GHANA ASSOCIATION OF BANKERS (GAB) WEBINAR

TOPIC: 'MANAGING BANKING RISKS IN UNCERTAIN TIMES - COVID-19 TEST CASE'

KEYNOTE ADDRESS

BY

DR. ERNEST K.Y. ADDISON,

GOVERNOR, BANK OF GHANA

FEBRUARY 16, 2021

The President, Ghana Association of Bankers (GAB)

The Chief Executive Officer of GAB

Members of the Executive Council of the GAB

Distinguished GAB Members

Distinguished Resource Persons

Invited Guests, Ladies and Gentlemen.

1. Good morning. It is always an honour to interact with stakeholders in the financial sector, especially the banking fraternity. Exactly a year ago, the global economy was hit with a pandemic, the scale of which has not been witnessed since the Spanish Flu in 1918. As we meet today, there appears to be no relapse and we are seeing higher infection rates, which has been further compounded by the emergence of new variants. Although this began as a health crisis, it quickly turned into an economic and financial crisis as measures taken to halt the spread of the virus created a sudden stop in economic activity, dampening growth and posing significant risks to financial systems which required timely policy interventions. It is in this regard, that I applaud the Ghana Association of Bankers' Executive Council and the organizers of this Webinar for this important discourse under the theme '*Managing Banking Risks in Uncertain Times - Covid-19 Test Case*'. This is timely, as it presents a unique opportunity for us to deliberate on the risks emerging in the financial sector as a result of the COVID-19 pandemic and explore the policy options and measures needed to manage such risks in these uncertain times.

2. Ladies and Gentlemen, the human, health, economic, and financial costs of this pandemic are still mounting. In Ghana, we were fortunate that the financial sector reforms introduced over the last three years strengthened the balance sheet of banks and improved their solvency. The Banking System was better placed to absorb crisis and provide the financing needs of the economy as a result of the reforms including the recapitalisation of banks. Secondly, the government was also swift in putting into place measures to mitigate the impact of the crisis on the economy. The bold measures, including the COVID-19 Alleviation and Program to contain the economic burden of the pandemic on households and small businesses including the GH¢600 million financial support to medium and small-scale enterprises, absorption of water and electricity bills, tax reliefs for frontline workers, among others. On the financial sector, the Bank of Ghana introduced policies and regulatory reliefs to support credit extension and ease off possible banking sector liquidity constraints that may emerge as a result of the pandemic. Among others, the Bank lowered the policy rate by 150 basis points, and reduced the macro-prudential Capital Conservation Buffer and Cash Reserve Requirement for banks, as well as lowered the primary reserve ratio of savings and loans companies, finance house companies, and rural and community banks. The provisioning for loans in the "OLEM" category was also lowered for both banks and Specialised Deposit-Taking Institutions (SDIs).

3. To a large extent, these regulatory reliefs proved timely for the banking sector as it navigated the unchartered paths during the pandemic. The latest assessments have shown the resilience of banks to the first wave of the pandemic supported by strong policy support and COVID-related regulatory reliefs which helped expand lending activities. New Advances grew by 15.8 percent year-on-year to GH¢34.4 billion in 2020, and banks provided support and reliefs in the form of loan restructuring and loan repayment moratoria to cushion some 16,694 customers severely impacted by the pandemic. At the end of December 2020, total outstanding loans restructured by banks amounted to GH¢4.5 billion, representing about 9.4 percent of industry loan portfolio. These add to the strong outturn of the Financial Soundness Indicators, alongside strong growth in assets, deposits, and investments.

4. These positive results notwithstanding, we must admit that the pandemic has also introduced several risks in the banking sector. Let me highlight three major risks that the pandemic either unearthed or intensified, which must be efficiently managed by banks to avoid any unintended consequences on the industry. **These are cyber security risks, credit risks, and operational risks.**

- **Cyber Security Risks**

5. Although the pandemic boosted the move towards digital transactions and financial inclusion, it also brought in its wake a heightened sense of cyber-attacks within the financial sector. The use of digital and mobile banking platforms to conduct banking transactions has increased since the outbreak of the COVID-19 pandemic. This is evidenced by peer-to-peer, bank-to-wallet, wallet-to-bank and wallet-to-bank transactions across all platforms. Banks have responded positively to this phenomenon and deployed sophisticated, yet user-friendly digital platforms to enhance the delivery of financial services. This trend is indeed welcome, as it broadly aligns with the overall objective of digitising the Ghanaian economy, and promoting financial inclusion and economic growth.

6. Yet, the drive towards more digitisation has heightened cyber risks and fraud, and therefore calls for effective cyber risk management policies and procedures by banks. The Bank of Ghana expects all banks to build robust systems to forestall such cyber security incidences. All the successes chalked in the digitisation of banking systems would be eroded if adequate investments are not made for effective protection of the information technology and security infrastructure. In this regard, the Bank has issued directives and guidelines such as the Cyber Security Directive that banks must meet on an on-going basis to effectively manage cyber risk and fraud.

- **Credit Risks**

7. Secondly, credit risk has become critical and requires the attention of all of us. The sharp slowdown in economic activity has ramifications for the solvency of some households and businesses. Lenders within sectors strongly hit by the impact of the pandemic, particularly those in industry and services sectors, are more vulnerable. To possibly mitigate the risk, moratoria on repayment of loans and overdraft facilities, flexibility in the application of accounting and regulatory standards in the treatment of potential impaired loans have been emphasized by international accounting standard setters and the Bank. This is why the introduction of the regulatory reliefs has proved timely and banks have responded appropriately with some form of forbearance for customers. These include rolling forward interest and principal payments, interest repayment waivers, and offering new loans to enable borrowers with reasonable longer-term prospects stay afloat in these challenging times.

8. The challenge going forward is how well banks account for the impact of the reliefs in terms of loan classification, expected credit losses, provisioning, credit risk weightings and the overall impact on their capital ratios/ key performance indicators. For instance, loan loss provisions grew by 28.0 percent, higher than the 23.6 percent a year ago reflecting elevated credit risks in 2020. Higher provisioning helps to improve loss absorption capacity and the early recognition of losses is helpful. Also, the Non-Performing Loans (NPL) ratio of the industry increased from 14.3 percent in December 2019 to 15.7 percent in June 2020, arising from the pandemic-induced repayment challenges, but has since declined to 14.8 percent in December 2020 due to loan write-offs and increased credits, particularly in the last quarter. In response to these developments, banks may need to strengthen credit risk management policies and engage in risk-sharing arrangements through syndications.

- **Operational Risks**

9. The COVID-19 related partial lockdowns and restrictions to contain the spread instigated the work-from-home concept, which poses some operational risks to the industry, which if not well managed can affect the smooth operations of any bank. The engagement of third-parties by some banks to perform some non-core functions could also be threatened by weaknesses in financial and operational resilience.

10. The Industry data showed that growth in operating expenses moderated from 11.1 percent in 2019 to 8.2 percent in 2020, driven mainly by a slowdown in growth of staff-related costs, which recorded a 6.2 percent growth in 2020 compared with 14.7 percent a year ago. Other operating expenses, however, increased by 10.6 percent from 7.2 percent a year earlier. Part of the increase in other operating expenses was related to costs associated with implementing safety protocols and containment measures of COVID-19, as well as activation of Business Continuity Plans (BCPs) by banks.

Notwithstanding the pandemic-induced increases in the industry's cost of operations, banks did not pass on those costs to consumers in the form of higher interest margins but adopted other cost control measures to cushion their bottom line.

11. Disruptions in banks' operations and business continuity concerns, orchestrated by the pandemic, remains critical in these uncertain times, especially with the recent rise in the infection rate. We must all adapt to this 'new normal' of working and going forward, BCPs must focus on end-point and network security measures with robust user authentication protocols to minimise abuse of banks' systems. Risk-based business continuity plans and innovation stands out as key to survive in uncertain times. Consequently, operational risks need to be effectively managed and banks must continuously test the adequacy of their BCPs to facilitate continuous operations and service delivery.

12. As regulators, Ladies and Gentlemen, let me assure you that the Bank of Ghana is continuously monitoring the financial and economic environment to ensure the banking system operates effectively in delivering financial intermediation to support the recovery efforts from the pandemic. To this end, the policy measures including the reduction of regulatory capital buffers were reduced to allow banks to continue to provide financing to households and businesses. To further build our defences against the pandemic, I would encourage the GAB to continuously engage industry players to collectively strengthen their operational resilience in these times. From supervisory perspective, I would entreat the various risk managers to continuously stress-test your banks under different extreme but plausible scenarios to enable you contain possible risks that may emanate from the COVID-induced uncertainties.

13. Let me conclude by encouraging industry players to strictly observe the COVID-19 protocols and with the GAB as a common front, let us explore innovative ways to conduct the banking business in a safe and convenient environment. I am sure that this Webinar will offer insights on how we can innovate and stay competitive, as we navigate through the risks posed by these uncertain times of a pandemic. I wish you fruitful deliberations.

Thank you for your attention.