Society of Actuaries in Ireland

1972 - 2022

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Society of Actuaries in Ireland Banking & Aviation Finance Committee

Current Topics Overview

Sanctions and Inflation – Credit Risk Management Issues

War and sanctions are likely to slow domestic economic growth and further inflate prices. The rise in energy prices will reduce the disposable income of consumers and, to the extent that businesses cannot pass on rising input and labour costs, put pressure on the debt-service coverage ratio of businesses.

Slowing growth and inflation have implications for the credit risk faced by banks in both the mortgage lending market and SME business lending market. The impact in the business lending market will be different in different sectors; those sectors that can pass on rising fuel, labour, and other costs, possibly airlines and healthcare, are likely to be least affected. Banks will also be examining their lending portfolios to identify businesses dependent on revenues from exports to Russia in order to assess if they are exhibiting a significant increase in credit risk.

IFRS 9 - Release of Loan Loss Provisions

IFRS 9 is an accounting standard which requires banks to make loan loss provisions when there is a '*material change in circumstances*'. IFRS 9 became effective for annual periods beginning on or after 1 January 2018.

Under IFRS 9, loans and advances to customers are classified into one of three stages:

- Stage 1: Includes newly originated loans and loans that have not had a significant increase in credit risk since initial recognition.
- Stage 2: Includes loans that have had a significant increase in credit risk since initial recognition but do not have objective evidence of being credit impaired.
- Stage 3: Includes loans that are defaulted or are otherwise considered to be credit impaired.

For the calendar year 2020, AIB Bank plc posted IFRS 9 provisions of €1.4bn while for calendar year 2021, AIB released €238m of provisions for expected credit losses.

For the calendar year 2020, Bank of Ireland posted IFRS 9 provisions of €1.1bn while for calendar year 2021 it released €194m of provisions for expected credit losses.

The releases reflect the improved economic outlook as economies reopened due to the successful vaccine rollout and actual loan loss experience lower than anticipated in 2020.

Dividends & Share Buybacks

For the calendar year 2021, AIB Bank plc in which the Irish state has a stake of more than 70% posted a net profit of €645m, released €238m of provisions for expected credit losses, proposed a dividend of €122m, and is in discussion with the Government to buy back €91m worth of shares in the bank.

In calendar year 2021, AIB posted €318m of exceptional costs almost one third of which were to compensate investors in the Belfry Funds, a legacy from investments in commercial property investments in the UK which went badly wrong. The remainder of the exceptional costs were accounted for by restructuring.

For the calendar year 2021, Bank of Ireland posted a profit before tax of €1.4bn, released €194m of provisions for expected credit losses and said it plans to return €104m to shareholders through dividends and buybacks.

EURO Swap Curve – Implications for Fixed-Rate Mortgages

A high proportion of those taking out a residential mortgage opt for a fixed rate of interest for the first five years of their mortgage. Over the period from December 2021 to end March 2022, the 5-year euro swap rate rose from around -15bps to +90bps. This move represents a rise in the cost of 5-year money. If the higher +90bps rate is sustained, it is difficult to see how 5-year fixed-rate mortgage products offered by banks would remain unchanged.

Competition in the Irish Banking Market

With both KBC Bank Ireland and Ulster Bank due to exit the Irish market shortly, something of the order of 1.5 million customers will have to move bank. At first glance, their options appear to be limited to AIB Bank plc, Bank of Ireland, Permanent TSB, An Post Money, EBS and Credit Unions.

However, fintech banks like Revolut and N26 offer online banking services and are expanding their customer bases and improving the range of services they offer Irish customers.

Earlier this year, Bank of Ireland announced that it planned to shut over 100[1] branches across the country. Its CEO, Francesca McDonagh, said that a major reason for the decision was the shift to online banking services.

Revolut, which has about 1.7m customers in the Irish market, has announced it will begin offering personal loans in Ireland and has opened a waiting list for such loans. Already in 2022, Revolut is offering its Irish customers bank accounts that are backed by the €100,000 Lithuanian deposit guarantee, following the granting of a full banking licence by the European Central Bank in December 2021.

N26 is a German digital bank with about 200,000 customers in Ireland. It does not currently offer overdraft facilities in Ireland but is considering doing so. N26 has a German banking licence and deposits up to €100,000 are covered by the German bank guarantee scheme.

[1] https://www.rte.ie/news/business/2021/0301/1199958-bank-of-ireland/

Sanctions, Sberbank and the Single Resolution Board

The Single Resolution Board ('SRB') is the central resolution authority of the 19 eurozone countries, Bulgaria, and Croatia. It works closely with the European Commission, the European Central Bank, the European Banking Authority, and national authorities to ensure an orderly resolution of failing banks and protect taxpayers from state bailouts.

Sberbank is Russia's biggest lender and is owned by the Russian state. In Europe, Sberbank had a staff of about 4,000 and over 750,000 retail and corporate customers located mainly in central and eastern Europe.

On 1 March 2022, the SRB made three important decisions:

(i) It decided not to adopt a resolution scheme in respect of Sberbank Europe AG established in Austria. Sberbank Europe AG experienced a run on its reserves following the imposition of sanctions on Russia. Sberbank Europe AG was unable to provide liquidity to its European operations because of a prohibition on the movement of funds out of Russia by Russia's central bank. Elka König, the chairperson of the SRB, was quoted on ft.com as saying that Sberbank Europe AG was insolvent due to lack of liquidity rather than negative equity and that she was confident the Austrian subsidiary's assets were sufficient to repay its €1bn of deposits.

(ii) The SRB carried out a valuation of Sberbank d.d., the Croatian subsidiary of Sberbank Europe AG, and decided to adopt a resolution scheme in respect of Sberbank d.d., providing for the transfer of all the shares issued by Sberbank d.d. to the Hrvatska Poštanska Banka following a marketing procedure. The Croatian National Bank will now implement the SRB decision.

(iii) The SRB carried out a valuation of Sberbank banka d.d., the Slovenian subsidiary of Sberbank Europe AG, and decided to adopt a resolution scheme in respect of Sberbank banka d.d., providing for the transfer of all the shares issued by Sberbank banka d.d. to the Bank to Nova Ljubljanska Banka d.d. following a marketing procedure. The Bank of Slovenia will now implement the SRB decision.