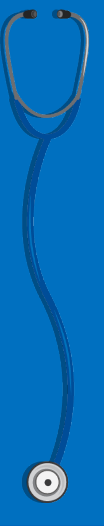
KPMG

Flexing your bank to respond to COVID-19



The COVID-19 pandemic has already brought unprecedented challenges to your own business and business of your partners and clients. Demand for many goods and services has fallen dramatically, whilst it rocketed for others leading to shortages in supply. Borders are being closed and entire societies are changing their "life as usual". Uncertainties about the future are hitting most of the market players, with financial institutions globally not being an exception.

You, as a bank, have an extremely responsible role in society, from different aspects:
— Protecting your own people
— Being supportive and responsible to your community
— Understanding the issues and being supportive to your clients
— Maintaining your own solvency in hard times.

While no-one yet knows how the pandemic will evolve, we do know that we have faced similarly significant challenges before. The financial crisis of 2008 brought extraordinary challenges. Many businesses, those that engaged their people, and took prompt collective action in response to this crisis, went onto thrive.

The consequences of the pandemic for our global economy and financial sector are unpredictable. Economists are convinced that we are heading for a significant economic downturn and depending on the duration of the pandemic potentially a serious global recession.

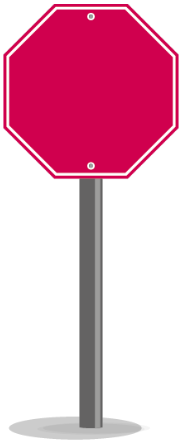
Governments, politicians, regulators, supervisors and other decision makers are responding to latest news on the pandemic. The response and measures of the Government of the Republic of Serbia are expected and will be communicated in our future communication with you.

This document has been created by our Risk consulting team that has analyzed how banks are and will be affected, aiming to:
— summarize our conclusions informing the bank's management,
— provide preliminary recommendations on actions management could consider in these challenging times,
— help specify actions plans and navigate in turbulent waters.

The document will be updated regularly as new developments arrive daily. We will be including such developments as they occur and apologize for any delay in view of the speed of change.

We are here to help.

Impact on your finance and risk



National bank of Serbia has imposed a moratorium on loan repayment

"In view of the need to preserve and further strengthen financial system stability amid potential risks caused by the emergency health situation in the country, the NBS has adopted decisions imposing a moratorium on debt payments."

During the moratorium, excluding the debtors that will opt against moratorium, the banks will not collect debt receivables for at least 90 days, i.e. for the duration of the emergency state declared due to the pandemic. Regular interest calculated for the period will be repaid in equal installments until loan maturity, after the emergency state is canceled.

This measure, together with the liquidity crisis and the need for additional cash from your clients will present a challenge in the times ahead.

Financial reporting

- Imposed moratorium will cause modification losses in P&L immediately since the carrying amount needs to reflect modified cashflows
- Depending on the adopted criteria for assessment of significance of modifications, in cases where this modification is significant – banks will need to derecognize and recognize new (potentially POCI) financial instruments
- Recent events are not considered to be adjusting when it comes to 2019 FS

Credit Risk

- Debtors seeking additional liquidity and heavily drawing down their credit facilities will be automatically downgraded by the behavior based rating systems
- Clients from certain industries will suffer heavily, thus needing restructuring and forbearance measures to be taken. Intense monitoring of debtors, together with revision of restructuring and forbearance options is needed
- Uncertainty about setting default flags, IFRS 9 stage 2 and 3 migrations and FLI when supporting debtors to survive this crisis

Liquidity

Worsening of liquidity positions (in the short-term) primarily driven by:

- Reduction of inflow from the loan portfolio
- Increasing draw-downs of facilities
- Decreasing market liquidity and increased volatility
- NBS expectations on increasing lending activities

Regulatory aspect

ECB Banking Supervision provided further flexibility to banks in reaction to coronavirus, i.e. in practice flexing its approach when it comes to both NPL recognition as well as encouraging banks to avoid excessive procyclical effects when applying IFRS 9 requirements.

Market risk

- High market volatility visible, e.g. on interest and FX rates, partially dramatic credit spread increases
- Lower prices for bonds influence P&L and equity

Self-reflection & action

Employees	The way you treat your employees now will have a massive effect on their wellbeing, and consequently on their loyalty and productivity. Be very vocal with your support for any changes they need to undertake to work arrangements and performance targets in order to fulfil their responsibilities towards their families and communities. Be a champion of good citizenship, and support containment and home-working where it is possible. Financial Services institutions all over the world are making significant changes to working arrangements – in some cases speaking with regulators to ensure that these meet compliance expectations – and this is helping them continue to deliver services to their customers.
Customers	Customers still have needs, and this includes regular reassurance from their Financial Services institutions on continuity of service delivery. You need to define an approach to the business management. For all segments where remote work is possible, banks should review their policies, practices, controls in order to adapt them to the changed circumstances and new work environment. Business continuity and Recovery plans potentially should also be updated. Banks that recorded significant progress in the digitalization process will surely be in advance.
Liquidity	Financial Services institutions need to thoroughly understand their available capital and liquidity resources and to assess the resilience of these. Central banks are under pressure to deliver stimulus packages in order to offset a larger, systemic liquidity crunch. This will bring down borrowing costs, but there is a risk that some companies will hoard cash and open credit lines to keep their businesses going through the crisis.
Third party service providers	The COVID-19 crisis forces companies to review their suppliers, assess which are most likely to be impacted, which are critical for ongoing business operations, and where they need to urgently mitigate risks posed by these relationships.
Communication and transparency	As the business and the economic impacts of the crisis begin to bite, you will need to ensure that you are communicating effectively with multiple stakeholders: employees, customers, shareholders and regulators. The crisis is a breeding ground for disinformation and rumor, so FS institutions need to ensure that they are clear about the steps they are taking to manage the impact of the pandemic. Regulators expect FS institutions to focus on and ensure continuity of their core operations, including support for their customers.
Scenario planning	Financial Services institutions are in the business of imagining the future – understanding the significant immediate challenges to society and economies posed by this pandemic, and how this will impact the interconnected financial system. Scenario modelling and contingency planning expertise developed in the past will help you and your customers to make good decisions in the face of a highly volatile operating environment. You will also need to incorporate new indicators, prioritized by the COVID-19 outbreak, into their decision making activities

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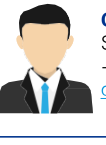

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