EXAMINATION

20 October 2020

Subject F206 – Banking
Specialist Applications

Time allowed: Three hours and fifteen minutes

Total marks: 100

INSTRUCTIONS TO THE CANDIDATE

1. *Ensure that you are logged into your ProctorU account before attempting the examination.*

2. *Questions are only available in this ASSA Examination platform and may not be printed.*

3. *You are required to submit all of your answers in the ASSA Examination platform only. No uploads of answers (handwritten or otherwise) to the ASSA Examination platform will be accepted.*

4. *You may not use any other computer program (e.g. Email, MS Word or Excel), files or open any other browsers during the examination.*

5. *You are strongly encouraged to use the first 15 minutes as reading time only, however, you may commence answering the paper whenever you are ready.*

6. *Mark allocations are shown in brackets.*

7. *Attempt all questions.*

8. *Show calculations where this is appropriate. You may use blank paper to carry out rough work calculations. You may use a calculator from the approved list only.*

9. *You may return to your answers to review and amend during the allotted examination time. Once you are happy with your answers you need to **Finish all and Submit** your work. Once you have submitted you will not be able to make any more changes to your answers.*

10. *It is the candidate's responsibility to ensure that all work is submitted BEFORE the end of the allotted examination time. Take this into account when planning your review and submission. There will be no time announcements.*

Note: Answers will be saved automatically during the examination. However, the Actuarial Society of South Africa will not be held responsible for loss of data where candidates have not followed instructions as set out above.

END OF INSTRUCTIONS

QUESTION 1

You are recently employed as an actuarial specialist at a South African bank with a subsidiary in the island nation of Carinthia. An epidemic causing severe fever has struck Carinthia and, though the illness has a very low mortality rate, the government of Carinthia has closed all ports of entry and exit and imposed strict local quarantine measures to contain the spread.

Residential mortgages represent approximately 80% of total advances in the subsidiary. In response to the in-country situation, the Carinthian management team has proposed suspending local mortgage repayments from their customers for a period of 3 months. The CRO of the bank has asked you to write a brief report highlighting the most important considerations in pursuing this course of action. You need to gather all relevant information from the Carinthian management team.

Outline the information you would request from the management team to inform your report.

[Total 16]

QUESTION 2

The state-owned airline in a neighbouring country has approached your bank in South Africa, indicating it wishes to renegotiate the terms on (firstly) an existing long term secured loan held with your bank and to (secondly) increase an existing unsecured credit line (an overdraft facility) used to fund working capital.

Relevant facts are:

- Both the existing loan and facility are denominated in US Dollars
- Currently the total exposure to this counterparty constitutes 8% of your bank's total advances
- The long term secured loan has 4 years remaining (it is a 10-year amortising loan secured by title to two airfields in the country)
- The loan agreement contains various covenants that gives your bank an early call-up right should any of these be breached
- Following recent elections in this country, the minister has replaced all existing board members, including the chairman
- The new board has replaced the existing CEO and CFO by two new individuals
- No covenants or other contractual terms have been breached
- Indications are that the airline seeks to re-negotiate:
    - The terms on the secured loan, specifically the cash-flow covenants and an extension to its repayment term
    - To double the existing unsecured credit line/ overdraft facility

As the CEO of the bank, discuss all the considerations you expect your integrated risk team to evaluate.

[Total 30]

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QUESTION 3

A recent internal audit revealed that the non-performing loans disclosed in the financial statements have been incorrect over the last two reporting periods. The CRO of the bank has approached you to evaluate the root cause for this incident and to develop a solution to reduce the likelihood of this type of incident to be repeated in any area within the Retail Bank.

i. Discuss how you would go about identifying the root cause. [9]

ii. Describe the solution you would put in place to reduce the risk of this being repeated in future. [7]

iii. Briefly describe the main aims of the Basel Committee for Banking Supervision (BCBS) standard number 239 (BCBS 239), the standard dealing with risk data aggregation capabilities and internal risk reporting practices. [4]

iv. Detail the 14 principles of BCBS 239. [7]

[Total 27]

QUESTION 4

You are the credit head for the unsecured loans division of Notre Bank. The bank recently started a new channel for sales (using WhatsApp as a channel) and the sales volumes from that channel are substantial. The CFO reviewed the abridged financials and is concerned by the results for the 2019 financial year after Q3; compared to 2018, quarter 3 profits are down substantially.

You can assume there have been no pricing changes, or deliberate changes in risk appetite or definitions used by the bank over the accounting period given. The bank has raised impairments under the IFRS9 accounting principles throughout the periods given.

<u>Notre Bank financials & ratios:</u>

Quarterly new business per channel (R'm)						
Quarter	**Branch**	**Online**	**Banking App**	**WhatsApp**	**Total new business**	**Total book size**
2018Q1	R550	R400	R350	R0	R1 300	R23 300
2018Q2	R555	R405	R353	R0	R1 313	R23 784
2018Q3	R561	R408	R357	R0	R1 327	R24 264
2018Q4	R568	R411	R361	R0	R1 341	R24 742
2019Q1	R576	R415	R365	R980	R2 336	R26 197
2019Q2	R581	R421	R368	R993	R2 362	R27 628
2019Q3	R586	R427	R372	R1 002	R2 387	R29 032

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Quarter end income statement (R'm)

Quarter	Average balance	Interest revenue	Non-interest revenue	Running costs	Cost of funds	Impairment charge	Quarterly profit
2018Q1	R22 650	R1 020	R170	R113	R396	R530	R151
2018Q2	R23 542	R1 055	R177	R113	R412	R567	R140
2018Q3	R24 024	R1 077	R180	R113	R420	R587	R137
2018Q4	R24 503	R1 100	R184	R113	R429	R576	R166
2019Q1	R25 470	R1 144	R191	R113	R446	R630	R146
2019Q2	R26 913	R1 211	R202	R114	R471	R788	R40
2019Q3	R28 330	R1 279	R212	R114	R496	R780	R101

Quarter end exposures per impairment stage and write-offs (R'm)

Quarter	Stage 1	Stage 2	Stage 3 (NPL)	Quarterly write-offs	Provisions released as a result of write-offs	Total impairments on balance sheet	Quarterly impairment charge
2018Q1	R18 640	R3 495	R1 165	R440	R330	R3 052	R530
2018Q2	R19 075	R3 544	R1 165	R524	R393	R3 095	R567
2018Q3	R19 460	R3 615	R1 189	R524	R393	R3 158	R587
2018Q4	R19 892	R3 662	R1 188	R535	R401	R3 199	R576
2019Q1	R20 617	R4 323	R1 257	R534	R401	R3 294	R630
2019Q2	R21 798	R4 531	R1 299	R566	R403	R3 516	R788
2019Q3	R22 906	R4 732	R1 394	R584	R467	R3 712	R780

Impairment coverage ratios

Quarter	Stage 1 (Current)	Stage 2 (Arrears)	Stage 3 (NPL)
2018Q1	7%	25%	75%
2018Q2	7%	25%	75%
2018Q3	7%	25%	75%
2018Q4	7%	25%	75%
2019Q1	7%	21%	75%
2019Q2	7%	21%	80%
2019Q3	7%	21%	80%

Quarter end income statement - Financial Ratios - Annualised

Quarter	% Book Growth	Average Interest Rate %	NIR expressed as % of advances	Running Costs expressed as % of advances	Cos of funds expressed as % of advances	Impairment charge expressed as % of advances	Return on average assets	Margin excluding impairment
2018Q1		18.0%	3.0%	2.0%	7.0%	9.4%	2.7%	12.0%
2018Q2	16%	17.9%	3.0%	1.9%	7.0%	9.6%	2.4%	12.0%
2018Q3	8%	17.9%	3.0%	1.9%	7.0%	9.8%	2.3%	12.1%
2018Q4	8%	18.0%	3.0%	1.9%	7.0%	9.4%	2.7%	12.1%
2019Q1	16%	18.0%	3.0%	1.8%	7.0%	9.9%	2.3%	12.2%
2019Q2	23%	18.0%	3.0%	1.7%	7.0%	11.7%	0.6%	12.3%
2019Q3	21%	18.1%	3.0%	1.6%	7.0%	11.0%	1.4%	12.4%

Percentage of book per stage

Quarter	Stage 1 (Current)	Stage 2 (Arrears)	Stage 3 (NPL)	Write-Off as a % off previous NPL balances	Provisions Released as % of write-offs
2018Q1	80.0%	15.0%	5.0%		75%
2018Q2	80.2%	14.9%	4.9%	45%	75%
2018Q3	80.2%	14.9%	4.9%	45%	75%
2018Q4	80.4%	14.8%	4.8%	45%	75%
2019Q1	78.7%	16.5%	4.8%	45%	75%
2019Q2	78.9%	16.4%	4.7%	45%	71%
2019Q3	78.9%	16.3%	4.8%	45%	80%

Balance sheet impairments per stage and movement (R'm)								
Quarter	Stage 1 (Current)	Stage 2 (Arrears)	Stage 3 (NPL)	Stage 1 Movement	Stage 2 Movement	Stage 3 Movement	Write-offs	Total impairment charge
2018Q1	R1 305	R874	R874					
2018Q2	R1 335	R886	R874	R30	R12	R0	R524	R567
2018Q3	R1 362	R904	R892	R27	R18	R18	R524	R587
2018Q4	R1 392	R915	R891	R30	R12	-R1	R535	R576
2019Q1	R1 443	R908	R943	R51	-R8	R52	R534	R630
2019Q2	R1 526	R951	R1 039	R83	R44	R96	R566	R788
2019Q3	R1 603	R994	R1 115	R78	R42	R76	R584	R780

i. Explain the IFRS9 impairment principles for credit exposures. [3]

ii. The CFO has requested that you review the financials provided and explain what caused the reduction in profits. [13]

iii. Describe additional information that you may require to comprehensively understand the financial results to draw conclusions for the CFO. [6]

iv. With one quarter remaining, the CFO has asked what can be done to improve the income statement profit for the current calendar year. Propose possible actions, reflecting on both short- and long-term implications. [5]

[Total 27]

[Grand Total 100]

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END OF EXAMINATION

