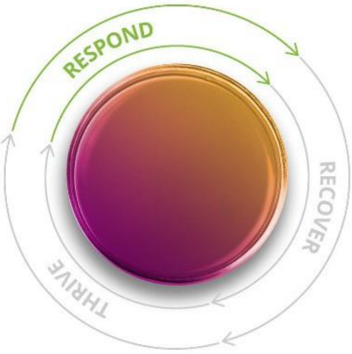

Combating COVID-19 with resilience

Banking and Financial Services

Not a banking and financial sector crisis but an economic disruption which can lead to one

COVID-19 has emerged as the black swan event of the century, with significant macroeconomic impact both globally and in India. However, the current crisis is different from the one we faced in 2007 – 08, as it is driven by disruptions in the real economy and not the financial system. Moreover, our financial system is more resilient than it was a decade ago, primarily due to various initiatives taken by the government and regulators—resulting in improved capital adequacy, credit worthiness, and asset quality. As we think about potential policy interventions to combat the economic fallout of COVID-19, we need to ensure that lending standards are not diluted and the overall asset quality of bank portfolios are maintained.

In the current environment, the Government and RBI can play a substantive role in facilitating support from banks and financial institutions to enable borrowers to ride out the resultant slowdown.

What's in store for the sector

Immediate implications

While the sector prepares to provide support to businesses and corporates, retail customers, employees and society at large, this is expected to put a strain in many ways. As financial services companies are mobilising and taking steps to minimise these impacts, they will likely face implications that they need to consider.

1. **Disruption in banking operations and service continuity:** With the sector facilitated by a network of over 1.5 lakh branches and serviced by 14.5 lakh bank employees, the lockdown has impacted customer reach and quality of services, which may lead to lower bank profitability.
2. **Strain on capital adequacy and other prudential norms:** With possible adverse impact of the economic slowdown on borrowers' condition, prudential norms of banks including capital adequacy may also take a resultant hit.
3. **Depleting liquidity and mounting debts in the MSME sector:** Due to large scale supply chain disruptions and relocation of labor, corporates, particularly MSMEs are likely to face a potential liquidity management and debt servicing problem.
4. **Export and import related vulnerability:** Near lock down and quarantine in the main export destinations like US and Europe have increased the financial vulnerability of the export sector and underlined the need for additional financial support.
   - Volatile exchange rates: A weakening rupee could burden importers with unintended costs and adversely impact the operating profit.

Formulating response to the crisis

1. Set up a national cloud infrastructure and augment ATM networks to enable uninterrupted branch services

- Build and strengthen the government's cloud initiative, **"Meghraj"**, to include a dedicated banking cloud platform for all banks, including regional rural banks, cooperative banks, Micro-Finance Institutions and NBFCs, to improve on financial inclusion.
  - A cloud based solution can (a) enable bank employees to work remotely, (b) establish connected contact centres, and (c) result in rapid scaling up of branches.
  - Add more ATMs including biometric enabled ones, with regular servicing of 24*7 bank transfers.

Case in point: Adoption of a cloud based strategy enabled a large global banking conglomerates to cut down installation time for its more than 20,000 internal applications from 45 days to less than 20 minutes for all new branches[1]

2. Relax current norms relating to Risk Weights and give credit expansion

- Most of the banks currently have adequate capital adequacy[2], with private sector banks typically having a higher capital adequacy ratio. Accordingly, a larger share of credit expansion could be organised through private sector banks.

- The government/RBI may consider relaxing current norms on external credit ratings on risk-weighted assets basis to allow for any short-term stress resulting from the current economic downturn.

Case in point: On March 11,2020 the Bank of England lowered capital requirements for UK banks, by reducing the "counter cyclical capital buffer rate " to 0% of exposures to UK borrowers from the original 1%[3]

3. Ensure adequate credit availability to corporates and MSMEs

- Release a substantial portion of the pending payments to corporates and SMEs, estimated at Rs. 48,000[4] Crores —either payments currently under processing, advances, or any payments / projects under dispute. Issue similar advisories to large corporates.
- Consider releasing advance subsidy payments for 1 month for all interest subsidies as well as sectors like food and fertilizers, which would amount to around ~INR 21,800 Cr., given annual budgetary outlay of Rs. 262,000 Cr.[5]
- Provide enhanced and value-added credit guarantee support through the CGTMSE scheme facilitating increased lending.

Case in point:
The US COVID-19 economic stimulus package includes USD 376 billion of additional financial support for small businesses and their employees.[6]

4. Encourage exports through exporter-specific schemes

- Boost emerging sectors through special export incentives (financial and non-financial)
- Support exporters by providing bridge financing (supply chain / working capital) for the next 12 to 18 months to make up for the lack of finance due to global liquidity problems.
- Manage overall forex volatility through intermittent market intervention to stabilise Indian Rupee to reduce the operating cost (import of goods & services in 2018 was 23.64% of GDP[7]).

Case in point:
Canada, under its COVID-19 economic stimulus package, has provided additional funds of 40 billion Canadian Dollars under the newly established Business Credit Availability Program. These funds, to be provided through the Business Development Bank of Canada and Export Development Canada will be used to extend loans and guarantees to exporters and SMEs.[8]

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[1] Source: https://www2.deloitte.com/uk/en/pages/financial-services/articles/getting-cloud-right-how-can-banks-stay-ahead-of-curve.html
[2] Source: Reserve Bank of India Financial Stability Report, December 2019
[3] Source: https://www.bankofengland.co.uk/news/2020/march/boe-measures-to-respond-to-the-economic-shock-from-covid-19
[4] https://economictimes.indiatimes.com/small-biz/sme-sector/choked-by-dues-what-efforts-are-being-taken-to-ease-the-biggest-problem-faced-by-indian
[5] https://www.indiabudget.gov.in/doc/eb/stat7.pdf
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[7] Source: https://data.worldbank.org/indicator/ne.imp.gnfs.zs
[8] https://www.canada.ca/en/department-finance/economic-response-plan.html

Contacts:

Deloitte Touche Tohmatsu India LLP

Acknowledgements:

Sanjay Kumar

Arindam Guha

Sanjoy S. Datta