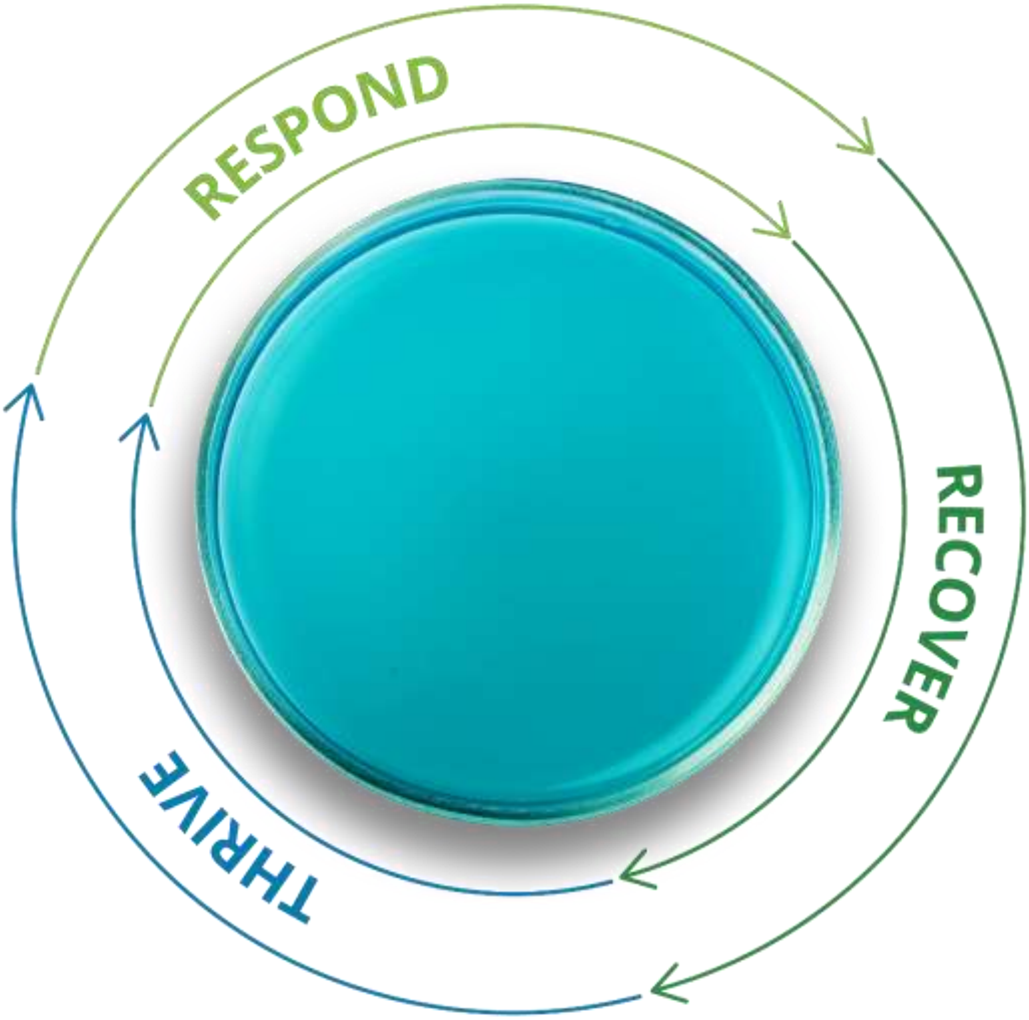
Deloitte.




# Flattening the curve

## Impact on the Indian banking and capital market industry

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# Introduction

The global COVID-19 pandemic has emerged as a "black swan" event and will require extraordinary measures from governments across the globe to re-ensure economic stability.

Globally, the pandemic has infected thousands of people in at least 190 countries and territories, according to the World Health Organization.[1] As the immediate containment of the virus requires firm measures of quarantine and isolation, this has disrupted world economy in an unprecedented way.

The Organisation for Economic Co-operation and Development (OECD) has halved the global gross domestic product (GDP) growth projection for 2020 due to the virus outbreak.[2] Based on when the pandemic is likely to come under control, several economic scenarios indicate global recession of varying magnitudes.

One far-reaching implication of the pandemic is that it is likely to change the world economic order. Economies that are able to "flatten the curve" in terms of containing the pandemic and showing resilience in resuming their consumption, manufacturing, and minimising disruptions to their global supply chains are more likely to gain a larger share of the world GDP growth in the coming decade. The pandemic is expected to redistribute global wealth in terms of GDP growth and trade share.

The situation has hit the Indian economy at a time when growth has slowed to the lowest in a decade. In the recent past, there were some signs of green shoots of recovery in the Indian

1 https://www.who.int/emergencies/diseases/novel-coronavirus-2019

2 https://economictimes.indiatimes.com/wealth/invest/stock-market-hit-by-coronavirus-reasons-for-turmoil what-equity-investors-should-do-now/articleshow/74623291.cms

economy. However, the impending outbreak of the virus is expected to severely delay the start of the recovery process.

While currently India still seems to be relatively insulated from large-scale infections, unless otherwise contained owing to the government's public health interventions, it is likely to grow exponentially. Economies across the world have come up with fiscal stimulus emphasising on quantitative easing; lowering interest rates, and relaxation of regulatory reserves for banks, tax incentives, government guarantees, subsidies, mortgage holidays, and bailout packages. There have been coordinated international efforts by several countries and international bodies to tackle the impact of the pandemic as it becomes imperative that governments come together and launch a coordinated effort to restore global stability.

The Indian Government and other authorities have announced immediate relief actions to tackle the impact of the pandemic on the Indian economy. The honourable Prime Minister, Narendra Modi has set up a special economic task force under the leadership of the finance minister. The task force has already announced a set of action items, and will continue do so for economic stimulus to mitigate the impact of the pandemic on the economy.

The Indian banking and capital markets sector will have to deal with the crisis in a manner never seen before. With the thrust on ensuring business continuity/contingency plans, this sector need to emerge as responsible institutions and ensure the safety and security of their employees, customers, and the society.

This note provides a brief overview of the impact that the pandemic is expected to have on the banking and capital markets sector, and recommendations related to "flattening the curve" for these institutions that could help support the industry to find resilience during this period as well as be prepared for faster recovery.

# Mapping the economic impact

Novel COVID-19 (the virus or the pandemic) is perceived to be the largest threat to the global economy since the 2008 financial crisis, as the economic upheaval resulting from the pandemic is mounting. With every passing day, the impact of the virus on economies is rising and the threat of a global recession looms. As nations are closing their borders, shutting down businesses, and imposing social distancing norms, short-term decline in economic growth has already been factored in by governments and central banks. However, the domino effect of the shutdown is difficult to comprehend.

There exists numerous ways in which the spread of the pandemic is affecting the global economy. The four main areas that are expected to be affected are supply chain, global and domestic demands, falling oil prices, and the financial impact on firms and financial markets especially due to increased stressed assets.

The global GDP growth projection for 2020 has been halved from 2.5 percent to 1.3 percent.[3] With the virus affecting manufacturing and travel sectors, the International Energy Agency (IEA) has predicted the first drop in global oil demand in a decade besides other country specific projections.[4] Economists expect China's growth rate to slump to 4.5 percent in the first quarter of 2020 from 6 percent in the previous quarter.[5] The Eurozone economy is expected to shrink by 0.1 percent in 2020, down from the previously expected 1 percent growth.[6]

Fear surrounding the impact of the pandemic on the global economy has hurt investor sentiment and brought down stock prices in major markets. In the US, the 10-year treasury yield fell from 1.69 percent to below 1 percent for the first time in 150 years, after remaining steadily around 1.7 percent to 1.8 percent throughout 2019 and early 2020.[7]

### Global initiatives of governments and central banks

The governments and central banks around the world have implemented various relief measures to stimulate their economies and calm markets. The relief measures announced by governments and central banks have been tailored according to the disruptions caused by the pandemic to their respective economies. However, the underlying themes driving these measures are relatively similar, viz. quantitative easing, lowering interest rates, relaxation of regulatory reserves for banks, tax and compliance incentives including deferments, interest free loans backed by government guarantees, wage subsidies, mortgage holidays, and most importantly bailout packages for the worst affected industries.

The guiding principles for governments and central banks to come out with these measures seem to be reducing volatility in the markets, ensuring adequate liquidity through monetary policy and other measures so that money supply is not constrained, i.e., the money supply is available to all sections of society and businesses. Another common theme across these relief measures is to reduce the impact of this economic upheaval on the weaker sections of society and uplift the Micro, Small & Medium Enterprises (MSME) industry participants and try to endure and enable large corporations to overcome these disruptions and guide them back to normality. While more initiatives may be announced in due course, some of these initiatives have been highlighted in Figure 1.

3 https://www.fitchratings.com/site/pr/10114929

4 https://economictimes.indiatimes.com/markets/commodities/news/oil-demand-set-for-first-contraction-since-2009-due-to-coronavirus-iea/articleshow/74560779.cms?from=mdr

5 https://www.reuters.com/article/us-china-health-economy-poll/chinese-economy-clobbered-by-coronavirus-but-set-to-recover-soon-reuters-poll-idUSKBN20801H

6 https://economics.rabobank.com/publications/2020/march/coronavirus-likely-to-push-eurozone-economy-into-recession/

7 https://www.americanprogress.org/issues/economy/news/2020/03/06/481394/economic-impact-coronavirus-united-states-possible-economic-policy-responses/

**Figure 1: Initiatives across countries announced by governments and central bank**

| Country | Select initiatives to tackle COVID-19 |
|---|---|
| **United Kingdom** | • **The UK Government** has announced a £30 bn (US$39 bn) stimulus package to support the economy through the outbreak.[8]<br>• **The Bank of England** has cut interest rates in the UK to the lowest level in the bank's 325-year history, from 0.75% to 0.25%.[9] |
| **USA** | • The **US Federal Reserve** has coordinated with central banks in Japan, Australia, and New Zealand in a joint-effort not seen since the 2008 financial crisis, to cut its key interest rate to near zero.[10] It has also cut the federal funds rate by 50 basis points, its first emergency move since the recession in 2008.[11]<br>• The **USA Government** has proposed a stimulus package of $2 tn to fight the coronavirus-driven economic slowdown.[12] |
| **Japan** | • **Japan** has released two stimulus packages worth $4.6 bn and $15 bn to support small businesses.[13] |
| **China** | • **The People's Bank of China (PBoC)** has implemented several policies to provide economic relief during the coronavirus outbreak. PBoC has pumped more than US$ 240 bn of liquidity into the financial system as a countermeasure to the virus.[14] |
| **European Union** | • The **European Central Bank** has announced a new Pandemic Emergency Purchase Programme (PEPP), which will have an overall envelope of €750 bn. It also announced additional €120 bn in land bond purchases; launch of a new temporary asset purchase programme, relaxing capital reserve requirements for banks to lend more, lowered interest rates, and eased lending requirements for its refinancing operations.[15] |
| **South Korea** | • **South Korea** has announced a $9.8 bn stimulus package focusing on minimising the economic fallout, especially for the vulnerable sectors, small to medium sized businesses, and self-employed people.[16] |
| **Australia** | • The **Australian Government** has announced $17.6 bn economic plan to tackle the economic impact of the pandemic. The package includes supporting the business investment, providing cash flow assistance to help small & medium sized businesses to stay in business, retain employees, and provide targeted support for the most severely affected sectors, regions and communities and household stimulus payments.[17] |
| **India** | • The **Indian Government** has set up a special economic task force to plan for further actions to try to mitigate the impact of the pandemic on the Indian economy.[18] The government has committed INR 15,000 crore emergency healthcare fund to deal with the pandemic.[19] |

8 https://time.com/5800241/coronavirus-cases-uk/

9 https://www.theguardian.com/business/2020/mar/11/coronavirus-bank-of-england-makes-emergency-interest-rate-cut

10 https://www.reuters.com/article/health-coronavirus-central-banks/fed-cuts-interest-rates-to-near-zero-coordinates-with-other-central-banks-to-combat-coronavirus-idUSL1N2B80E8

11 https://www.businessinsider.in/stock-market/news/the-fed-announced-an-unexpected-interest-rate-cut-on-tuesday-heres-a-timeline-of-the-last-7-emergency-rate-cuts/articleshow/74480488.cms

12 https://www.wsj.com/articles/trump-administration-senate-democrats-said-to-reach-stimulus-bill-deal-11585113371

13 https://www.boj.or.jp/en/announcements/release_2020/k200316b.pdf

14 http://www.pbc.gov.cn/en/3688110/3688181/3967540/index.html, https://www.reuters.com/article/us-china-economy-rrr-cut/china-pumps-79-billion-into-economy-with-bank-cash-reserve-cut-idUSKBN2101B3

15 https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200315~1fab6a9f1f.en.html

16 https://www.reuters.com/article/us-southkorea-economy-budget/south-korea-unveils-9-8-billion-stimulus-to-fight-coronavirus-idUSKBN20R046

17 https://www.pm.gov.au/media/economic-stimulus-package

18 https://economictimes.indiatimes.com/news/politics-and-nation/pm-narendra-modi-forms-economic-response-task-force-calls-for-janata-curfew/articleshow/74715013.cms?from=mdr

19 https://www.businesstoday.in/current/economy-politics/rs-15000-crore-alloted-for-healthcare-to-fight-coronavirus-says-pm-modi/story/399119.html

- The **RBI** has committed to conducting a 6-month dollar/rupee swap on 23 March 2020 along with carrying out a long-term repo operation of up to INR 1 lakh crore (~US$ 131 bn) in multiple trances[20] and several other new measures on ensuring liquidity and easing financial stress
- The **Finance Ministry** has also announced a slew of measures for extension of statutory and regulatory compliances.[21] It includes measures such as, insurance cover worth INR 50 lakhs for sanitation workers, ASHA workers, doctors, nurses, paramedics, collateral-free loan will be given up to INR 20 lakh from INR 10 lakh earlier for Women Self Help Groups, PM Gareeb Kalyan Scheme to entail INR 1.7 lakh crore and consists majorly of two benefits around food and security.[22]

Due to the uncertainty of the situation (as there is more visibility on the stress in the coming days) additional actions may be required by central banks, regulators, and governments necessitating speedy co-ordination at both national and international levels.

## Impact on the Indian economy and banking, and capital markets industry (financial institutions)

Depending on the economic scenarios, India's economic growth could be moderately to severely impacted in the next fiscal year because of the disruptions caused by the pandemic. [23]

The Indian rupee has hit a record low against the US dollar in the last few days. So far, in 2020, foreign investors have sold nearly $10 billion in equity and debt markets.[24] The pandemic has hit the economy at a time when growth had already slowed to the lowest in a decade, lowering hopes of a speedy economic recovery.

Banking and other financial services firms (referred to as financial institutions) have been mobilising and taking steps to minimise the pandemic's effects on day-to-day operations. These institutions have put heightened measures in place to ensure the safety and health of their employees. Firms are implementing business continuity plans, including alternate workplace arrangements, such as splitting work sites, work from home options, and rotating shifts for employees.

The finance minister has announced several measures to deal with the economic distress caused due to the pandemic and the national lockdown. These measures pertain primarily to food and security at the bottom of the pyramid and entail PM Gareeb Kalyan Scheme of INR 1.7 lakh crore, insurance cover worth INR 50 lakh for select sanitation workers, food security, increase in wage, and other support under various government schemes. While more measures are expected in future, the Ministry of Finance has announced a slew of measures to extend the statutory and regulatory compliances. The highlights of the measures are provided in Figure 2.

20 https://economictimes.indiatimes.com/markets/stocks/news/rbi-to-inject-rs-1-lakh-crore-liquidity-via-repo-operations/articleshow/74772264.cms

21 https://www.businessinsider.in/policy/economy/finance-minister-nirmala-sitharaman-speech-highlights-and-updates/articleshow/74789836.cms

22 https://economictimes.indiatimes.com/news/economy/policy/fm-nirmala-sitharaman-announces-rs-1-7-lakh-crore-relief-package-for-poor/articleshow/74825054.cms?from=mdr

23 https://economictimes.indiatimes.com/news/economy/policy/outbreak-will-set-back-indias-growth-recovery/articleshow/74663633.cms, https://economictimes.indiatimes.com/news/politics-and-nation/covid-19-indians-economic-growth-likely-to-decline-by-200-bps-in-fy21-says-yashwant-sinha/articleshow/74848093.cms, https://economictimes.indiatimes.com/news/economy/indicators/moodys-slashes-india-gdp-growth-in-2020-to-2-5/articleshow/74840446.cms?from=mdr

24 https://www.livemint.com/news/india/rupee-slips-to-record-low-nears-75-a-dollar-mark-11584589276149.html

**Figure 2: Measures to extend the statutory and regulatory compliances announced by Indian Government and regulators**

| Categories of measures | Details of measures |
|---|---|
| Financial services institutions[25] | • Waiver of ATM withdrawal charges for a period of three months<br>• Waiver of charges on not maintaining minimum balance in the savings account<br>• Reduction in bank charges for digital transactions for trade and finance customers<br>• Threshold for default under the Insolvency and Bankruptcy Code raised to INR 1 cr. This step has been taken to prevent triggering of insolvency proceeding against MSMEs. |
| Regulatory easing[25] | • Last date for filing tax returns for FY19 has been extended to 30 June 2020. For delayed payments made until 30 June, interest rate is halved to 9% from 18%.<br>• Deadline for linking Aadhaar with PAN extended until 30 June<br>• Vivaad se Vishwaas scheme extended to 30 June<br>• Last date of filing Goods and Services Tax (GST) returns for the months of March, April, and May 2020 including composite schemes extended to 30 June. For companies with turnover of less than INR 5 cr no penalties, fees, and interest on deferred payment. For companies with turnover of more than INR 5 cr, the penalties and fees waived off and the interest rate on deferred payments brought down to 9% from 18%.<br>• Sabka Vishwaas scheme for indirect taxes extended to 30 June 2020 with no interest levy<br>• Custom clearance made operational 24*7 until 30 June<br>• MCA-21 Registry: A moratorium being issued from 1 April until 30 September and no additional fees for late filing<br>• Mandatory requirement for holding physical board meetings relaxed until 30 June<br>• Additional six months provided to newly established companies to file declaration for commencement of business |
| Measures announced by RBI[26] | • **Monetary Policy:** RBI has announced that the policy repo rate will be cut by 75 basis points to 4.40% from 5.15% and reverse repo rate by 90 basis points to 4 percent with immediate effect. The marginal standing facility (MSF) rate and the Bank Rate stand reduced to 4.65% from 5.40%<br>• **Liquidity Management:** RBI will conduct auctions of Targeted Long Term Repos (TLROs) of up to three years tenor for a total amount of up to INR 1 lakh cr. RBI has relaxed Cash Reserve Ratio (CRR) requirements by 100 bps to 3% of Net Demand and Time Liabilities (NDTL) with effect from the reporting fortnight beginning March 28, 2020 for a period of 1 year ending on March 26, 2021. This reduction in the CRR would release primary liquidity of about INR 1.37 lakh cr uniformly across the banking system. Accommodation under Marginal Standing Facility (MSF) to be increased from 2% of SLR to 3% with immediate effect till June 30. It will release INR 1.37 lakh cr into the system. These three measures relating to TLTRO, CRR and MSF will inject a total liquidity of INR 3.74 lakh cr to the system<br>• **Regulation and Supervision**: All commercial banks, co-operative banks, all-India financial institutions, and NBFCs are being permitted to allow a moratorium of three months on payment of instalments in respect of all term loans outstanding as on March 1, 2020. Deferment of interest on working capital facilities for three months on payment of interest in respect of all such facilities outstanding as on March 1, 2020. Deferment of last tranche of Capital Conservation Buffer (CCB) from March 31, 2020 to September 30, 2020 |

25 https://www.businessinsider.in/policy/economy/finance-minister-nirmala-sitharaman-speech-highlights-and-updates/articleshow/74789836.cms | https://economictimes.indiatimes.com/news/economy/policy/aadhaar-pan-linking-extended-till-june-302020-regulatory-deadlines-extended-till-june-30/articleshow/74790336.cms

26https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR21302E204AFFBB614305B56DD6B843A520DB.PDF, https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR2129F5E23A447E0F4A00955429716C53F5A2.PDF

| Categories of measures | Details of measures |
|---|---|
| | • **Financial Markets:** RBI has decided to permit banks in India to participate in the Non-Deliverable Forward (NDF) market with effect from June 1, 2020 |
| Measures announced by SEBI[27] | • Penalty for non-collection or short collection of margins by brokers deferred until 30 April<br>• Brokers working from alternate locations exempted from penal provisions for not maintaining call recordings of orders or instructions received from clients until 31 March 2020<br>• Threshold for placing members in risk reduction mode increased to 90% of the capital towards margin<br>• Implementation of SEBI's circular on risk management framework for liquid schemes of mutual funds extended by one month<br>• Effective date of SEBI's guidelines on valuation of money market and debt securities based on mark-to-market valuation extended by one month until May |
| Measures announced by IRDAI[28] | • IRDAI has asked all insurance companies to give an additional grace period of 30 days to their customers, for payment of renewal premium<br>• The insurance regulator has given an extended period of 15 days for insurance companies to submit monthly returns. In addition, the regulator has given an extended period of 30 days for insurance companies to submit quarterly returns |

27 https://www.thehindu.com/business/sebi-defers-new-norms-for-brokers-mfs/article31145317.ece

28 https://economictimes.indiatimes.com/wealth/personal-finance-news/irdai-allows-extra-time-to-pay-life-insurance-renewal-premium-due-to-covid-19/articleshow/74781550.cms

# Assessing the pandemic impact on financial services

The pandemic is impacting the financial services sector in multiple ways—from business continuity issues and operational considerations to the overall financial outlook. While these institutions prepare to provide support to employees, customers and society as their paramount responsibility, this is expected to put a strain on them 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—both short and long term.[29]

## Wave 1: Short-term impact (3-6 months)

**High capital losses:** Several financial institutions might suffer moderate to heavy capital losses in the near future. Risk-weighted assets (RWA) are expected to be impacted by higher charges from increased volatility levels and higher counterparty risks. Potentially less favourable economic outlook might negatively impact the loss allowances. In addition, borrowers may want to refinance at longer maturities to lock in lower interest rates. Financial institutions might have to put their growth targets on the backseat due to these losses, as it would require raising additional funds.

**Decreased operational efficiency and lower revenues:** As the pandemic advances, the temporary closure of branches and employee absences will impact operations. This might affect lead generation and the sales pipelines, thus slowing down business for multiple quarters. There might be increased demand for cash in the near future due to the effect on replenishment schedules. In case of interest rate cuts, banks' net interest income and fee income is expected to be challenged. Due to lower offtake and other pressures, such as lower asset under management and lower investment activities, banks could face degrowth scenarios.

**Liquidity crisis:** Some institutions' contingency funding plans (CFPs) may have already been invoked. Moreover, due to market volatility, there could be significant swings in stress testing results and limit/threshold breaches. Some market participants may already be experiencing increased liquidity tightening situations. With a sudden halt in cash inflows in the form of loan repayments, there might be a possible scenario of liquidity imbalance leading to an asset liability mismatch. Financial institutions may be required to sell assets not intended to be sold under regular market conditions to cover the sudden liquidity shortfalls. A sharp drop in interest rates and increased volatility in securities and foreign exchange prices may increase the institutions' market risk.

## Wave 2: Long-term impact (>6 months)

**Higher delinquencies and higher capital requirements:** Impediment in cash flows can lead to loan default by various sectors impacted by the pandemic. Financial institutions are already staring at exposure to sectors, such as hospitality, shipping, transport, tourism, and aviation. This is bound to increase until business stability is attained. Under the current regulations, non-performing assets reported by these institutions may see a surge in the first quarter of FY21. A subsequent decrease in shareholder value can result in selling off securities and redemption through mutual funds, thus impacting the liquidity of financial institutions (FIs).

29 Reference taken from Deloitte report on COVID-19 potential implications for the banking and capital markets sectors; https://www2.deloitte.com/us/en/insights/economy/covid-19/banking-and-capital-markets-impact-covid-19.html

With clients potentially experiencing stressed financial conditions, credit quality/ratings may be impacted. The pandemic-induced market environment may negatively impact financial institution's credit rating profile. New systemic, country, or other business risk factors may intensify and affect the creditworthiness of financial institution, counterparties, and borrowers, especially in the high-yield grade. It is imperative to evaluate how credit rating agencies will account changes to these risk factors.

**Decreased profitability:** Continued business slowdown can cause a significant decrease in profitability and consequently a decrease in the earnings before interest, tax, depreciation, and amortization (EBITDA). This could result in loss of investor confidence in the institution and further strain the existing woes with respect to funding. Any future growth plans would consequently be affected and might be in need of deferment, as the institution would need to focus on improving margins and topline growth.

**Non-financial risks:** Financial institutions are exposed to various other non-financial risks, such as conduct risk/culture, brand risk, model risk, third-party risk, and cyber risk that may or may not have any financial impact in future. If a bank's operating model needs to change, it may become difficult for the boards of these institutions to continue to meet governance obligations, such as overseeing risk, providing credible challenges to the management, and acting as responsible stewards of the institution. These challenges are expected to translate into high capital infusion requirements for the financial institutions to maintain both regulatory capital and growth capital.

The long-term implications of the pandemic for the Indian financial services sector are unknown. When normalcy returns, financial institutions are expected to have learnt a few lessons, including how to best retain operational resilience when confronted with future pandemics, and possibly, how to redesign new operating models such as alternate work arrangements. The pandemic may further accelerate migration to infrastructure of the future–digital channels and connectivity.

# Rapid responses–Flattening the curve for the financial services industry

Beyond the operational actions already underway, the financial services industry players need to actively consider the short, medium, and long-term operational, financial, risk, and regulatory compliance implications resulting from the continuing uncertainty around the pandemic. Banks and financial institutions must re-analyse their business models and plan for different scenarios. This will help ascertain areas of focus and prioritise action items. It will also highlight the degree of risk at an early stage, so that institutions can devise mitigating steps to contain the impact of the pandemic. Regular monitoring and analysis of outcomes can help institutions manage risks and ensure continuum of operations.

## Define scenarios and possibilities

To better understand the impact of pandemic on their own portfolio and financial health, given the rapidly evolving market forces, financial institutions need to define various scenarios based on the spread of the virus and corresponding economic implications. These scenarios can then be used to stress test their portfolios and forecast their respective financial positions, which can help financial institutions design their response to the pandemic and be better prepared to handle the situation as it unfolds.

While defining the scenarios (refer Deloitte’s global perspectives on COVID-19[30]), the following must be kept in mind.

**Make it a collaborative effort**
Identify the key people from the relevant functions (marketing, sales, finance, business, operations, HR, IT, etc.) and form a working group. This core team will be responsible for developing and managing the scenario definition and reforecasting processes by preparing for it.

**Identify and agree upon scenarios**
Define plausible alternate future scenarios to assess the impact of your decisions, and build scenarios based on potential virus spread and human reaction. The scenarios should be built around the spread of the virus and not just on the impact on GDP and macro variables. This will require developing a range of expectations for the progression of the disease, government response, and supply and demand shifts. Additionally, each scenario must contain enough details to assess the likelihood of success or failure of different options.

**Focus on the drivers that matter for your business**
Customise the scenarios to your particular context and challenges, including less obvious possibilities. Be sure to include external risks, such as travel or regional shutdowns, as well as potential opportunities.

The unknown scenarios are numerous, including whether the virus will peak or flatten and how soon, the gravity and length of the economic downturn, the level of debt strain on countries, local government, corporations, small businesses, and consumers, the impact of delinquencies, extent of support to be provided to support borrowers, the impact on topline

30 Referenced from:
https://www2.deloitte.com/global/en/pages/about-deloitte/articles/build-scenario-thinking-or-sensing-into-strategic-decision-making.html?icid=covid-19_thrive_twine

and margins for banks and several other factors. For an indicative illustration on different scenarios that might be considered by the financial institution, refer to Figure 3.

**Figure 3: Potential illustration of different scenarios (this needs to be based on broad outlook tailored to the business model of the financial institutions)**


In China, transmission has slowed already. Although some outbreaks occur elsewhere, these do not create a massive spread of the disease. As the global number of cases stabilises, the economy returns to normal, global GDP takes a big hit in Q1 2020 but bounces back in Q2 and Q3—although some of the lost production is never replaced. Specific sectors experience short-term supply disruptions, but the impact on the global economy is not grave and most importantly temporary. The efforts taken by the Government of India and globally have contained the pandemic, and cases are on a decline. Economic and financial position is hit until the Q1 of FY21, but banks and other institutions show signs of recovery post the Q2.

Although the spread of the disease has slowed globally, outbreaks occur on a rolling basis around the world. Each outbreak requires slowing production in that area, and in a globalised world, which means rolling disruptions to different regions and industries as outbreaks occur. Tourism and related businesses continue to decline sharply impacting the tourism-based businesses and regions. The overall impact will disrupt economic activity enough to slow global growth substantially. Certain other sectors are severely impacted and struggle for cash and banks and other financial institutions continue to see an increase in stressed assets and might require measures to maintain liquidity.

Economic centres around the world are subject to lockdowns and shutdowns for long periods, including India. Uncoordinated decisions on a country-by-country basis disrupt the movement of both people and goods. Global manufacturing declines, as businesses with international supply chains can operate only intermittently. Stagnation of global GDP, falling of international trade, depreciating the rupee further, and global recession is a possibility. Banks continue to see stressed assets through the fiscal year, business slow down, and the need for additional capital infusion is necessary.

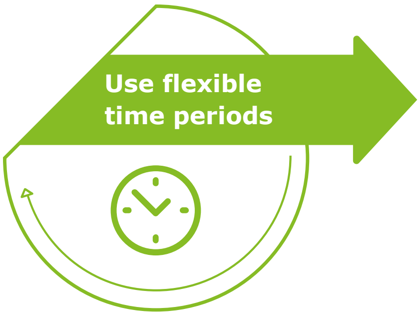
Delayed shipments and production schedules create financial problems for companies with heavy debts. In an attempt to manage liquidity, investors seek a flight from risk by selling off their securities. Concern about counterparty risk accelerates the decline and dries up liquidity in the financial markets. The central bank in India and across the globe scramble to manage this problem. Mounting stressed assets, unfavourable economic conditions and business slow down, leaves banks lurking for capital. Financial markets—and the global economy—recover only after a V-shaped recession.

## Leverage scenario-based stress testing and forecasting

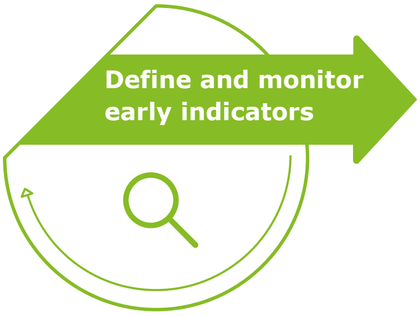
Amid the highly uncertain situation due to the pandemic, financial institutions should stress test their portfolios, for each of the defined scenarios to better understand the impact. Per the existing regulatory framework, financial institutions are anyways required to conduct stress tests on their portfolios. The current economic and market environment warrants additional stress testing and unlike regulatory stress testing, this will not be just a hypothetical exercise. Stress-test results will have direct implications for decisions that financial institutions need to make in real time. Identifying sectors/regions/clients that are most at risk and re-evaluating the loan loss provisions under different economic scenarios will be essential.

Furthermore, using the defined scenarios, financial institutions should use scenario based forecasting to navigate their own finances through this level of uncertainty and disruption. With scenario-based forecasting, financial institutions can assess the different alternatives.

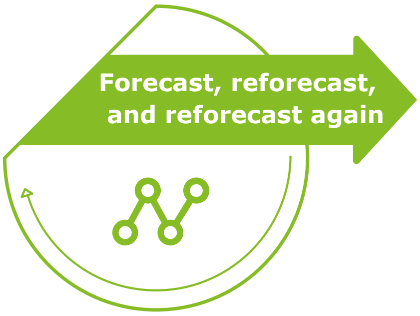
The following should be kept in mind while forecasting:[31]




Be sure to forecast for the short, medium, and long terms in line with the different nuances of each scenario. Understanding the different implications and options at each turn is key to being able to adapt.




Identify the first signs of the big changes that differentiate the various scenarios. This is particularly important as you identify the appropriate execution for each scenario and your answer does not fit all scenarios.




As you go through one of the scenarios, diligently monitor the evolution of your response, and agree with the members of the working group on how the assumptions in the model might need to change. If it's appropriate, reforecast weekly, or daily.

### Plan for business continuity in the face of a pro-longed lockdown

Financial institutions have taken responsive measures and aim to reduce in-person interactions, downsize operations while providing financial support to retail and institutional customers. Temporary closure of offices, rotation of employees, reduced operational hours are some of the measures banks have implemented so far. Following the government announcement of a 21-day lockdown period, banks will only offer essential services, i.e., cash deposit and withdrawal, cheque clearing, remittances, and government transactions. Non-essential services can be availed of through mobile and online banking channels. Given the situation, it is imperative that banks ensure well-equipped systems to manage the increased load, quick troubleshooting, and resolution to ensure seamless operations and adequate security risk controls.

A continued spread of the pandemic and its aftermath can significantly slow down business. Hence, financial institutions would need to take additional measures to ensure business continuity by rethinking their customer acquisition strategy and cross selling products. Timely communication of incentives and revised policies through various channels to customers will be the key to establish trust and ease panic. Given the uncertainty that India is facing currently, banks can potentially use services such as video-know your customer (video-KYC) for a paperless on boarding, chatbots for customer relationship management, and video

31 Referenced from https://www2.deloitte.com/global/en/pages/about-deloitte/articles/build-scenario-thinking-or-sensing-into-strategic-decision-making.html?icid=covid-19_thrive_twine

conferencing facilities for customers to have a doorstep banking experience. Innovation in times of difficulty is essential.

Banks and financial institutions must prepare for scenarios that might occur post the lockdown period as well. This would be critical in developing a flexible contingency plan that best equips the banks for crisis management and provides supportive solutions to its customers.

### Pre-empt future risks and capital requirements for banks

Based on the scenario analysis, banks will be in a better position to pre-empt their future capital requirements on the following parameters:

**Market risk:** Managing and mitigating risks is one of the most critical aspects of any financial institution. Asset Liability Management (ALM) is a comprehensive framework for measuring, monitoring, managing, and mitigating market risk of a bank and other financial institutions. During adverse market conditions, banks and financial institutions may face situations of asset liability mismatches due to delayed cash inflows than what was earlier expected in the form of loan repayments. They may need to revisit internal models capturing market risk and respond to this appropriately by accounting for additional capital that maybe required to narrow down this mismatch. The banks also need to communicate with RBI and understand if capital is adversely affected and materially differs from model-implied scenarios.

**Liquidity risk:** Due to market volatility, there could be unexpected stress testing results and threshold breaches because of severe liquidity crunch. CFPs helps banks and other financial institutions raise additional capital required in adverse market conditions. They need to monitor market activity against their liquidity stress indicators for triggers that would activate the CFP. Financial institutions must review their CFPs, evaluate what went wrong, incorporate key learnings from this experience, and accordingly modify their CFPs to safeguard themselves from something akin to this that might take place in the future.

**Credit risk:** Banks and other financial institutions already stare at significant exposure to certain sectors. The onset of the pandemic has exacerbated the same and resulted in amplified strain on the asset quality of these institutions. Businesses have witnessed a shortfall in cash flows and are anticipating turbulence in the coming months. Hence, banks could potentially witness a sharp increase in the inability or a delay in repayment of loans in the current quarter. Banks must plan the liquidity support and capital infusion they might require from the RBI to maintain credit disbursement, while effectively managing stressed assets.

**Operational risk:** Financial institutions have invoked several measures to reduce face-to-face interactions and increase usage of digital tools on scale that has been unprecedented in India to date. Day-to-day operations have surged reliance on the IT infrastructure of the institutions, highlighting the need for essential cybersecurity controls in place. Banks need to continually monitor their legacy architecture and ensure appropriate checks to mitigate the risk of cyber frauds and phishing attacks. Contractual obligations and management structure must be revisited to ensure continuity of operations as a change in working conditions is most likely to cause interruptions. The legal risk, the institution is exposed to, is particularly aggravated in the given circumstances. Hence, institutions must take appropriate measures to minimise operational errors, interruptions, and damages.

Several banks and financial institutions have deferred their plans to raise capital for their growth targets, given the volatility of the market. However, conducting a comprehensive financial analysis against the economic factors, risks, and evolving investor sentiment to best manage their liquidity while maintaining growth in credit disbursements is needed. Scenario analysis would be essential to take pro-active measures that will go a long way in determining the financial health of the financial institutions and the economy as a whole.

### Assess and manage global and local operations
Each market could experience varying levels of stress and disruption. Hence, it is important for financial institutions especially banks to identify and evaluate how efficiently critical activities can be rerouted to local and global offices, and how resilient this could prove to be. For this to materialise, the banks must do a location-based geographical analysis on areas that are worst affected and areas that are relatively resilient in times like these.

Banks with a global presence need to evaluate how can capital allocations be determined across trading books in stressed markets, and whether precautionary steps, such as trading asset divestments are required. If so, which assets could be disposed of first and how quickly hedging strategies can be adjusted across foreign exchange, commodities, equities, or fixed income, as the situation develops. For this, capital allocation and hedging strategies across trading books should be re-evaluated.

### Invest in infrastructure that banks may need
A financial institution's ability to manifest opportunities out of the disruptive environment based on technology and external partnerships to create customer value will determine its success in the future. To enable flexible or remote work, organisations need to have the right infrastructure in place. There may be increased demands on organisations' digital infrastructure to replace manual operations, which should be seen as a business opportunity to centralise core operations and optimise on cost savings. Banks and financial institutions should consider testing and planning for alternate capacity to process and continue to deliver services whenever possible. These institutions may also need to review infrastructure that is currently in place, such as VPN connections, security tokens, bandwidth, and laptops to assess additional investments in technology required to achieve the desired infrastructure.

### Re-evaluate working methods
One of the biggest challenges for financial institutions is to enable alternative work arrangements for the employees if needed to protect staff and adapt to possible office access restrictions, all while assuring business continuity. Given the current situations and lockdown

scenarios, financial institutions are exploring possibilities of staggering shifts for the employees and engaging with central response teams to manage critical communication with the employees.

As a response to the outbreak, financial institutions may need to consider applying future of work concepts and practices that are already under exploration. They need to prioritise the most important projects, workflows, and deliverables, and communicate these clearly to employees. Establishing open lines of conversation, including frequent communication with employees and customers will help these institutions in dealing with uncertainties. For example, sales teams can connect with customers over voice calls and explain the steps taken by them and their impact on their customers.

While disrupting client service, the pandemic will also impact the delivery value chain of distributors, such as agents, brokers, and advisors. A scaled up approach to using digital tools for customer relationship management and acquisition would facilitate continuity of operations. Equipping employees with appropriate tools, employing relevant tactics to maintain quality of work/productivity, and ensuring that technology options are in place to connect employees working remotely without compromising access and data security is not just the need of the hour but the way forward.

Banks must frequently communicate with offshore delivery centres and develop appropriate contingency plans if not in place yet. They may also consider testing alternate work arrangements from offshore delivery centres to determine if service performance is affected in any way. The need to find alternate venues for service delivery if a particular centre experiences an operational disruption may also arise.

**Re-evaluate business models to consider immediate to medium term implications**

Financial institutions would need to re-assess the impact on their business models to operationalise the mandates for changes required in systems, credit, compliance, and operations due to the regulatory measures and business implications. This will include re-evaluating strategies of portfolio management (rates, portfolio optimisation) and non-performing asset management (curated models for offering non-performing asset waivers and its implications). In the medium to long term, the institutions may need to relook at their trade finance and cross-border businesses due to potential changes in supply chain models of key client industries and country risk profiles. At the core of all these scenarios, the customer experience needs to be unhindered. The business model changes need to consider higher customer acceptance of touchless and digital interactions. This will have huge implications on the way financial institutions build the future of customer experience for their organisations.

# Building resilience–Regulatory and government support

Besides the broader economic stimulus announced under the PM Gareeb Kalyan Scheme, the Reserve Bank of India has also announced its initial set of measures for the banking and capital markets sector. While we await the sectoral specific measures of the economic taskforce, financial institutions should plan and prepare for further measures, which may have implications on their business models. Based on the financial services related measures undertaken by several global economies to provide economic stimulus to banking and capital markets, some of the measures that may need to be factored in the scenario planning by financial institutions have been indicated below. These institutions will need to conduct a detailed impact analysis on their profitability and balance sheet across measures (already announced) and few additional scenarios.

**Liquidity support measures**
- Measures akin to the US federal rate decrease providing quantitative easing may ensure more money supply in the economy
- Certain operations (select derivative trading) may be temporarily curtailed
- Corporate customers and MSMEs may be provided special lines of credit and may require support to avail it
- Capital infusion fund may be set up to be available to all players

**Stressed asset management related measures**
- Non-performing asset recognition norms (including SMA guidelines) may be changed or forbearance may be provided to borrowers
- Scenario planning may need to include the decline in value of pledged collaterals and its impact of portfolios
- Large amount of loan re-structuring may be required across portfolios; prioritising these based on the impact and scale of potential recovery will be the key
- It may be imperative to assess and possibly separately provide for disclosure of pandemic impact as an extraordinary item (net losses post 13 March) or as part of explanatory notes
- Access may be made available to identify and transfer select non-performing loans cross select sectors in case a "bad bank" or equivalent is proposed

**Regulatory easing related measures**
- Reduction in CRR and SLR requirements and impact on the financial institution's liquidity positions and lending strategies needs to be evaluated further
- There maybe a need to reconsider capital adequacy requirements and forecast on several parameters including CCB requirements, progressive discounting of tier-II instruments, revaluation reserves, reduction/change in risk weightage across capital and non-capital instruments, deferred tax assets, regulatory retail portfolio, card receivables, housing loans, claims on public sector enterprises based on their risk ratings, claims from government entities, etc.
- Impact of valuation of portfolio at moving average prices as cut-off as a scenario should be evaluated

**Other measures**
- Specific measures related to MSME may require differentiated focus and approach

- The government could plan for new opportunities and products, e.g., participation in secondary capital market platform for SME loan portfolios, subsidised/government supported life and health insurance products, subsidised/government supported affordable housing products, inclusion of health care in priority sector target, etc.
- Reconsidering distribution network across ecosystem partners including fintechs for customer segments may require differentiated segmental strategies

# Conclusive Remarks

Financial institutions should plan for multiple scenarios until the normalisation of operations, keeping both customers and employees needs at the centre of their businesses. It is expected that the government stimulus will address the broader economic challenges.

There will be disruptions and delinquencies; however these challenges will open up choices for deepening customer relationships, investments in technology of the future, shift in mindsets to truly adopt and execute future of work.

Financial institutions need to evaluate, test, and implement business continuity and contingency plans along with innovation in times of trial. Institutions that take sensitive measures to provide customer and employee reliefs can truly differentiate, eventually grow, and sustain themselves. Institutions using the downturn to sharpen their business models are expected to gain more from the impetus which government stimulus is likely to provide.

In summary, times are expected to be tough but by adopting a vigilant short, medium and long-term action plan, financial services players can emerge from this crisis as stronger, confident, and socially responsible institutions.

# Appendix 1: Global response to the pandemic

Nations across the world have introduced fiscal stimulus with an emphasis on quantitative easing, lowering interest rates, relaxation of regulatory reserves for banks, tax incentives including deferments, interest-free loans backed by government guarantees, wage subsidies, mortgage holidays, and most importantly bailout packages for the worst affected industries such as aviation. Some of the steps taken by governments as a response to this global threat have been highlighted below.[32]

**China**
The Peoples Bank of China (PBoC) has initiated several measures to provide economic relief during this outbreak. In the first week of February 2020, PBoC injected ~US$174 billion through reverse repo operations in the market.[33] It has also lowered the interest rates on reverse repurchase agreements by 10 basis points to relieve pressure from the economy. PBoC cut banks' reserve requirement on 13 March 2020 for the second time this year, releasing 550 billion yuan (~US$79 billion) to help its coronavirus affected economy.[34] China's fiscal health is under significant pressure and a bigger stimulus is being anticipated to boost the economy.

**Japan**
Japan has released two stimulus packages of small business loans, one worth US$4.6 billion in February 2020, and another worth US$15 billion in March 2020. Bank of Japan has announced a significant increase in monetary easing by further increasing the supply of funds, introduction of the Special Funds-Supplying Operations to facilitate corporate financing, increasing purchases of Commercial Papers (CPs) and corporate bonds, active purchases of Exchange Traded Funds (ETFs) and Japan Real Estate Investment Trusts (J-REITs), and several other quantitative and qualitative monetary easing measures.[35]

**South Korea**
South Korea announced a US$9.8 billion stimulus package on 3 March 2020 focusing on minimising the economic fallout, especially for the vulnerable sectors, small to medium sized businesses, and self-employed people. According to the package, loans are to be provided on relaxed terms to affected exporters while people who have lost their jobs will be re-trained.[36]

**United States of America**
In the first week of March, the government sanctioned a spending bill of US$8.3 billion to fight the pandemic.[37] The Federal Government pledged to distribute up to US$50 billion in aid to states, cities, and territories. The US is preparing a US$2 trillion fiscal stimulus package proposal in response to the pandemic and will include direct payments to Americans under a certain income threshold, direct government backed loans to the airline industry and other severely distressed sectors, and also forgivable bridge loans to small businesses.[38]

32 Source: Deloitte Analysis, Reuters, Bloomberg, CNN, CNBC, ECB, IMF, WB

33 http://www.pbc.gov.cn/en/3688110/3688181/3967540/index.html

34 https://www.reuters.com/article/us-china-economy-rrr-cut/china-pumps-79-billion-into-economy-with-bank-cash-reserve-cut-idUSKBN2101B3

35 https://www.boj.or.jp/en/announcements/release_2020/k200316b.pdf

36 https://www.reuters.com/article/us-southkorea-economy-budget/south-korea-unveils-9-8-billion-stimulus-to-fight-coronavirus-idUSKBN20R046

37 https://www.cnbc.com/2020/03/06/trump-signs-8point3-billion-emergency-coronavirus-spending-package.html

38 https://www.wsj.com/articles/trump-administration-senate-democrats-said-to-reach-stimulus-bill-deal-11585113371

**United Kingdom**

By paying a part of the citizens' wages for the first time in the nation's history, U.K. has announced an unprecedented stimulus plan to cushion the economic blow from the coronavirus. The stimulus announced by the government so far covers workers' wages, deferred VAT payments, interest-free loans for businesses severely affected, additional welfare support including an increase in universal credit payments, and support for rent payers and for the self-employed citizens. In totality, the government will provide an initial £330 billion (~US$386 billion) of guarantees–equivalent to 15 percent of UK's GDP.[39]

**European Union**

The European Central Bank has announced a new Pandemic Emergency Purchase Programme (PEPP), which will have an overall envelope of €750 billion (~US$811 billion). It has also announced an additional €120 billion (~US$130 billion) in land bond purchases, launch of a new temporary asset purchase programme, relaxing capital reserve requirements for banks to lend more, and lowered interest rates eased lending requirements for its refinancing operations.[40]

**Italy**

The Italian Government is willing to spend as much as €25 billion (~US$28.3 billion) on stimulus measures to shield the economy from the impact of the virus. Among other things, the stimulus will include adding money to a fund guaranteeing loans to small and medium businesses, money to companies who have been affected most by the virus, and support for workers who are facing layoffs.[41]

**Australia**

The government has announced an AUD 17.6 billion (~US$10.5 billion) economic plan. The package will support business investment, provide cash flow assistance to help small and medium sized businesses to stay in business and keep their employees in jobs, targeted support for the most severely affected sectors, regions and communities, and household stimulus payments that will benefit the wider economy.[42]

**Coordinated international efforts**

In times like these, where some countries may not individually have the required resources to rescue their respective economies, it becomes imperative that governments come together and launch a coordinated effort to restore global stability. For instance, The International Monetary Fund (IMF) has made US$50 billion in loans available to deal with the virus, including US$10 billion of zero-interest loans to the poorest IMF member countries.[43] The World Bank Group is also providing an initial package of up to US$12 billion in immediate support to assist countries coping with the health and economic impacts of the global outbreak. Through this new fast track package, the World Bank Group will help developing countries strengthen health systems, including better access to health services to safeguard people from the epidemic, strengthen disease surveillance, bolster public health interventions, and work with the private sector to reduce the impact on economies.[44]

39 https://www.gov.uk/government/news/chancellor-announces-additional-support-to-protect-businesses

40 https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200315~1fab6a9f1f.en.html

41 https://www.bloomberg.com/news/articles/2020-03-10/conte-calls-on-ecb-to-do-whatever-it-takes-against-coronavirus

42 https://www.pm.gov.au/media/economic-stimulus-package

43 https://www.imf.org/en/News/Articles/2020/03/04/sp030420-imf-makes-available-50-billion-to-help-address-coronavirus

44 https://www.worldbank.org/en/news/press-release/2020/03/03/world-bank-group-announces-up-to-12-billion-immediate-support-for-covid-19-country-response