COVID-19 and the Financial Sector

The outbreak of the coronavirus disease (COVID-19) has caused a sharp decline in global economic growth. Large-scale pandemic containment measures—lockdowns, travel restrictions, and quarantines, along with growing business closures and rising unemployment—have adversely affected both supply and demand. Business and consumer confidence have deteriorated. In response, governments around the world have launched sizable fiscal stimulus packages and central banks have aggressively eased monetary policy to mitigate the negative economic impact of COVID-19. The financial sector can ease the stress on government finances by unlocking resources from the private sector to join the fight against the pandemic. This special section discusses some of the financial sector's solutions for mobilizing private sector resources.

The global fight against COVID-19 can be viewed as a war. As war is a costly endeavor, it brings to the fore the issue of financing. Other than conventional bonds, pandemic bonds have been issued to cover extreme mortality during the pandemic. Sometimes, such bonds offer a higher yield to investors for taking higher risk. Asian governments have begun to explore the potential of pandemic bonds to finance large and growing public expenditures in response to COVID-19. On 7 April, the Government of Indonesia successfully issued its first "pandemic bond," raising over USD4.3 billion. **Box 2** discusses how, given the huge amounts of fiscal spending that will be needed to tackle the health and economic crisis, the bond market is likely to play a prominent role in funding the global war against COVID-19.

While COVID-19 slows down overall economic activity, it hits smaller businesses and poorer households disproportionately hard. Social bonds can help small and medium-sized enterprises and vulnerable groups survive the current turmoil. They are a useful tool for mobilizing resources for sectors that have a large social impact such as medical services, sanitation, small and medium-sized enterprises, housing, and gender equality. **Box 3** explores recent developments in the global social bond market amid the COVID-19 crisis.

The lockdown and social distancing prevalent during COVID-19 has restricted the normal functioning of traditional financial services. The pandemic has led to more economic activities shifting online. Financial technology (fintech) offers good solutions to deliver safe and contactless financial services while also serving financially underserved group. Thus, fintech can contribute to inclusiveness and economic resilience during the COVID-19 pandemic. **Box 4** elaborates on how fintech can effectively provide financial services, especially to underserved and vulnerable groups, amid the current environment.

While the financial sector can help finance funding needs and mitigate the wide range of risks confronting the economy during the COVID-19 shock, it too faces systematic risks that will be difficult to diversify. Policy makers need to work with the financial sector to provide liquidity in the economy and support firms. **Box 5** discusses the role of government in designing market-specific policies that can guide the financial sector to function as a liquidity provider during the pandemic.

This special section discusses the different financial instruments and technologies that can unlock private sector resources to support businesses and households during the COVID-19 pandemic. Since the pandemic poses systemic risks to the financial sector too, properly designed policy tools can mitigate these risks and effectively support the functioning of the financial sector.

Box 2: Pandemic Bonds—An Option for Fighting COVID-19

The world is in the midst of an unprecedented public health and economic crisis due to the coronavirus disease (COVID-19) outbreak.[a] As of 15 April 2020, there were almost 2 million confirmed cases and more than 125,000 fatalities worldwide.[b] Unlike a conventional war, there are no soldiers, tanks, or warships in the global fight against COVID-19. However, it is a war all the same as humanity is facing a common insidious, invisible, and formidable enemy that is ravaging health-care systems and inflicting economic pain. Doctors, nurses, other health-care workers, first responders, and medical scientists are on the frontlines of this unconventional war.

As in all past wars, governments are leading the overall war effort. They are managing and coordinating the reorganization of the economy and society to defeat the viral enemy. It is the government that determines whether community quarantines are necessary and enforces them accordingly. Many governments around the world have imposed lockdowns, from the Philippines to Italy and elsewhere. Another example is the United States (US) government ordering General Motors to make ventilators on 27 March. To do so, President Donald Trump tellingly invoked the Defense Production Act, which dates back to the Korean War. The act gives the President the authority to mandate that businesses produce goods needed for national defense (i.e., war) purposes.

The global fight against COVID-19 is clearly a war and wars are a costly endeavor, which brings to the fore the issue of financing. That is, how can countries find the resources required to fight this war? One option comes from past experiences of financing conventional wars through "war bonds," which refer to bonds issued by the government to finance military spending or other wartime expenditures. They are either retail bonds sold directly to the public or wholesale bonds traded on an exchange. Bond sale campaigns during wartime have often been accompanied by appeals to patriotism, while retail war bonds generally offered below-market yields.

One of the best-known early examples of a public war bond comes from Germany during the First World War. The bonds, which were called *Kriegsanleihe*, sought to mobilize domestic borrowing for the German war effort. Most bond buyers were large companies and institutions, such as university endowments, rather than individuals. Perhaps the best-known war bonds were those issued by the US government during the Second World War. The sale of these bonds was accompanied by intense patriotic propaganda efforts directed toward the public. The sales campaign was hugely successful, and the bonds became a major source of funding for the US war effort. By the end of the war, 85 million Americans had purchased bonds worth USD185 billion.

The logic of using pandemic bonds to finance the fight against COVID-19 is simple and straightforward. War bonds are used to finance wars, and the fight against COVID-19 is a war, so why not use war bonds to finance the COVID-19 war? There is a large reservoir of goodwill among ordinary citizens to contribute to the global fight against the pandemic. It is difficult not to be moved when we see doctors and nurses heroically helping COVID-19 patients in overcrowded hospitals at great risk to their own safety. Similarly, most citizens are probably willing to lend a helping hand to less fortunate fellow citizens who have lost their job through no fault of their own.

To further cement the sense of solidarity that will drive people to buy pandemic bonds, governments can launch sales campaigns. Just as propaganda machines went into overdrive during war bond drives, the government can take the lead in advertising and advocating the purchase of pandemic bonds. There is no shame in engaging in propaganda to promote the social good. The proceeds from the pandemic bond sales can be used to finance various expenditures related to COVID-19. Obvious priority spending areas include strengthening health-care systems and boosting collapsing economies.

Asian governments have begun to explore the potential of pandemic bonds to finance large and growing public expenditures due to COVID-19. Most notably, on 7 April, the Government of Indonesia successfully issued its first pandemic bond, raising over USD4.3 billion. The issue included a USD1.0 billion 50-year tranche, which represents the longest-dated USD-denominated debt tranche ever issued in Asia. The government indicated that it would use part of the proceeds from the bond deal, which is the largest in the country's history, to fund its COVID-19 relief and recovery efforts. Most of the proceeds will go toward covering the country's widening fiscal deficit.

Indonesia's USD4.3 billion pandemic bond issue is not, strictly speaking, a pandemic bond since only part of the proceeds will fund COVID-19-related expenditures. However, the bond issue does illuminate a broader point. Given the huge fiscal spending required to tackle the current crisis and lay down the foundation for an economic recovery, the bond market is likely to play a prominent role in funding the global war against COVID-19 and the post-COVID-19 reconstruction effort.

[a] This box was written by Donghyun Park, Principal Economist in the Economic Research and Regional Cooperation Department of the Asian Development Bank.

[b] World Health Organization. COVID-19 Situation Report—86. 2020. https://www.who.int/docs/default-source/coronaviruse/situation-reports/20200415-sitrep-86-covid-19.pdf?sfvrsn=c615ea20_6.

Box 3: Social Bonds and the COVID-19 Crisis

Aggregate social bond issuance in 2020 stood at almost USD12 billion as of 12 May, compared with a total of USD16 billion in full-year 2019 (**Figure B3**).[a] Social bonds make up around 16% of total sustainable bond issuance—comprising green, social, and sustainability bonds—thus far in 2020, compared with only 6% in 2019. About 70% of social bonds issued in 2020 refer to mitigation of the impacts from the coronavirus disease (COVID-19) in their use of proceeds.

Having long been green bonds' less well-known sibling, the issuance of social bonds (and to a lesser degree sustainability bonds) is on the rise, albeit thanks to an unfortunate catalyst. Social bonds are used to finance projects that aim to address or mitigate a specific social issue and/or seek to achieve positive social outcomes directed toward a specified target population. Sustainability bonds can finance both green and social development projects.

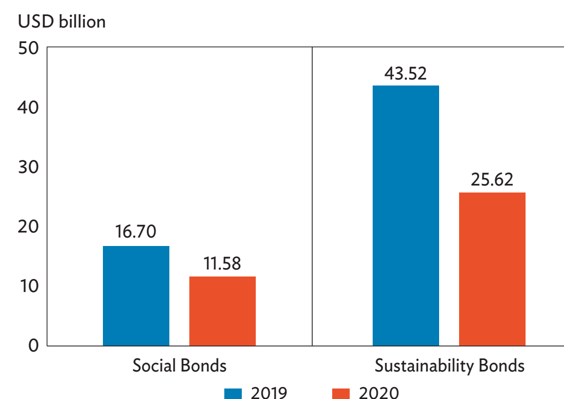
Given the socioeconomic issues that economies around the world have been facing amid the COVID-19 pandemic, social bonds are beginning to emerge as a readily actionable mechanism for the market to respond to the social and economic consequences of the crisis. The global outbreak is a social issue that threatens the well-being of the world's population, especially the elderly and those with underlying health problems. In addition, millions of people around the world are suffering, or will be suffering, from the resulting economic downturn.

The Social Bond Principles (SBP) were published by the International Capital Market Association (ICMA) in 2017 to provide voluntary guidelines for the issuance of social bonds. They build on the use of a proceeds concept and, like the Green Bond Principles, consist of the following four pillars:

1. Use of Proceeds
2. Process for Project Evaluation and Selection
3. Management of Proceeds
4. Reporting

Any debt issuer in the international capital market can issue a social bond related to COVID-19 as long as all four core components of the SBP are recognized and the bond's proceeds go exclusively toward addressing or mitigating social issues wholly or partially emanating from the COVID-19 outbreak.

Figure B3: Social Bonds and Sustainability Bonds



USD = United States dollar.
Note: Data for 2020 is as of 12 May 2020.
Source: International Capital Market Association analysis using Environmental Finance data.

Illustrative examples of eligible social projects include COVID-19-related health care and medical research and the development of vaccines, investment in additional medical equipment or manufacturing facilities to produce health and safety equipment and hygienic supplies, and specific projects designed to alleviate unemployment generated by the crisis. These projects can target specific groups directly impacted by the COVID-19 outbreak, although they may also seek to support a wider population affected by the economic crisis.

Sovereign, supranational, and agency issuers, who were among the first to develop the thriving green bond market, have been in the vanguard of the move toward social bond issuance. On 11 March 2020, the International Finance Corporation issued a USD1 billion 3-year social bond to "support the private sector and jobs in developing countries affected by the COVID-19 outbreak." The fact that this bond experienced exceptional global investor demand at a point when financial markets were in turmoil can be viewed as a reflection of the interest in a debt instrument that addresses the consequences of a global threat, which can be compared to the appetite for green bonds amid increased global understanding of the threat of climate change. On 27 March 2020, the African Development Bank issued the largest social bond to date in response to COVID-19: a USD3 billion 3-year bond to help alleviate the economic and social impacts of the pandemic on African livelihoods and economies called the Fight COVID-19

[a] This box was written by Simone Utermarck, Director of Market Practice and Regulatory Policy at the International Capital Market Association.

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Box 3: Social Bonds and the COVID-19 Crisis *continued*

Social Bond. On 1 April 2020, the European Investment Bank launched a SEK3 billion 3-year Sustainability Awareness Bond to combat the socioeconomic impacts of COVID-19. The proceeds from the issuance are earmarked for the European Investment Bank's lending activities that contribute to sustainability objectives, including Universal Access to Affordable Health Services (United Nations Sustainability Development Goal No. 3). In April, there were additional issuances from the Council of Europe and the World Bank, which issued the largest COVID-19-themed bond to date, an USD8 billion sustainability bond with proceeds dedicated to employment generation.

It is not just multilateral development banks that are accessing the market. Corporates and financial institutions are also issuing social and sustainability bonds. Pfizer, for example, is using bond proceeds to improve access to essential services such as health care. The Bank of China and Kookmin Bank are directing bond proceeds toward the financing of small and medium-sized enterprises affected by the virus.

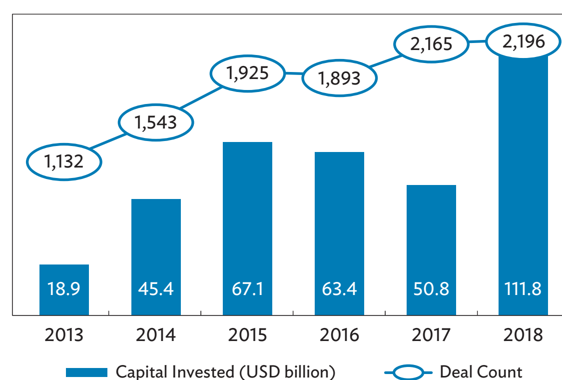
There have been other bonds issued recently that are not considered social bonds, yet they seek to address the consequences of COVID-19. For example, a sovereign issue by the Government of Indonesia raised funds for general budgetary purposes. While this and other bonds may provide financing to help repair the social and economic damage caused by the pandemic, they are not aligned with SBP or Sustainability Bond Guidelines, and therefore do not fall within the ICMA definition of a social bond.

For issuers that would like to issue bonds aligned with the SBP or Sustainability Bond Guidelines, the Executive Committee of the Green Bond Principles, Social Bond Principles, and Sustainability Bond Guidelines, supported by ICMA, released a public statement in March 2020 underlining that existing guidance for social and sustainability bonds was immediately applicable to efforts addressing the COVID-19 crisis. Additional advice for issuers in the form of an updated Q&A and new case studies were also provided.

Box 4: Fintech for Inclusive Growth and Pandemic Resilience

Financial technology (fintech), or the fusion of finance and technology, has emerged as a new model for financial innovation.[a] Fintech covers a constellation of complementary technologies—including mobile networks, big data, cloud computing, distributed ledger technology, artificial intelligence, and data analytics—that jointly shape a broad swathe of operations in the financial industry. The past few years have witnessed the rapid growth of investment in fintech (**Figure B4**). Fintech has already left its imprint on a wide array of financial services, including microfinance, blockchain, payments, personal finance, digital banking, insurance, wealth management, capital markets, money transfers, and mortgages.

Figure B4: Total Investment Activity in Fintech—Venture Capital, Private Equity, and Mergers and Acquisitions



Source: Asian Development Bank chart based on data from Consultancy.eu. 2019. *Global FinTech Investment More than Doubled to $112 billion.* https://www.consultancy.eu/news/2390/global-fintech-investment-more-than-doubled-to-112-billion.

Fintech enhances financial inclusion and broadens access to financial services by capitalizing on technological advances. Fintech mitigates the risks and lack of information associated with underserved households and small and medium-sized enterprises (SMEs) via digital financial services and enhanced risk-assessment skills. Specialized digital banking businesses serve specific sectors and demographic groups

[a] This box was written by Donghyun Park (Principal Economist) and Shu Tian (Economist) in the Economic Research and Regional Cooperation Department of the Asian Development Bank.

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Box 4: Fintech for Inclusive Growth and Pandemic Resilience *continued*

via business-to-consumer and business-to-business debit and credit extended to underbanked and unbanked individuals, households, and SMEs. In doing so, fintech not only improves the variety and efficiency of financial services, but also enhances financial inclusion. According to the Asian Development Bank (ADB) (2017), digital financial solutions can address about 40% of unmet demand for payment services and about 20% of credit requirements of poor households and small businesses in Asia.[b]

Fintech's role as a driver of financial inclusion is especially pronounced in financially underdeveloped emerging markets. Qamruzzaman and Wei (2019) document a positive association between financial innovation and financial inclusion in a sample of six South Asian countries.[c] CBInsights (2019) show that customers in emerging African markets have benefited from digital microfinance, especially mobile payments, microcredit, and saving accounts.[d] ADB plays an important role in supporting financial inclusion via fintech across developing Asia.[e] For example, ADB supported an artificial-intelligence-enabled credit score system that helped more than 8,000 SMEs in the Greater Mekong Subregion obtain credit of USD50,000 each. ADB also supported a cloud-based banking app in the Philippines and branchless banking in Indonesia, contributing to financial inclusion in member economies of the Association of Southeast Asian Nations. Asia is now a major player riding the global fintech wave, hosting 34 out of the top 100 global fintech innovators at the end of 2019.[f]

The role of fintech in improving financial inclusion comes to the fore during big economic shocks such as the COVID-19 pandemic. The poor suffer disproportionately during such shocks. Their hardship is exacerbated by lack of access to financial services, and they often do not have online bank accounts. Even in advanced economies like the United States, delivering financial assistance to the unemployed and small businesses has emerged as a major problem during the COVID-19 pandemic. The nimbleness and flexibility of fintech can mitigate such problems. For example, on 14 April 2020, PayPal and other fintech companies in the United States were approved to participate in a government program to extend loans to small businesses.

The COVID-19 crisis creates opportunities to further expand the role of fintech in financial inclusion in developing economies. Fintech can not only contribute to inclusive growth but also contribute to the economic resilience of the poor and SMEs in times of economic shock. Developing economies can harness fintech to keep the poor and SMEs connected to the financial system even in the face of a crisis such as a pandemic. In particular, fintech can unlock new sources of finance for groups that are underserved by banks and other traditional financial institutions. In addition, fintech can enable banks and lenders to extend funds more quickly and smoothly to these groups, which is critical during major economic shocks.

In developing Asia, fintech companies are coming up with innovative solutions to fund SMEs struggling to stay afloat amid COVID-19. They are providing new turn-key loan origination and underwriting platforms to allow banks and lenders to provide financing for small businesses. These platforms encompass risk assessment and insurance capabilities. Fintech also offers innovative finance solutions that are valuable to low-income groups during pandemics. For instance, the Indonesian ride-hailing delivery start-up GO-JEK offers a cash-in, cash-out platform for financial services. India's EKO, a financial transactions platform, is trying to create "human automated teller machines" out of anyone with a mobile phone and a little cash.

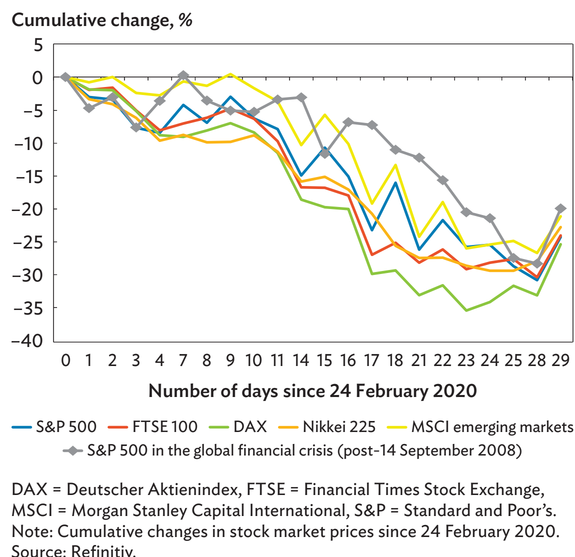
While financial innovation promotes financial inclusion, it also raises regulatory challenges such as cybersecurity, other technical vulnerabilities, data governance, and privacy protection. At a broader level, regulators must strike the right balance between enabling fintech innovations that benefit the poor and SMEs while also monitoring and managing the risks associated with innovation. Given the frenetic pace of innovation in the fintech sector, which is likely to pick up even more speed in the increasingly digital post-COVID-19 world, regulatory capacity must be strengthened to keep pace with change. Finally, developing economies must make digital infrastructure investments to improve the interface between the digital and nondigital economies for the poor.

[b] ADB. 2017. *Accelerating Financial Inclusion in Southeast Asia with Digital Finance*. https://www.adb.org/sites/default/files/publication/222061/financial-inclusion-se-asia.pdf.
[c] M. Qamruzzaman and J. Wei. 2019. Financial Innovation and Financial Inclusion Nexus in South Asian Countries: Evidence from Symmetric and Asymmetric Panel Investigation. *International Journal of Financial Studies*. 7(4). pp. 1–27.
[d] CBInsights. 2019. *Global Fintech Report Q3 2019*. https://www.cbinsights.com/research/report/fintech-trends-q3-2019/.
[e] Developing Asia comprises the 46 developing member economies of ADB.
[f] D. Ngo. 2019. *Top 100 Fintech Companies Repartition Map, 2019 Fintech100, H2 Ventures/KPMG, November 2019*. https://fintechnews.hk/10385/various/top-fintech-companies-asia/attachment/top-100-fintech-companies-repartition-map-2019-fintech100-h2-ventureskpmg-november-2019/.

Box 5: Financing Firms during the COVID-19 Pandemic

The coronavirus disease (COVID-19) outbreak has imposed a heavy toll on economic activity worldwide.[a] Because of the rapid transmission of the virus, social distancing measures have been applied to save lives and avoid the collapse of health-care systems, which in turn has led to a synchronized downfall in economic activity around the world and has had a significant impact in financial markets (**Figure B5**).

Figure B5: Decline in Global Stock Markets



DAX = Deutscher Aktienindex, FTSE = Financial Times Stock Exchange, MSCI = Morgan Stanley Capital International, S&P = Standard and Poor's.
Note: Cumulative changes in stock market prices since 24 February 2020.
Source: Refinitiv.

In contrast with the global financial crisis, the shock did not originate in the financial sector. This has important implications for the menu of options available for policy makers, who must be creative until the health crisis is resolved. Currently, economies are facing a combination of supply and demand shocks, as well as the interruption of relationships between firms and their stakeholders, leading to a collapse in corporate cash flows. Firms have struggled to survive as their working capital gets depleted. A firm's ability to continue operating during the pandemic shock thus depends on whether it can raise additional financing and adjust expenses. Although it alone is not enough, a well-functioning financial system can help firms stay alive and preserve their relationships with stakeholders.

Policy makers can play a role in stabilizing the economy by working with the financial sector to keep firms afloat. However, because of the unique characteristics of the current crisis, the first set of policies relates to adapting the institutional framework, while a second set is linked to the provision of credit to firms.

Adapting the Institutional Framework

Although financial systems have worked as expected, they are ill equipped to cope with a shock like COVID-19 because they are geared toward detecting idiosyncratic risk when it arises (e.g., an increased credit score of nonperforming loans). However, during the COVID-19 crisis, signaling firms in trouble would not be very informative, given that most firms have suffered a sizable and unexpected negative external shock. To the extent that financial sector stability can be preserved, allowing forbearance and avoiding undue increases in borrowing costs might be necessary.

An important margin of adjustment is choosing which firms to apply such forbearance measures to. On the one hand, while universal application is easy to implement and increases the chance of survival for all firms, it creates significant risks for banks if they impose no conditions on firms. On the other hand, policies that allow for some screening of firms would probably entail smaller transfers and reduced fiscal costs, though screening could delay implementation and would not offer the same chance of survival for all existing firms.

Providing Credit to Firms

Policy makers around the world have considered several options to enhance the provision of credit to firms. Central banks have quickly responded by lowering interest rates. However, standard monetary policy measures might have limited effects during the COVID-19 outbreak because of the uncertainty surrounding the shock and measures to contain it, and limited scope to reduce already low interest rates.

Central banks have thus turned to liquidity measures, while governments have stepped in with policies that absorb the extra credit risk and transfer the increased liquidity into

[a] This box was written by Sergio Schmukler, Lead Economist and Acting Research Manager for the Development Research Group of the World Bank. This text box summarizes the following World Bank publications: T. Didier, F. Huneeus, M. Larrain, and S. L. Schmukler. 2020. Financing Firms in Hibernation During the COVID-19 Pandemic. *Working Paper*. No. 9236. http://documents.worldbank.org/curated/en/818801588952012929/Financing-Firms-in-Hibernation-during-the-COVID-19-Pandemic; and T. Didier, F. Huneeus, M. Larrain, and S. L. Schmukler. 2020. Financing Firms in Hibernation During the COVID-19 Pandemic. *Research and Policy Briefs*. No. 30. http://documents.worldbank.org/curated/en/228811586799856319/Financing-Firms-in-Hibernation-During-the-COVID-19-Pandemic.

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Box 5: Financing Firms during the COVID-19 Pandemic *continued*

the real economy. For large companies, governments have supported financing through capital markets by, for example, purchasing corporate liabilities to be resold once the firm has recovered. For small and medium-sized enterprises (SMEs), who mostly rely on bank financing, governments have capitalized state-owned banks and/or scaled up public credit guarantee programs. Some economies with fairly well-developed capital markets have moved toward allowing the central bank or the government to engage in large-scale purchases of SME loans. Other central banks have developed lending facilities to encourage investors to purchase securities collateralized by a portfolio of SME loans. All of these measures seek to provide incentives to banks to lend to firms.

Policies aimed at transferring credit risk to the government should be designed to minimize the cost to public coffers and should benefit from two characteristics. First, scale is crucial to allow for risk diversification as not all firms and industries have been equally affected. Second, providing incentives for both creditors and debtors is also important to avoid irresponsible lending by banks and moral hazard by firms. For example, public credit guarantees should be partial so that banks have an incentive to monitor and screen borrowers. Regarding firms, their challenge is to avoid the ex-post moral hazard problem of not repaying loans.

Conclusion

Governments have limited resources so they must prioritize and evaluate the trade-offs associated with different policies. Their assistance may be needed now more than ever as banks and investors face unprecedented uncertainty.

There are stark differences between developed and developing economies regarding the scope for policy action. Economies with shallower financial markets, less fiscal space, and more constrained central banks will face greater challenges in channeling credit to struggling firms. With the rise in global risk, developing economies have faced a sudden stop in capital inflows, rising costs to issue new debt in capital markets, and a sharp depreciation of domestic currencies. These significant macroeconomic challenges, combined with the large financing needs that have arisen amid the pandemic shock, could trigger widespread sovereign debt restructurings.[a] This could be followed by widespread turbulence in the corporate sector, especially in economies where firms entered the pandemic shock with high outstanding debt levels. The liquidity issues in developing economies might thus rapidly turn into solvency problems—and not only at the firm level. Multilateral policy action, involving international financial institutions and creditor economies, could help resolve a common threat facing many developing economies.

[a] O. Blanchard. 2020. *What It Will Take to Save the Economy from COVID-19*. Presentation for a Peterson Institute for International Economics Webinar. 6 April; P.-O. Gourinchas and C.-T. Hsieh. 2020. The COVID-19 Default Time Bomb. *Project Syndicate.* 9 April.