

iNSiDE

COVID - 19

CRISIS RESPONSE,
CREDIT SHOCK AND OPPORTUNITY

exton
consulting

STRATEGY &
MANAGEMENT

Reacting to COVID-19

In this document, we outline our perspectives on the crisis and keys to a credit response

1

Holistic COVID-19 response framework

Reacting in three waves

2a

Firefighting

Supporting clients and short-term credit needs

2b

Strategic credit shock management

A nuanced approach to mitigate credit losses

*Credit risk
management
response*

Executive Summary

Covid-19 and the associated credit quality shock require banks to act



Banks must balance short-term efforts **with a more strategic approach**..

- Banks face an unprecedented challenge to respond to the pandemic
 - They must balance short-term fire-fighting efforts with a **more strategic approach** in a potentially prolonged crisis
-



And a nuanced response to the credit shock..

Supporting clients while protecting the balance sheet

- The economic impacts of wide-spread social distancing will create one of the **largest credit shocks in living memory** – at an unusual speed
 - Scenario-based assessments of **credit impact** by market and sector can inform bank wide **risk appetite** and direct a **nuanced credit response**
-



Accounts and payments data should play a key role in steering **real-time perspectives**

- Existing rating and warning systems won't be optimal for speed required
- Beyond top-down analysis, banks should **leverage insights from account and payments data** to provide real-time perspectives on projected financial distress of clients, from **revenue loss** and **supply chain constraints**
- Banks that have invested in flexible data architecture should reap the rewards - others will need **workarounds**

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Crisis Response in the face of COVID-19

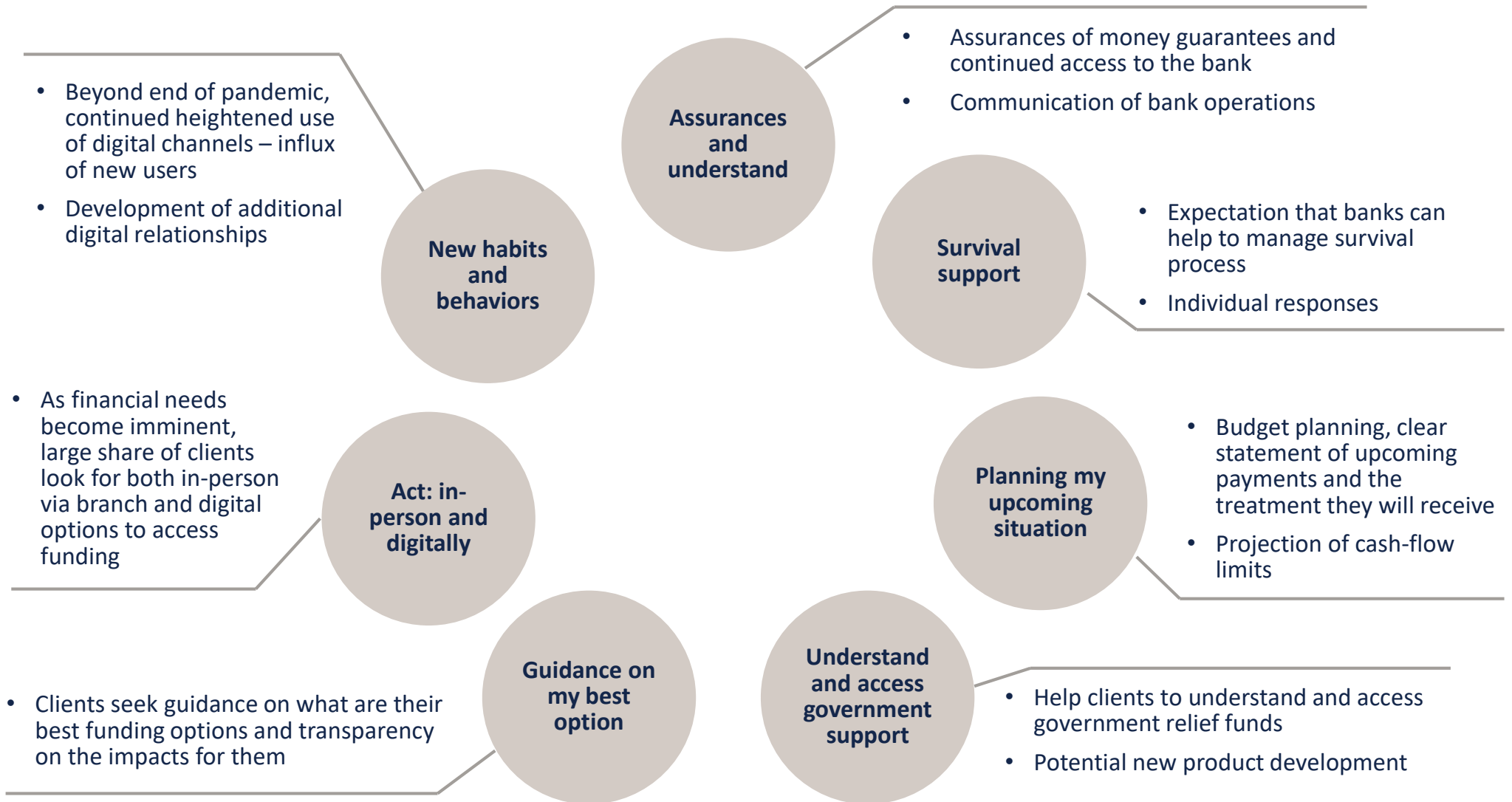
Banks are faced with an unprecedented challenge to respond to the pandemic, in which we can visualize three phases of response – with firefighting in progress and short-term actions required now



Detail: Crisis Response in the face of COVID-19 in three steps

	 Rapid response: Firefighting	 Short-term action: Managing impact and supporting clients	 Mid-to-long term : Preparing for a recurring / prolonged crisis
 CEO	<ul style="list-style-type: none"> Initial communication to clients and investors: transmit security, business continuity Build response teams and assign responsibilities, ensure following contingency plan 	<ul style="list-style-type: none"> Next stage communication planning to all stakeholders Necessary adjustments to strategy (not waiting for next "regular" update) Review project portfolio – accelerate / slow down as needed 	<ul style="list-style-type: none"> Business continuity planning – upgrade based on lessons learned Digital Working – a CEO priority Digital transformation roadmap adjustments
 CRO	<ul style="list-style-type: none"> Agree parameters for government relief programs Adjust lending criteria to new situation 	<ul style="list-style-type: none"> Risk-Appetite review, e.g. payment holidays and relaxation for certain segments Fine-tuning of early warning tools, e.g. use of payment data or sector analysis to predict default likeliness Adjustment of risk criteria for new and existing portfolio 	<ul style="list-style-type: none"> Updated contingency planning Decision tools for dealing with clients "in trouble" - prolongation, refinancing, etc.
 CFO	<ul style="list-style-type: none"> ALM / Refinancing and Capital impact – first assumption 	<ul style="list-style-type: none"> Stress scenarios development: different degrees of crisis severity Detailed Impact assessment analysis – cash-flow and P&L 	<ul style="list-style-type: none"> Resilience planning
 Network / Channel heads	<ul style="list-style-type: none"> Branch hygiene/safety Capacity adjustments, e.g. move branch staff to remote customer service 	<ul style="list-style-type: none"> Rededication of branch resources in anticipation of ramp-up and volumes Digital channel strategies: adapting to “remote reality” 	<ul style="list-style-type: none"> Push of digital migration – focus on first-time users now aware of benefits Introduction / expansion of virtual advisor offering
 Product / Segment heads	<ul style="list-style-type: none"> "Quick adjustments" e.g. offer commission waivers, relax access criteria to certain products, investment strategy daily update... 	<ul style="list-style-type: none"> Per segment / product: re-assign agile teams to conduct design sprints to identify "crisis offer" to clients, e.g. liquidity forecast tools on website, e-shops for stores Simplify crucial crisis-related Customer Journeys (e.g. support request for Government loan) --> Moment of Truth! 	<ul style="list-style-type: none"> Analysis on long-term implications of client behavior and expectations "Save the year" initiatives (e.g. Bancassurance refocused)
 Head of HR / COO	<ul style="list-style-type: none"> Travel restriction Split teams Worker safety, setup of remote working capabilities 	<ul style="list-style-type: none"> Extensive staff training – dealing with customers remotely Remote working adjustments: adaption of worker policies, expanding digital capabilities 	<ul style="list-style-type: none"> Accelerated digital working in the organization based on new established norms / expectations from workers

Customer upcoming expectations



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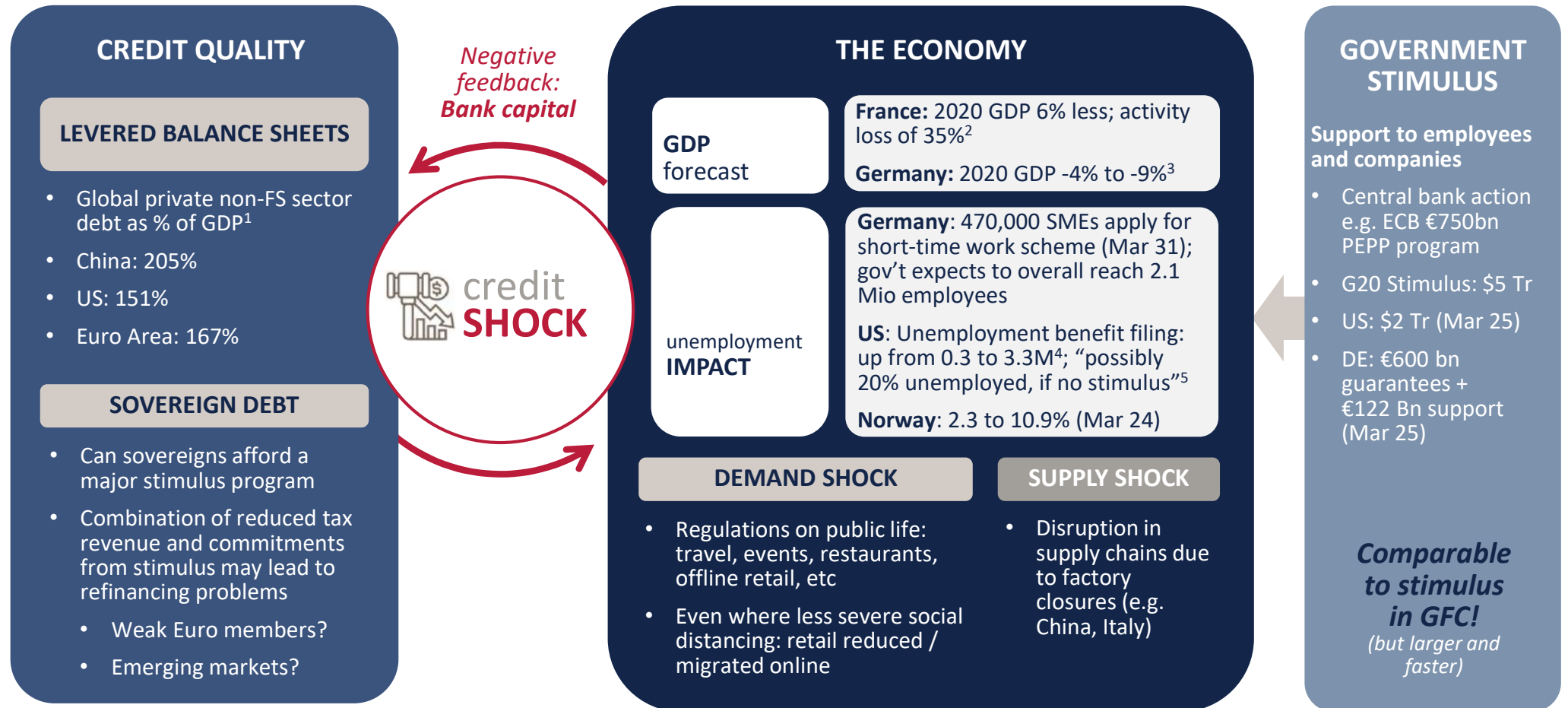
- Overview

- Fire-fighting

- Strategic credit response – potential approach

The likely COVID-19 Credit Shock

Beyond its social impacts, the severe restrictions in many markets on daily life and businesses will likely create one of the largest credit shocks in living memory

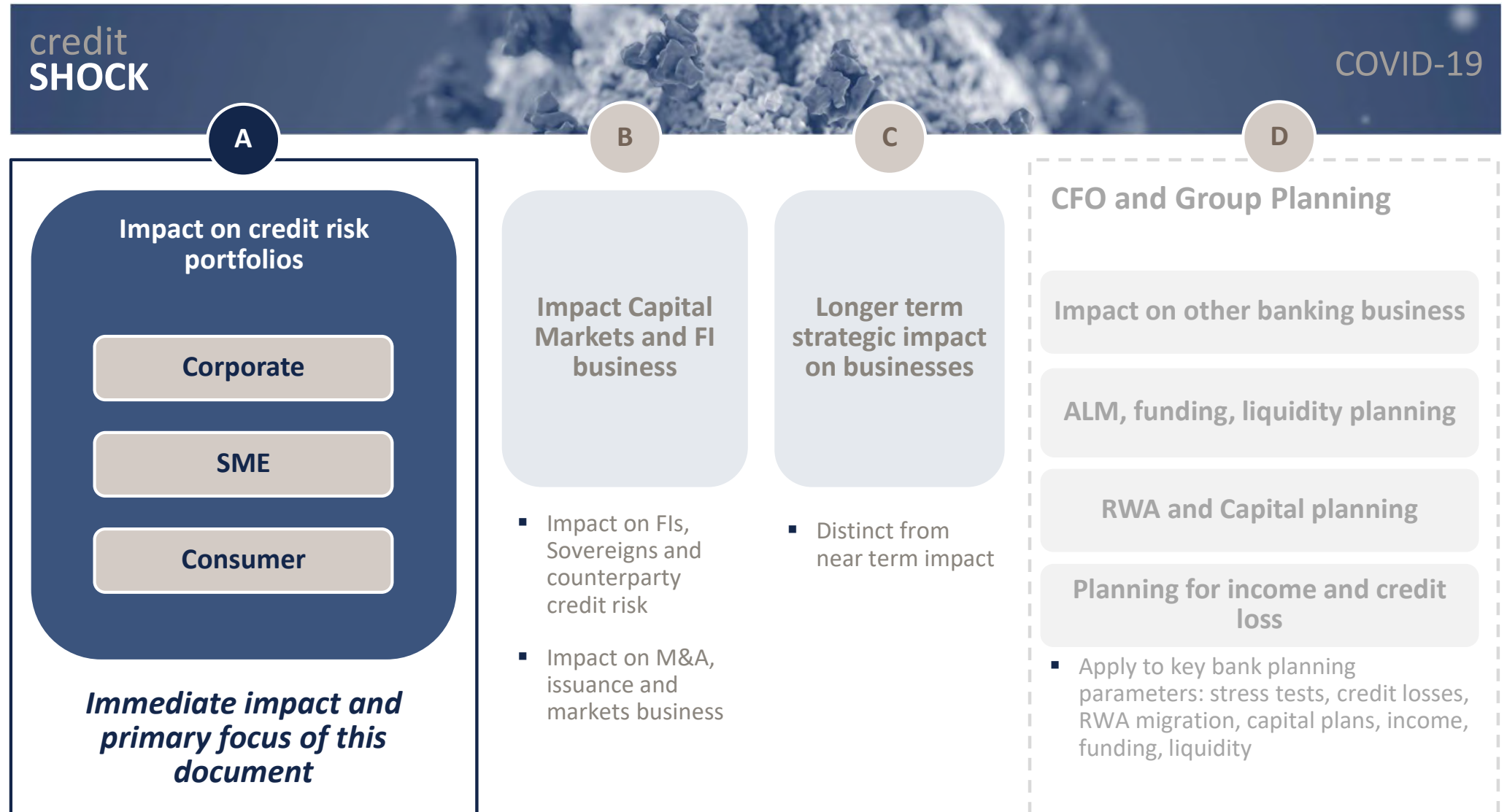


Though previously unseen levels of government stimulus will help to lighten economic implications, the background of leveraged corporate balance sheets will likely leave a credit shock

1) BIS quarterly Mar 2020: Sept 2019 data
 2) INSEE activity loss estimate Mar 26th, GDP estimate based on assuming 2 months confinement
 3) IWF Institute – GDP forecast subject to scenarios of 6 week lockdown or 3 months longer lockdown; Mar 19th
 4) US weekly new unemployment benefit filings, Mar 26th
 5) Mnuchin (US Treasury Secretary), Mar 18

A shock to credit portfolios ... and the rest of the bank

The most immediate and obvious impact will be on the bank's credit portfolios and - though the focus of this document - the considerations do not stop there with important questions to be answered beyond that



The credit portfolio: a balanced response between supportive and protective measures

Banks need a nuanced response to the credit shock: on the one hand supporting customers but at the same time protecting the balance sheet – relying too heavily or by default on one or the other will be costly

Supporting customers

- Proactively reach out to customers in a short term liquidity crunch by providing (credit) support, when they are highly likely to “survive” financially in the long term
- Strengthen long-term relationships (and immediate business) by providing advice
- Consider waiving fees for payment holidays to build long term goodwill
- Support on understanding and accessing government support programs and best practice to manage the situation



Protecting the balance sheet

- Mitigate credit risks with customers that are unlikely to financially recover sufficiently to repay
 - Business model already unsustainable before Covid-19
 - Financial buffers irredeemably eroded due to large (expected cumulative) loss of revenue vs only marginal profitability in BAU
- Access government support / lending functionalities to support own balance sheet
- Strengthen restructuring teams to deal with increased workload, and update restructuring approach to the evolving economic reality

*Access **gov't support** programs that mitigate risks for both bank and client*

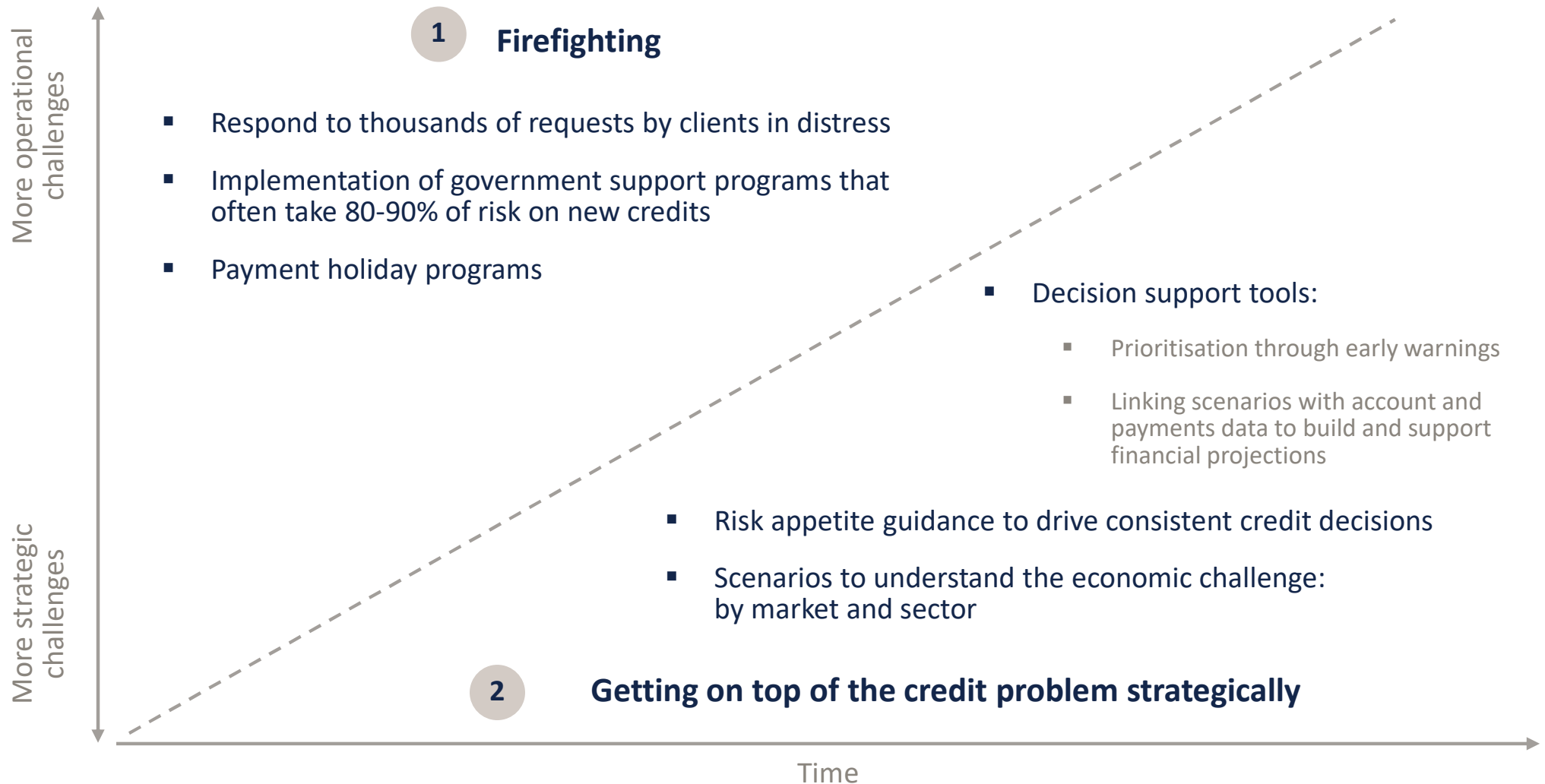
Majority of Customers

*Adjust **pricing** to reflect the higher risks of the current situation*

Targeted Mitigation:
worst 5-20% of customers?

To address the credit crisis, two parallel efforts are needed

First, banks must address thousands of client requests, complicated and evolving government support and payment holiday programs – while defining more strategically how to address the credit problem



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Firefighting – A mostly operational challenge

Combination of centralized and distributed efforts with front-line staff to support influx of credit requests

Centralized efforts














- **Guidelines for implementation of government support programs**
 - Centralized team responsible for understanding, crafting bank role of support, and distributing guidance and training to frontline staff
 - Credit stance where bank has material residual risk
- **Blanket credit decisions such as payment holidays for certain products**
 - Policy reflective of market-specific government mandate and policies
 - Including checks on regulatory requirement for credit processes; adapted where possible to minimize bottlenecks
- **Guidelines for grouping clients by type of request**
 - Streamlined batch processing of similar credits, alleviating capacity constraints in credit department
- **Guidelines to respond to new credit requests**
 - Rapid investments e.g. in supply of essential medical equipment / critical support infrastructure
 - SMEs in liquidity crunch – tiered by sector

Distributed efforts

- **Preparation of branch and advisor network for adapted working conditions and client contacts**
 - Safety and health guidelines for branch operations
 - Remote RM capabilities
- **Boosting contact center and credit decision capacities to handle influx of requests**
 - Support of front-line staff in handling influx of questions and decisions – expanding capacity where possible – considering also sick absences
 - Pre-empting client questions by web-based information incl information needed to enroll in government support packages
 - Pushing of digital channels where possible and ensuring soundness of online servicing and product capabilities (digital signing, ident-check, etc.)
- **Training and rollouts of new guidelines to front-line staff**
 - Clear communication of evolving credit guidelines
 - Trainings for staff on handling complex credit situations including government options, in-house credit policy and last-resort









Firefighting: Examples of government and bank short-term actions (1 of 2)

In addition to the measures taken by governments regarding credit access and relaxation, large incumbent banks in multiple markets have gone beyond – implementing additional actions to better support clients

Market	Example government measures	Example bank “firefighting” actions			
	<ul style="list-style-type: none"> ▪ KfW assumes risk of up to 90% for SMEs and 80% for large companies for new credits ▪ Credit amount depends on factors such as annual sales in 2019; or wage costs in 2019, etc. 				
		<ul style="list-style-type: none"> • Up to 3 months of payment breaks for instalment loans in special cases e.g. short-time work 			<ul style="list-style-type: none"> • Flexible loan for SMEs up to 100k€ redemption free in the first year
	<ul style="list-style-type: none"> ▪ Payment of interests and fees within the 1st year of loans up to 100k€ for SMEs ▪ Up to 3 months of payment holidays for mortgages 				
		<ul style="list-style-type: none"> ▪ Overdrafts taken between March 27th and April 30th are interest-free ▪ No late payment charges on credit cards for 3 months 	<ul style="list-style-type: none"> ▪ Overdrafts with £300 interest-free buffer ▪ Flexible mortgage arrangements, eg extending terms, switching rates, etc. 		<ul style="list-style-type: none"> ▪ No fees for missed payments on loans, mortgages and credit cards ▪ Access to savings in term deposits without charges in case of emergency
	<ul style="list-style-type: none"> ▪ Student federal loans payments will be suspended until September 30th ▪ Loans up to 10m\$ for Small companies with a deferred payment time of 6 months 				
		<ul style="list-style-type: none"> ▪ Possibility to defer mortgage and loan payments up to 90 days ▪ Customers can request refunds for overdraft fees 	<ul style="list-style-type: none"> ▪ Defer auto loan and mortgages payments up to 120 days ▪ No overdraft fees until July 18th 		<ul style="list-style-type: none"> ▪ Business lines of credit of up to 200k\$ without interests for 90 days

Firefighting: Examples of government and bank short-term actions (2 of 2)

To face the threat of the virus on activities, governments issue new directives for credit, followed by Banks and other financial institutions

Market	Example government measures	Example bank “firefighting” actions	
	<ul style="list-style-type: none"> French public investment bank Bpifrance to provide State guarantees on commercial loans and credit lines, respectively, for enterprises with up to 5,000 employees Guarantees to banks on new loans for all types of companies 	<p>Collective measure</p>  <ul style="list-style-type: none"> Fast-track credit approval procedure in less than 5 days for urgent cases Credit payments to be deferred for up to 6 months and eliminate penalties and additional costs for extensions 	<p>Individual measure</p>  <ul style="list-style-type: none"> Contact point with all professional client and assessment of exposition and repercussions of the situation
	<ul style="list-style-type: none"> Guarantees on new loans and refinancing operations (total budget of approximately €20 billion (60-80% guaranteed) Royal Decree on moratorium of mortgage payments on the main residence until September 	<p>Collective measures</p>  <ul style="list-style-type: none"> 20B line of pre-approved loan facility with interest due within one year for SMEs and self-employed workers (risk 60-80% supported) Loans up to €500K (50% finance guaranteed by the government) 	
	<ul style="list-style-type: none"> State guarantee to support a debt moratorium for SMEs, which includes the postponement of repayments of overdraft facilities, bank advances, bullet loans, mortgages and leasing operations (max 33% guaranteed) 	 <p>Mortgages: suspension of payments on the principal amount for up to 12 months</p> <p>Enterprise: 1) medium-long term loans: suspension of payments on the principal amount falling due within three to six months, with an option to extend up to a maximum of 12 months; 2) extension of credit for imported goods up to 120 days to support working capital management; 3) granting of temporary liquidity lines with up to six months.</p>	 <ul style="list-style-type: none"> Suspension of instalments of existing loans and mortgages for up to 3 months with possibility to extend it by 3 or 6 months

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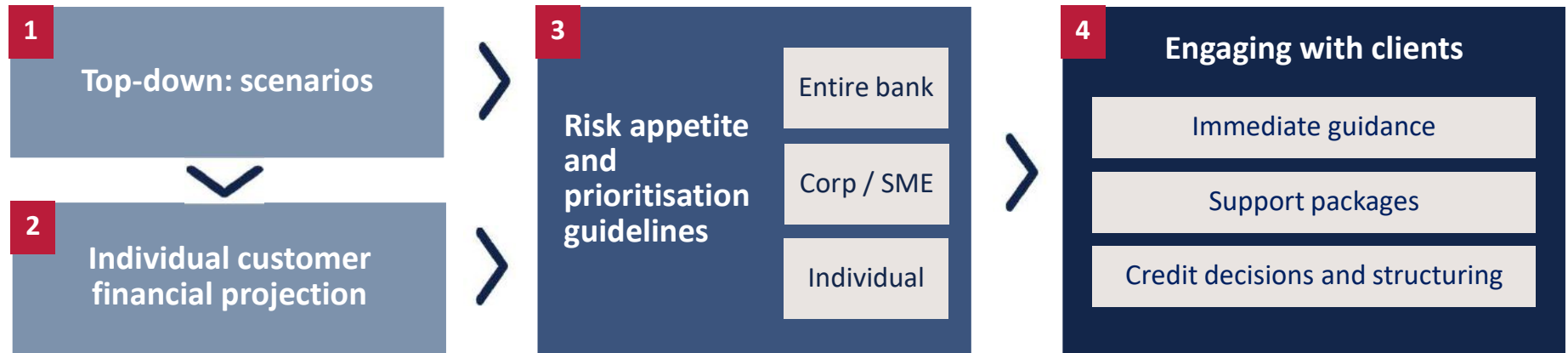
- **Strategic credit response – potential approach**

Getting on top of the future credit problem – Strategic response

Directing nuanced decisions on credit approach under significant uncertainty – with progressively refined iterations serving to drive increasingly informed and strategic decisions

Top-down scenarios and segment level risk appetite need to be combined with up-to-date information on customers to direct credit approach

Proactively engage with prioritized clients – Implementing credit response



Illustrative approach: Three waves of prioritization and engagement – with first two starting in parallel

Wave 1 (2-3 weeks)

- Develop scenarios
- Support credit staff and RMs with financial projection tools tailored to Covid-19 situation

- Agree on bank wide risk appetite and develop rudimentary credit guide and prioritisation

- Clients are supported with packages developed in “fire-fighting”, check-lists to help them cope and credit support is provided in line with prioritization / credit risk appetite

Wave 2 (4-6 weeks)

- Account / Payments data are centrally extracted and combined with scenarios and past financials to project financial impact on clients

- Projections create a centrally driven “early warning” prioritisation
- Analysis covers entire portfolio, and can be rolled up to bank wide reporting

- RMs leverage client projections (that they verify) to engage with wider number of clients

Wave 3 (months 2-3)

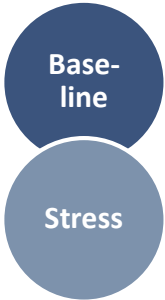
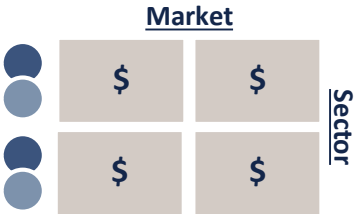
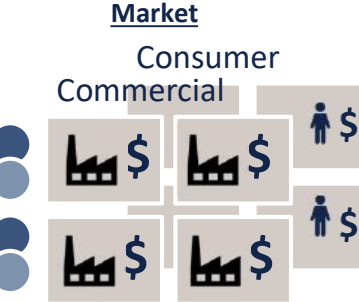
- Projections are automated to include ongoing real-time payment data and refreshed scenarios with impact varied by markets and sectors

- Updated financial forecasts can be used in underwriting.
- For ambitious banks, automated warning system can also be enhanced by sector specific warning signals and ratios

- Outreach to expanding areas of the portfolio with continued prioritization of emerging and identified at-risk clients

1 Defining top-down scenarios

Top-down scenarios should be agreed by top management and a primary focus in the immediate-term: moving from descriptive scenarios to quantitative scenarios for both markets and sectors

Top-down scenario progression & description	Illustration	Questions and considerations for scenario
<p>Descriptive scenarios capture uncertainty</p> <p>↓</p>		<ul style="list-style-type: none"> How long will restrictions on travel, community life and businesses last (incl repeats)? Will restrictions be effective in containing the pandemic for good? Will some restrictions stay in place for long while others relaxed (e.g. clubs & bars vs restaurants) Will the economic side effects be too painful (and globally humans accept that they will need to live with the virus)? Will an effective vaccine be available any time soon? Supplement: impact on sovereign solvency (see next page)
<p>Quantitative scenarios by market and sector for 2020</p> <p>↓</p>		<ul style="list-style-type: none"> Certain sectors are hit hard (tourism & transport, hospitality, events & offline entertainment, offline non-essential retail, oil, etc), but restrictions vary significantly by market <ul style="list-style-type: none"> Primary impact vs secondary impact from economic sentiment and mitigation due to government response Live estimates of revenue declines can be obtained from public sources, and sense checked vs bottom up payments data – prolonged impact assessed by applying scenarios
<p>Quantitative credit risk scenarios by market, sector (for SMEs and employees) for 2020</p>		<ul style="list-style-type: none"> Where risk systems are flexible, effects on financials and credit quality can be determined through simulating longer term impact client by client, and then rolling up to bank wide credit impact (which can be compared top down with experience in past credit shocks or prior stress test exercises)

Detail: Capital markets business needs to reflect on potential for more severe shocks

Cost of stimulus packages can raise concern on sovereign solvency / Eurozone stability

Projection of Business Volume

Projection of Risk / Risk Limits / Capital

Impact of pandemic scenarios

on the economy and capital markets

Base-line

Stress

- Corporate finance: issuance and M&A
- Sales and trading

- Market Risk (under increased volatility)
 - By product: FX, rates, credit, equity, commodities
 - By underlying market and/or industry sector
- Counterparty Credit Risk (after material MtM moves and subject to higher volatility)
- Stress loss potential, ICAAP and ILAAP

Impact of pandemic

on sovereign solvency and e.g. Eurozone stability

- *Extreme stress*
- *Market perspective on likelihood*

Ex-treme

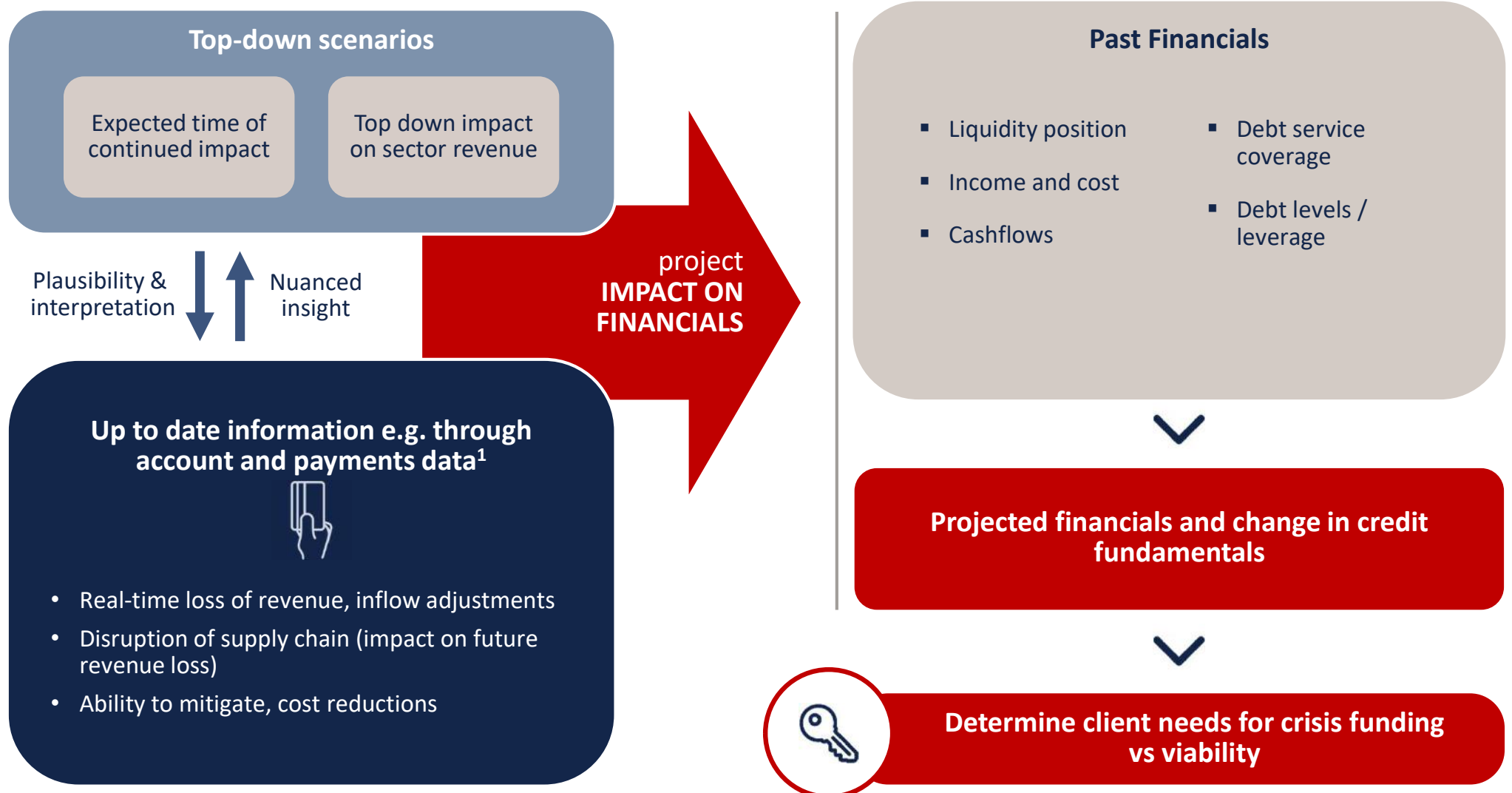
Proba-bility

- Sovereign credit risk
 - Fundamental reassessment based on size of stimulus required and likely loss of tax revenue
 - Market perspective, and impact on funding cost
- FI counterparty credit risk
 - Fundamentals vs too big to fail / too big to save
 - Doom loop: sovereign – FI
- Validity of contract structures
 - ISDA, CSA, CDS under extreme shocks
 - Will policy makers use selective default tools
- Bank Resolution rules vs likely practice
- Refresh contingency plans from eurozone crisis 2012

Risk appetite adjusted qualitatively based on bank views on chance of extreme risks: both for capital markets business and for commercial / consumer credit

2 Projecting individual client financials and credit troubles

COVID-19 evolves faster than past credit shocks – account and payment data, linked to top-down scenarios, can provide real-time insights on evolving customer financials and need for crisis funding vs liability



1. Account and payments data provide a more complete picture for clients with primary account relationship. For other clients proxies are needed, or the RM will need to get an accurate picture of the last few weeks of business based on client information.

2 From simple to sophisticated use of account and payments data

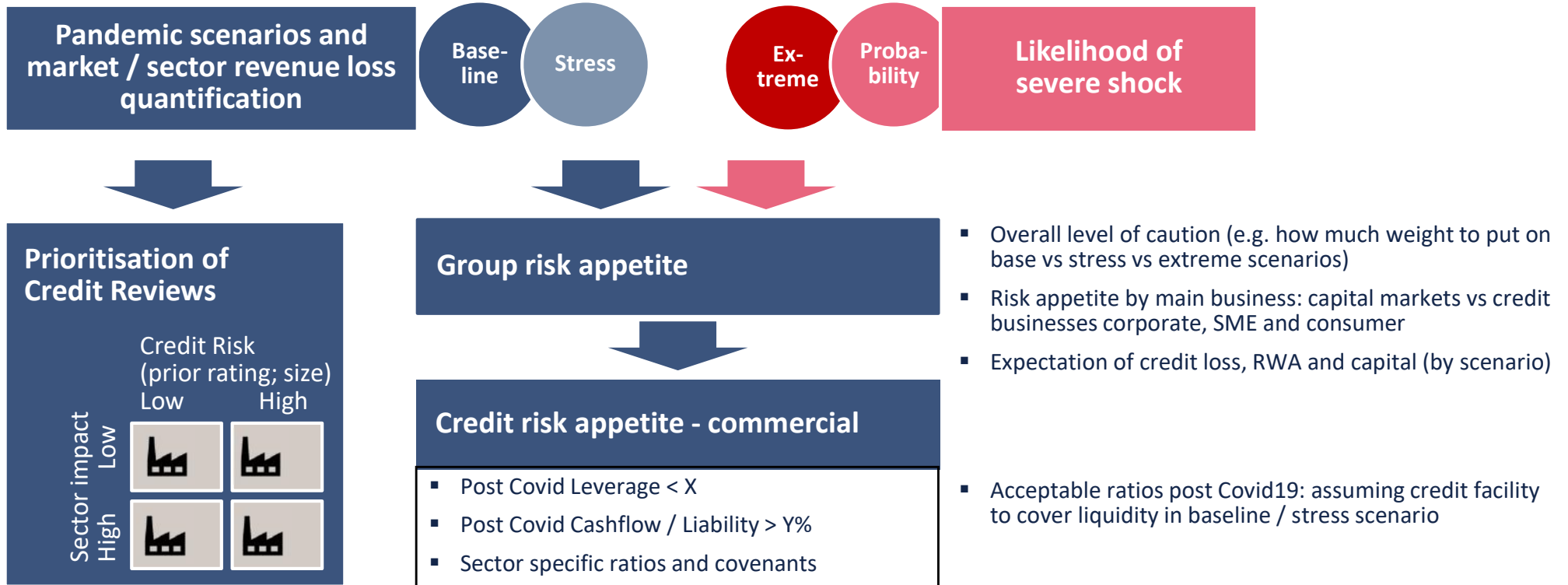
Clients that have invested in data architecture and management can leverage accounts and payment data likely sooner and at larger scale – but those lagging behind have options for short-term workarounds

Accounts and payment data		
Simple	Middle	Sophisticated
<ul style="list-style-type: none"> Account and payments data is reviewed manually by RMs for select group of identified at-risk SMEs/ – as prioritized from scenarios, sector-level models, prior risk rating and credit amount RMs can further leverage conversations with clients to get a clearer perspective on the short term revenue shock, in particular when the bank's account is not the main banking relationship 	<ul style="list-style-type: none"> A model is developed to project, based on available payment data and pandemic scenarios and sector models, individual client financials Early warnings for clients identified as at-risk based on evolving credit fundamentals For SMEs and Corps, RMs leverage the data tool to reach a wider range of clients but continue to be the final say in credit decisions For consumer, projection model is used to group clients into risk-based buckets with high-risk prioritized for first contact / support message 	<ul style="list-style-type: none"> Automated refresh of both evolving scenarios and ongoing payment data are incorporated into real-time financial projections and credit impact This data can be rolled-up to a group level producing both real-time early warnings on a client level and a group-level perspective Rolled-out across both consumer and wider range of SMEs with continuous updates of prioritization; RMs continue to confirm output of data tool and complement with additional information
Manual efforts (select prioritised clients)	Analytics on entire portfolio to aid in prioritization	Automated: Warnings for short-term credit crunch and future ongoing business

Clients may take also a progressive or wave-based approach as have described, moving from simple to sophisticated accounts and payment data approach as data, teams, and capabilities progress

3 Setting risk appetite and prioritising response

Wave I – prioritise clients top down based on sector impact and rating



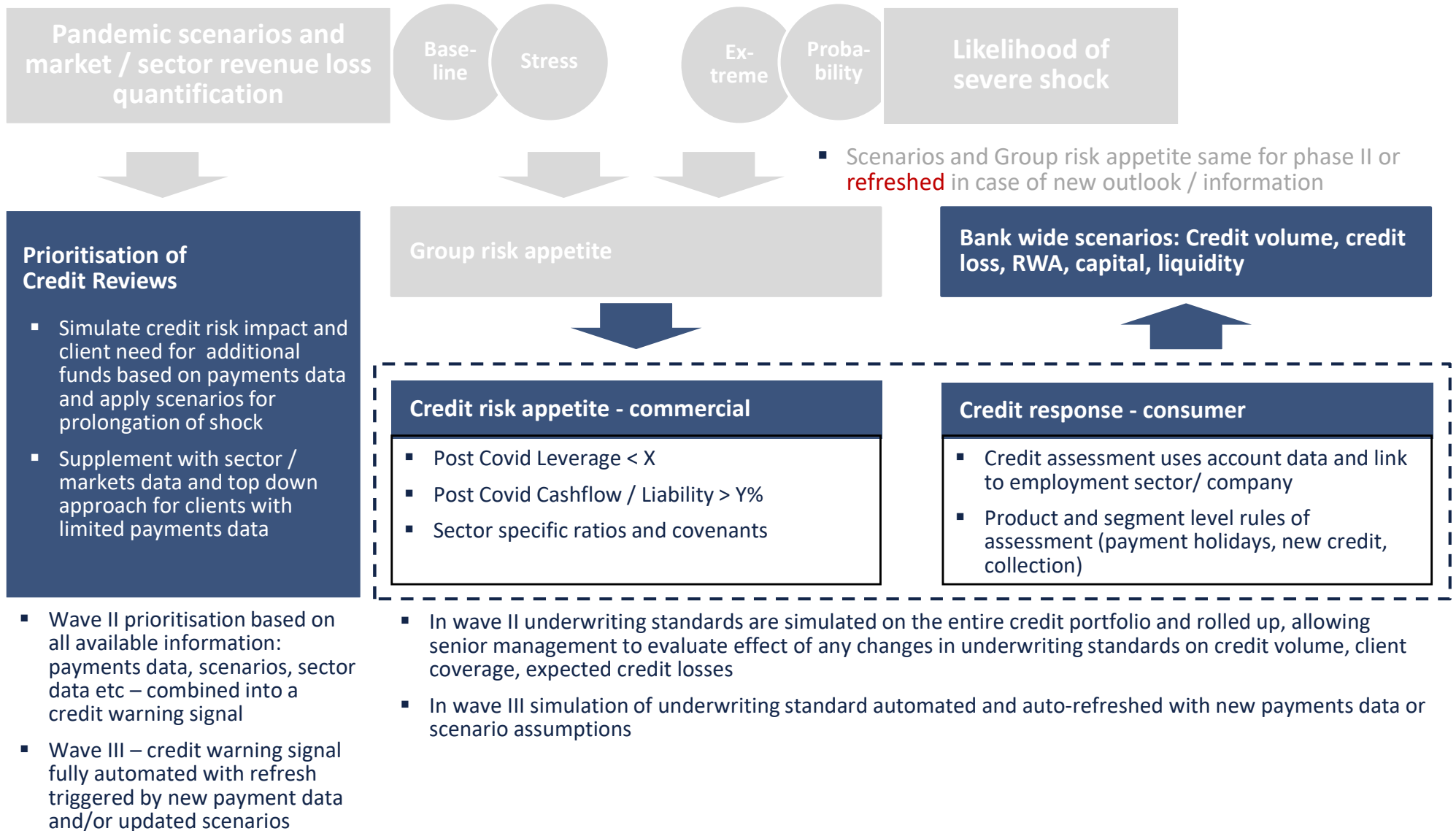
- Initial prioritisation based on easily accessible information: e.g. sector, rating and size of credit
- Waves II and III replace simple prioritisation by more sophisticated credit warning signal based on account / payments data, scenarios combined with financials

- Risk appetite initially applied manually to prioritised set of cases: not representative and not possible to roll up to bank wide credit impact
- In waves II and III impact of underwriting standards can be rolled up for entire portfolio, allowing senior management to evaluate effect of any changes in underwriting standards

- Overall level of caution (e.g. how much weight to put on base vs stress vs extreme scenarios)
- Risk appetite by main business: capital markets vs credit businesses corporate, SME and consumer
- Expectation of credit loss, RWA and capital (by scenario)
- Acceptable ratios post Covid19: assuming credit facility to cover liquidity in baseline / stress scenario

3 Setting risk appetite and prioritising response

Phase II / III – impact of credit appetite simulated on all clients



Results of a successful strategic credit response

Optimal credit decisions implemented: protecting the bank and serving clients in need



- In-line with refreshed risks appetite: **Realistic expectation of credit losses** by scenario, sector, market and customer segment
- **Refreshed credit underwriting standards** in all key customer segments
 - Tailored to the evolving Covid-19 crisis
 - Articulating the bank's preferred balance between protecting the balance sheet and effectively supporting the majority of customers
- **Data driven granular segmentation and prioritisation of customers** that allows a streamlining of the response and proactive reach-out
 - Risk tiering and needs tiering – streamlining application of underwriting standards
 - Product packages pre-selected by segment
- **A streamlined and competent response to needs for the majority of clients** – strengthening loyalty in a “moment of truth”
- **Mitigation of credit risks** from the 5-20% highest risk clients
 - Mitigation, restructuring & collection tailored to how Covid-19 crisis affected client segment
- For banks that are able to fully automate the integration of client account/payments data, client financials and sector scenarios: **an improved automated early warning system** that will be effective in **a potential second wave of the pandemic, and beyond**



Exton experts are ready to help

Covid-19 response team

Overall bank wide Covid-19 response



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Covid-19 response: delivery teams

- Fully distributed and remote service
- We eliminate contagion risk from our team to your organization by working fully remote
- We monitor our own operations to ensure stability for your project

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