions designed to mitigate risks in some areas, such as providing loan guarantees for SMEs.

Other important parts of the financial system, though, have already experienced financial strains, such as money market funds and mortgage servicers. Globally, banks now account for only half of the credit provided to corporates, while about 25% is provided by non-bank and non-insurance lenders. Authorities have had to directly intervene to provide liquidity support to some of them and might need to intervene again if losses or liquidity shortages create additional issues.

Authorities will also need to monitor closely the impact on real estate markets and the associated systemic risks on financial systems. Where governments imposed a moratorium on rent payments or were not able to provide liquidity support immediately, they should monitor the impact of those actions on landlords and securitization markets. In particular, there might be a need for temporary liquidity support to institutions or entities facing short-term cash gaps and whose default could trigger a spiral of fire sales or foreclosures. In the United States, mortgage servicers face severe liquidity issues that could undercut confidence in the residential mortgage-backed and commercial mortgage-backed securities markets. Sudden market corrections on the back of a liquidity crisis have the potential to undermine the solvency of many mortgage customers and generate large markdowns for financial institutions that could impact financial stability and banks' ability to support the economic recovery.

Up to an additional $1 trillion of global bank capital could be available through policy steps to support the global economy — but unintended consequences must be carefully managed

Authorities have taken steps to make more bank capital available to support the economic shock in the short term, and further steps are under assessment. European regulators have reduced capital requirements by about $500 billion by eliminating countercyclical capital buffers and reducing "Pillar 2" capital requirements. While the United States has not taken similar steps, there are a number of live debates around GSIB buffers and stressed capital buffers; banks have already been able to delay the capital impact of the reserve build-up under the new current expected credit losses (CECL) standard for provisioning. In aggregate, its plausible that up to an additional $1trillion of bank capital could be made available through these steps to support the global economy.

But regulators will need to monitor the banking sector closely and be ready to intervene when and where this might be needed as second order issues emerge. The massive recovery and resolution efforts undertaken in the last 10 years should be used as a guide to intervene early. And steps need to be taken to ensure that we do not come out of the crisis with structurally weak banks that significantly reduce economic growth potential for a sustained period of time.

IDEAS 5: NEW CAPITALIZATION VEHICLES

Macro- or micro-prudential tools alone are likely to be insufficient to relieve the strain on available bank capital and allow banks to adequately support growth. Authorities should start to assess what will happen next if large numbers of companies become at risk of insolvency. In some countries there may be a need to support the economy and clean up banks' balance sheets by setting up a "bad bank" or central restructuring entity ensure a balance between workout, restructuring, and investment in growth companies, to facilitate entry of third-party capital, and to interface with other critical government initiatives. For countries new to this, much can be learned — both good and bad — about how to do this from the experiences in Spain, Greece, and Ireland over the last decade. In particular to prepare for this to be effective and achieve rapid recovery and growth, authorities and banks should work together now to determine sectoral hotspots of vulnerability, and likely areas of market failure that can be addressed. They should consider the objective function for government in insolvency workouts, including the benefits of employment, the impact of insolvency on future growth, and the role of government's other objectives (such as regional and industrial strategy). Note the set-up of vehicles like this will need to be combined with the sorts of debt-equity swap solutions outlined in Ideas 2 and Ideas 3 above.

PREPARE FOR LOSS ABSORPTION IN FUTURE OUTBREAKS

With the rise in systemic risks such as terrorism, cyber, climate change and pandemics, the links between financial risk management and loss absorption across government, banks, investors and insurers are becoming more crucial and more complex.

The thick of a crisis may seem the wrong time to address this, but to ensure the right longer-term growth credit and capital is available to companies now, we need a loss absorption system that provides the right confidence to investors.

For example, offering insurance against severe macroeconomic outcomes or future pandemic outbreaks can help businesses prepare financially, and can help both banks and insurers better understand and price the risks they are taking on. The availability of such products is still limited, and given the systemic nature of the risk, government support will be required to provide the required level of coverage. Some governments are considering setting up insurance plans against future pandemic outbreaks and providing financial support for them. In other cases, they could be the catalyst to build industry-level assets with broader use, such as an SME registry capturing relevant financial information to allow for quick credit decisions.

Authorities might also want to incentivize or impose better operational and financial readiness of the private sector for future outbreaks or pandemics. In particular, authorities might want to consider how to create additional loss-absorption capacity in the private sector, especially in the most strategic and vulnerable industries. Public authorities might want to impose minimum solvency requirements and resolution preparedness for systemic companies beyond financial institutions to favor bail-ins over bail-outs in future crises.

As they do so, authorities might want to consider the opportunity to foster preparedness of the economy for other risks, such as natural catastrophes or climate change — which pose the same essential challenge — that the conditions result in widespread and undiversifiable economic losses.

IDEAS 6: PROTECT AGAINST MACROECONOMIC TAIL RISKS

Investors face high levels of uncertainty that could deter equity investment in sectors that are particularly vulnerable or in midsized companies that are less known. This is a problem, in that currently debt is significantly more attractive to provide than equity, and some of the government incentives to more equity outlined above are needed to rebalance this. In addition, the government could provide cheap insurance against a drop in gross domestic product of more than X percent for Y quarters or against other macroeconomic scenarios of particular concern. This could prove costly for taxpayers in extreme cases, so it would be particularly important to keep this offer focused on new investment in the targeted firms. What's more, governments would almost certainly have provided substantial levels of additional support to the economy in those extreme cases. Why not get some offset through insurance premiums in advance while providing clarity to both sides about what the payments would be? Other parts of the future crisis response would remain unknown, but the total level of uncertainty would be reduced. As a side benefit, this could also facilitate credit provision to some businesses.

IDEAS 7: SETTING UP PANDEMIC INSURANCE AND REINSURANCE

The severity of the Coronavirus Recession has been exacerbated by the massive hit to income of companies that were forced to close for an extended period, many of which have had to take severe action to manage their workforces, leading to a further drop in aggregate demand and rapid shift from profit to loss. On the surface, this type of risk cries out for insurance. However, few insurers have been willing or able to provide blanket coverage for pandemic risk, which by its nature is not a risk which can be spread and reduced through diversification, a core principle of insurance. Pandemics affect huge numbers of people and most geographies, more or less at the same time. Based on our analyses in an advanced economy, the cost of such an providing blanket business interruption insurance in the current episode could have been more than three percent of GDP and 60 times greater than the average annual claims for natural catastrophes. We have seen exceptions of course, such as business interruption insurance for the Wimbledon tennis tournament that was broad enough to cover a pandemic and hence allowed the organizers to recover a high proportion of their lost revenues, but these were the result of specially-negotiated wordings where the pandemic risk was explicitly noted and priced for.

In this environment, Governments naturally end up being the underwriters of last resort, through funding of furlough schemes, small business support and other ex post mechanisms that we are seeing around the world. However, as we are also experiencing, this can be a very inefficient and ineffective way of reducing the economic impact from a global pandemic. As an alternative, Governments can form part of a Public-Private Partnership that allows businesses to buy Business Interruption cover from a dedicated insurer leveraging the risk management, underwriting and claims management expertise within the insurance industry, but with Governments providing a capital backstop to ensure widespread coverage capacity. Similar mechanisms are already in place in many countries to cover Flood and Terrorism risk. While it's too late for this to help on the current global outbreak, we would see this as an effective mechanism to reduce the economic impact in future pandemics, or potentially even from a recurrence of this one. Such a PPP could offer business-interruption insurance for pandemics directly, or private sector insurers could do so, relying on the ability to buy protection from a government-backed reinsurer against the risk. The latter model also ensure that the risk management discipline encouraged by risk-based pricing is maintained.

Such a program could still generate a large cost to governments in a future pandemic. However, the absence of such insurance is likely to lead to massive government payouts to businesses on an ad-hoc basis, as we have seen in this crisis. It would be better, perhaps, to collect premiums in advance to cover some of this cost, while also providing a greater degree of certainty to both businesses and taxpayers. Oliver Wyman, Marsh, and Guy Carpenter are currently working with nearly 20 countries globally on innovative programs to meet the insurance and reinsurance dimensions of the coronavirus challenge.

HUGE UNCERTAINTY STILL: THE NEED FOR COVID-19 SCENARIO-BASED PLANNING

There is still much that is unknown about how this pandemic is going to play out. What we do know is that the many initial predictions of V-Shaped and U-shaped recoveries were far too simplistic — we face a complex situation with gradual unwind of lockdowns, a series of containment measures ongoing, and significant risks of future outbreaks and further partial or even full lockdowns.

At Oliver Wyman, we have built the COVID-19 Pandemic Navigator, a powerful toolkit that combines the most sophisticated epidemiological modeling with industry impact analysis, integrating all government health and economic stimulus actions. The toolkit can assess different likely scenarios, and ultimately analyze loss absorption in banking and insurance so that policymakers can truly assess the trade-offs they must make between health and economic consequences in the decisions they face under different scenarios.

We firmly believe authorities must prepare response plans around these kinds of scenarios and should use the time now as the last outbreak unwinds to plan the economic response in case near term and future public health measures impact the economy dramatically again. The economic response plan should include an assessment of the economic impact of the scenario by sector and the related impact on banks' solvency, as well as an analysis of the ability of the banking sector and private financial system to support the economy.

CONCLUSION

The world economy faces a Credit Crisis that is potentially broader and deeper than anything seen in generations, including in the Great Financial Crisis of 2009. Authorities have quickly unveiled a large and impressive set of measures to address the economic impact of the COVID-19 pandemic. However governments, despite recent moves, do not have an open checkbook, and steps taken from here must be highly cost-efficient and effective.

The deployment of the support has often required more time, effort, and financial resources than initially anticipated so far. Banks have played a critical role in this initial step and will need to work closely with Authorities to support the economic recovery.

The initial support has been focused on providing liquidity to impacted corporates and businesses. This has bought some time, but solvency issues will unfold as revenues erode and debt increases.

Authorities will need to consider measures to specifically address those solvency issues, or we run the risk of serious economic damage and the danger of undermining the speed of economic rebound and growth.

As banks operate temporarily with lower capital buffers in a highly uncertain environment, bank regulators will need to monitor financial stability closely and be ready to intervene in a timely and targeted manner.

In preparation for those potential aftershocks, it is also paramount that authorities work jointly on the health and economic front by defining their policy response across a range of scenarios, including scenarios with new severe outbreaks.

While it may be considered ahead of time, solutions like re-capitalization vehicles and pandemic insurance solutions should be put in place as soon as possible to create confidence for providers of capital and longer term debt to be incentivized to support the rebound and growth of our economics.

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

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