Adapting to the Turning Tides in Lending Risk Governance

COVID-19, or the novel coronavirus, appears to be having a far-reaching impact globally–from compromising health to disrupting the economy. The UN's trade and development agency (UNCTAD) expects COVID-19 to trigger a potential recession-like scenario in some countries, resulting in the slowdown of global annual growth to below 2.5%, with an estimated impact of around a trillion dollars. Declining oil prices, supply disruptions from China, and the negative impact of COVID-19 on sectors such as airlines, tourism, education, food services, auto-parts manufacturing, and semi-conductor manufacturing pose a significant threat of a global downturn. However, given the interdependent nature of the global economy, the impact on different sectors will vary and will likely be determined by each country's GDP growth inhibitors.

How banks' customers are impacted

- Supply-chain Disruptions
- Declines in Demand
- Lower Profitability
- Weakening Liquidity
- Worsening Credit Quality

Stress on lending processes

The FDIC and the Office of the Comptroller of the Currency (agencies) have encouraged US-based banks to use their capital and liquidity buffers to support households and businesses. According to the FDIC, US banks' capital and liquidity exceed regulatory requirements (the largest banks together hold USD 1.3 trillion in common equity and USD 2.9 trillion in high-quality liquid assets) and can be used to provide the necessary credit-driven impetus. In addition, the six largest banks in Canada have pledged to help SMEs manage challenges related to the Covid-19 outbreak. Support requirements will be evaluated on a case-by-case basis and include mortgage-payment deferrals for up to six months and relief in terms of other products. We believe that, given the backdrop of weakening credit quality of loan portfolios and additional pressure to support businesses, banks' lending processes will come under significant stress.

- High refinancing/ amendmentsworkflow
- More frequent loan reviews
- Higher covenant defaults and associated waivers
- Increased customer interactions
- Additional documentation requirements and management
- Event impact analysis on portfolio
- Significant model re-runs for the leveraged loans portfolio
- Managing higher GL reconciliation entries

Given our industry experience, we can help banks navigate some of these challenges

Credit analysis
- Interim reviews of at-risk businesses fee-waiver requests, covenant breaches
- Event Impact Analysis on loan portfolio
- De-leveraging model updates

Stress testing
- Monitoring liquidity positions
- Monitoring limits and thresholds
- Cash flow analysis
- Maintaining portfolio dashboards with triggers for liquidity tightening/stress indicators

Covenant headroom
- Covenant headroom analysis and deviation
- Early Warning Signals and Trend Analysis
- Covenant compliance status

Re-risk rating
- Commentary on rating agencies' views and downgrades
- Re-risk rating (quantitative and qualitative), based on the bank's rating model
- Risks and mitigants reporting

Ad hoc requests
- Rush spreads for additional facility requirements
- Pre-deal credit memos

Credit admin
- Executing closing documents (pre-funding)
- Collateral administration
- General-ledger-entries reconciliation

We aim to drive efficiency through centralization, standardization, and optimization

Standardization
Methodology documents/standard-operating-procedure documents laying down the processes to be followed, assumptions and information sources

Improved cycle time
Improved time to market for renewals/extensions/new-loan underwriting

Improved monitoring
Set up early-warning systems and create borrower/portfolio-level dashboards for improved risk monitoring

Technology and automation
Support lending-platform migrations and custom-automation initiatives

Increased client-facing time
Actively participate in building and managing 'non-client/risk differentiating activities'

Robust MI
Maintain an effective MIS to provide actionable data points on process lapses, cost to serve and timeliness of reviews

Flexible staffing
Provide variable support to manage spikes in volumes

Improved quality
Set up SLAs/KPIs to assess the quality of deliverables