NEXT LEVEL SOLUTIONS

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THE 1ST RISK & REGULATORY OUTLOOK 2021

VIRTUAL SEMINAR

CENTRAL BANK OF THE BAHAMAS

THE INSURANCE COMMISSION OF THE BAHAMAS

SECURITIES COMMISSION OF THE BAHAMAS

FINANCIAL STABILITY IN AN ERA OF COVID-19

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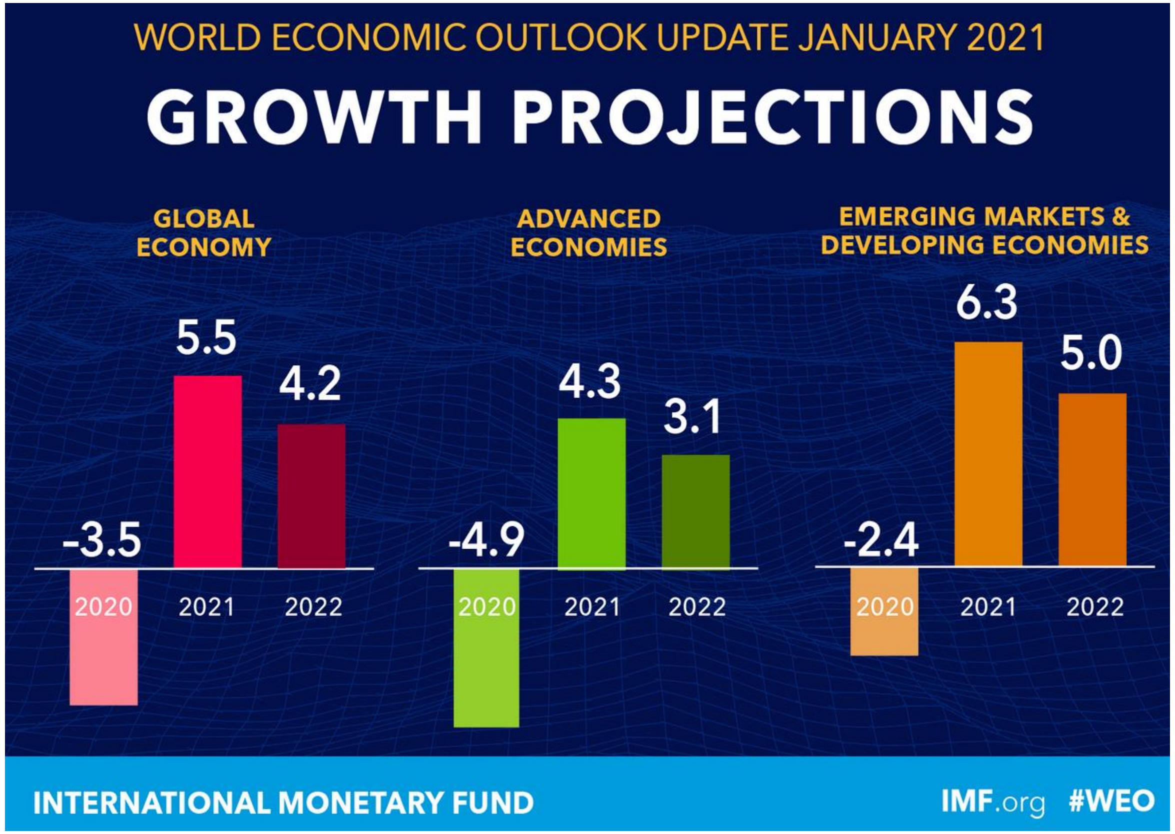
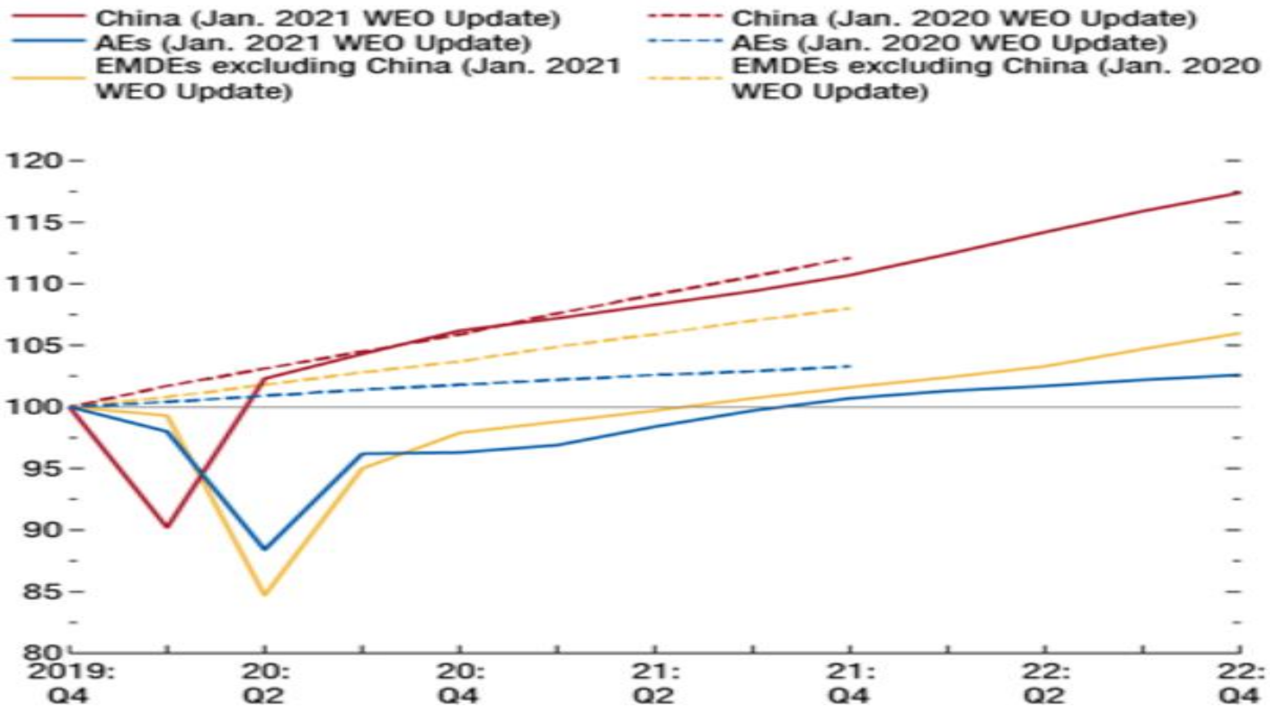
Order of Presentation

- Impact of Covid19 and Financial Stability
  - COVID-19 pandemic is the greatest threat to global financial stability in 2021 - Annual Systemic Risk Barometer published by the Depository Trust and Clearing Corporation (DTCC).
- Cyber Risks – Banks and FIs at high risk of cyber events
- Geopolitical Risks - directly impact trade, fiscal and monetary policies
- Corporate Solvency
- Short and Medium Term Outlook





Source: IMF staff estimates.
Note: AEs = advanced economies; EMDEs = emerging market and developing economies; WEO = World Economic Outlook.

- Vaccine available
- Current wave and new variants of the virus are of concerns.
- Acute adverse impacts on women, youth, the poor, the informally employed, and those who work in contact-intensive sectors.
- The strength of the recovery is projected to vary significantly across countries
- Depending on access to medical interventions, effectiveness of policy support, exposure to cross-country spillovers, and structural characteristics entering the crisis. (Are projections overly optimistic?)

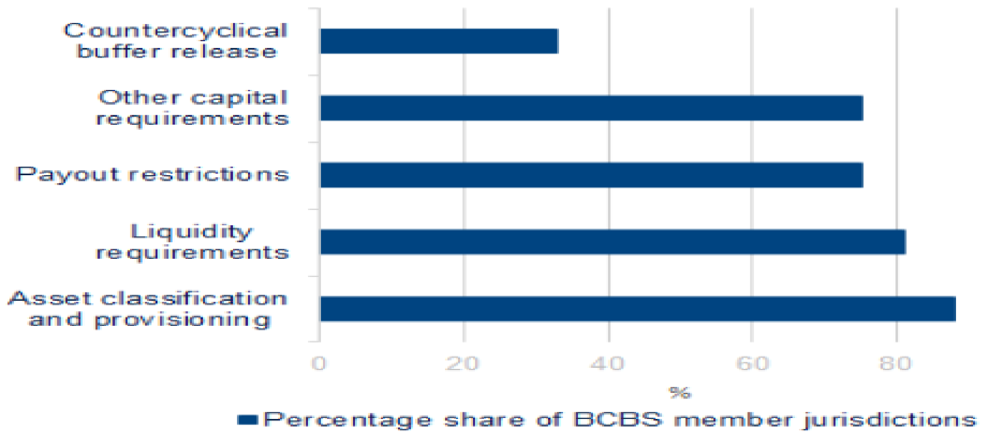
Banking System Attributes		
	Developed Countries (DCs)	Emerging market countries (EMCs)
Cost structure & Efficiency	• Similar cost to income ratios; slightly better in EMCs. • EMCs' cost structure is twice as heavy as that of DCs. • Improved efficiency	
Profitability	Very weak (anticipating LLP more than EMCs)	Declining (higher than DM)
Asset Quality	Expect higher NPLs and Credit losses	
Solvency	Relatively comfortable (keep regulatory measures in mind – strategy and forbearance) (will talk about buffers later)	
Liquidity	Not an issue, cash is being hoarded. Customer deposits have increased in most countries, both DM and EM Deposits have grown much faster than loans despite the governments' loan guarantees	

Unprecedented Coordinated Policy Response

Fiscal Policy	**Strong and swift reaction** (no other way once activity broadly stops due to need to deal with health concerns and confinement periods) **but there is a legacy being built: higher deficits and public debt**
Monetary Policy	**Further unconventional measures** (as a backstop for financial markets as well as to ensure credit provision to households and businesses) **in Developed countries but Emerging countries are also cutting rates and testing QE**
Regulatory Measures	Focus to **support the flow of credit** to the economy, **mitigate operational** and **financial risks for the banking system** and **increasing operational capacity** to respond to short term financial stability priorities

- Current phase of the virus challenging for EMEs.
- Financial conditions are fragile
- Lack of fiscal policy space
- Some countries facing high risks to debt sustainability.
- 1/3 of all EMEs entered the crisis with high-debt levels
  - Assessed to have no space for undertaking additional discretionary fiscal policy, or as having that space significantly at risk.

USE OF PRUDENTIAL MEASURES
(% OF BASEL MEMBER JURISDICTIONS)

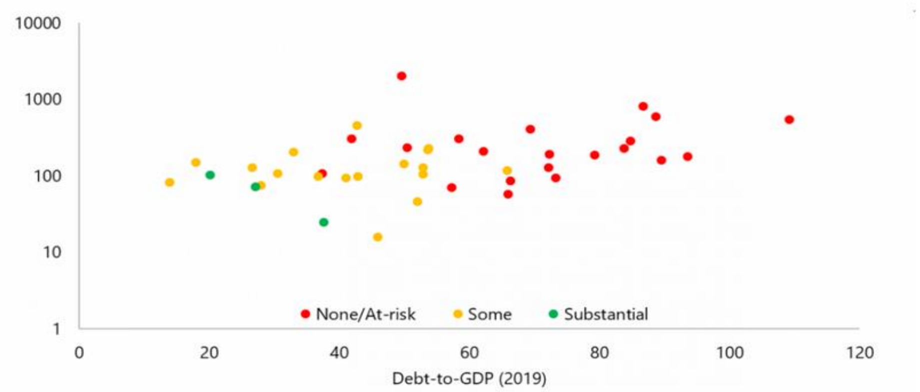


Source: Basel Committee on Banking supervision; BIS calculations

A worrisome lack of fiscal space

One-third of Emerging Market Economies have limited or no room for fiscal policy to counter a prolonged crisis.

(EMBI bps in log scale; percent)

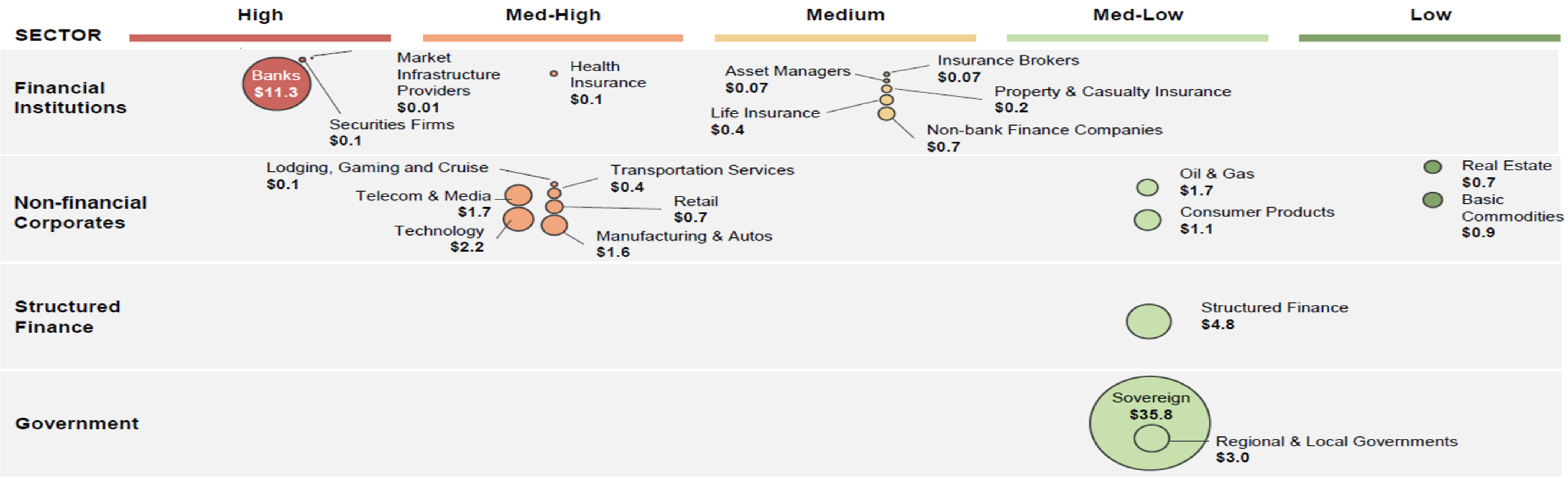


Sources: Bloomberg; WEO live; VE database; and IMF staff calculations.
Note: EMBI changes account for the period 1/1/2020 - 7/10/2020. Colors of dots represent fiscal space assessments. Fiscal space is defined as the room for undertaking discretionary fiscal policy relative to existing plans without endangering market access and debt sustainability.

Impact on the banking sector

	POSITIVE	NEGATIVE	CHALLENGES
Monetary policy	Low financial tensions and help financial stability	Lower for longer interest rates: pressure on banking revenues	Scale-down of unconventional measure
Credit guarantee and moratoriums	Burden-sharing. Moderation of dramatic increase in bank losses	Lack of visibility around borrower's' financial health	Execution of guarantees phase out of support measures. Support to zombie firms. Credit crur when lifted
Regulatory framework	Mitigate financial impacts and alleviate operational burden. Regulation flexibility	Lack of transparency; Difficult balance between financial stability and regulatory forbearance	Financial stability implications; Too early temporary prudential treatment withdrawal?

Banks are at high risk of a cyber event

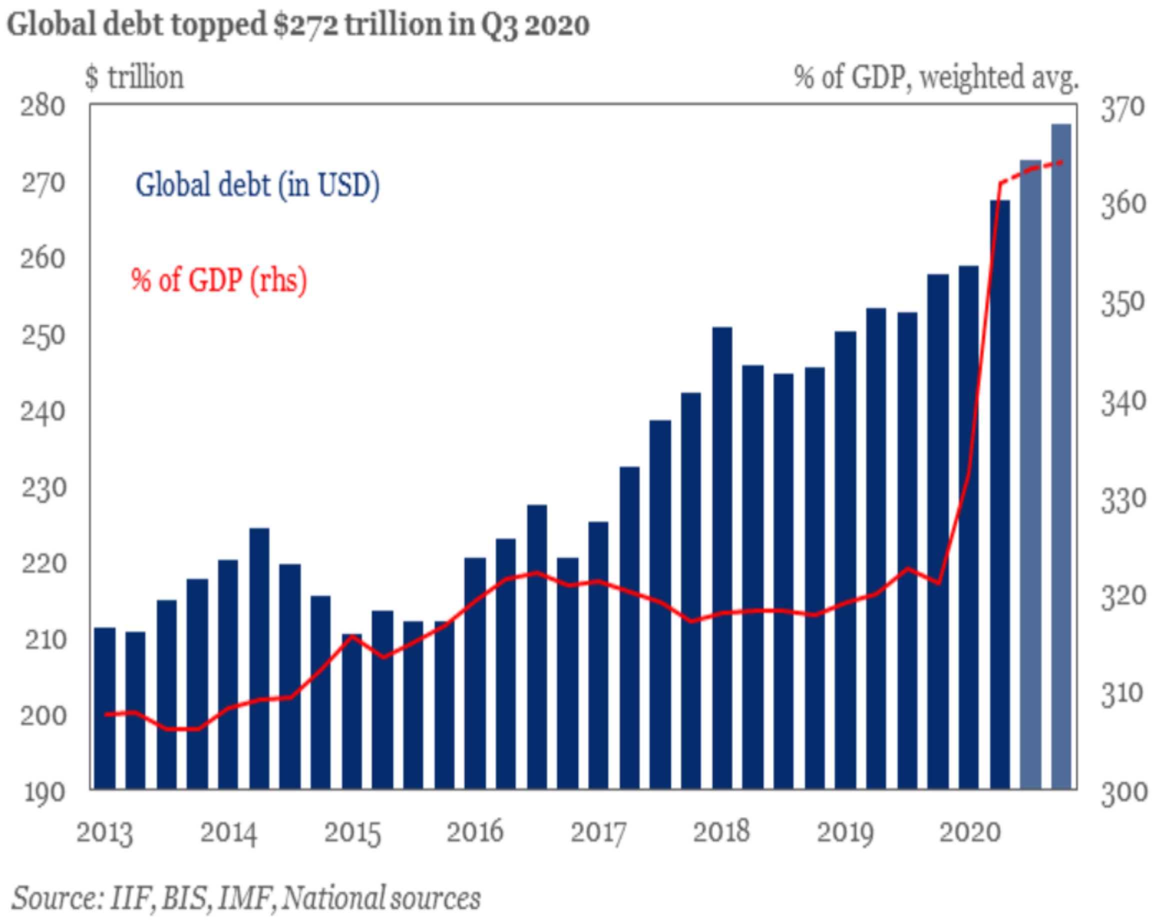


Note: Debt in trillion USD
Source: Moody's Investors Service

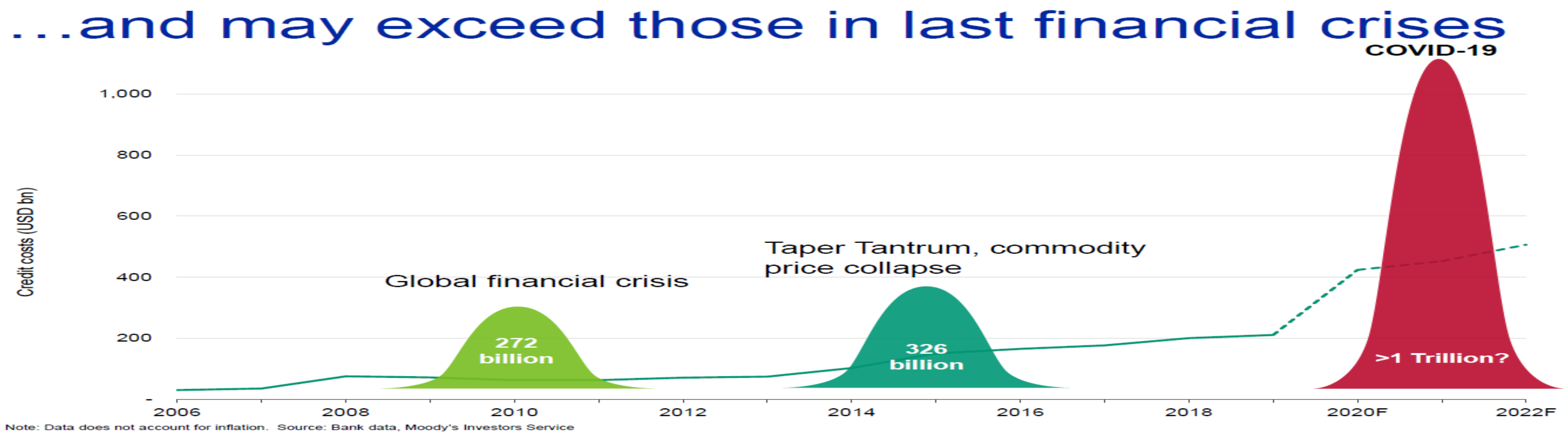
- Cyberattacks are becoming increasingly sophisticated - Cyber risk is always an underlying threat.
- Cyber risk is increasing due to more remote working environments as a result of the pandemic.
- Solarwinds

Global Debt

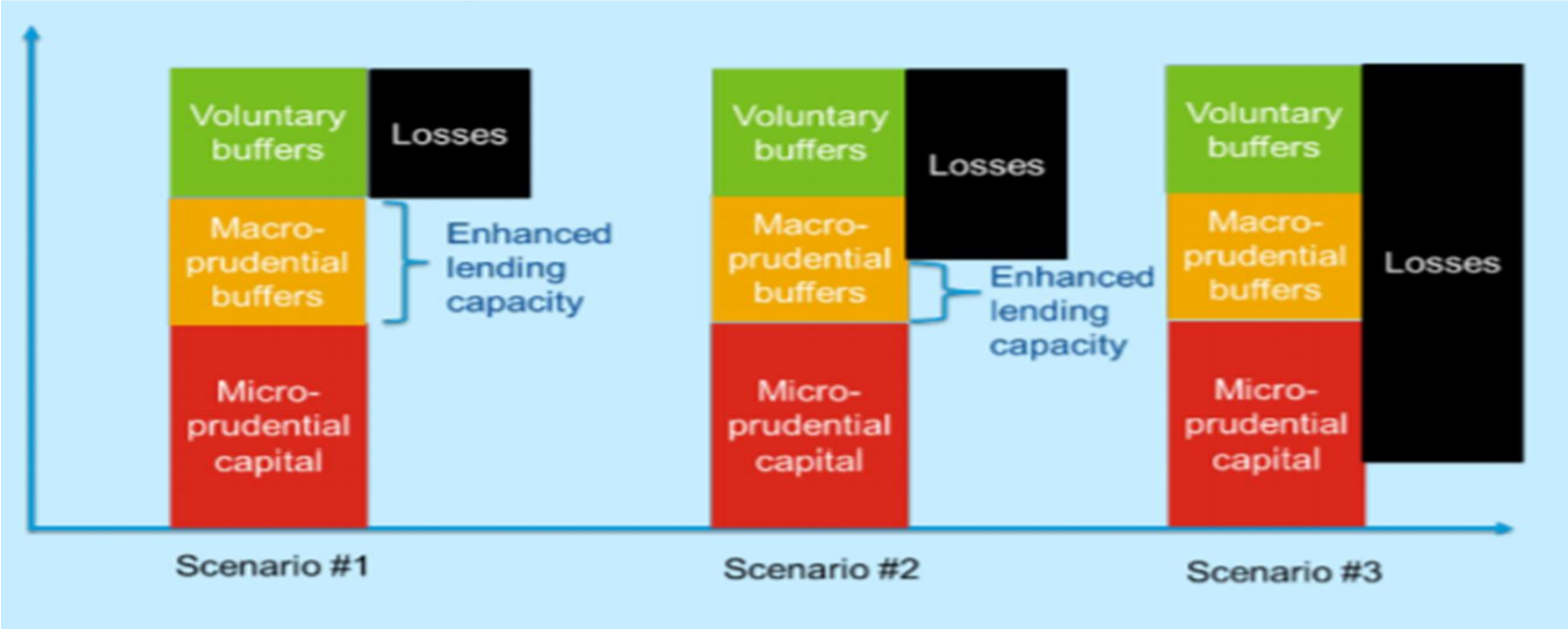
- Excessive global debt is a significant point of concern
- Global debt levels were already elevated prior to the covid19 outbreak
- Increased due to a series of stimulus measures and monetary policy accommodations
    - Successfully mitigated some of the pandemic's ST economic impact
    - BUT the sustainability of the resulting high debt levels could present challenges in the future.



- Expect higher NPLs and Credit Losses
  - Asia-Pacific banking's NPL and consequent CLs could rise by US$600 billion and US$300 billion, respectively, in 2020 because of COVID-19, the oil price shock, and market volatility.
  - Chinese banking system we estimate that credit losses will increase by about US$370 billion to the end of 2021 because of COVID-19 (S & P Global Oct. 2020)



- **Risks emanating from U.S.-China strategic could results in material economic costs**
- **Directly impact trade, fiscal and monetary policies for the next few years.**
- Could create significant business disruptions and place additional pressure on economic and credit conditions **Geopolitical risks and trade tensions were cited as a top five risk by 45% of respondents**



Scenario 1:

- If bank losses are no greater than the voluntary buffers banks hold on top of micro- and macroprudential requirements, the relaxation of macroprudential capital buffers can all be used to enhance banks' lending capacity, although it would remain uncertain how much actual lending would take place.

Scenario 2:

- If losses eat into macroprudential buffers, the relaxation would provide less capacity to support continued lending to the real economy.

Scenario 3:

- If losses entail breaching the minimum microprudential requirements, banks would be subject to supervisory action that discourages new lending.

Policy Response for Corporate Solvency Problem

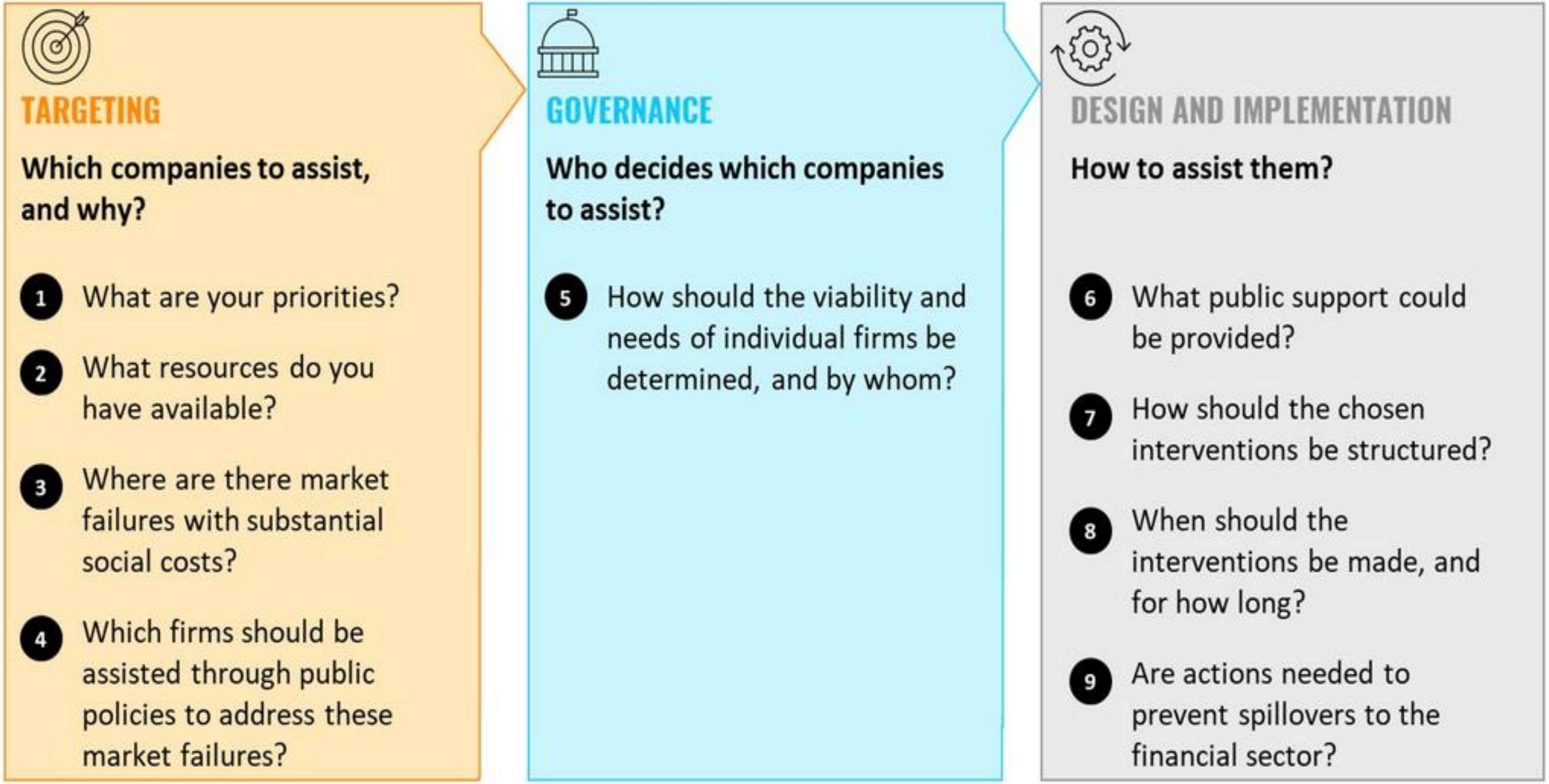
Guiding principles for address Corporate Solvency:

1. Shift the focus from the liquidity challenge to the solvency challenge – encourage new investments or facilitate conversion of debt to equity
2. Response must be targeted – With limited response, only offer to viable companies; allow some failing businesses to fail and avoid zombies; must have safety net/social benefits for employees

Tool	Description	Primary focus
1. Infusions of equity or equity-like investments	Policies to make, or encourage the infusion of, equity or equity-like investments in viable firms	Support the corporate sector in the current crisis
2. Balance sheet restructuring of otherwise viable businesses	Enable restructuring of balance sheets to be achieved rapidly and inexpensively for qualifying businesses, including through modified bankruptcy processes and workout procedures	
3. Measures to deal with bad debt efficiently and effectively	Buying or guaranteeing bad assets, establishing "bad bank" structures, or encouraging the use of specially designed Asset Management Companies to take on non-performing assets	Support the health of the financial sector
4. Government-backed (re)insurance	(Re)insurance against future pandemic-related business interruption	Protect against future pandemic risk

Source: Policy responses to the corporate solvency problem in the ongoing Covid-19 crisis Andrew Bailey, Douglas J. Elliott, Victoria Ivashina 21 January 2021

Policy Response for Corporate Solvency Problem – Decision framework



Source: Policy responses to the corporate solvency problem in the ongoing Covid-19 crisis
Andrew Bailey, Douglas J. Elliott, Victoria Ivashina 21 January 2021

Short and Medium Term Outlook	
Monetary policy: Low interest rates for longer. Some EM close to ZLB	Net interest margin compression in countries that lowered rates. Banking systems which are very dependent on net interest income will suffer the most. A flattened yield curve is very damaging for the banking business; flat yield curves for longer. The elimination or reduction of financial tensions and the overall loose financial conditions through liquidity providing are supportive for banks and borrowers. But long term, challenges of these policies (and trade offs) will become explicit.
Digitalization in banking: innovation and adoption gain speed due to Covid; opening opportunities to reduce costs and boost revenues	
Regulation	Short Term: Supportive; Policy short term trade offs between financial stability and, eventually, transparency/recognition of losses; Inconsistencies between home/host supervisors; RRP & Stress testing Medium Term: Uncertainty regarding the coherence, interaction and impact of multiple regulations (at play now!) Recalibration of prudential framework: less structural capital and more countercyclical capital buffers. More attention to Non Banks**, Fintech, BigTech** (level playing field needs to be a priority in the agenda!) Coordination prudential regulation & competition policies Global coordination remains imperative Authorities´ renewed interest on CBDC options and on the regulation of digital

Short and Medium Term Outlook	
Consolidation in Banking System	Short term: Bank profitability has been very low, which has been exacerbated by the COVID crisis; Poor earnings estimates in all jurisdictions; Lower revenues; Higher loan loss provisions; Huge impact on banks' share prices and valuation metrics Medium/Long Term: Will the current concentration levels in most countries increase?; Regulators seem to favor further consolidation (M& as a way to strengthening the banking systems: financial stability
Government support measures are certainly positive, but uncertainty looms after phasing out and will need to be addressed	

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