

West Africa Webinar Series: Navigating Credit Risk and Expected Losses Beyond COVID-19

June, 2020

West Africa Webinar Series

Episode 1
Tuesday, 16 June

10:00 BST | WAT

Navigating Credit Risk and
Expected Losses Beyond
COVID-19

Episode 2
Monday, 29 June

10:00 BST | WAT

Capital Adequacy
Challenges for West
African Banks Post COVID-
19

Agenda

1. Outlook and challenges for the Banking sector as a result of disruption caused by Covid-19 and low oil prices
2. How are credit risk indicators and expected credit losses trending?
3. Panel Discussion:
 - What can Financial Institutions do to navigate credit losses post pandemic?
 - Adapting and leveraging scorecards and models for identification of vulnerabilities
4. Regulatory views and guidance on the ECL focused policies

Speakers

- » Paul Onigbogi – Head, Credit and Investment Risk Division, Risk Management Department , Central Bank of Nigeria (CBN)
- » Dr Jude Monye – Executive Director, Heritage Bank
- » Armen Mirzoyan – Senior Economist, Moody's Analytics
- » Metin Epozdemir, CFA – Risk and Finance, Moody's Analytics
- » Joseph Ingwat – Relationship Manager, Moody's Analytics

Challenging Road Ahead for Nigerian Banks

Negative Outlook for the Banking System



Weakening Economic Conditions

Low oil prices and the fallout from the pandemic. Credit growth will slow but facility drawdowns by companies whose cash flows have tightened will support growth, at the cost of portfolio quality.



Loan quality will deteriorate markedly

Nonperforming loans (NPLs) are expected to more than double to between 12% and 15% of total loans. The toll on loan quality will increase further should oil prices remain at the bottom-end of (\$35-\$45) for longer than a year.



Capital ratios will fall but remain adequate in base-case scenario

Tangible common equity is expected to decline to 12.7% of risk-weighted assets (Moody's adjusted) at year-end 2021 under.



Profitability will substantially deteriorate due to strained revenue and rising loan losses.

Banks' net profitability will substantially weaken, with return on assets falling to below 1% in 2020. Lower interest income and higher loan-loss provisions, amid already high costs, will be the main drivers.



Local-currency funding and liquidity will remain solid, but foreign-currency liquidity will decline.

Nigerian banks' local currency liquidity and funding profiles will remain solid. However foreign-currency deposits will drop materially as a result of the depressed oil prices.



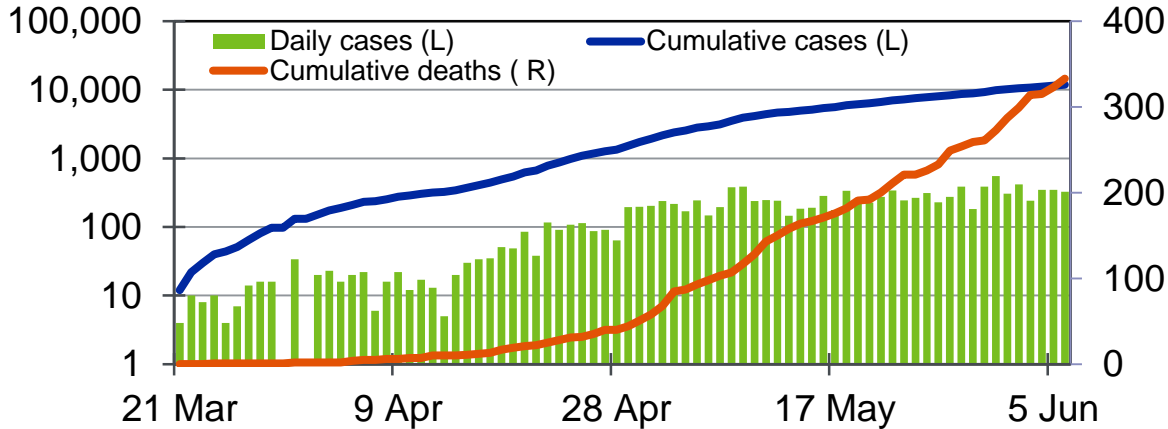
The likelihood of government support for the largest banks will remain high

Government willingness to support systemically important banks in case of need will remain strong

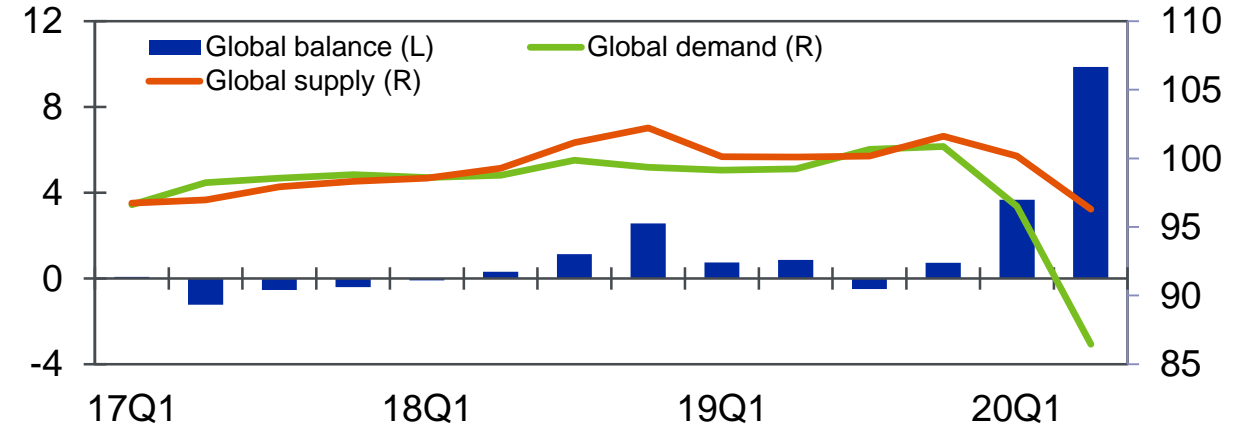
Source: Moody's Investors Service Banking System Outlook – Nigeria, 21st May 2020

External Environment Driving Economic Shocks

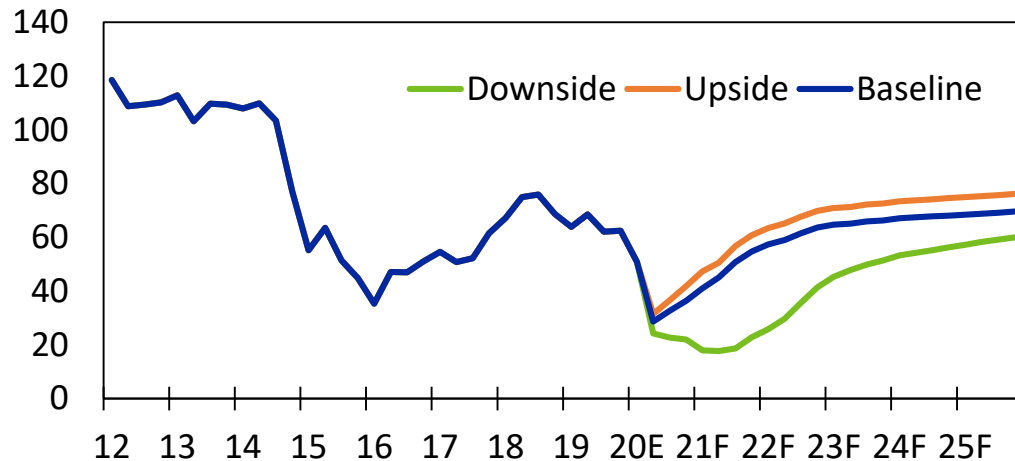
Epidemiological Situation



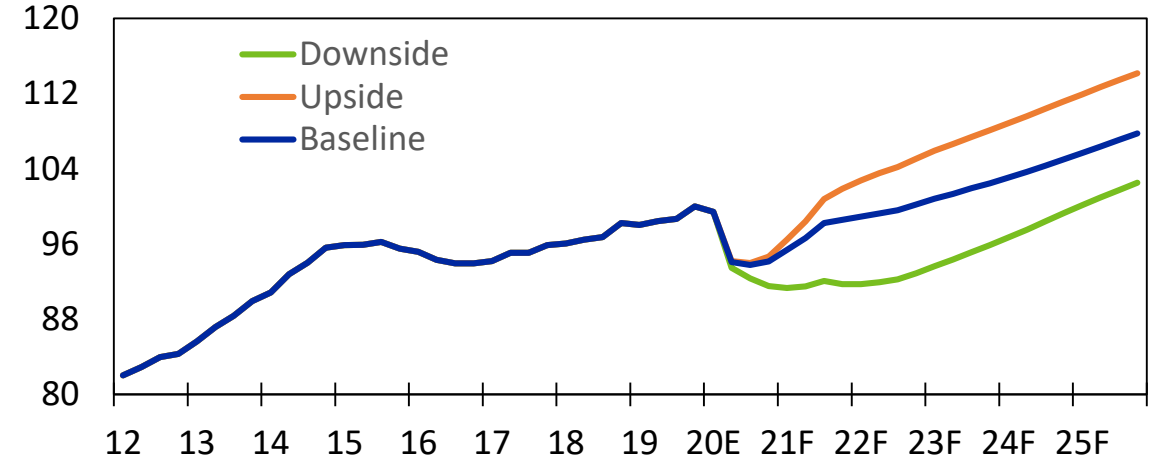
Global Oil Glut



Brent Oil Price Outlook

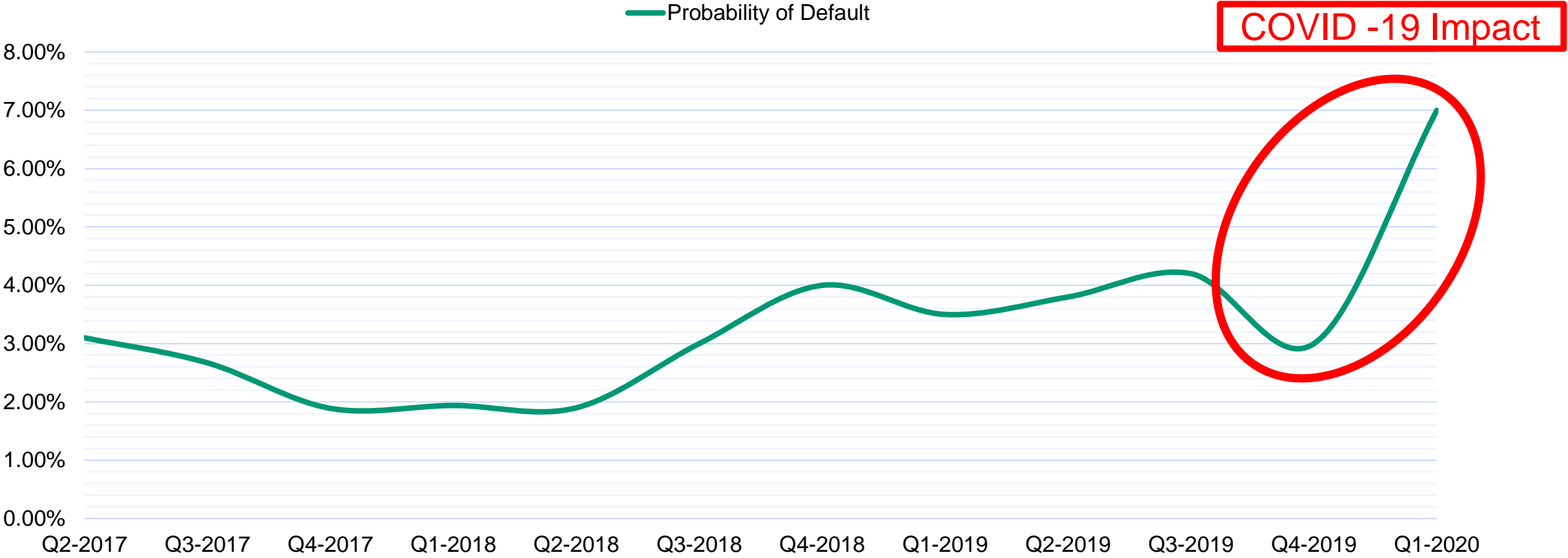


Real GDP, 2019Q4 = 100



COVID-19 Impact on Corporate Credit in Nigeria

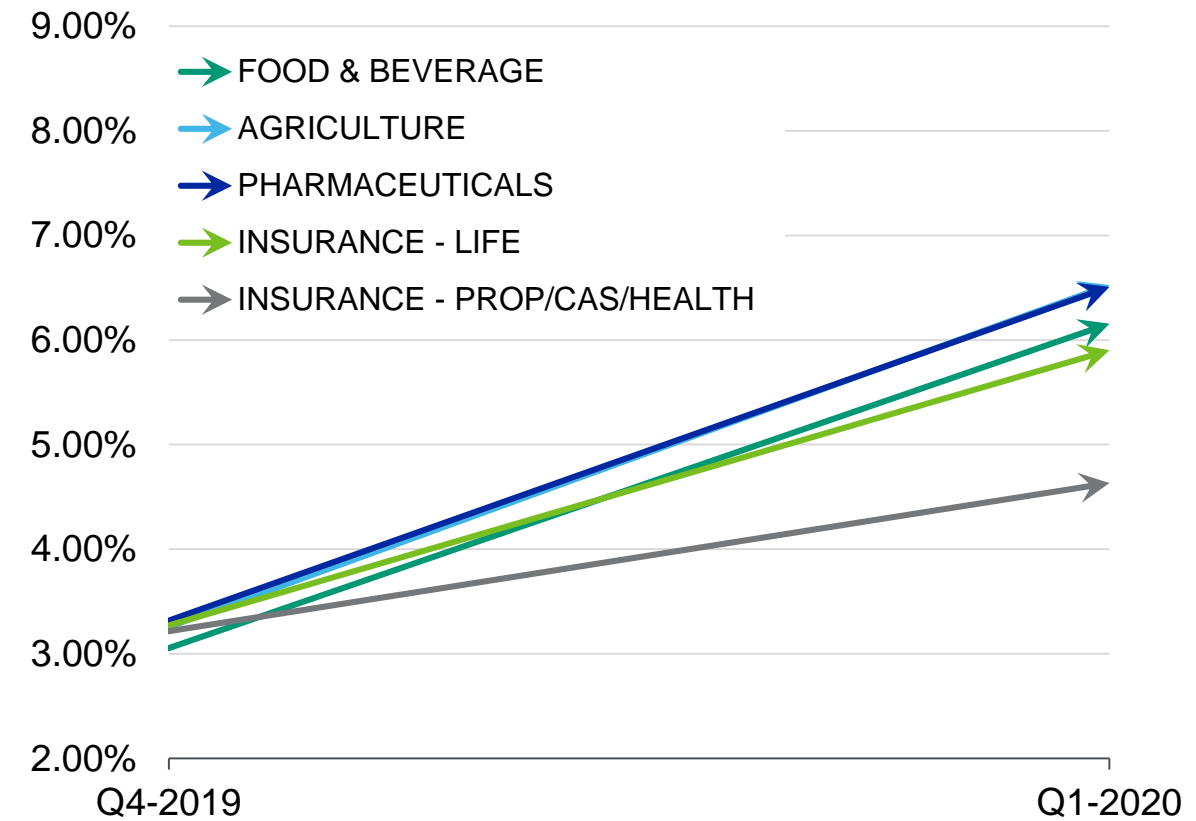
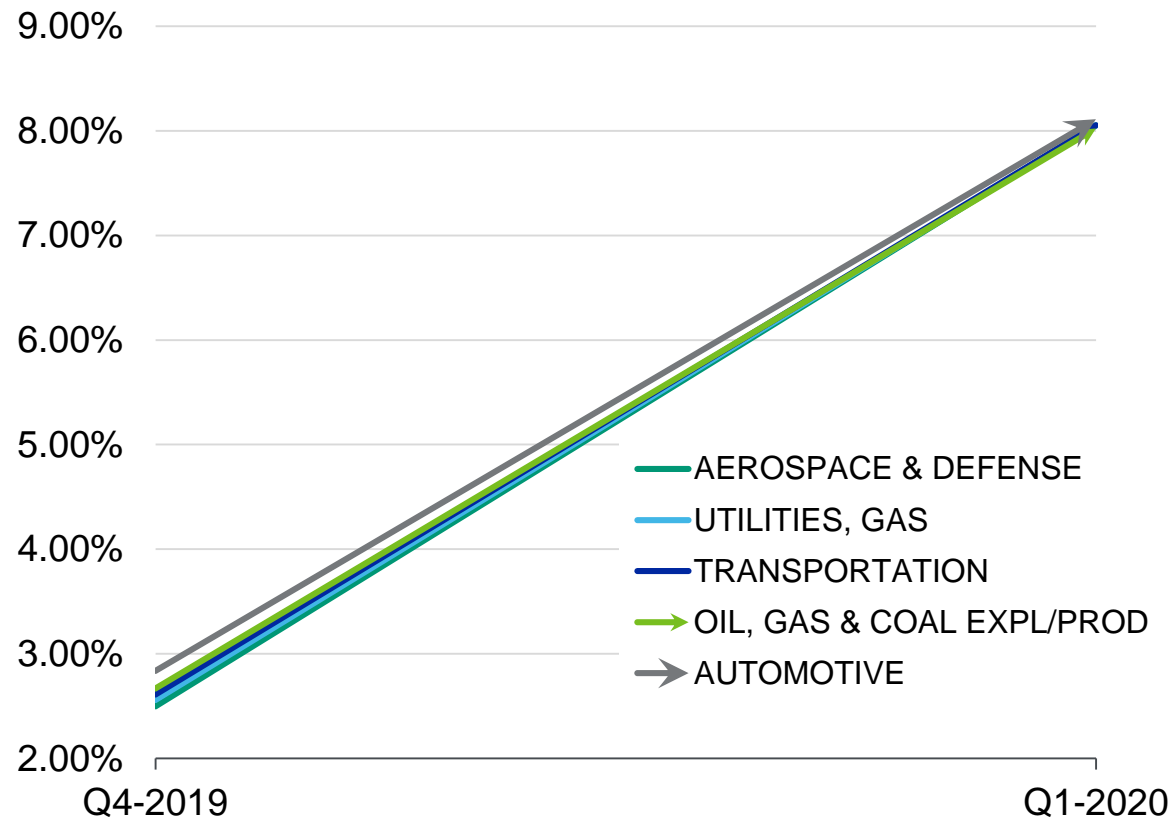
Average Probability of Default for Corporate (All Industries)



Source: Based on Moody's Analytics EDF™ Credit Measure and Point in Time Converter Model

Sectoral Differences in Credit Risk

Industries with Most and Mild Impact from COVID-19

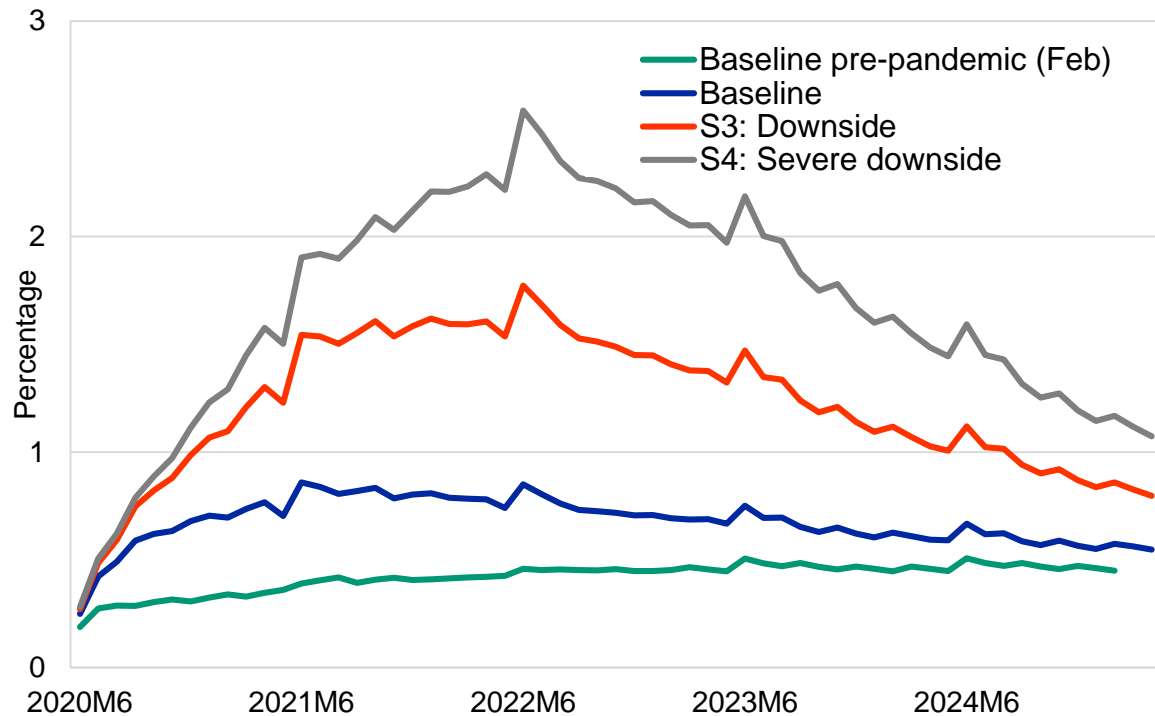


Source: Based on Moody's Analytics EDF™ Credit Measure and Point in Time Converter Model

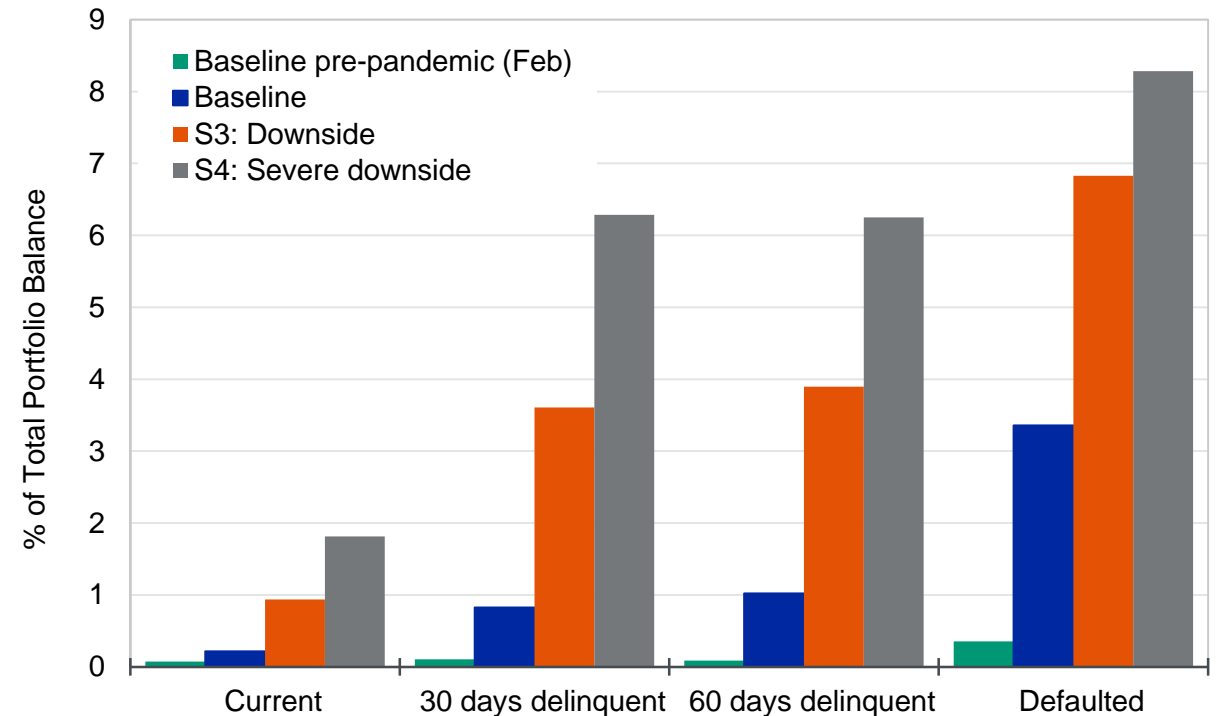
Expected Credit Losses Set to Increase

Forward-looking views on economy and market reaction contribute to spike

Probability of Default, %



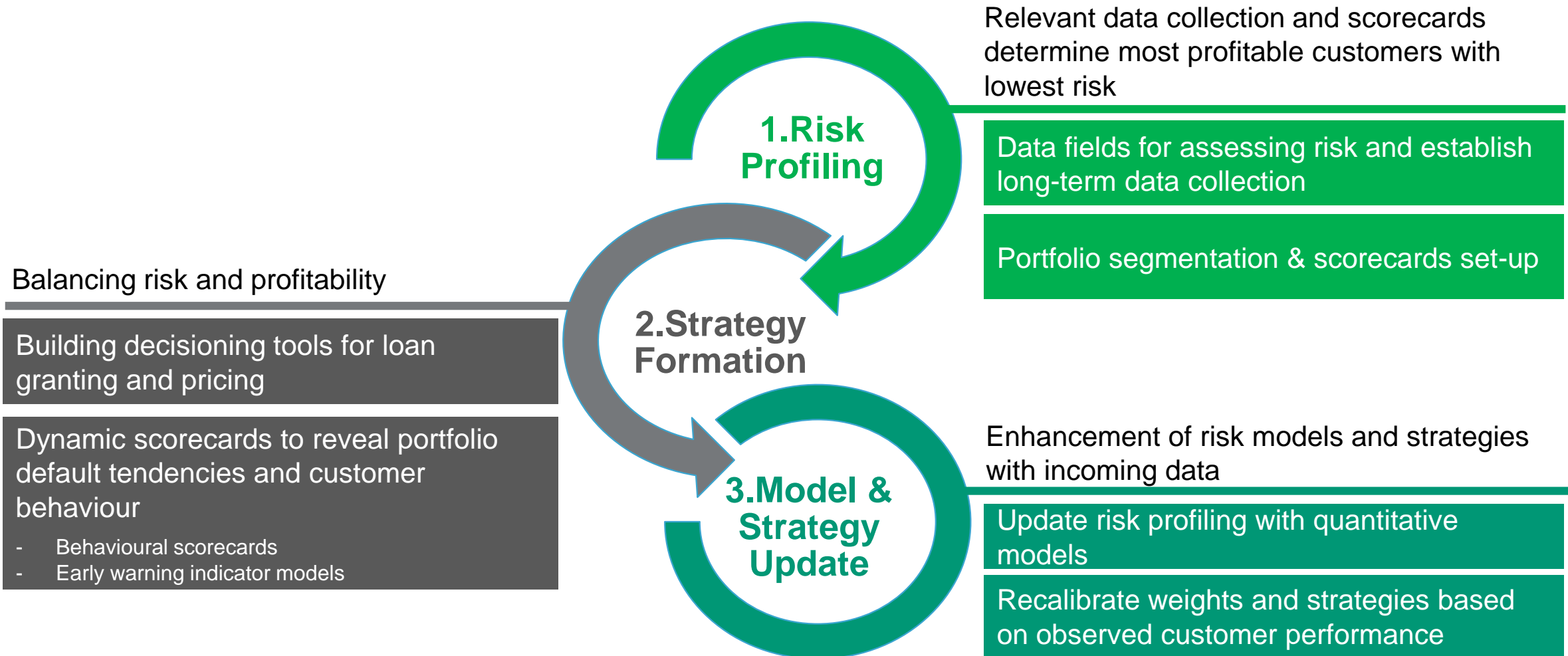
Expected Credit Loss, %



Sources: Mortgage Portfolio Analyzer, Moody's Analytics

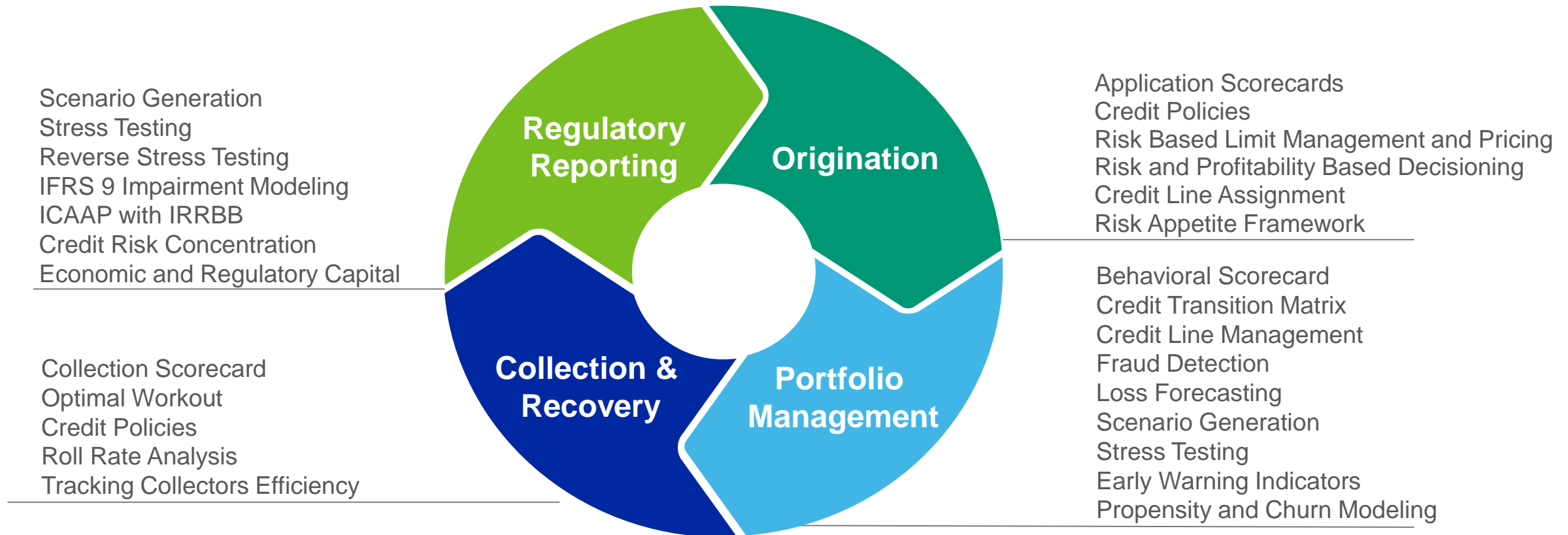
Three-Step Approach to Managing ECL / NPLs

Holistic view on credit risk measurement and management



Key to Success: Models to Inform Decisions

Manage risk, identify opportunities and comply with regulation



Many Banks' Credit Risk Models Are Vulnerable

Many credit measures don't work in the current environment

Internal Ratings

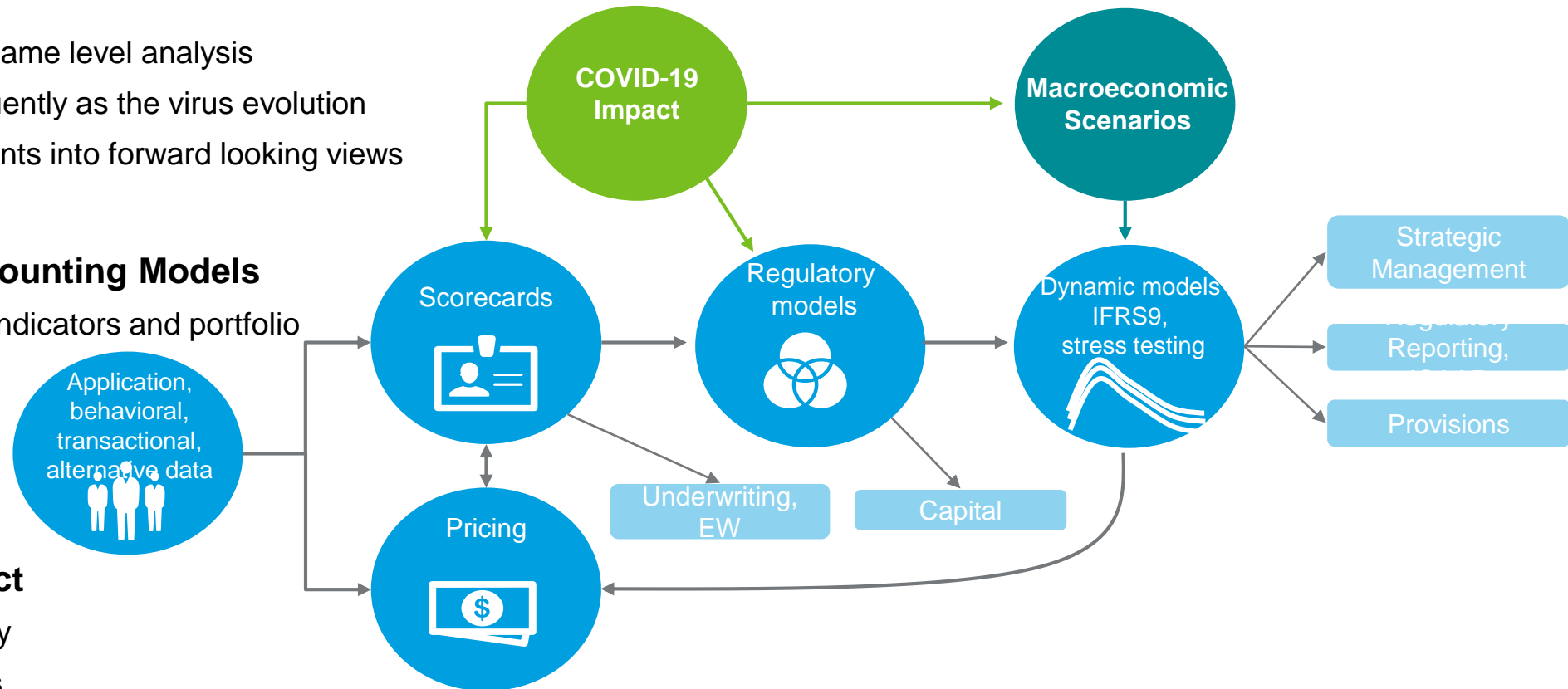
- » Rely on historical data and name level analysis
- » Cannot be updated as frequently as the virus evolution
- » Hard to incorporate past events into forward looking views

Loss Forecasting and Accounting Models

- » Use broad brush economic indicators and portfolio level forecasts
- » Can't differentiate across Impacted industries

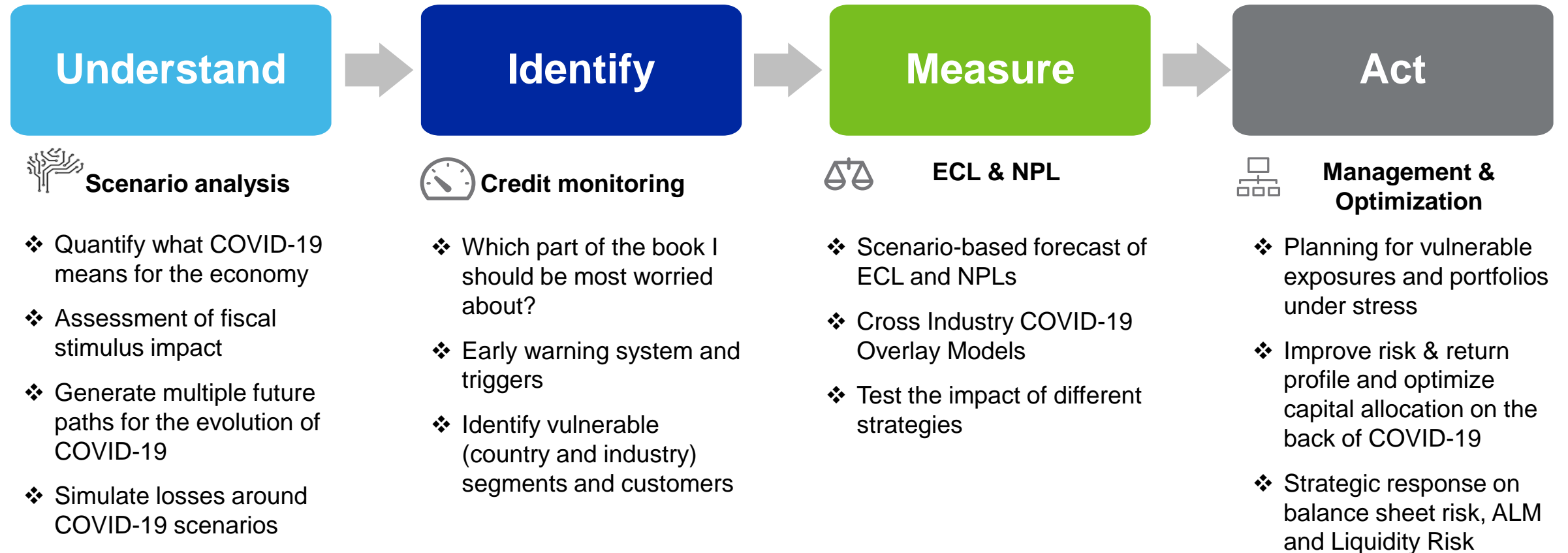
Fiscal and Monetary Impact

- » Doesn't factor virus trajectory
- » Doesn't factor fiscal stimulus



What Should Financial Institutions Do?

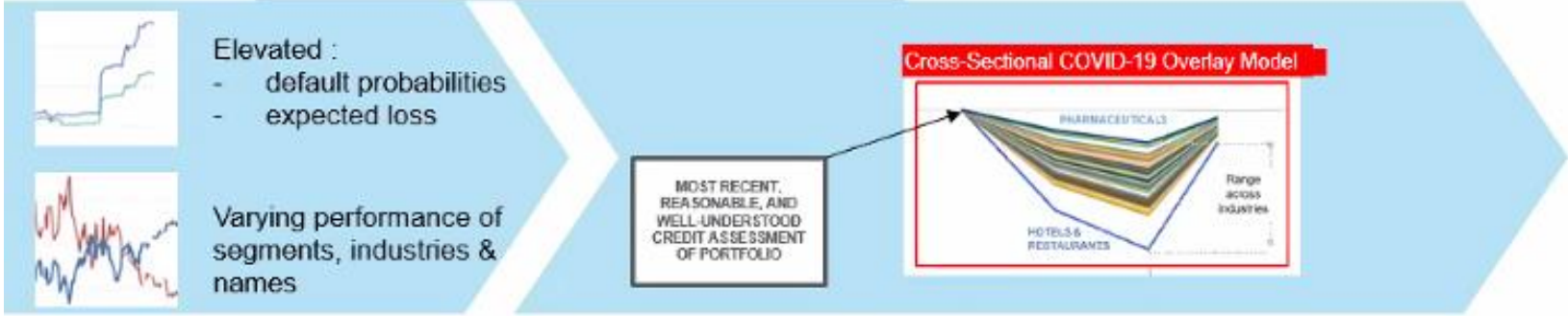
Focus on forward-looking capital and liquidity planning



Adapting and Leveraging Existing Models

Overlays and Adjustments to Identify Vulnerabilities and Manage

ASSESSING WHAT HAS HAPPENED SO FAR

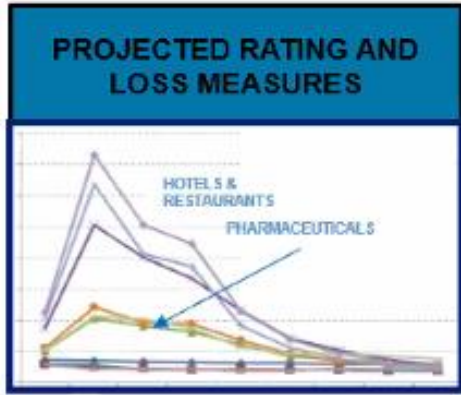
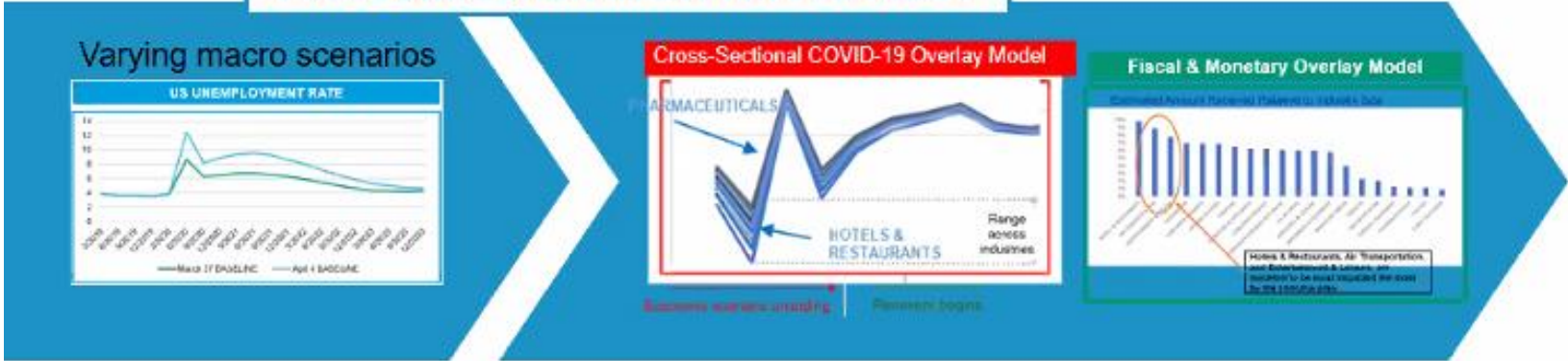


CURRENT INTERNAL RATING ASSESSMENT

Current State Internal Rating Assessment

Industry	Investment Grade		High-Yield	
	Rating Dec 31, 2019	Rating Assessment April 29, 2020	Rating Dec 31, 2019	Rating April 29, 2020
BANKING	Baa2	Baa3	B2	B
TRANSPORTATION	Baa2	Ba2	B1	C
TELECOM	A2	Baa1	B3	C
CONSUMER DURABLES	Baa2	Ba1	B2	C

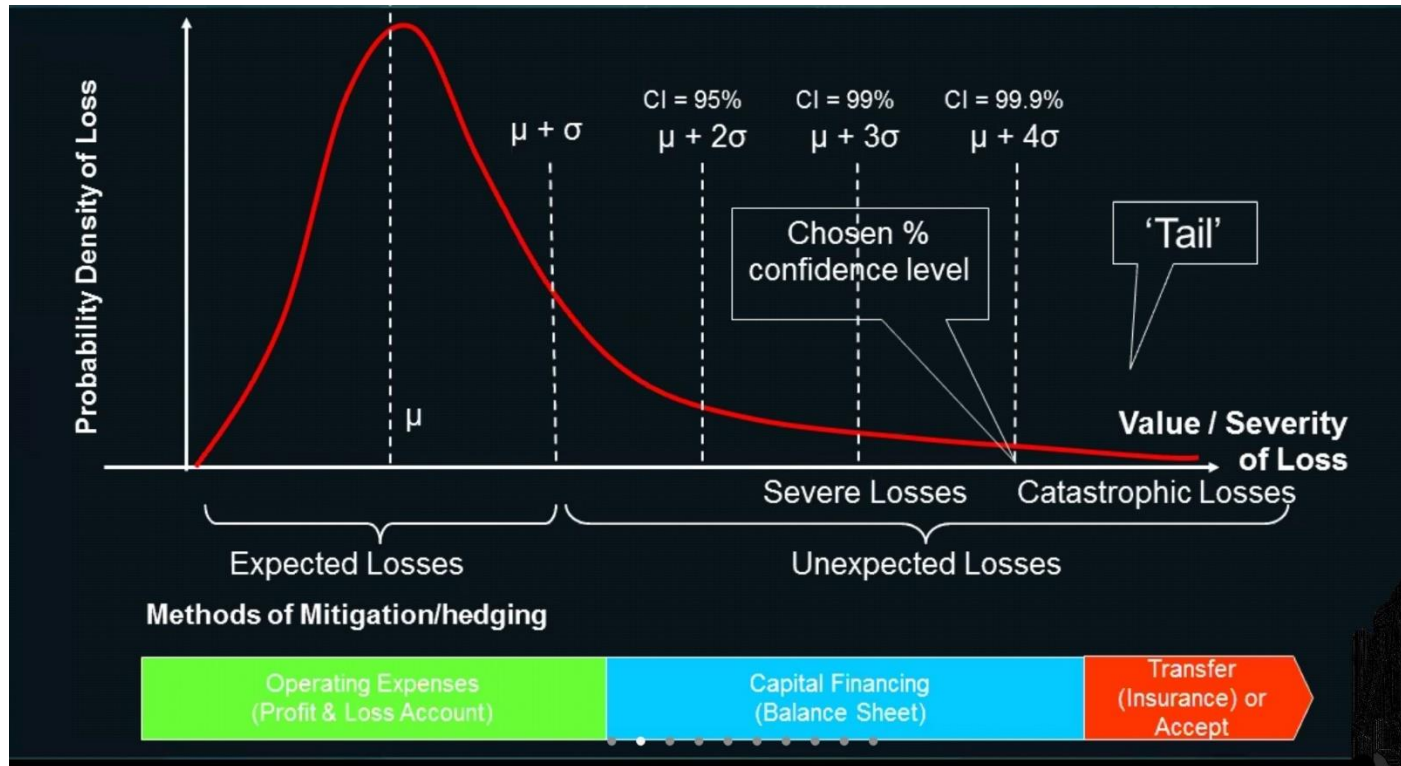
PROJECTING WHAT MIGHT HAPPEN NEXT?



HSBC may write off \$11bn in loans as profits tumble



The HSBC Holdings headquarters building in Hong Kong. The group is braced for losses despite support from central banks
ROY LIU/BLOOMBERG/GETTY



Loss Distribution



Regulatory Views and Guidance on the ECL Policies

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