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The Impact of Covid-19 Pandemic on Financial Services

[1] Ruzibaeva Nargiza Khakimova

[2] Khotamkulova Madina Sanjar kizi

Abstract

This article describes the impact of the COVID-19 pandemic on financial services and the role of technology in their development. It should be noted that statistics have been made based on the official statistic internet sites.

Keywords*: financial services, fintech, crisis, customer, finance.*

[1] Lecturer of Samarkand Institute of Economics and Service

[2] Student of Samarkand Institute of Economics and Service

Introduction. New challenges and opportunities are quickly reshaping financial services – from AI to fintech, to open platforms and data analytics, to greater customer centricity and workforce shaping – all of which financial institutions need to address while navigating the evolving risk and regulatory landscape. Organizations are looking at a future that is more interconnected, more collaborative, and frictionless – one where trust, growth, and delivering value are paramount. Global, multi-disciplinary teams of professionals understand what it takes to deliver successful outcomes in the financial services industry and they are continuously evolving and growing to ensure the capabilities, strategies, and networks to deliver the insight-driven and technology-enabled services that drive the sustainable value creation organizations require. Especially, these skills are desperately important for companies during the post-pandemic context. Therefore, having discovered the significance of technology in financial services, companies have been investing money in it from the very first days of lockdown. In this article, we are going to discuss the effect of the pandemic in this sector, and recent changes as well.

Literature Review. Several scientific articles and literature have been studied to analyze financial services and their current state after the lockdown. According to International Monetary Fund, financial services are something that is best described as the process of acquiring financial goods. In other words, it involves the transaction required to obtain the financial good [1]. Financial services play an important role in the organization of the most important priorities for socio-economic development and the deepening of reforms in the financial system of the country. The development of technology has created great opportunities for digital financial services. Auer R. et al stated that [2] digital financial services are financial services (e.g., payments, remittances, and credit) accessed and delivered through digital channels, including via mobile devices. These encompass established instruments (e.g., debit and credit cards) offered primarily by banks, as well as new solutions built on cloud computing, digital platforms, and distributed ledger technologies, spanning mobile payments, crypto-assets, and peer-to-peer applications. These new solutions are commonly referred to as fintech.

Arner et al noted that [3] the digital revolution is changing the landscape of the financial services industry at an unprecedented rate. The emergence of fintech (or financial technology) has fueled the development of a wide range of new digital financial products and services. While their emergence can be related to the recent fintech movement, it is important to point out that the financial industry has a long history of reliance on technology. The industry has always been one of the prime users of technology-driven solutions, at least in developed markets.

It is also stated that [4], [5] the promise of greater inclusion through digital financial services has been strengthened by the COVID-19 crisis. At the same time, the crisis also raised great awareness about the potential risks. These have included concerns that the transition to digital financial services might be widening gaps and exacerbating financial exclusion for vulnerable groups that could be left behind, especially those with lower socioeconomic status and limited digital skills. The consequences of not being able to fully participate in the new digital financial system can exacerbate existing financial fragilities and limit one's ability to build financial resilience and long-run financial security. Concerns related to consumers' data privacy and security, regulatory arbitrage, fair competition, and financial stability have also been raised. These need to be addressed through legal frameworks that regulate the entry and activities of non-bank fintech entities in a way that enables healthy competition in the marketplace, while

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simultaneously ensuring consumer protection. The approaches adopted so far have varied across geographical locations and financial activities.

Methodology of the research. The methodology includes historical analyzes, systematic analyzes, and graphic methods. Statistics have been made with the help of official statistic sites.

Results. Several studies have been carried out to analyze the role of digital financial services in the development of companies and efficient ways of implementing fintech to deliver excellent services to clients of both bank and non-bank organizations.

Studies have shown that at the start of the pandemic, 10% of financial services companies had the technology infrastructure needed to make the transition to remote working [6]. Sales and marketing departments also struggled to keep pace with customers' digital needs, the survey showed. The crisis spurred these firms to adapt quickly. A year later, a new survey about enterprise agility in five major industries—financial services, healthcare, manufacturing, public sector, and telecommunications—found that financial services companies are now considered leaders in business agility, defined as the ability to rapidly pivot people, processes, and technologies to maintain business growth and competitive advantage.

The sector ranked second in overall agility, after telecom, and first in agile customer experience, risk management, and finance. Here are some of the other sector highlights from the survey:

4 x increases in agile data management and security. At the beginning of the pandemic, just 13% of executives said their data management and security processes were agile; a year later, that ratio had risen to 55%. Executives also cited roughly three-fold gains in agility finance and budgeting and IT architecture.

2 x increases in the share of firms with agile workplaces. Of all the shifts brought by the pandemic, none was as swift as the move to remote work. Only 13% of financial services firms showed agility in workplace management at the start of the crisis, and only 10% cited agile employee services. But as a result of their investments in remote working, 25% of firms report agility improvements in both areas.

78% of firms expect a return on investments in remote work. Executives reported that they are already seeing significant returns on investments in agile remote working and change-management processes and that they anticipate greater returns over the next two years. They also expect big gains from investments in customer workflow technology and IoT tools.

100% of firms expect to integrate technology and data platforms within two years. The telecom sector led all five sectors in digital platform integrations, but financial services made important advances. Within two years, all executives said they expect to fully integrate their technology and data assets into a digital platform; 75% also reported that their financial and accounting platforms will integrate multiple functions.

63% of execs cite data quality and access as chief agility barriers. Even as financial services firms rushed to improve agility, the goal hasn't been easy to achieve. Poor data quality and a lack of data access are the main culprits, followed by uncertain ROI and the lack of a compelling business case. More than half of executives cited a lack of leadership in developing agility plans.

The next research analyzed the post-pandemic state of two of the main and common financial services: insurance and asset management markets [7]:

Insurance. The insurance industry is by its very nature generally well prepared to deal with

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significant industry loss events, such as the COVID-19 pandemic. Several insurers learned lessons from the SARS outbreak of 2003 and introduced exclusion clauses for communicable diseases and epidemics/pandemics into most non-life products, such as business interruption (BI) and travel insurance. However, there is still uncertainty associated with the full extent of claims for life and health insurers and the timing of those claims, as the impact will vary country by country. The industry is closely monitoring the effect on mortality rates and life insurers are also expecting to be severely affected by the financial markets (e.g. life investment bonds).

As business interruption and contingency claims (e.g. event cancellations) continue to unfold for general insurers, which could potentially result in a reduced capacity (i.e. available capital) in the market. With a trend towards higher combined ratios and decreasing levels of return on equity because of COVID-19 losses, insurers will need to increase rates, which will result in higher premiums. This has led to some insurers raising additional capital in the market, in anticipation of a 'hardening market' in early 2021.

As a consequence, multinational insurance groups are assessing how potential COVID-19 claims may affect their solvency capital requirements from a regulatory perspective, and whether they need to amend the terms of their existing inter-company reinsurance programs (e.g. tighten the exclusion wording to exclude further pandemics) or increase the level of cover as the 2021 renewal season approaches.

From a TP perspective, multinational insurance groups, which are looking to increase their intra-group reinsurance cession levels or put in place additional contracts to better manage volatility, should maintain adequate documentation to support the commerciality of the arrangements, in particular why the new contracts were introduced or changes to the terms have been made, to ensure that the arrangements are commercially rational.

In addition, insurance groups should analyze the impact that increased cession levels may have on the pricing of the ceding and profit commissions for proportional reinsurance and the premium costs in the case of non-proportional reinsurance. In an environment where there is increased scrutiny and pressure on cost bases, profit-based contingent commissions may become more common for proportional reinsurance such that ceding companies are rewarded based on the overall profitability of the business reinsured.

Where the ceding company uses the net cost-plus method to test whether the ceding commission appropriately covers its production costs with an appropriate mark-up, consideration must be given to whether the net cost-plus method is still sustainable if the reinsurer is making losses and, therefore, may not be willing to pay additional commissions to cover the cedant's costs. In addition, from the reinsurer's standpoint, multinational insurance groups should consider revisiting their return on capital benchmarking to ensure that the comparables reflect market conditions and take into account the impact of losses.

Hub-and-spoke underwriting models may need to be scrutinized to stress test how the underwriting approval process has worked in the COVID-19 environment, and whether this affects the location of the KERT functions in an underwriting branch scenario. Likewise, the knock-on effects for the allocation of investment assets and capital to branches under the AOA will need to be carefully considered. Similarly, the way that KERT profit split models will work in underwriting and investment loss split situations may need to be revisited and allocation keys reconsidered.

Asset management. As the COVID-19 pandemic continues to create uncertainty, asset managers in the traditional and alternative sectors are under stress on several fronts. These challenges affect both regulated and unregulated funds at both the fund and investment levels.

The sector has witnessed the combined impact of massive outflows of assets, as investors focused on liquidity as well as lower asset valuations eroding the stream of management fees. In addition, lower asset valuations are likely to also reduce the level of performance fees available, if any, which have become an important source of income also for traditional funds.

Certain funds have been facing difficulties in meeting investor redemptions. As such, the initial response was focused on complying with regulatory requirements and avoiding a liquidity crunch for the funds, respectively for the management companies (Mancos) or alternative investment fund managers (AIFMs) managing these funds. Financial regulators were already focused on fund liquidity before the COVID-19 outbreak, and given these fresh risks, the management of liquidity has become even more important for the asset management sector.

For alternative funds, the COVID-19 pandemic will also likely affect the quality of investment assets (e.g. considering the broader impact of the COVID-19 pandemic on the commercial real estate sector with outstanding rents, debt relief, etc.) and trigger questions around the underlying financing arrangements that are inherently linked to the quality of the assets being financed.

The practical challenge is how to treat potential loss situations for regulated entities and group internal service providers where potential floors (minimum compensation clauses), support payments, or liquidity injections may be triggered / required to stabilize the profit, liquidity, or capital positions. Other questions relate to potential fee waivers and to what extent these should be shared.

The focus is shifting to assessing the potential impact of the 'new normal' on existing TP models to remunerate the key functions across the value chain, fund administration, portfolio management, and capital raising/distribution. The key question for TP purposes is how existing TP models can appropriately deal with implied loss situations (e.g. where the shares determined under fee splits are insufficient to cover the costs of local distribution operations) or actual loss splits (e.g. where a profit split model turns into a loss split model). Here, the clear recommendation is to actively monitor the effective distribution of profits or losses by combining existing price settings with outcome testing approaches to corroborate actual results.

Following conducted research revealed that financial services business leaders across the globe are consistently focused on six principle challenges in dealing with the impact of COVID-19 and in dealing with the increasingly stringent containment measures that governments are putting in place.

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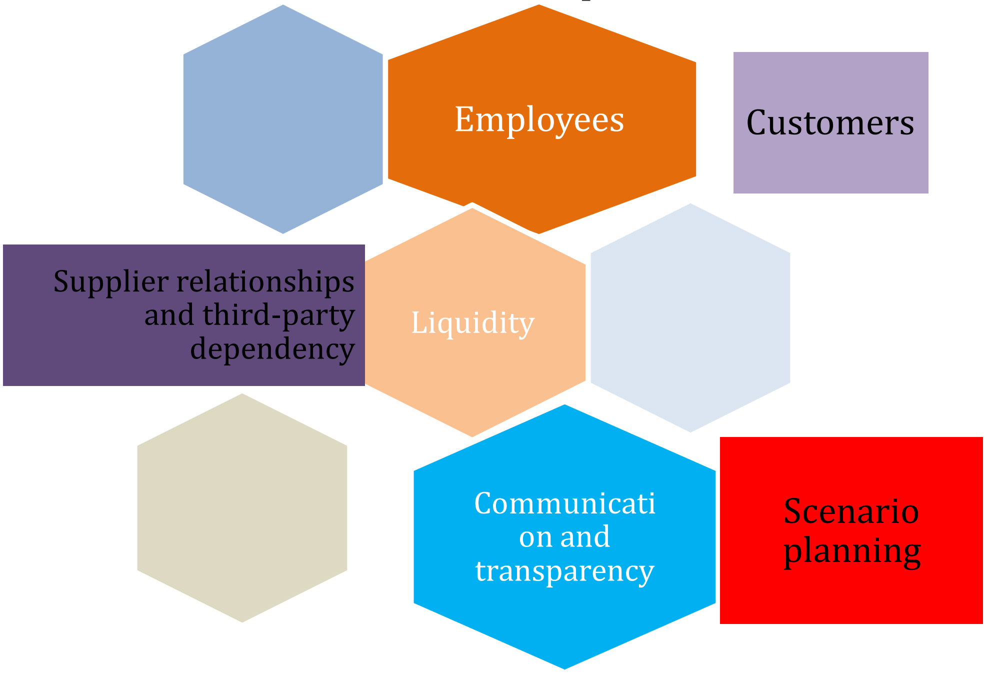
Figure 1 Six principle challenges in dealing with the impact of COVID-19 for financial service companies [8]



1. **Employees.** How you treat your employees now will have a massive effect on their wellbeing, and consequently on their loyalty and productivity. Be very vocal with your support for any changes they need to make to work arrangements and performance targets to fulfill their responsibilities to their families and communities. Be a champion of good citizenship, and support containment and home-working where it is possible. Financial services institutions all over the world are making significant changes to working arrangements - in some cases speaking with regulators to ensure that these meet compliance expectations — and this is helping them continue to deliver services to their customers.

2. **Customers.** In severely hit countries, business customers are experiencing urgent needs as revenues are disrupted while, on the personal side, hard-working people's incomes are coming under threat. The role of financial institutions becomes more important than ever — where possible, providing liquidity, support, and necessary forbearance to personal customers undergoing temporary difficulties. It is important too that they give regular reassurance on continuity of service delivery. Customers also need to know how their providers are dealing with issues directly related to COVID-19 — health and travel insurance, investment portfolio performance, and online payment facilities. For companies, effective digital delivery of services is essential while organizations deal with staff shortages, office closures, and other public health protection measures (e.g. businesses refusing to handle cash).

3. **Liquidity.** Financial services companies need to thoroughly understand their available capital and liquidity resources and to assess their resilience of these. Central banks have been delivering enormous stimulus packages to offset a larger, systemic liquidity crunch. This is bringing down borrowing costs, but there is a risk that some companies will hoard cash and open credit lines to keep their businesses going through the crisis.

4. **Supplier relationships and third-party dependency.** Financial services companies (and their customers) have substantial third-party networks — vendors (including in-person agent networks), outsourcing partners, technology providers, etc. They need to regularly assess and monitor these third parties on information security, business continuity, and other risk domains. The COVID-19 impact forces companies to review these suppliers, assess which are most likely to be impacted, which are critical to ongoing business operations, and where they need to urgently mitigate risks posed by these relationships.

5. **Communications and transparency.** As the business and economic impacts of COVID-19 bite, financial services companies will need to ensure that they are communicating effectively with multiple stakeholders: employees, customers, shareholders, and regulators. The situation is a breeding ground for disinformation and rumor, so financial services companies need to ensure that they are clear about the steps they are taking to manage the impact of COVID-19. Regulators expect financial services companies to focus on and ensure continuity of their core operations, including support for their customers. Financial services companies need to regularly assess their digital communication capabilities, and how to leverage such capabilities to communicate with customers and the broader marketplace.

6. **Scenario planning.** Financial services companies are in the business of imagining the future — understanding the significant immediate challenges to society and economies posed by COVID-19 and how this will impact the interconnected financial system. They are using their scenario modeling and contingency planning expertise to help themselves and their customers to make good decisions in the face of a highly volatile operating environment. They will also need to incorporate new indicators, prioritized by the COVID-19 outbreak, into their decision-making activities.

The last research has been conducted to reveal current concerns of the financial service companies [9] and the followings have been concluded:

- **Productivity improvement and technology enablement.** Financial services firms are looking for ways to rapidly accelerate their digital transformation and cloud enablement roadmaps.
- **Reconnecting with customers.** Recognizing that customer expectations and needs have rapidly changed firms is now implementing programs aimed at improving customer engagement.
- **Creating vibrant ecosystems and partnerships.** With business models and market dynamics continuing to evolve, financial services firms are engaging with non-traditional partners to create new value propositions for customers.
- **Embedding social responsibility and purpose.** As markets and economies look towards recovery, there are growing calls for increased focus on environmental, social, and governance considerations.
- **Improving risk management and agility.** The leading financial services firms are taking steps today to improve their ability to deal with sudden shocks and unexpected risks in the future.

Conclusion. In conclusion, it can be concluded about financial services that:

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- ✓ financial service providers (in the broadest sense) are constantly on the move, improving their operations by adding new types of financial services;
- ✓ within the framework of the activities of financial institutions, new financial, economic, and social relations are formed, i.e. between financial institutions and consumers of financial services (products);
- ✓ Financial institutions provide their clients with financial resources for short-term and long-term use (including in the form of leasing). This will pave the way for deposit, currency, and lending operations.

Financial institutions across the world are monitoring and dealing with the effects of the COVID-19 pandemic. They are working to understand the immediate challenges to society and economies, and the long-term impact on the interconnected financial system. They are using their expertise to help themselves and their customers to make good decisions in today's highly volatile operating environment.

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