

# *Preserving Access to Finance during the Global Crisis*

## *Session 3 – Enhancing Crisis Resilience of Financial Institutions and its Management*

2009 KfW Financial Sector Development Symposium  
Berlin, 3 December 2009

**Sylvia Wisniwski**  
Chief Operating Officer, EFSE



Die Zukunftsförderer

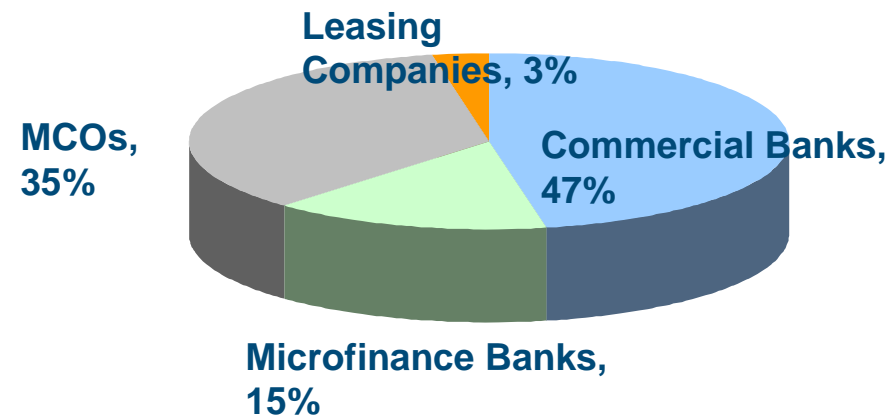


- **Objective**

Present the ability and limitations of Financial Institutions' management to plan and mitigate adverse impacts of the crisis in a region severely affected: Southeast Europe

- **Financial Institutions Universe**

56 Financial Institutions  
(breakdown by type:  
commercial banks,  
microbanks, MCOs,  
non-bank financial institutions)



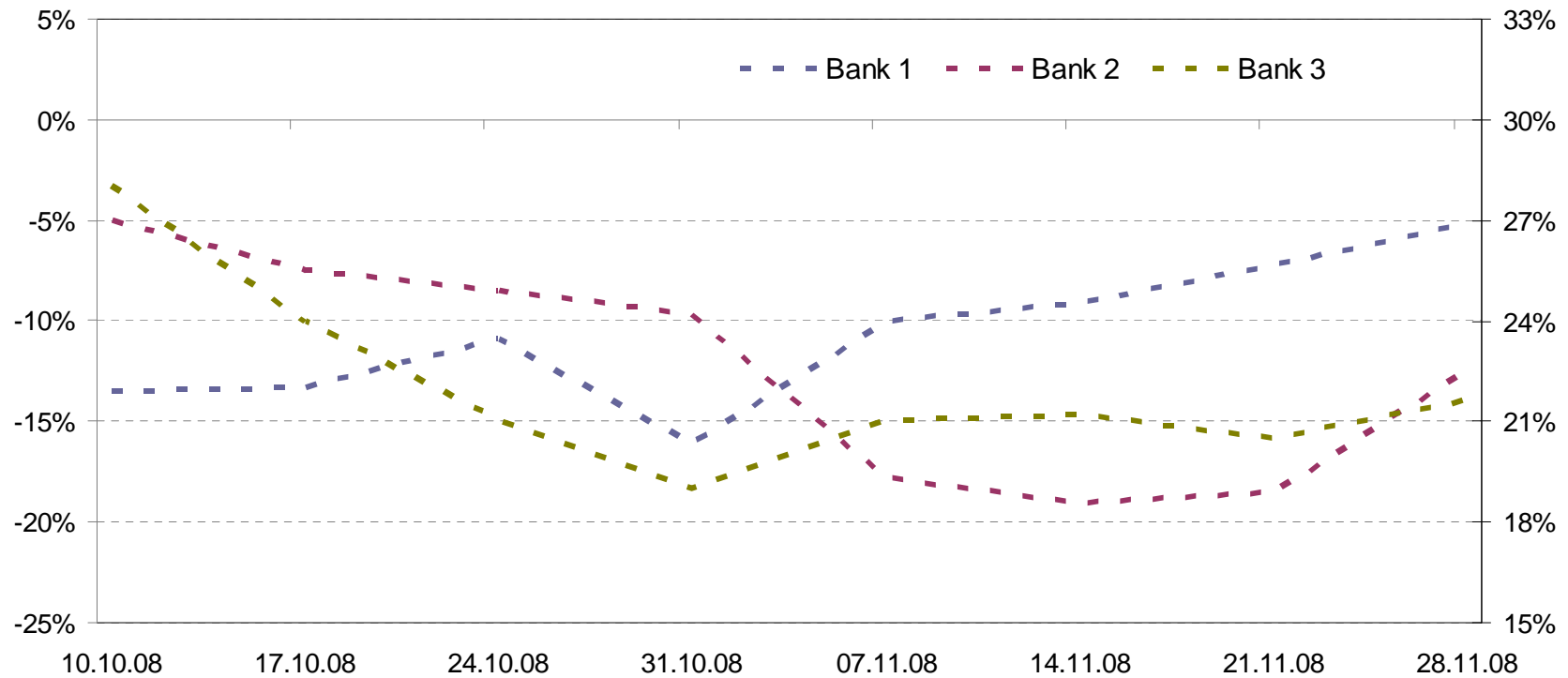
- Managing Liquidity
- Asset Quality Management & Provisioning Policies
- Managing Maturity Mismatches
- Managing Open Currency Positions
- Managing Interest Rate & Repricing Risk
- Managing Profitability

## Managing Liquidity

# Liquidity Crisis: Montenegrin Banks' Strategy



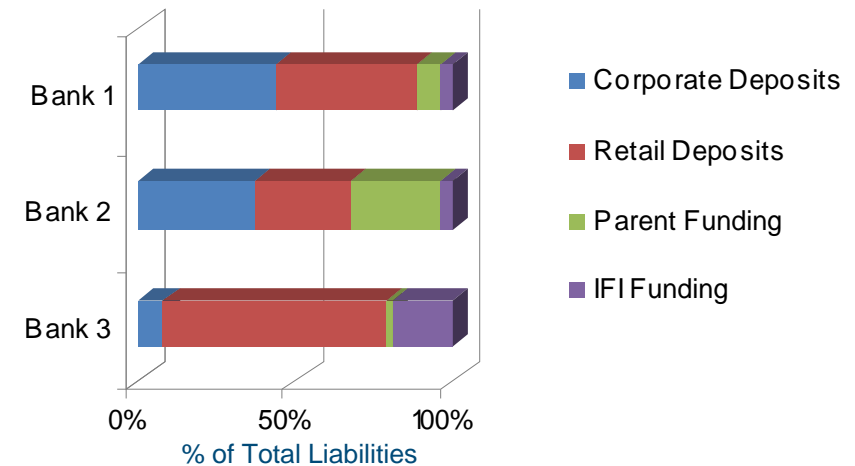
### Individual Banks' Deposit Loss in Oct and Nov 2008



Source: EFSE PLIs

## Take-Away 1 – Deposit Structure and active Management Critical

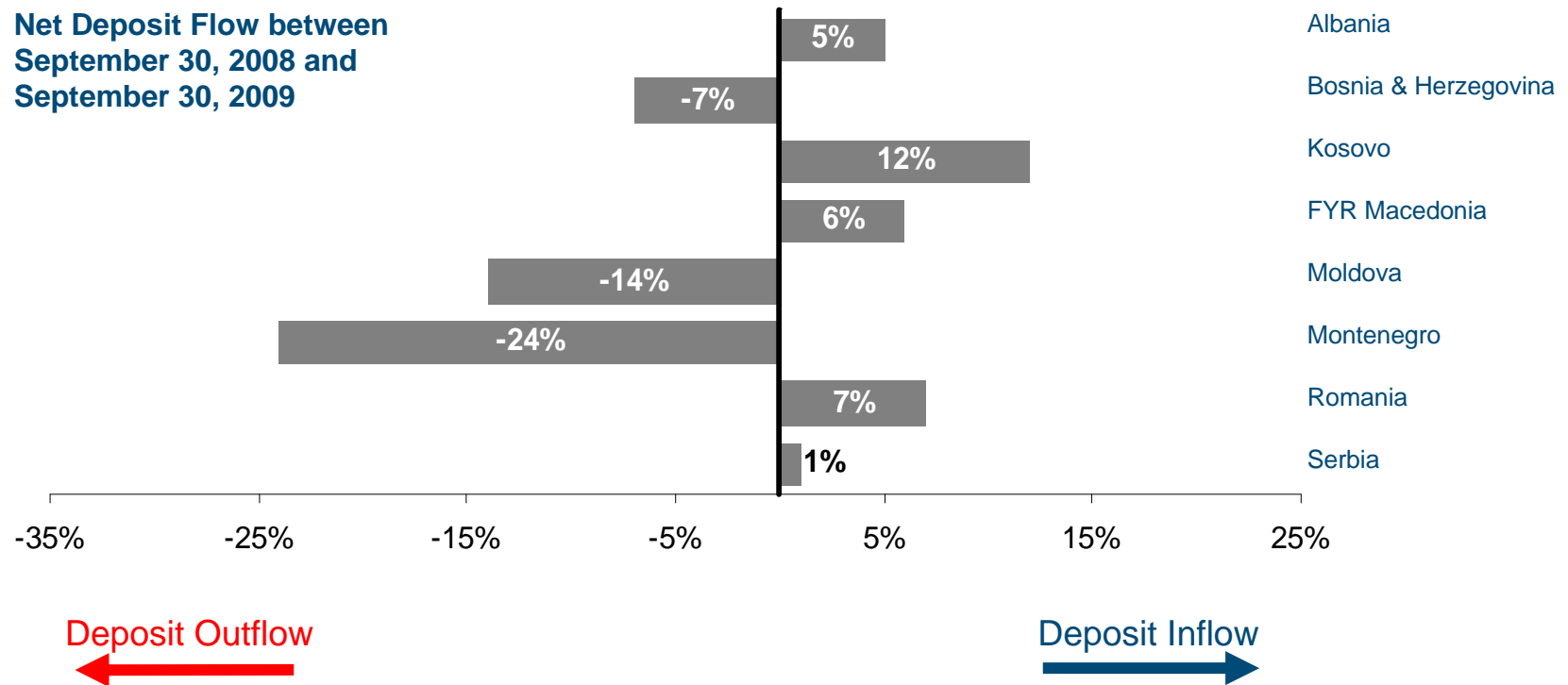
- Corporate deposits show generally greater stability
- KYC particularly critical for retail deposits
- Build confidence in times of crisis: continue paying out and get engaged in an active dialogue with clients



# Outflow of Deposits: Q4 2008 – Q2 2009

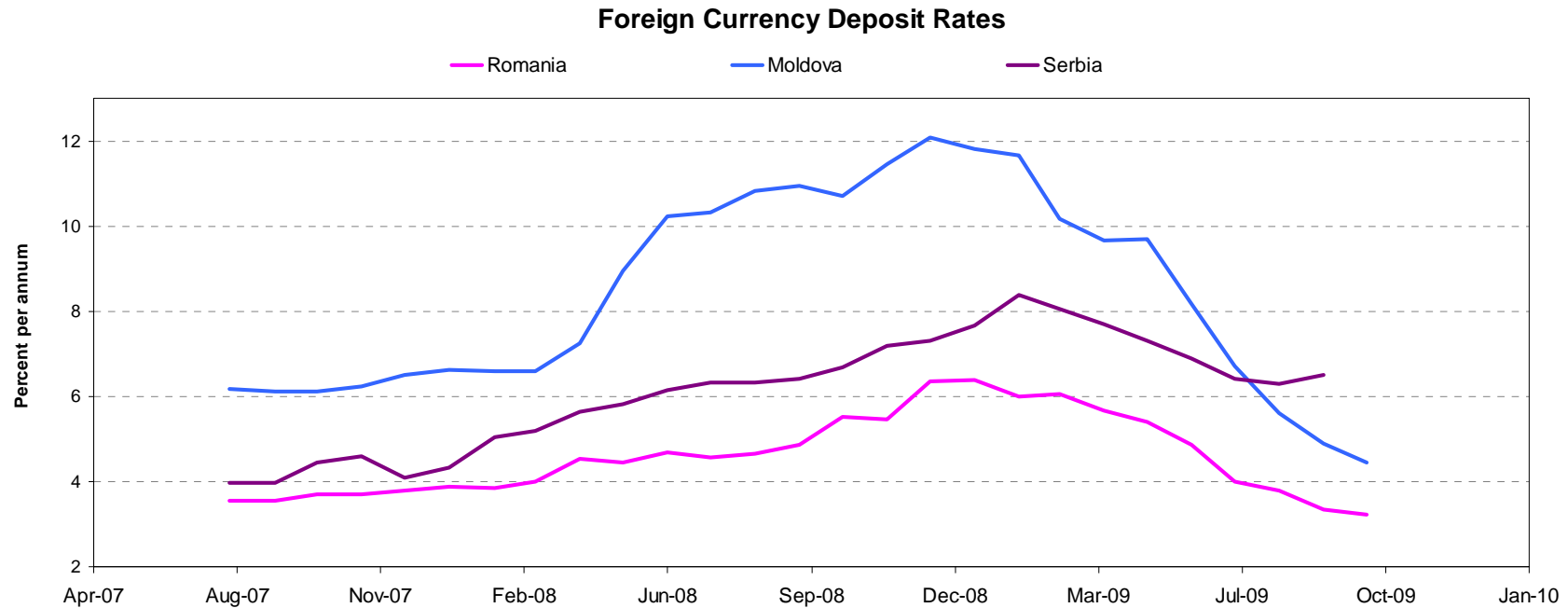


Net Deposit Flow between  
September 30, 2008 and  
September 30, 2009



Source: EFSE PLIs

# Deposit Rates Dynamics in the Region



## Take-Away 2 – Restored Trust primary Driver for recovered Deposits

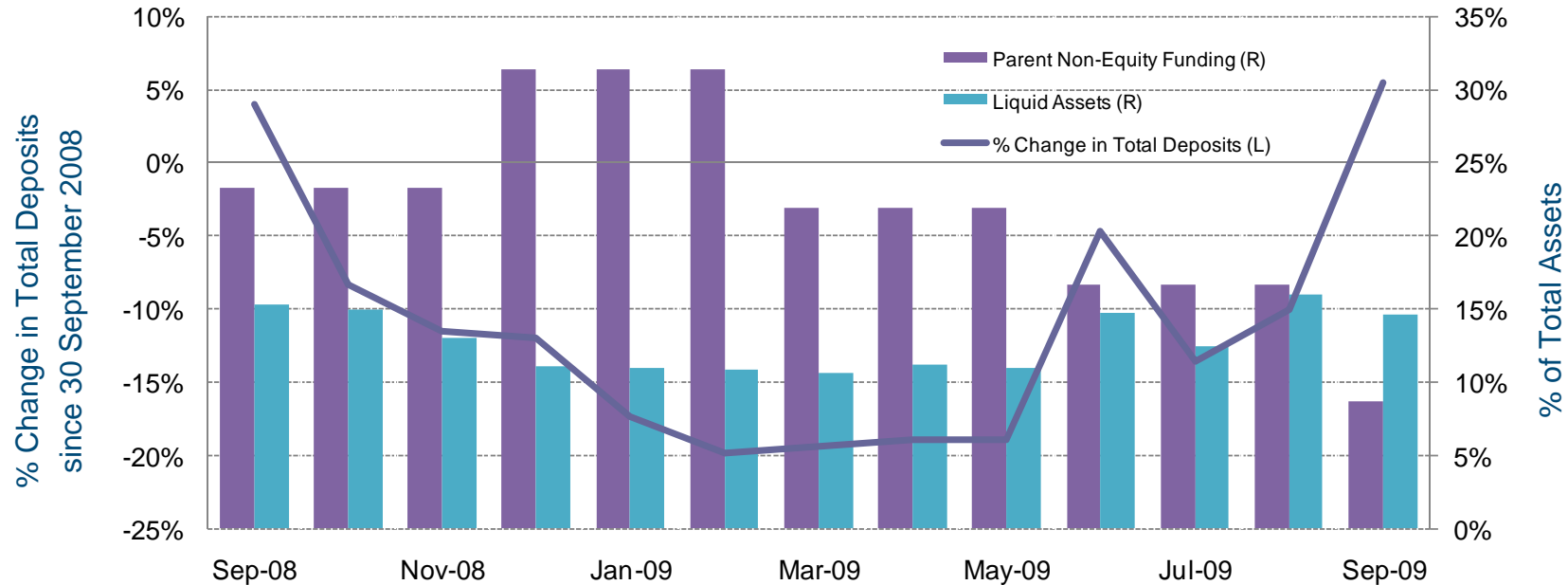
- Little to no correlation between deposit increase and deposit rates

Source: Central Banks' data

# Role of Parent Funding



**Bank 2 – Deposit Base, Liquidity and Parent Funding, 09/08 – 09/09**



## Take-Away 3 – Parent Funding = Lender of Pre-last Resort

- Parent funding played a very important role to keep satisfactory liquidity levels: group liquidity management and own core liquidity
- Parents' own liquidity even more critical as group liquidity systems got impaired

Source: EFSE PLIs

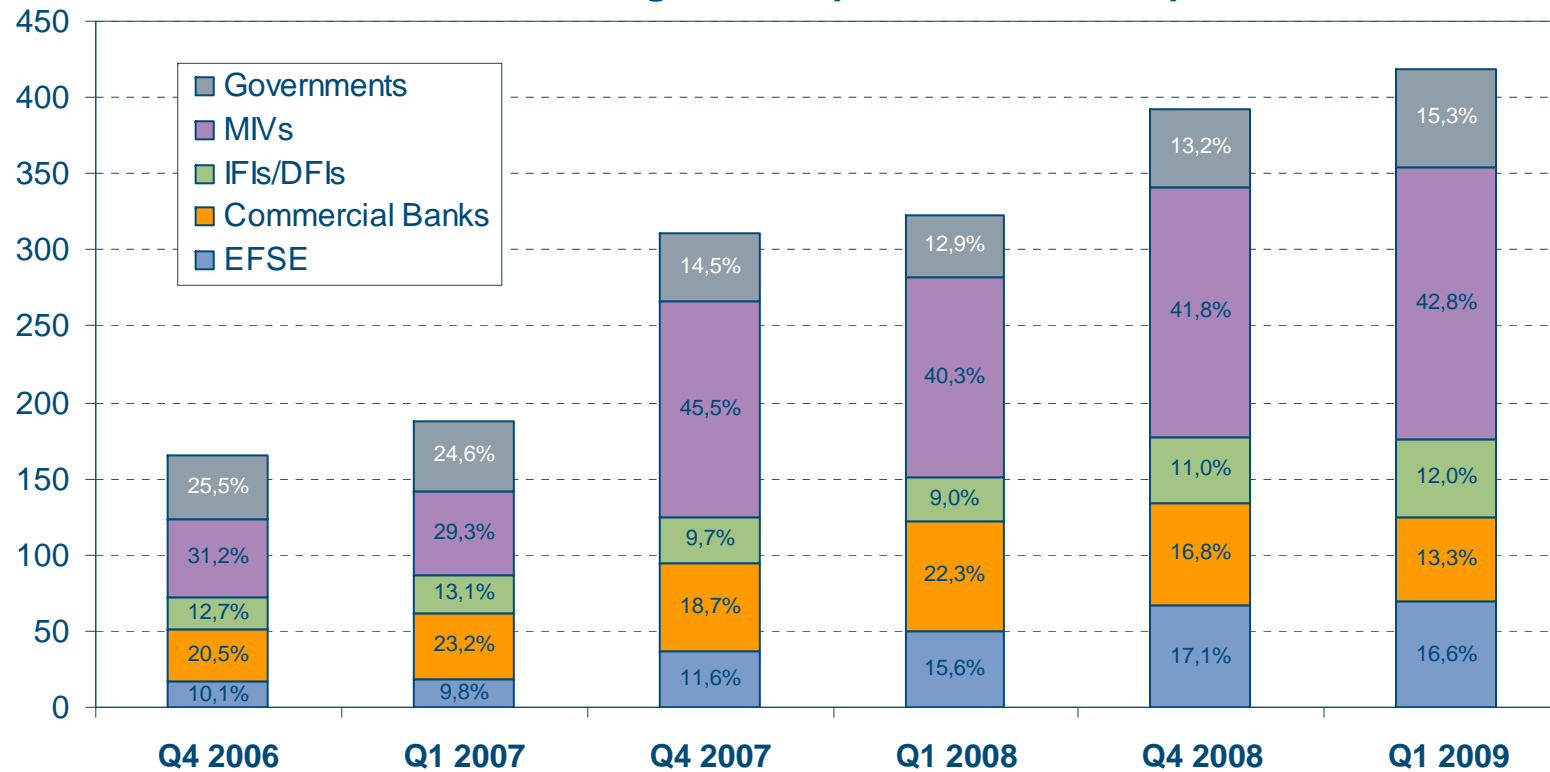
## Take-Away 4 – More Luck than proper Liquidity Management

- Funding strategy for growth not for actively managing liquidity under stress
- Limited to no liquidity risk monitoring
- No liquidity contingency plan
- Limited to no funding made available from MFI networks
- Well performing MFIs had already locked in funding for Q4/08 and Q1/09 under the assumption of future growth
- While funding from local commercial banks collapsed, private individual Funds and IFIs stepped up to the plate

# Bosnia and Herzegovina – Total Funding Volume Composition to MFIs



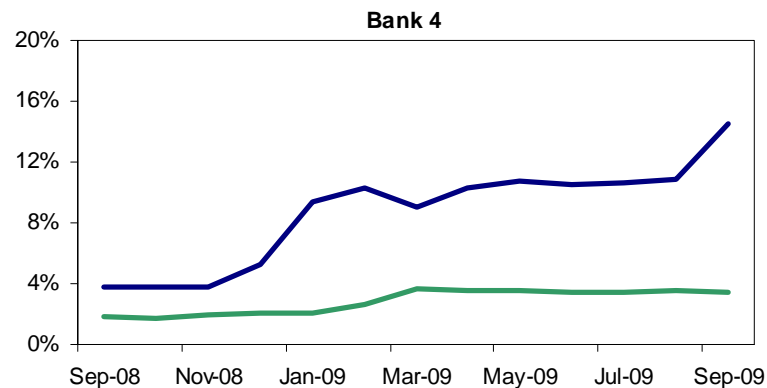
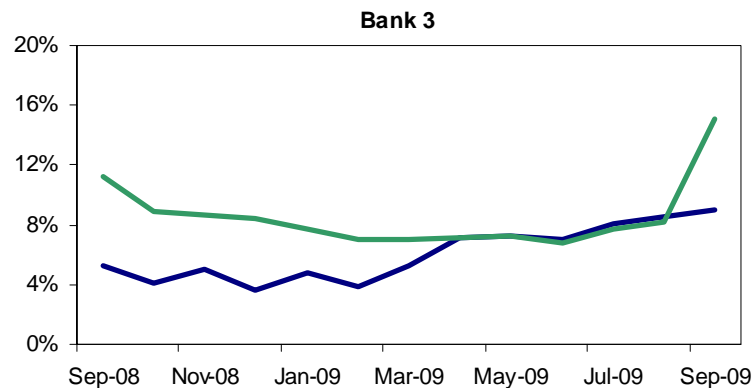
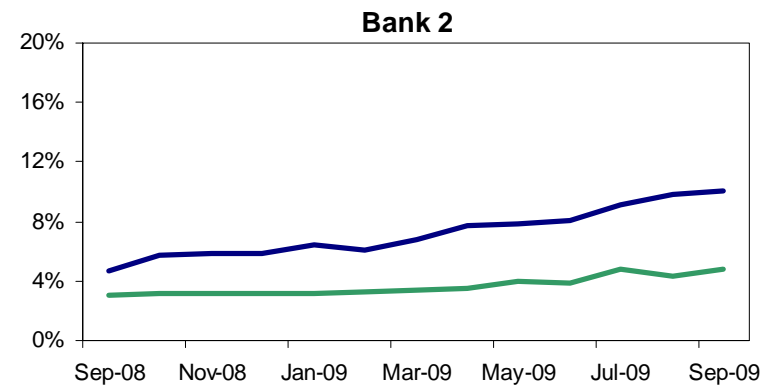
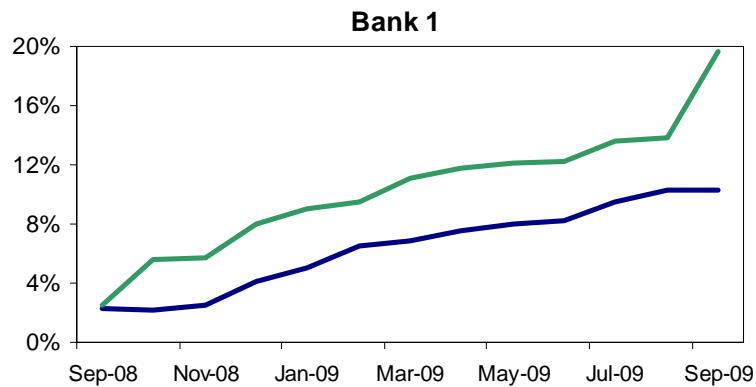
## Total Funding Volume per Investor Group



Source: EFSE PLIs

## **Asset Quality Management & Provisioning Policies**

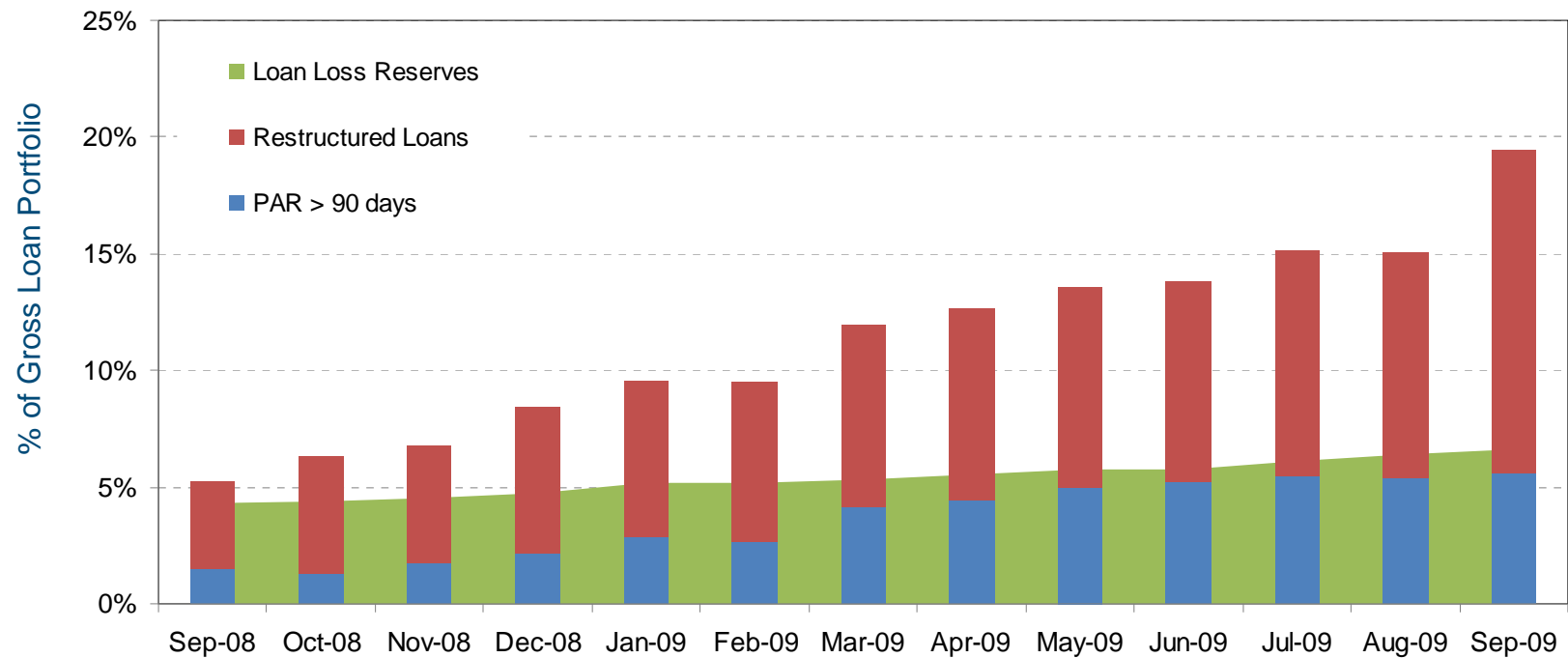
# Moldova: Different Strategies by individual Banks in dealing with Asset Quality



— NPLs as % of Gross Loan Portfolio  
— Restructured Loans as % of Gross Loan Portfolio

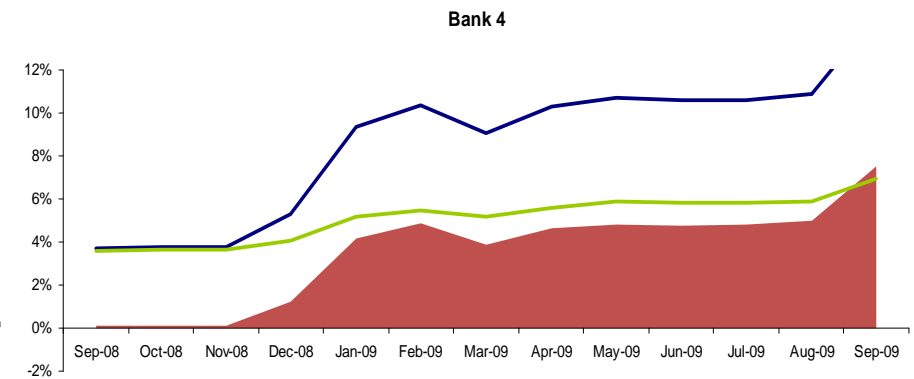
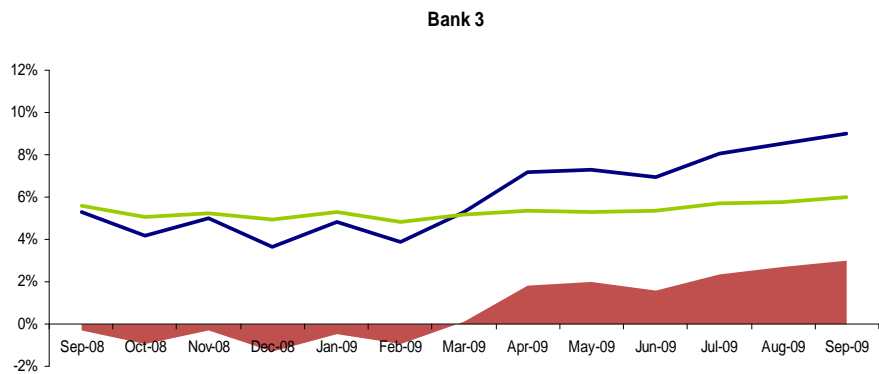
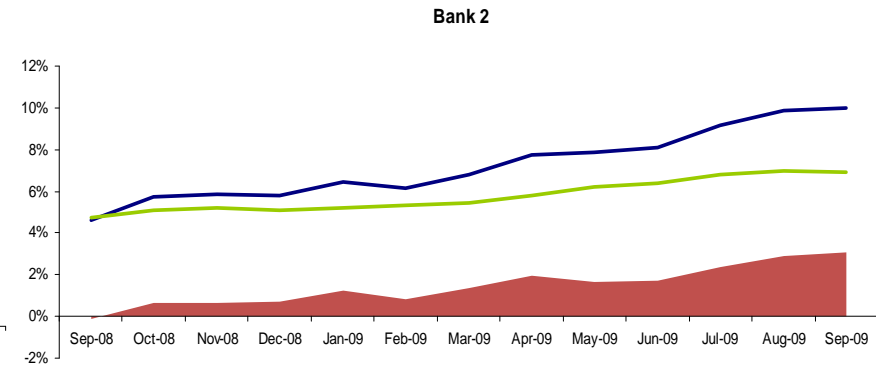
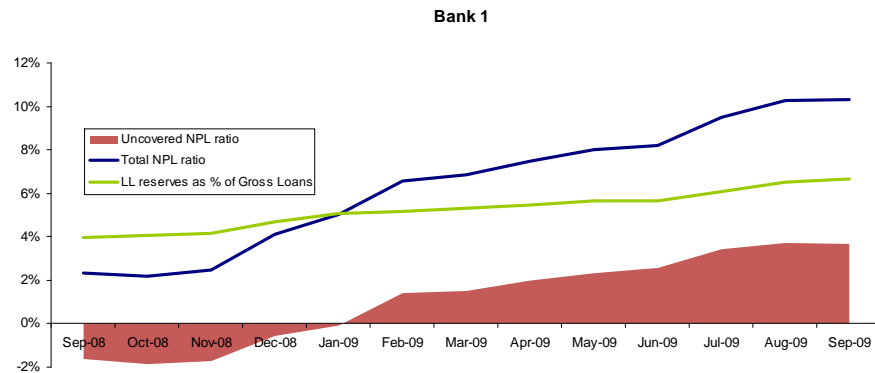
Source: EFSE PLIs

Moldova - Loan Loss Reserves Coverage of Problem Loans



Source: EFSE PLIs

# ... varying Provisioning Policies



- Uncovered NPL Ratio/Provisioning Shortfall
- Total NPL Ratio
- LL Reserves as % of Gross Loans

## **Take-Away 5 – Credit Management for the bad Times ... some mixed Results**

- Experienced credit managers and adequate systems in place
- Restructuring actively used as a commonly acceptable tool
- Collection and work-out divisions

### **However**

- Rating tools and scoring tools not crisis-proven
- Loan classification system not properly reflecting probability to default and potential loss
- Often too lax provisioning

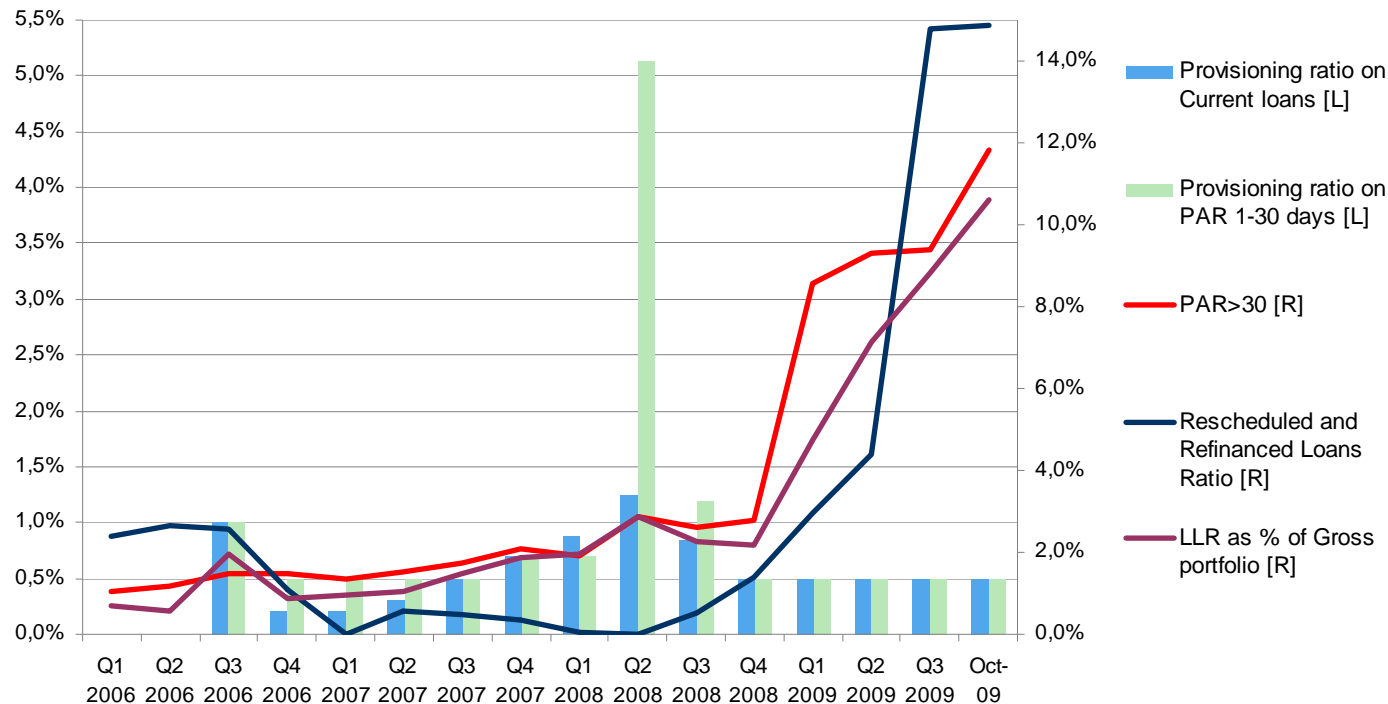
## Take-Away 6 – One-eyed Credit Management ... for good Times

- Thorough understanding of the credit risk basics
- MFIs in the region: bonanza manager generation
- Limited forward looking trend/stress analysis
- Restructuring sometimes still considered a „no go“
- Delinquency management/collection new feature
- Rapid historic growth cum decentralization of operations cum economic crisis = fraud-conducive environment
- Strive for efficiency left insufficient resources to cope with the crisis

# An MFI Example: Managing Asset Quality & Provisioning



MFI Moldova, Asset Quality and Provisioning Policy



## Take-Away 7 – Commercial Shareholders no Guarantee for sound Asset Quality Management

- Risk appetite, provisioning and capital levels do not always match
- Profit maximization vis-à-vis maximization of risk mitigation

## Managing Maturity Mismatches

## Take-Away 8 – Managing Maturity Mismatches least of Concerns

- Maturities on bank loans are shortening with the majority of long-term funding being parent and IFI funding

### EFSE Subloan Portfolio by Maturity Buckets\*

MSE	< 1 year	1-3 years	3-5 years	> 5 years
Q1 - Q3 2008	31,7%	39,5%	23,8%	5,0%
Q1 - Q3 2009	44,2%	34,1%	16,5%	5,2%

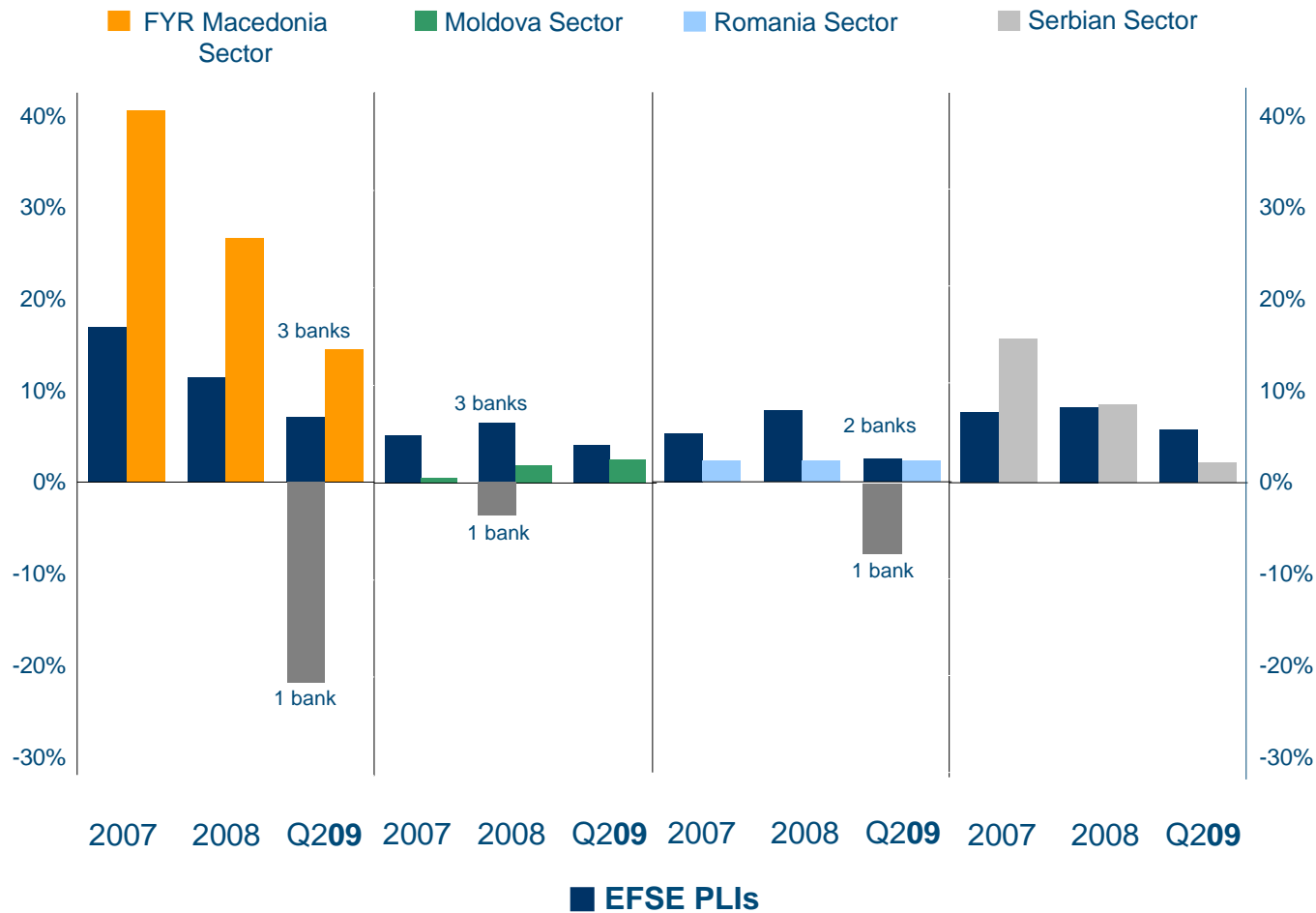
\* Subloans disbursed during the period

## Managing Open Currency Positions

# Direct Exposure to FX Risk in Banking Sector



## Foreign Exchange Open Position as % of Regulatory Capital

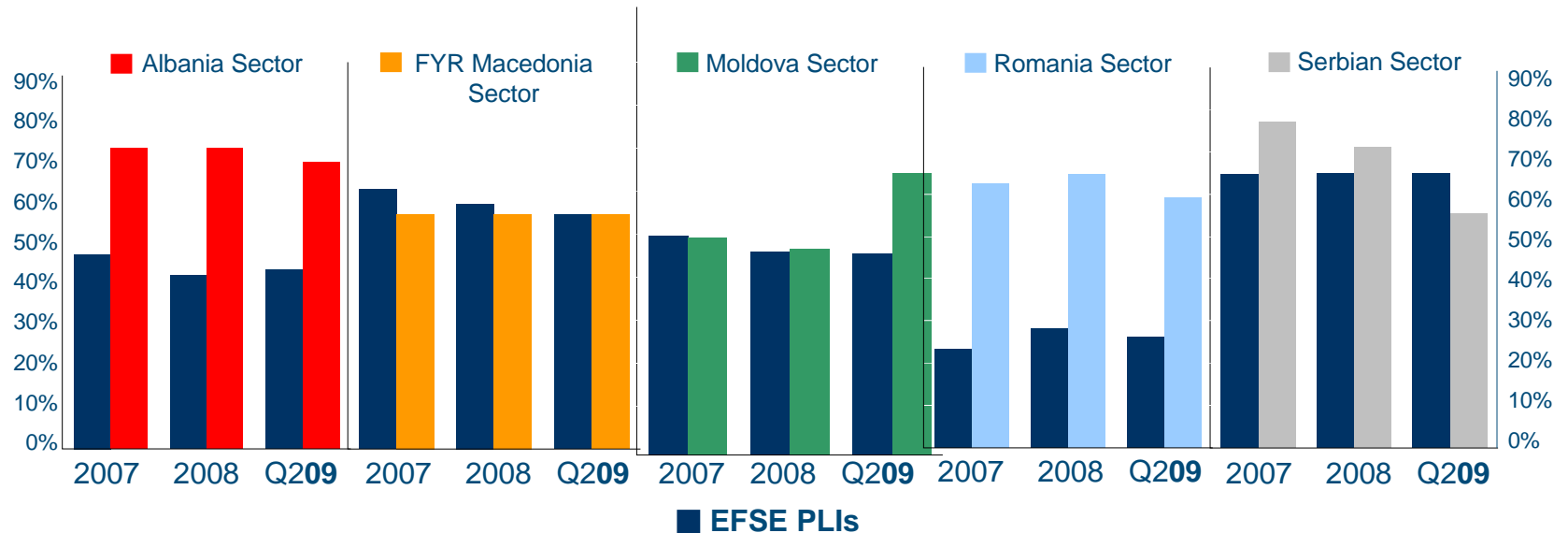


Source: EFSE PLIs, Central Banks' data, Thomson Datastream

# Indirect FX-induced Credit Risk in Banks



## Foreign Currency Lending as % of Gross Loan Portfolio



Currency Depreciation (positive change indicates depreciation)										
	ALL-USD	ALL-EUR	MKD-EUR	MKD-USD	MDL-EUR	MDL-USD	RON-CHF	RON-EUR	RSD-CHF	RSD-EUR
APR 08 - MAR 09	25.50%	6.85%	1.63%	19.37%	-10.42%	5.39%	19.30%	14.09%	21.52%	16.21%
OCT 08 - MAR 09	12.07%	6.27%	1.23%	6.75%	1.68%	7.93%	17.69%	13.20%	28.45%	23.55%
MAR 09 - SEP 09	-11.64%	1.78%	-0.39%	-13.31%	15.84%	4.91%	-4.23%	-1.79%	-3.25%	-0,93%

Source: EFSE PLIs, Central Banks' data, Thomson Datastream

## Take-Away 9 – Limited FX Gap at the cost of large FX-induced credit risk

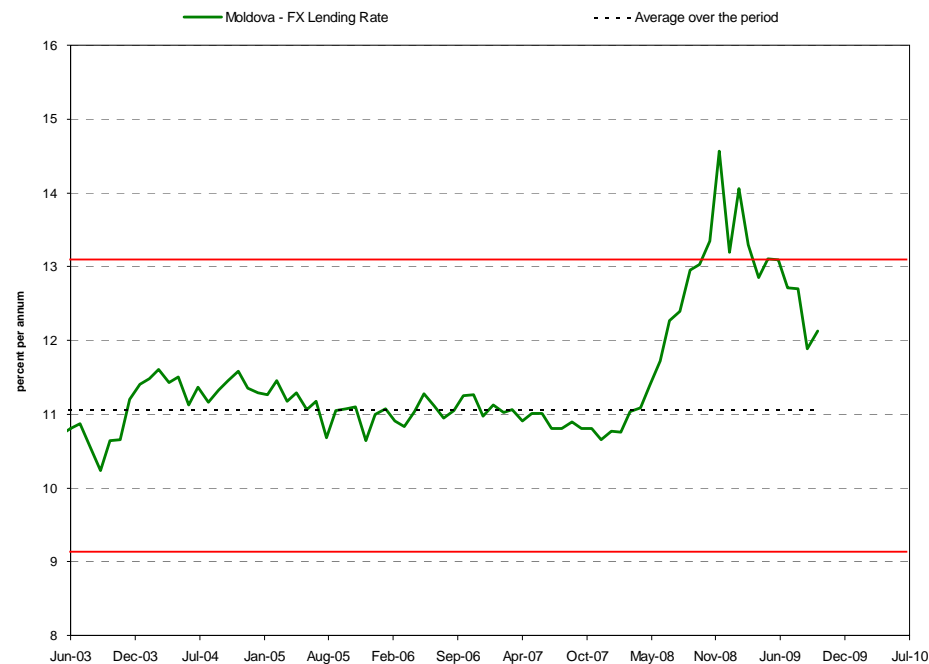
- FX gaps have been declining
- Strategic long EUR positions are often used to protect equity position in countries with expected depreciation
- VaR calculations general standard for international banks
- Very limited FX swap market – if FX swaps are available, only for short-term
- FX gaps closed primarily via FX-denominated lending
- **However** – hidden beast of FX-induced credit risk given large portion of FX or FX-indexed loans

## **Managing Interest Rate & Repricing Risk**

## Take-Away 10 – On the Radar Screen, but only a limited picture

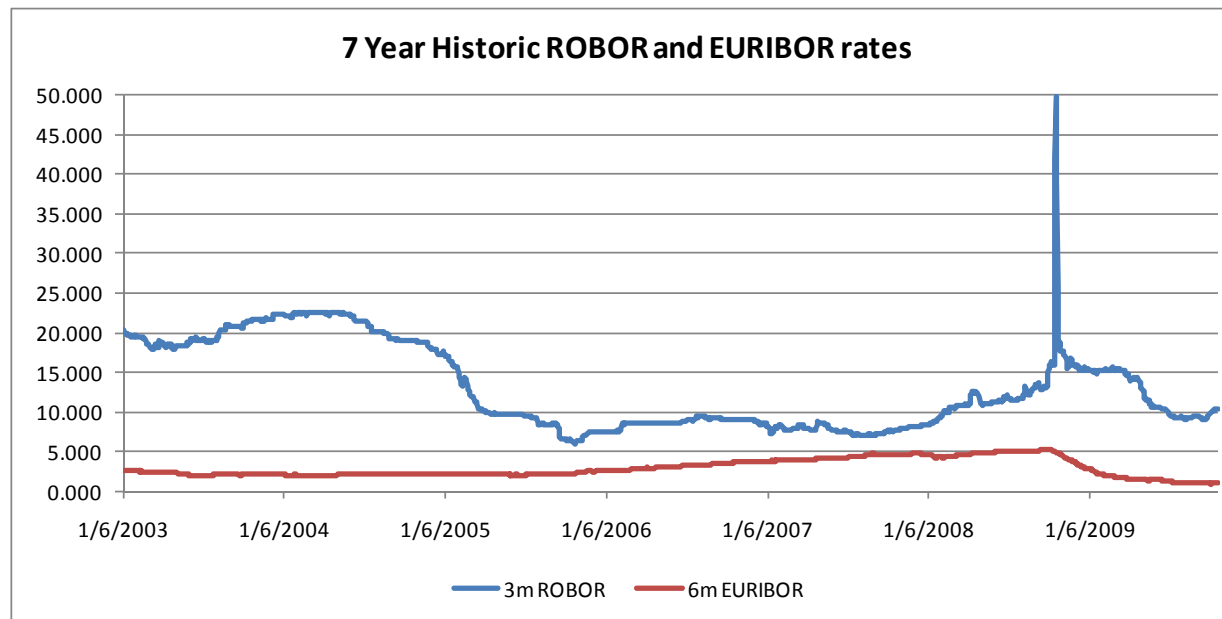
- Basic interest rate risk mitigation strategy in the absence of derivative instruments
- Banks regularly undertake interest rate risk analysis, however, often with standard parameters

Moldovan Average Lending Rates



## Take-Away 11 – Not systematically on the Radar Screen of MFIs

- MFIs do generally not measure interest rate risks
- Interest rate risk on long-term funding often not addressed

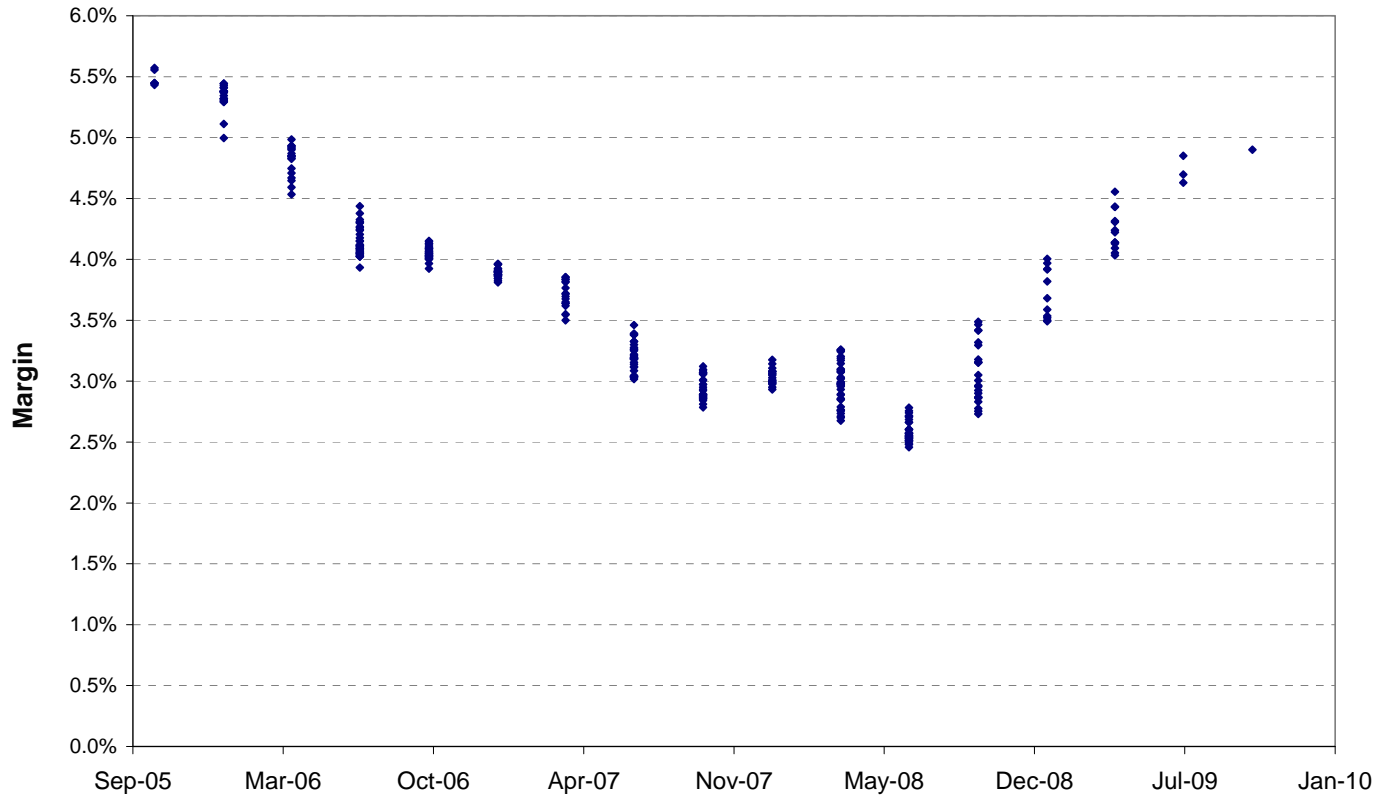


## Managing Profitability

# Importance of Refinancing Costs on Profitability



Average Marginal Funding Costs in Bosnia and Herzegovina



But ...

# Importance of Refinancing Costs on Profitability



### Average Nominal Funding Costs in Bosnia and Herzegovina



**Take-Away 12 – Profitability benefits from declining funding costs in nominal terms**

### **Take-Away 13 – Creative Profitability Management**

- Refinancing costs are not the driving factor for low/negative profitability
- High liquidity levels, sluggish lending activity and limited fee/other business activities hurt profitability
- Attempts to increase loan rates for existing loans often failed
- In some countries even lower interest rates on new loans
- Main measures to actively manage profitability levels: provisioning, operational costs

**Thank you for your attention!**