The Effects of COVID-19 and the Need for Bank Restructuring

International Finance Corporation
WORLD BANK GROUP

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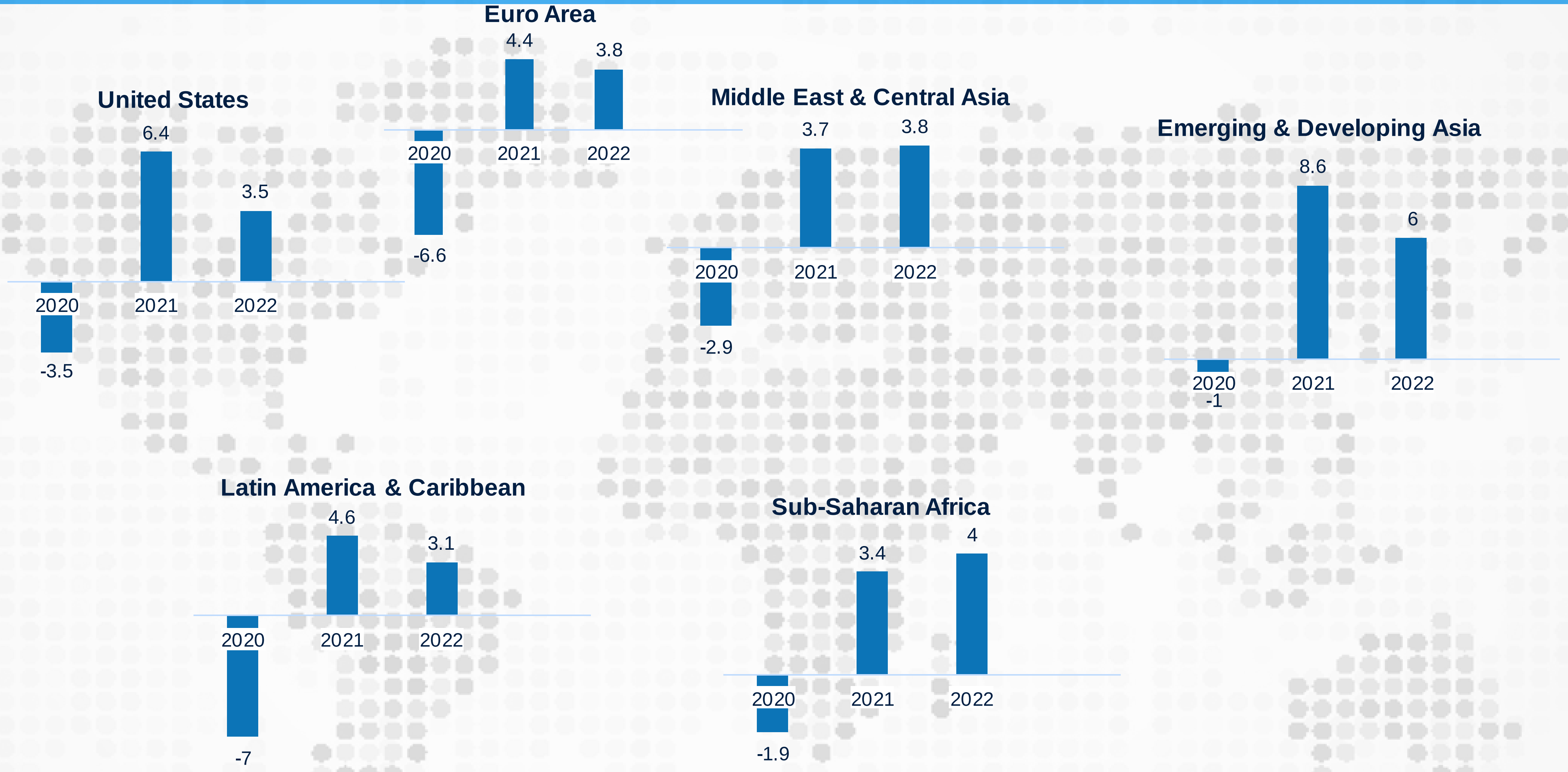
STRUCTURAL CHANGES CAN LEAD TO GROWTH



“The COVID-19 crisis, especially if prolonged, can lead to substantial structural changes such as the expansion of e-commerce and various e-services (including e-government ones), telework, teleconferences, online education and the contraction of business travel, traditional retailing and therefore, demand for office and commercial space” European Parliament's committee on Economic and Monetary Affairs (ECON).

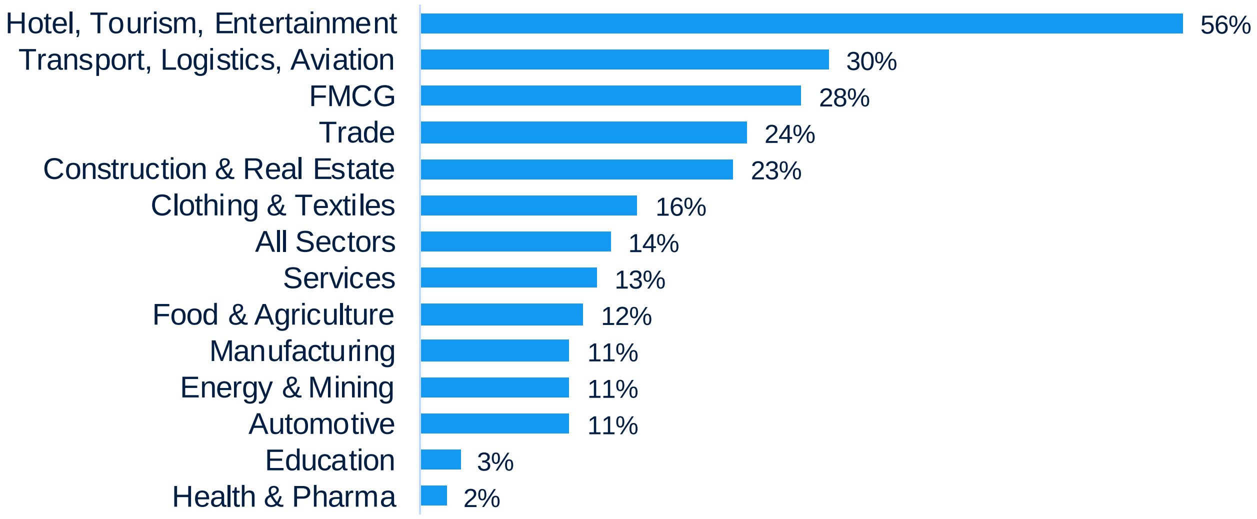
THE IMPACT OF COVID-19

- The economic impact of the COVID-19 crisis is very different from the Global Financial Crisis (GFC) of 2007- 2009 and other past financial crises or business-cycle downturns. The GFC caused a disruption in financial intermediation, which, by its nature, had a deflationary character.

- **The current crisis** started as a health crisis and now is a combination of demand-side and supply-side shocks that is **at the risk of becoming a long-standing economic crisis.**

- The pandemic has delivered the worst set back to poverty in generations. WBG projects in 2021 approx. **120 -150M people will be pushed into poverty**

Most affected Sectors



- Early findings suggest that an estimated of **250M jobs have been lost around the world.**

- The number of people affected with acute food insecurity is estimated to doubled to nearly 300M people by end of 2020

Sources: WBG, IFC Trade Survey, European parliament: Thinking Beyond the Pandemic

AFTER OVER 20+ YEARS OF PROGRESS, THE PANDEMIC IS NOW NEGATIVELY AFFECTING THE MSME SEGMENT

…And the impact has gone beyond, impacting relatively large companies

- SME **ability to repay** their loans significantly adversely affected in the short to medium term. This is generated by supply chain disruptions due to lockdowns, delayed receivable collections, drain in cashflows due to fixed expenses, sectoral impact and labor constraints.
- MSME customers in urban locations are vulnerable, and rural MSME are outside the reach of FIs.
- **SMEs dependent on import/export** supply chains are most exposed to disruptions and reduction in demand.
- **Digital channels**, where in place, are not always widely accepted or understood by MSMEs. This is especially true for rural clients. Women MSMEs are low on digital access and are most likely to suffer the most.
- Data suggests that many countries have experienced a decline in the number of bankruptcy fillings in 2020, but WBG considers that the numbers will increase. There is a rise in bankruptcy of US firms at the top of the value chain.
- Evidence suggests that insolvency proceedings are on the rise as well, especially with larger firms. For example, 147 companies globally with greater turnover than $60 million became insolvent in 2020.

*The crisis is **disproportionately impacting SMEs** and the informal sector - an estimated 81% of 2.7 billion informal workers globally have been affected by the lockdowns*

GLOBAL BANKING SECTOR CHALLENGES

COVID-19 has exacerbated existing challenges of the traditional banking business model such as revenue pressure, tight regulation and competition from digital entrants.

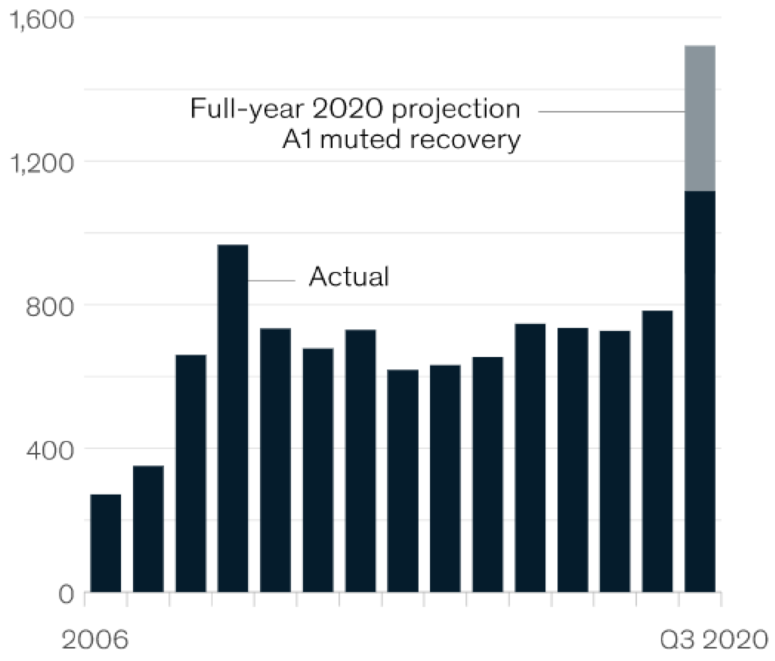
- **Bank's strength compromised:** the contraction in the global economy has already diminished loan growth and payment transaction volumes. Banks will have to reckon with an economic fallout and larger share of distressed assets in their books. In some countries, banks tier 2 capital ratios could decline over 2%-points. The banks overall weak capital position could pose a threat to economic growth as lending could only channeled to the most creditworthy.

- **Regulation**: support in terms of NPL recognition, management, resolution and capitalization will be necessary to face the pandemic.

- **Low interest rates**: likely to remain low for a substantial period of time which is beneficial in the short run but may pose a risk for banks in the long run as NPLs continue to increase and threaten banks' solvency

- **Digitization:** The move towards digitalization and FinTech has increased competition in the market for banks, with new digital entrants taking on banking-related activities and challenging existing banking models

Nominal provisions for loan losses ($ bn)



Source: McKinsey Global Banking Annual Review

Banks have not yet had to contend with substantial write- offs, but in 2021, loan-loss provisions could exceed those of the global financial crisis.

Sources:
1. https://www.santander.com/en/press-room/insights/challenges-of-the-banking-sector-after-the-covid-19-crisis
2. https://www2.deloitte.com/us/en/insights/industry/financial-services/financial-services-industry-outlooks/banking-industry-outlook.html#

EARLY IMPACT OF COVID-19 ON FINANCIAL INSTITUTIONS

Results of IFC Research on 317 Financial Institutions Nov in 2020 & IFC Annual Trade Survey

- Problems of the corporate segment are going to be compounded by weaknesses of the financial sector

- Seven months from the outbreak of the COVID-19 pandemic, IFC financial institution (FI) clients were still **operating at about 80 percent of pre-crisis levels.** The vast majority of FIs were reporting lower loan collection and disbursement level. Government moratoria and voluntary deferrals affected over half of FI portfolios.

- Despite the widespread restructuring of portfolios, FIs started to register **significant increases in non-performing assets.**

- Notwithstanding the unprecedented challenges, **FIs managed to preserve liquidity** partly aided by strong deposit levels through the first months of the crisis.

- **Diversification of funding sources** is critical especially the development of retail deposits.

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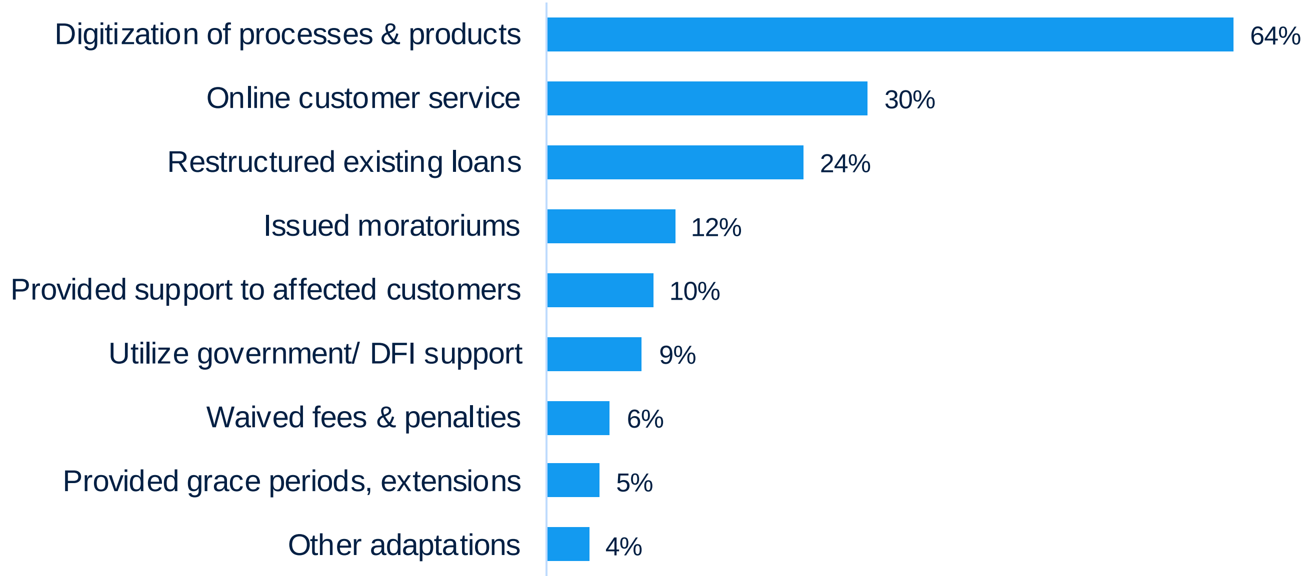
- The crisis led **most FIs to assign even greater priority to the digital transformation** of front- and back-end operations, as well as to the development of retail deposits as a key funding strategy.

Strategies adapted by EM Banks for customer business continuity amidst the crisis



"[The crisis] has completely changed the scenario. Banks had to operate with the least number of employees on premises and more working from home. Banks encouraged [the use of] digital solutions and platforms." - GTFP Client Bank, South Asia

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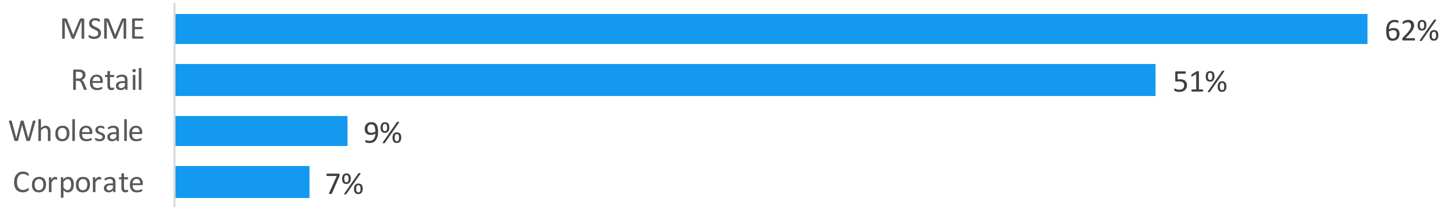
- All sectors and customer segments were gravely affected by the crisis, creating increased stress and potentially devastating short- and medium-term impacts on trade and economies in general. 39% of survey respondents reported some form of correspondent banking stress, including fewer lines, increased pricing/cost, line limit restrictions, and increased compliance requirements

- While demand for MSME finance was expected to recover through 2021, FIs raised **significant concerns about the increased risks** for this segment. Micro, small, and medium enterprises are expected to demand medium to long term products.

Most affected Segments – frequency of mentions



- **Demand for investor support was strong**, in particular demand for local currency products and medium to long-term financing, as well as technical support for digital transformation and risk management.

REGULATORY RESPONSE TO COVID-19

Six main categories of interventions

1. Credit repayment moratoriums
2. Supporting or facilitating the restructuring of loans
3. Relaxation in the classification and/or provisioning of non-performing assets
4. Injecting liquidity and easing monetary conditions,
5. Releasing or deferring existing capital buffers
6. Interest rate reliefs or deferments/ Tax exemption

Rationale for regulatory interventions

- **More than 1,400 measures** have been adopted to support the financial sector by over **140 countries**.
- Over **110 countries** have sought to **buy time for solvent borrowers** to withstand the effects of the supply and demand shocks induced by the lockdown.
- The objective was to stabilize financial markets, so that **credit and liquidity can keep flowing to the most affected and vulnerable sectors** – SME, Small income households
- By October 2020, the global fiscal support expending by Government was around $12 trillion. Government programs and forbearance process for banks have been successful in flattening the bankruptcy curve.

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BANK'S RESPONSE TO COVID-19

The pandemic has challenged traditional banking models and products, changed the competitive landscape and served as a catalyst for digitization

- **Banks will need to get to know their customers** (again): understand shifts in customers' preferences – banks recognize that advanced data analytics will help customize their offerings as well as adapt to the shifting business landscape.

- Banks should rethink how to conduct business and **transition from physical to digital customer relationship management.** This implies Bridging gap between branch and bank digital strategy and harnessing customer digital adoption. Banks that made strategic investments in infrastructure have emerged strong and competitive in the market, and prompted other players in the industry to rapidly modernize as well

- New growth models, banks are pushed to **Explore business process innovation to facilitate business sustainability and reduce costs**. This includes:
  - Designing new customers offering for the new normal and be supported by new tools/ partnerships like open banking and fintechs.
  - Proper planning for post- crisis operating models

- Managing people "in the cloud" will become increasingly important

IFC, McKinsey, EY Report on How Banks can successfully emerge from COVID-19,

BANK RESTRUCTURING

- Because banks lie at the center of modern economies, policies related with bank restructuring can have far-reaching implications, political as well as economic. This is particularly important in these times where so many economies are struggling, and banking system are challenged due to COVID-19.

- Bank Restructuring is one of the most difficult tasks confronting policymakers. Measures might be decided quickly and sometimes in the eye of a crisis, guided by imperfect information.

- The approach or response a Government chooses depends on several factors such as: the political economy, economic conditions, governments' fiscal situation, scale and severity of the problem and financial health of specific banks/system', limitations of the legal and regulatory framework, and institutional/technical capacity of the involved institutions, among others.

- Governments should strongly support supervisors in the event of a decision related to closing insolvent banks. Fiscal resources might need to be committed to fixing problems in banking system.

- Transparent arrangements might be adopted at an early stage to deal with NPL so a core of healthy banks can continue to facilitate economic development. This includes recognizing problem assets, supporting Bank-led and systemwide NPL Resolution strategies and generating the enabling environment which includes insolvency and creditors' rights.

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WBG RAPID RESPONSE TO COVID-19

$80 Billion
In financing committed

$12 Billion
Health support

Includes $8 Billion for private sector

58 Webinars, over 3.000 participants in FIG Asia

- WBG is **taking fast, comprehensive action to save lives, protect the poor and vulnerable, achieve sustainable growth**, and rebuild in better ways. Between April and December 2020 financing committed included over $30 billion of new concessional transfers from IDA with built-in debt relief for countries at risk of debt distress.

- **Launched COVID- 19 emergency health support** to strengthen country responses, and **broader program to cushion economic impact**.

- Helping the private sector cope with impact of pandemic. Keeping companies' solvent is key to saving jobs and limiting the economic damage. **New investments, trade finance and working capital lines to clients**. Focus on **MSMEs**, so that they can resume their key contribution to growth and job creation. In addition, Multilateral Investment Guarantee Agency (MIGA) launched a $6.5 billion facility to support private sector investors and lenders in tackling the pandemic.

- Part of IFCs COVID-19 crisis response was to **provide webinars covering portfolio stress testing, SME finance and digitization** among others to Banks and FIs.

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Gold $377.00 $462.20 22.60%
Platinum $277.00 $366.19 32.20%
Silver $501.00 $516.03 3.00%
Copper $370.00 $517.26 39.80%
Steel $491.00 $643.21 31.00%
Beryllium $371.00 $455.59 22.80%
Manganese $205.00 $240.26 17.20%
Aluminum $539.00 $678.06 25.80%
Chrome $592.00 $820.51 38.60%
Nickel $574.00 $697.98 21.60%
Bauxite $369.00 $507.74 37.60%
Cotton $190.00 $197.22 3.80%
Flax $280.00 $284.48 1.60%
Textiles $107.00 $116.63 9.00%
Wool $156.00 $192.19 23.20%
Fur $280.00 $316.40 13.00%
Sateen $181.00 $197.65 9.20%
Silk $188.00 $198.53 5.60%
Oil $794.00 $1,105.25 39.20%
Gas $502.00 $673.68 34.20%
Electric power $599.00 $700.83
$1,200.00
$1,000.00
$800.00
$600.00
$400.00
$200.00

Thank you