



# Positioning your credit risk organization to manage the impact of COVID-19

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Commercial and consumer lenders that stand up COVID-19-specific processes and best practices will be best positioned to manage customer needs, maintain strong customer relationships, minimize credit losses, and comply with accounting and regulatory requirements.

The business closures, stay-at-home and distancing measures are creating uncertainty for borrowers and lenders as to the ability for borrowers to meet current and future loan obligations, and has compounded credit concerns already observed in the energy and retail markets. The CARES Act, signed into law on March 27, 2020, provides short-term funding for some U.S. businesses and consumers impacted. The Act, coupled with guidance from regulatory agencies, has provided temporary relief to lenders from certain reporting and accounting requirements to provide lenders flexibility to support borrowers affected by COVID-19 in the form of payment relief, modifications and forbearance. While the long-term impact is not yet fully understood, lenders that are proactive in the following areas will be best prepared to handle the downstream impacts of the current global situation:

- Establishing sound processes for managing customer outreach,
- The identification of potential payment relief, short-term liquidity financing, and forbearance needs, and
- The detection and tracking of existing and emerging credit risks

Commercial and consumer lenders may consider these seven steps to manage the impact of COVID-19.

## 1 Evaluate targeted modification programs and self-service options

A single modification program does not work for all borrowers. Targeting modification programs for customers with similar profile and establishing related self-service options for certain loan segments are methods to adeptly meet the needs of large groups of customers:

- Identify key loan attributes (e.g., loan type, collateral, interest rate, etc.) and evaluate integrity of existing data
- Group borrowers by common characteristics and engage borrowers with similar needs for modification programs, and establish a process for borrowers to determine eligibility for self-service options
- Ensure compliance with fair lending regulations (e.g., Equal Credit Opportunity Act and Fair Housing Act) that are already in place under the normal course of business when designing and implementing loan modification programs. Lenders need to assess any unintentional disparate impacts that may affect a particular group of borrowers.

**2 Update servicing systems and processes**  
 Customer portals and loan servicing platforms may need to be updated in consideration of COVID-19-related modifications and the requirements of legislative funding programs like Paycheck Protection and Main Street Lending:

- Ensure capacity to support substantial volume of applications and requests
- Track modifications related to COVID-19 separately for regulatory reporting and accounting treatment
- Ensure support for specific servicing and monitoring requirements from legislative programs (ex. SOFR for Main Street Lending).

**3 Create loan risk assessment and monitoring plans**  
 It is critical to proactively engage with commercial borrowers to understand their needs and how they have been impacted. In addition, assessing and documenting how COVID-19 will impact borrowers should include a deeper evaluation beyond lost revenues, including key customers and distributors, supply chain disruption, work-from-home (WFH) capabilities of employees, and other aspects of their business models:

- Assess how slow pay receivables, lost suppliers and service providers, tenant loss, and other risk factors impact your borrowers
- Risks should be documented, tracked and refreshed on a regular basis
- A chronological list of communications and credit actions connected to COVID-19 should be maintained.

**4 Perform a resource assessment and develop a target team model**  
 A robust risk monitoring framework will enable lenders to plan for the ongoing management of credit risk with the appropriate teams and skill sets, with special consideration to the likely need to manage higher volumes of troubled or deteriorated assets:

- Consider teaming models to cross-train credit professionals on problem loan management
- Assess crossover skills across teams in underwriting, portfolio management, loan review and audit
- Use risk assessments to predict where credit deterioration will predominate
- Conduct gap assessment to determine potential shortfalls based on predicted or early observed volumes.

**5 Consider effects of modifications, forbearance, and trouble debt restructurings (TDR)**  
 Relief provided to lenders from delinquency reporting, TDR assessment and other considerations are likely to be temporary, and future decisions on such matters are likely to be influenced by the totality of credit events:

- Maintain a lineage of credit actions and events since the outset of COVID-19 to support future assessments of TDR and impairment
- If additional forbearance is granted, consider the prevailing regulatory guidance and legislative relief at the time of such action.

**6 Develop guidelines for reassessing risk ratings**  
 Lenders should be assessing how the global situation impacts the appropriateness of their loan risk ratings, and institute a cohesive rating reassessment approach, as default probability increases from emerging quantitative and qualitative factors:

- Lenders should not wait for a payment default or new financial reporting before assessing risk ratings
- As conditions emerge, impacted segments or borrower groupings may be identified for bulk risk rating actions
- Assess if credit policy risk rating definitions provides adequate flexibility to consider COVID-19-related risk factors
- Risk rating actions should be interconnected with reserve/allowance modeling to help ensure comprehensive consideration without overlap.

**7 Conduct a data and modeling assessment**  
 The accessibility, completeness and reliability of a lender's loan level data will impact its capacity to understand how various market conditions will impact borrower defaults:

- Determine if loan level performance factors that influence credit quality are being captured and can be leveraged for analysis
- Establish a framework for collecting data to help maximize opportunities for stress testing, metrics and other analytics.

At KPMG, we have deep industry experience in both the consumer and commercial lending domains in understanding how to establish credit risk management processes and procedures to manage the unique challenges posed by a rapidly changing risk environment. We know how to derive targeted changes that remove the guesswork around how to respond to the evolving needs of customers in this environment, and in how to prepare for accounting and regulatory requirements as they emerge.

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