GCR Financial Institutions Sector Risk Scores
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Related criteria and research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Financial Institutions, May 2019
GCR Rating Scales, Symbols & Definitions, May 2019
GCR Country Risk Scores, October 2021

The GCR Financial Institutions Sector Risk Assessment

The Financial Institutions sector risk score (ranging from 0 to 15) is a key factor in the operating environment component score. The core of the GCR Ratings Framework is based on GCR’s opinion that an entity’s operating environment largely frames its creditworthiness. As a result, the operating environment analysis anchors the underlying risk score for the GCR rating methodology. GCR combines elements of the country risk and sectoral risk analysis, blended across countries for entities operating across multiple jurisdictions, to anchor an insurer to its current operating conditions. For more details on the above, please read the related criteria and research listed below.


Financial Institutions Sector Risk Scores

Republic of Botswana, Sector Risk Score 6.5, Country Risk Score 7.75*, Mapping Table 7.5 to 8.0

The Botswana financial sector risk score has been revised upward, reflecting good asset quality, healthy capitalisation that continues to be driven by favorable profit margins even amidst a challenging operating environment, high proportion of deposit-based funding, sufficient liquidity, and strength of the sovereign. We think banking regulation is adequate, while the concentrated sector structure resembles that of neighboring peers (top four banks account for just under 80% of total sector assets) underpinning overall sector stability. In addition to this, foreign currency lending is low and the operating environment is conducive to sustain the observed trends in these key performance factors given the expected recovery in the country’s GDP growth in 2021, comparably low household indebtedness, and a large public sector presence (with specific reference to the employee base of government/public institutions) which underpins income security and is expected to support broadly resilient asset quality within the core household lending portfolio of the sector-wide banking system.
Cote D’Ivoire, Sector Risk Score 3.5. Country Risk Score 4.5*, Mapping Table 4.5 to 5.0

The financial institutions sector risk score of ‘3.5’ for Cote D’Ivoire balances the strong economic growth and sound government fiscal position with moderately high non-performing loans and aggressive competition in the sector, as demonstrated by generally low levels of capital adequacy and profitability. Lastly, we balance the largely deposit-led funding base with underdeveloped capital markets.

Ghanaian Financial Institutions Sector Risk score: ‘3.0’. Country Risk Score 3.5*, Mapping Table 3.5 to 4.0

The Ghanaian financial institutions sector risk score of ‘3.0’ is balancing ongoing ramifications of the COVID-19 pandemic and the sound performance of the banking sector. The financial sector has proven to be resilient to the weakened operating environment. However, Ghanaian banks face increased asset quality risk from borrowers pressured by the economic effects of the coronavirus pandemic. Positively, the policy measures taken by the Bank of Ghana may help minimise the associated downside risk somewhat. Furthermore, the score takes in account the modest fiscal position of the government and state-owned enterprises. We also consider the banking sector to be somewhat fragmented and regulated in line with regional norms.

Asset risk and diversification compares adequately to regional peers. The banking sector is adequately capitalized, with capital adequacy ratio (CAR) averaging 20.2% at February 2021 (Dec 2020: 19.8%), comfortably above the minimum regulatory requirement. We expect profitability to remain sound, albeit constrained by the introduction of a financial sector clean-up levy in April 2021. Weak credit demand on account of the pandemic, culminated in a decline in growth in gross loans and advances to 5.8% in December 2020. On the other hand, investments grew strongly by 33.4%, resultantly, investments remained the largest component of banks’ assets (43.1%). Positively, the foreign currency exposures of 29.6% at Feb 2021 are moderate for the region. According to the BoG, 9% of banking sector loans had been restructured at end-2020 benefitting from debt relief. We expect to see non-performing loans (NPLs) to increase moderately as these measures unwind in 2021. Accordingly, the NPL ratio increased to 15.3% in February 2021 from 14.8% in December 2020 (15.7% in June 2020, 14.3% in December 2019). Positively, margins are high, and we therefore expect the capital adequacy to remain strong.

Republic of Kenya, Sector Risk Score 3.5. Country Risk Score 4.0*, Mapping Table 4.0 to 4.5

Kenya’s Financial Institutions Sector Risk Score of 3.50 balances the country’s good economic diversification with moderate economic growth, an increasingly strained government fiscal position and weak sector-wide asset quality with non-performing loans of around 14.6% at March 31st 2021. Positively, the foreign currency exposures (around 20%-25%) are moderate for the region and the Kenyan shilling has been supported by strong remittances. We also consider the sector somewhat overbanked and strongly competitive and believe that consolidation will be a recurrent theme going forward. Nevertheless, profitability has remained robust, despite a dip in 2020 due to lower interest rates and higher cost of risk resulting from the indirect and direct effects of COVID-19. This profitability has supported broadly adequate levels of capitalisation, with total capital to risk weighted assets at 18.9% at 31st March 2021. Regulation is broadly in line with the regional average and we consider the funding for the top end of the market to be stable.

Republic of Malawi, Sector Risk Score 2.0. Country Risk Score 1.5*, Mapping Table 1.0 to 2.0

The Malawian financial institutions sector risk score of ‘2.0’ reflects the modest economic growth of the country, alongside the restrained government fiscal position, weak but improving levels of non-performing loans and moderately high industry concentrations (trade, agriculture and manufacturing) in the loan and non-performing loan book. We consider regulation to be broadly in line with the region and complexity of the system. The banking sector is
somewhat concentrated. Two out of the total nine banks dominate the sector with a combined market share of just over 45%. Positively, profitability and capitalisation remain at fairly good levels. Short-term deposits dominate the funding structure of the system. There are moderately high levels of foreign currency funding and lending (approximately 25%) and underdeveloped capital markets.

Republic of Mozambique, Sector Risk Score 2.0. Country Risk Score 1.0*, Mapping Table 1.0 to 2.0

The Mozambican financial institutions sector risk score of ‘2.0’ is restrained by the current fiscal position of the government and some state-owned enterprises. Furthermore, non-performing loans are high but improving. Foreign currency lending is at moderately high levels, at approximately 25%. We view regulation as broadly in line with the region. The funding base of the sector is predominantly made up of retail and corporate deposits. Capital markets remain underdeveloped.

Republic of Namibia, Sector Risk Score 6.0. Country Risk Score 5.5*, Mapping Table 5.5 to 6.0

The Namibian banking sector risk score of ‘6.0’ balances reasonable capital and liquidity buffers and structural stability, against challenging operating conditions, posing medium term risks to asset quality. Furthermore, the largely wholesale deposit funding structure increases deposit sensitivities to market sentiment.

Namibian banks have been operating under highly subdued economic conditions for the past few years, and despite a downward trend in profit margins, the sector’s balance sheet has been maintained at sound levels, reflected in good liquidity and capital ratios. The onset of the COVID-19 pandemic in 2020 caused a sharp downward spike in earnings, with return on assets dropping to a 5-year low of 1.3%, from 2% in 2019, primarily due to higher credit losses and reduced net interest income (as a result of large interest rate cuts). We expect earnings to gradually recover as credit losses normalise from the peak of mid-2020, net interest income stabilises and transactional activity gains momentum, but we think return on assets may remain low, between 1.5%-1.8%, compared to historical levels of above 2%. This, in conjunction with loan growth extension expectations of between 3%-5% should support an industry average Common Equity Tier 1 capital ratio of around 13% going forward. Additionally, this muted loan growth may also allow existing liquidity buffers to be sustained, at least over the short term, with the banking sector holding high liquid assets relative to regulatory minimums. On the negative side, asset quality may remain pressured (non-performing loans deteriorated to 6.4% in 2020, from 4.8% in 2019) given the unfavourable sector dynamics underpinning borrower credit quality. This includes high household indebtedness, negative property valuation trends (with the sector representing over 50% of total industry loans) and comparably high corporate debt as a percentage of GDP (of around 70% at 2020 versus South Africa’s c.40%). However, the low interest rate environment may support debt serviceability as economic conditions gradually improve, but downside risk will prevail if employment and income growth do not improve. The sector continues to exhibit a high reliance on wholesale funding, however, to date, this has been fairly well managed.

Federal Republic of Nigeria, Sector Risk Score 3.5. Country Risk Score 3.75*, Mapping Table 3.5 to 4.0

The Nigerian Financial Institutions Risk Score of 3.5 is supported by strong local currency liquidity within the sector and stability in the funding (which is largely deposit based). Also, the banking sector appears well capitalized on average. In addition, consideration was given to regulatory compliance, which is considered adequate and in line with the regional average. However, concentration of the loan book by sector (oil and gas) heightens credit risk, though with modest levels of non-performing loans. We note that the Nigerian banking sector is highly fragmented, with the top tier of the sector controlled by a few players and increasing competition amongst players within the sector. The relatively low private sector debt is expected to continually increase going forward given the regulatory backed position of increased lending to the private sector, which would enable diversification. The standard negative one (-
1) adjustment for NBFI was applied. However, there could be further negative adjustments up to negative two (-2) for any rated entity in sectors without strong regulatory oversight.

**Republic of Rwanda, Sector Risk Score 3.75. Country Risk Score 3.5*, Mapping Table 3.5 to 4.0**

The Rwandan Financial Institutions Sector Risk Score of ‘3.75’ balances the weakening government fiscal position (government debt to GDP ratio is expected to increase to 80% by end of 2022 from 71% in 2020) with the banking sector’s rising levels of non-performing loans (non-performing loans increased to 6.6% at 31 March 2021 and the cost of risk reached a five year high of 3.6% in 2020). It also reflects the estimated high degree of restructured lending (c.20%) and relatively moderate foreign currency loans versus regional peers. Additionally, it factors in regulation and sector wide governance standards, which are deemed to be appropriate for its current levels of development and complexity. We do consider the sector to be somewhat overbanked given the size of the economy, noting that the top tier of the sector is controlled by a few players but that regional banks are increasingly competitive in the country. Positively, the banking sector appears well capitalised on average (c.20%), and profitability is solid and stable. Funding is largely deposit based, with limited wholesale and external funding, but some banks are reliant on interbank funding. The local capital markets are considered to be relatively underdeveloped.

**Republic of South Africa, Sector Risk Score 7.5. Country Risk Score 7.0*, Mapping Table 7.0 to 7.5**

The Financial Institutions Sector Risk score of 7.5 balances the ongoing positive characteristics that GCR believes will continue to support sector wide strength and stability as the country gradually moves towards a post pandemic recovery. Positive factors include the good regulatory frameworks that underpins the systems stability and demonstrated track record of the big banks in managing risk through severe downturns by sustaining capital strength through risk management practices that ultimately ensured adequate profitability to preserve the existing balance sheet buffers. We also believe that targeted stimulus measures were able to stave off a liquidity crunch in the financial sector and support the good build-up of liquidity buffers which will continue to support credit extension over the next 12-18 months. Overall, asset quality was undoubtedly impacted in 2020 and the bulk of the banks put through significant provisions in the first half of the year to cater for the potential negative impact on credit quality. Subsequently, the loan portfolio showed more resilience than expected in the second half of the year as hard lockdowns were eased and economic activity slowly normalised. As such, year end results were robust in the context of the environment, and the sector is expected to report further improvements in profitability in 2021 and 2022, although there may be some tail effects of the pandemic on asset quality as some hard hit sectors will not be able to fully recover.

**United Republic of Tanzania, Sector Risk Score 2.5. Country Risk Score 3.75*, Mapping Table 3.5 to 4.0**

The relatively low financial institutions sector risk score of Tanzania of ‘2.5’ reflects the long-term weak asset quality of the sector, which has caused low levels of provisioning. Furthermore, there are relatively high (approximately 30%) levels of foreign currency lending and funding. The banking sector is moderately fragmented, with the top five and ten banks contributing 54% and 71% of total assets, and modestly profitable. We also note some shortfalls in the supervision and prudential regulation of the banking sector. The systemwide funding is largely retail and corporate deposit based, however, there have been historically large concentrations from institutional investors especially from those banks in the second and third tier.
United Kingdom of Great Britain and Northern Ireland, Sector Risk Score 11.0. Country Risk Score 14.5*, No Mapping Table

The United Kingdom of Great Britain and Northern Ireland (“UK”) financial sector risk score reflects the strong operating environment, underpinned by high levels of wealth, good economic diversity, a strong regulatory framework supporting financial sector stability, low through-the-cycle credit losses, generally strong risk management, and diverse funding structures with deep, liquid capital markets.

Banking sector asset quality has improved since the peak of the pandemic in mid-2020. Most UK Banks raised significant COVID-19 related credit overlays in 2020, causing credit losses to exceed historical levels, and along with low interest rates and subdued client activity, depressed earnings. In 2021, asset quality held up better than expected thanks mostly to the rollout of various government support packages meant to assist the hardest hit economic sectors. The macro-economic outlook for UK is much more positive than a year ago with stronger GDP growth expected in 2021 and 2022, and most banks were able to release excess provisions towards the latter half of 2021, resulting in much improved 3Q 2021 performance.

Nevertheless, the sector still faces a great deal of uncertainty over the next 12-18 months which could undermine a sustained recovery. This mainly stems from 1) curtailed government support that could exacerbate asset quality pressure in strained sectors, while also noting SME’s that may have benefited from some form of financial support are generally more geared now, compared to pre-pandemic levels, 2) possible post ‘Brexit’ economic fallout and 3) more persistent inflationary pressure and supply chain disruptions that could lead to higher interest rates. As such, credit losses and NPLs may revert to historic levels within the next 2 years, following credit impairment releases observed across most industry participants in 2021 so far, but could remain strong in the short-term should the UK sustain its economic recovery.

Positively, the UK banking sector reflects a strong balance sheet, with solid liquidity and sound capitalisation, providing a buffer against low industry profitability (mostly due to very low interest rates). These strengths are likely to be sustained as loan growth is expected to average 2%-3% in 2022 and risk adjusted capital metrics benefit from lower risk weighted asset growth.

Republic of Uganda, Sector Risk Score 3.5. Country Risk Score 3.25*, Mapping Table 3.0 to 3.5

The Ugandan financial institutions sector risk score of ‘3.5’ balances the low levels of private sector leverage (approximately 15% of GDP) and currently modest levels of non-performing loans, with high amounts of foreign currency lending (35% of total loans) and high concentration risks. The system is dominated by the largest commercial banks, which largely have well managed foreign owners. Positively, profitability and capital adequacy of the system currently appear to be robust. Banking supervision and regulation are sound. Deposits dominate the funding base of the system. Capital markets are underdeveloped.

Republic of Zambia, Sector Risk Score 2.0. Country Risk Score 1.0*, Mapping Table 1.0 to 2.0

The Zambian financial institutions sector risk score of ‘2.0’ is restrained by the currently high fiscal strain facing the Zambian government and public sector more generally, but also high levels of foreign currency lending (over 35%) and high lending concentrations. We consider the regulation to be broadly behind the regional average, but the structure of the sector benefits somewhat from the dominance of foreign owned banks, which control 83% of the
banking sector assets. We believe corporate and retail deposits make up the majority of the funding base, although we also anticipate a high amount of foreign lines. Capital markets remain underdeveloped.

**Republic of Zimbabwe, Sector Risk Score 1.0, Country Risk Score 0*, Mapping Table 0.0 to 1.0**

The Zimbabwe financial institution sector risk of ‘1’ is restrained by hyperinflation, foreign currency (“FCY”) challenges and the ramifications of the on-going COVID-19 pandemic posing major risks to the banking industry’s operations and performance. Furthermore, inconsistent monetary policy, and a long-term weak fiscal position are a material risk to business stability and the already weak banking sector consumer confidence. As a result of the hyperinflationary environment, monetary losses will erode performance gains and nominal capital. Furthermore, yields are under threat from high inflation.

Despite the sound loan book performance of the banking sector, we expect that banks’ operations may face additional challenges with credit extension and FCY loan repayment. Local currency liquidity is sound, however, GCR expects foreign currency liquidity challenges to persist and high probability of default on FCY debt. Positively, GCR notes, 1) the stability of the exchange rate from Q4 2020 albeit, with dislocations from parallel rates; 2) introduction of the auction system that has worked well in availing foreign currency to otherwise disadvantaged individuals; and 3) review of the minimum capital requirements, provided a firm stance is taken against non-compliant institutions.

Regulation is viewed relatively weaker than the regional average, improvement efforts are constrained by a high probability political interference resulting in an unstable operating environment. Failure by regulatory and monetary authorities to arrest regulation, governance & policy certainty may result in the sector score being negatively impacted. The score also considers the somewhat fragmented sector, but the banks in the top tier are generally profitable and adequately capitalized. Funding is largely deposit based, spread between corporate and retail deposits. However, the Zimbabwean government and her agents continue to fail to honour obligations in foreign currency (“FCY”) in a timely manner. As a result, GCR will continue to reflect a default event, for both foreign and local currency obligations, for the international issuer and issue scale ratings of Zimbabwean entities.

Due to severe foreign currency shortages, hyperinflation, and significant monetary and exchange control policy changes over the last 12-18 months in our opinion, the national scale credit ratings on Zimbabwean entities are not directly comparable to credit ratings and risk scores within other markets. Furthermore, outlook statements may fail to capture forward looking trends due to the extreme volatility in the operating environment and audited opinions. See the latest Jurisdictional Supplement for Criteria, published July 2020, available at https://gcrratings.com/criteria/

*Country Risk scores as at date of publication.