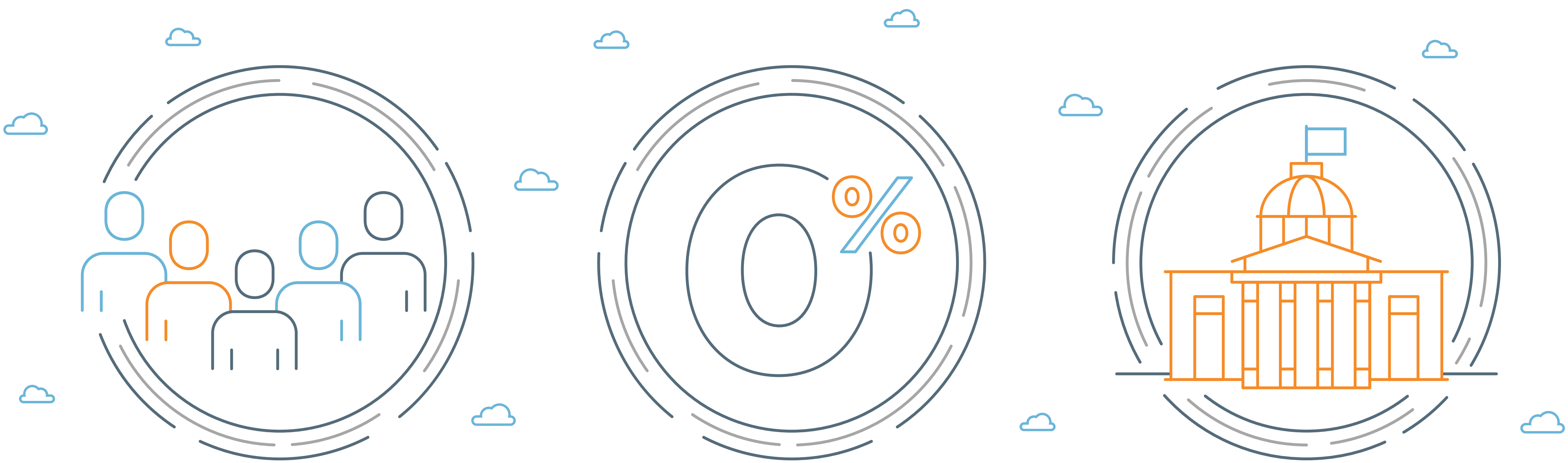
ZERO & NEGATIVE INTEREST RATES
OPERATIONAL & BUSINESS DEVELOPMENT INSIGHTS

TIPS FOR LESSORS IN AN UNPRECEDENTED MARKET CONDITION



IDS™ | Asset Finance Technology

Negative Interest Rates? Maybe...

BUT EVEN 0-0.25% RATES PRESENT LESSOR CHALLENGES

Prompted by signs that the COVID-19 crisis was pushing the U.S. economy toward recession, the Federal Reserve responded by cutting interest rates to their lowest levels since the Great Recession. While the Fed's initial move was to set rates at 0-0.25%, the potential for negative interest rates remains a possibility. Some in government and the financial industry view negative rates as a non-starter, while others see it as a mechanism to increase economic activity and spark faster upticks in GDP, employment and stock prices.

Other countries have, on rare occasions, pursued negative interest rates with mixed results. Making cheap money available to banks and enterprises clearly has some upside. It can encourage spending and mitigate layoffs, defaults and other undesirable outcomes. But the truth is, pulling the negative rate lever has a different effect on each economy. If the Fed were to dip into negative territory, no one knows precisely what the impact would be.

While it is unknown if we'll see negative interest rates, it's important to prepare for them. Fortunately, the same operational steps and business development strategies you deploy for 0-0.25% rates are approximately the same if rates do go negative. And 0% is a reality lessors need to prepare for now. Whether it's months or years, the U.S. economy will recover from this coronavirus-induced dive. But the systems and processes you put in place today to deal with negative or 0% interest rates will provide a great safety net for the future.

This ebook offers ideas for adapting to 0% or negative interest rates. Some insights are operationally focused and others offer ideas for business development in these unfamiliar market conditions. You can also contact us for additional help, whether or not you are a current IDS customer.

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Learning from the Past

QUICK REVIEW OF THE HISTORY OF ZERO & NEGATIVE INTEREST RATES

Throughout its history, the U.S. has rarely seen interest rates reach 0%. And should the Fed decide to go one step further and institute negative interest rates as a last resort to spur economic growth, it will be the first time in U.S. history.

Negative interest rate policies are a relatively new phenomenon. Sweden's central bank was the first to deploy them in July 2009 at the height of the Great Recession. That initial action was followed by the European Central Bank (ECB) going negative in 2014, with a number of European countries following suit over a three-year period. While the theory and impact of negative interest rates are highly complex, the primary goal that has historically driven the strategy is to strongly disincentivize saving. Instead of earning interest, cash reserves in a bank yield a storage charge. This alternate reality of banks charging consumers and organizations for deposits — while essentially paying others to borrow money — is done primarily to promote borrowing and encourage spending that will, in theory, accelerate economic growth.

Of course, theory and practice are two different things. The truth is that the move to 0% or even negative rates is often met with silence. Historically, organizations and consumers don't spring into the market and increase their spending. Spending is largely based on confidence — and other emotions — and the increase in economic activity usually doesn't show until companies and consumers begin getting a sense that things are trending back to normal. That's the point where cheap money tends to kick in and make a noticeable economic impact.

DEFINITION

0%

Zero Interest Rate Policy (ZIRP)

ZIRP is when a central bank sets its target short-term interest rate at or close to 0%, as the Federal Reserve did on March 15, 2020. The goal of ZIRP is to spur economic activity by encouraging low-cost borrowing and providing cheap credit options.[1]

[1] https://www.investopedia.com/articles/investing/031815/what-zero-interestrate-policy-zirp.asp

Access to Cheap Money

IMPACT ON THE ENTERPRISES YOU SERVE

The move to 0-0.25% was one of the Fed's last bullets. Dropping to negative interest rates would likely be the last — at least from a historical perspective. The idea is to make borrowing inexpensive so that both businesses and consumers will buy, invest and spend more. But from an enterprise perspective, it's probably not that simple.

Given the option of inexpensive capital, corporations will likely consider a number of strategic options. Conservative and risk-averse CFOs might look at the landscape and the trajectory of the economy and decide to wait — not take on any new debt and make few new investments. Many will take that stance, but it seems more will take some kind of strategic action afforded by low-cost borrowing to pursue their corporate growth strategies. Either way, the decisions companies make now should align with their long-term interests.

Publicly traded companies, for example, might use the excess capital to buy back stock. Others may decide to greenlight the construction of research facilities, acquire other companies, invest in new digital infrastructure or construct new manufacturing plants. From a lessor's perspective, the move to 0-0.25% or negative interest rates means that your customers and prospects will be actively exploring a number of options — ranging from doing nothing to making big investments in high-value assets. It's an opportunity to become a strategic partner that helps them explore their options by providing them with financial information and options they need to make their decisions.

Spreadsheets Won’t Cut It

INCREASE EFFICIENCY TO PRESERVE SHRINKING MARGINS

In their current form, the calculations and workflows you use to execute contracts likely don’t account for 0-0.25% interest rates, much less negative interest rates. Failing to address this issue — in both existing and new contracts — would result in deals that produce with no margin or possibly negative margin. For the most part, none of us thought we’d get here. The U.S. economy, in particular, was in the midst of historic run of growth until the coronavirus began to spread.

For contracts that will allow it, this move to 0-0.25% necessitates review and alteration of the formulas used to calculate payments. This is a complex and time-consuming task — and it presents ample opportunities for costly human errors. While the drop to negative interest rates seems unlikely, it’s a still a possibility, and it requires preparation from an operational perspective. Moving in this unprecedented direction would further complicate critical workflows and drive down already razor-thin margins. After all, constructing profitable deals when the Fed is paying the banks to borrow money is something most of us have never even contemplated.

In light of these dramatic interest rate changes, spreadsheet-based management systems will present significant vulnerabilities as lessors begin re-calculating their deals to safeguard against the prospect of no-margin and negative-margin contracts. Additionally, human errors and spreadsheet-related administrative costs will be magnified, leading to ill will on the part of customers or financial losses on the lessor side.

One solution is taking this opportunity to go digital — make the move from spreadsheets to a cloud-based solution that automates negative interest calculations and drives new efficiencies into the process. Moving to a cloud-based software system for origination and portfolio management is one way organizations can protect razor-thin margins across a large number of leases and lease types — eliminating unnecessary operational and administrative expenses. For lessors, implementing cloud-based leasing software can reduce risk, increase accuracy and improve contract margins amidst significant market volatility.

CLOUD-BASED SYSTEMS ALSO EMPOWER LESSORS TO INTEGRATE ADDITIONAL ADD-ON SERVICES—SUCH AS VERTEX, DOCUSIGN, AND PAYNET—THAT ENABLE THEM TO DELIVER EFFICIENT, AUTOMATED CUSTOMER EXPERIENCES FROM ORIGINATION TO END-OF-TERM.

An Opportunity to Grow?

IMPACT ON LESSOR BUSINESS DEVELOPMENT

No one knows for sure what's going to happen now that we're in 0-0.25% territory. Will the Fed drop into negative territory for the first time ever?

Given this level of uncertainty, it seems that agility will be one of the greatest business development tools for lessors in the coming months. The ability to quickly — and accurately — run scenarios and provide a range of options to customers and prospects may position lessors as a trusted partner as corporations and other organizations work through their strategies. In order to provide customers and prospects with this kind of insight and information, lessors need digital tools that allow their teams to work faster than ever. If you're working in spreadsheets or using other processes that were built before the possibility of negative interest rates, the speed probably won't match what customers and prospects will want. You'll also be opening the door to the likelihood of costly human errors — working fast in uncharted territory is not ideal.

Deploying cloud-based portfolio management technologies will provide your operation with the agility it needs to win new deals in an uncertain and rapidly changing market. The right system will include modules or features that automate calculations and allow you to expertly navigate the new world of 0-0.25% interest — or even the deeper complexities of negative interest rates.

Based on Experience

HIGHLY APPLICABLE LESSONS LEARNED

Like you, IDS is following the actions of banking systems around the world, including the Fed in the U.S. While this is new territory for all of us, we've been preparing for the realities of negative interest rates for several years. We've built some core capabilities into our SaaS platform, IDScloud — and we're actively working to expand capabilities as we work with our clients and learn more. While these market realities are new for all of us, we have discovered some best practices as we help our clients move forward:

1. SURVEY YOUR BEST CUSTOMERS.

If you have good relationships with CFOs and other senior leaders in customer organizations, connect with them and ask if you can provide them with information they need to develop their strategies moving forward.

2. CONNECT WITH YOUR PEERS.

Other asset finance organizations are navigating the same new interest rate realities as you are. They're also dealing with the challenges of remote work, employee health concerns and other key issues. Connect with your peers, compare notes and take advantage of new ideas.

3. EVALUATE YOUR PROCESSES.

Your processes likely are not built to efficiently handle the move to 0-0.25% or negative interest rates. Almost no lessor was ready for this. Take time to step back, evaluate your processes and see where you need to deploy new tools or processes in order to protect your margins.

4. REACH OUT TO YOUR SOFTWARE PROVIDER(S).

Make sure you understand all of the options and proposed solutions available within your origination and lease management applications.

5. EXPLORE MOVING TO CLOUD.

If you were waiting for a practical reason to move from spreadsheets or on-prem software to a SaaS mode, this is likely the event you were waiting for.

Resources for Lessors

CONSULTATIVE EXPERTS & NEW TECHNOLOGY

IDS has worked closely with asset finance organizations — from the world's largest banks to entrepreneurial independents — since 1974. We've lived through bear markets, downturns and recessions. We were there supporting customers the last time rates dipped to near-zero in the U.S. So, we have lots of tribal knowledge about these current circumstances. That knowledge shows in the design of our software and the consultation and services we provide to our customers.

If you need help moving off spreadsheets or if you are looking for tools to reduce costs or drive new business in this zero-or-maybe-negative market, contact us. We make the transition from spreadsheets — or from on-premises software — to the cloud fast, easy and non-disruptive. We can also show you how to make powerful new SaaS tools work specifically for your operations.

WANT TO EXPLORE IDScloud MORE ON YOUR OWN?

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WANT TO TALK TO ONE OF OUR EXPERIENCED SOLUTION CONSULTANTS?

Contact us here.