Quarantine diaries:
The impact of COVID-19 in the Greek banking sector and credit risk
Athens, March 2020
Since only few weeks ago, mankind is facing an unprecedented crisis with direct impacts on public health, way of living and economy. COVID-19 outbreak poses unprecedented challenges to human societies, policy makers, businesses and financial institutions across the globe.

This document is chiefly addressed to decision makers and banking practitioners although our hope is that it could serve as a point of reference to wider parts of the society. Its main purpose is to outline the main implications of the COVID-19 outbreak foreseen at this preliminary stage in the Greek banking sector with a focus on credit risk.

The disruption and implications of COVID-19 are already imminent in the society and economy. Rapidly changing social norms, restrictions on transportation, slowdown in the level of economic activity, possible disruptions in the supply chain, high degrees of volatility in the markets and shock in the market sentiment constitute some of the preliminary challenges to deal with. Responses from governments and regulators are intense but as the outbreak prompts high social and financial stakes with unknown outcomes at this moment, substantial adjustments and policy actions should still be expected in order to mitigate the impact of the disease in the global and domestic economies.

Despite the global nature of the outbreak, Greek banks are facing the challenge to deal with a new type of crisis after only a profound “small break” from a prolonged period of turbulence. In this context, decision makers and practitioners need to understand the implications of the outbreak caused as a result of COVID-19 and manage effectively the risks stemming from it in order to ensure resilience. At this moment no one can provide a reasonable estimate about how long the outbreak will last and as such timely responses are necessary.

With the aim to tread along these unfamiliar paths with confidence, holistic approaches are needed in order to mitigate the impact of this “black swan” event to the degree possible. If the common goal, is to preserve social and financial stability and resilience in this turbulent era, it is in our joint interest to help motivate all forces available to win this battle.

“Οἱ ἄνθρωποι γνωρίζουν τὰ γινόμενα. Τὰ μέλλοντα γνωρίζουν οἱ θεοί, πλήρεις καὶ μόνοι κάτοχοι πάντων τῶν φώτων. Ἐκ τῶν μελλόντων οἱ σοφοὶ τὰ προσερχόμενα ἀντιλαμβάνονται. Ἡ ἀκοὴ αὐτῶν κάποτε ἐν ὥραις σοβαρῶν σπουδῶν ταράττεται. Ἡ μυστικὴ βοὴ τοὺς ἔρχεται τῶν πλησιαζόντων γεγονότων. Καὶ τὴν προσέχουν εὐλαβεῖς. Ἐνῶ εἰς τὴν ὁδὸν ἔξω, οὐδὲν ἀκούουν οἱ λαοί”.

Σοφοί δὲ προσιόντων, Κ. Π. Καβάφης
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01. Background information
Background - the chronicle of COVID-19 outbreak

Developments related to the dispersion of COVID-19 as well as responses from Governments and regulators are rapid. The period that the outbreak will last is definitely critical for its impact in public health and economy.
Background – country by country case trajectories comparison

Timely and strict application of rules, community responses as well as intensity of test and trace programmes represent the main drivers of case trajectories.

- The pace of dispersion in Greece is slower than other benchmark countries mainly due to the imposition of strict and timely precautionary measures (closure of schools, businesses e.t.c.) and quarantine rules.
- However, as the intensity of test and trace – programmes differs significantly on a country by country basis reasonable conclusions are yet to be drawn.

Data source: European Centre for Disease Prevention and Control, Graphic: Deloitte FRM intelligence team

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02. Economic impact of COVID-19
Economic impact of COVID-19 outbreak could affect global and Greek economy on the basis of four main ways:

**Direct impact on production**
Production has already been substantially affected by the shutdown in many countries globally including China. In Greece the closure of businesses has led the BoG to adjust its expectations for GDP growth at -4% for 2020 under the baseline scenario.

**Supply Chain and market disruption**
Many firms rely on imported intermediate inputs from countries affected by the disease. The slowdown in economic activity – and transportation restrictions could result to shortages in goods if the outbreak continues for several months. Businesses tied to travel, leisure and tourism activities.

**Impact on markets**
Significant volatility and decline in equity and bond markets should be expected. The real estate market in Greece would also be affected since demand from overseas (e.g. Golden Visa, Airbnb rentals) might decline for a considerable period of time.

**Psychology**
Market sentiment is low under this unprecedented shock. Both consumer and investor confidence are expected to decline as a result of the market turmoil. However, internal movement restrictions could have an opposite impact in consumption when the measures stop.
03. Regulatory response to address the challenges of COVID-19
Regulatory responses to address the challenges of COVID-19

The ECB announced a set of short-term measures in order to address the challenges caused by COVID-19 by EU-wide level banks.

### Flexibility in prudential treatment of government backed loans
- Exercise flexibility regarding the classification of debtors as “UTP” when Banks rely upon public guarantees granted in the context of COVID-19.
- Flexibility towards the implementation of NPL reduction strategies which are considered difficult to attain and unrealistic due to the circumstances.

### Capital and liquidity relief
- Postpone by six months, the existing deadlines for remediation of OSI, TRIM findings and the Verification of compliance with qualitative SREP measures.
- Banks will be allowed to operate below the P2G level and LCR and to frontload the rules on the composition of P2R originally scheduled to come into force in 2021 with CRD V.

### Avoid procyclicality of IFRS 9
- Postpone the EBA stress test exercise for 2021 and postpone by six months, the issuance of TRIM decisions, OSI follow-up and internal model decisions.
- Banks should give a greater weight to long-term stable outlook evidenced by past experience when estimating ECL in order to avoid excessive procyclicality.

### Preferential treatment in terms of supervisory expectations about loss provisioning (NPL backstops) for loans that become NPE and are under public guarantees (zero loss coverage for the first 7 years).

Central macroeconomic scenarios will be provided by the ECB to support Banks in applying IFRS 9.

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The impact of COVID-19 in the Greek banking sector and credit risk
Regulatory responses to address the challenges of COVID-19
In the same direction, the EBA announced a number of considerable relief measures in the application prudential framework as follows:

Default classification
- Classification of default is performed where economic losses are likely to take place.
- Public and private moratoria should be treated similarly, to the extent they have similar characteristics.
- Renegotiations should not result to diminished financial obligations in order to avoid classification to default status.
- The assessment of the unlikeliness to pay criterion should refer to the modified schedule of payments in case of modifications due to COVID-19 and not on the original one.

Forbearance
- General relief measures granted to borrowers to mitigate the impact of COVID-19 (e.g. payment holidays) do not automatically trigger forbearance classification.
- As the moratoria represent responses to tackle the systemic risk of COVID-19 in the EU wider economy and the measures are not borrower specific they do not normally meet the EBA’s definition of forbearance.

IFRS 9 considerations
- The exercise of judgment is encouraged in order to avoid mechanistic approaches in the identification of SICR.
- The application of public or private moratoria aiming to address the adverse systemic economic impact should not be considered automatically as a trigger for SICR.
- Excessive levels of procyclicality should be avoided by following a long term view where relevant.
- Segmentation of borrowers among those who their credit granting would not be significantly affected in the long term and from those that would be unlikely to restore their credit worthiness is essential.
Regulatory responses to address the challenges of COVID-19

EBA guidelines on legislative and non–legislative moratoria

01 The moratorium was launched in response to COVID-19 pandemic

Deadline for the application of moratorium has been set on 30 June 2020

02 The moratorium has to be broadly applied

The moratorium is either based on applicable national law or on a relief initiative of an institution as part of an industry wide agreement

03 The moratorium has to be applied to a broad range of obligors

The moratorium applies to a large group of obligors without the assessment of their creditworthiness. The scope might be limited to performing obligors

04 The same moratorium offers the same conditions

The same conditions are offered to all loans subject to the moratorium

05 The moratorium changes only the schedule of payments

No other terms or conditions of the loans subject to moratorium should be changed except from schedule of payments

06 The moratorium does not apply to loans granted after its launch

New loans granted after the date the moratorium was announced are outside of its scope

Conditions

For general payment legislative and non–legislative moratoria in order not to be considered forbearance

The moratorium was launched in response to COVID-19 pandemic

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The moratorium has to be broadly applied

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Key considerations for credit committees

Key considerations for credit committees in order to proceed with approvals of renegotiations/modifications as part of either legislative and non-legislative moratoria as well as new lending arrangements to customers are as follows:

**Compliance with the criteria set by EBA on moratoria**
- Adherence to EBA GLs on legislative and non-legislative moratoria is key in order to take advantage of the regulatory relief measures and avoid forborne and non-performing classification.
- In case of massive modifications, the amounts suspended, postponed or reduced because of the application of moratorium as well as the obligors and specific exposures should be well documented.

**Economic Loss considerations**
- Renegotiations and modifications should be limited to changes in the schedule of payments and shall not result to economic loss.
- This means that the NPV of cash flows pre and post modification should remain almost the same.
- In case that the modification results to economic loss the analysis should include also the associated impairment charges.

**Renegotiations tailored to specific clients**
- Tailored made solutions to specific clients would not fail under the scope of relief measures announced by EBA and as such they might trigger forbearance or default classification.
- In case of renegotiations of contractual terms as part of the normal business the approval decision should be based on a formal analysis presenting the facts and circumstances of the renegotiation and whether or not the reason behind it stems from financial difficulties of the obligor.

**New lending arrangements**
- New lending arrangements should follow normal credit policies and should be based on creditworthiness assessments taking into account associate public guarantees if relevant.
- The use of existing credit lines or renewal of revolving loans is not considered a new loan.
- Granting new loans to an obligor under the moratorium does not automatically lead to forbearance classification, although conditions should be assessed case by case.

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04. NPE target plan implications
NPE target plan implications
NPE plans should be re-assessed as targets have become difficult to attain given the current circumstances. The degree of flexibility will be assessed on a case by case basis by the JSTs.

NPE outflows due to recoveries (cures)
Recoveries (cures) from non-performing debtors are expected to decline due to the economic turmoil.

Planned recoveries

![Image](XX% Lower)

Actual recoveries

NPE outflows due to Significant Risk Transfers
NPE outflows due to SRT transactions (securitizations) might be postponed or cancelled due to the current market outbreak. Main considerations include the following

1. Changes in the appetite to undertake risks
   Due to the economic outbreak counterparties (servicers, funds etc.) might experience lower appetite to undertake the risk of portfolios subject to securitization.

2. Re-assessment of terms of the transaction
   As the profitability of the counterparty (servicer, fund etc.) depends on the portfolio recoveries, the terms of the transaction might be less favorable compared to pre-COVID-19 outbreak era.

NPE outflows due to litigations and collateral liquidation
The following considerations are relevant as the crisis deepens:

1. Changes in the legal environment
   As the crisis deepens policy measures in order to protect borrowers (e.g. legal moratoria) could be expected.

2. Decline in the value of collaterals
   In case that the outbreak lasts for several months, a decline in the value of collaterals would be expected as a result of limited demand and stress.

New NPE formation
Despite the flexibility offered by the ECB and EBA in the application of Default, the decline in economic activity and closure of certain businesses might lead to increase in the New NPEs. SME, SME retail as well as consumer portfolios are expected to experience a greater impact.

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05. IFRS 9 ECL Measurement
IFRS 9 ECL measurement considerations

### Key consideration of IFRS 9 impact under economic stress

<table>
<thead>
<tr>
<th>Portfolio characteristics</th>
<th>Migrations from 12m ECL to LECL</th>
<th>Scenario Forecast considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Certain characteristics make some portfolios more susceptible to impacts under conditions of financial stress.</td>
<td>Despite the flexibility offered by the regulators, credit quality tends to deteriorate under stress. As such migrations to stage 2 should be expected, leading to an increase in impairment.</td>
<td>Forecasting IFRS 9 requires firms to take a view on forward looking expectations of the economic conditions during the lifetime of loan portfolios.</td>
</tr>
</tbody>
</table>

**Asset class/industry:** Some asset classes (e.g. SME retail, consumer) are more vulnerable to changes in the economic environment. Furthermore, certain industries have been hit more severely by the crisis than others.

**Tenor:** Longer maturity products (e.g. mortgages), both contractual and behavioural, will attract higher lifetime expected losses.

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**Focus on loans subject to relief measures due to COVID-19 outbreak...**

- Both the ECB and EBA announced flexibility in the treatment of loans subject to relief measures (i.e. repayment holidays) for the purposes of IFRS 9.
- The ECB has announced that it will exercise flexibility regarding the classification of those borrowers as Unlikely to Pay (Stage 3).
- In addition, in accordance with the EBA repayment holidays should not automatically, other things being equal, trigger forbearance and migration to Stage 2.
- However, it should be noted that as the outbreak transmits to real economy it is unlikely to let asset quality unaffected.

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**...and on procyclicality**

- ECB encourages Banks to avoid excessive procyclical effects when measuring ECL.
- In the absence of reasonable and supportable information at this moment, a greater weight should be given in the long-term stable outlook evidenced by past experience which is likely to be challenging to prove for the case of Greece.
- Economic support measures announced by global fiscal and monetary authorities should be taken into account when forming future forecast.

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06. Impact on modelling practices
Impact on credit risk modelling practices

Amendments to credit risk models in terms of calibration and updated forward looking information should be expected. However, Greek Banks should avoid procyclicality in their estimates to the degree possible.

<table>
<thead>
<tr>
<th>Impact</th>
<th>Data</th>
<th>Key Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exposure at Default</td>
<td>Data granularity should be kept at a maximum. All new COVID-19 related modifications should be flagged separately to allow future tracking if needed.</td>
<td></td>
</tr>
<tr>
<td>Probability of Default</td>
<td>Further portfolio segmentations might be relevant for model development purposes.</td>
<td></td>
</tr>
<tr>
<td>Loss Given Default</td>
<td>Point in time (PiT) calibration using the most recent available data.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Possible post – model adjustments (management overlays) in order to incorporate information from vintages that have not yet matured.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Additional scenarios could be used to capture “tail risks” instead of changing dramatically existing ones.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Scenario weights might need re-assessment as the Management’s view and Appetite might be subject to change due to the crisis.</td>
<td></td>
</tr>
</tbody>
</table>

Key considerations

- **Model risk** is expected to increase as model estimates might be prone to errors due to the shocks in the external environment.
- The expected new stock of NPEs could have a detrimental impact in terms of **model accuracy** and **calibration** levels of credit risk models.
- **Stability** is expected to decline as distribution drifts among different grades or pools due to changes in the risk profile of borrowers/facilities.
- As a result from the changes in population stability, discriminatory power is expected to diminish with the passage of time.
## 07. Regulatory capital impact

<table>
<thead>
<tr>
<th>Stock</th>
<th>Price</th>
<th>Change</th>
<th>Volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>SPINC</td>
<td>4.44</td>
<td>-0.45</td>
<td>24,300</td>
</tr>
<tr>
<td>29</td>
<td>484</td>
<td>+0.83</td>
<td>1,220,900</td>
</tr>
<tr>
<td>2.02</td>
<td>64.5</td>
<td>-0.77</td>
<td>4,319,600</td>
</tr>
<tr>
<td>6.95</td>
<td>+1.46</td>
<td>577,100</td>
<td></td>
</tr>
</tbody>
</table>
## Regulatory capital impact

In order to mitigate the impact in the regulatory capital regulators have undertaken significant capital relief measures including flexibility to operate below the P2G level and to frontload the rules of the composition of P2R originally scheduled to come in force in 2021.

<table>
<thead>
<tr>
<th>Capital Requirements</th>
<th>IFRS 9 Impact on Standardised Assets</th>
<th>IFRS 9 Impact on IRB Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pillar 1</strong></td>
<td>New specific IFRS 9 provision stock x STA RW x 8%, if there is no increase in defaulted assets.</td>
<td>✗ No impact on performing and/or F-IRB assets</td>
</tr>
<tr>
<td><strong>Pillar 2 Buffers</strong></td>
<td>✗ Capital relief has been granted as Banks will be allowed to operate below the P2G level and as such the risk of a larger depletion of surplus capital, which would translate into a larger capital buffer has been mitigated.</td>
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</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital Resources</th>
<th>Reduction in quality of capital</th>
<th>Reduction in quality of capital</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tier 1</strong></td>
<td>✪ 1:1 New general IFRS 9 provision stock</td>
<td>✪ 1:1 New general IFRS 9 provision stock, if IFRS 9 EL &gt; Basel EL, no change otherwise</td>
</tr>
<tr>
<td><strong>Tier 2</strong></td>
<td>✴ 1:1 New general IFRS 9 provision stock, subject to 1.25% RWA ceiling and any further changes in regulatory rules</td>
<td>✴ 1:1 New IFRS 9 provision stock, subject to 1.25% RWA ceiling, if IFRS 9 EL &gt; Basel EL, no change otherwise</td>
</tr>
</tbody>
</table>

Banks might suffer from a decline in regulatory capital although ECB stated explicitly that Banks should avoid excessive levels of procyclicality in order to mitigate impact to regulatory capital due to the increase in IFRS 9 provisions. In addition, Banks not opted for the IFRS 9 transitional arrangement are allowed to do so now.
08. Appendix: Deloitte Contacts