Press Release
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Egypt FRA: Stress testing results show robust financial position of NBFIs

- **Dr. Omran: FRA conducted its first-ever stress testing to gauge the non-banking financial sector's ability to withstand Covid-19 impact**
- **Dr. Omran: Stress testing is part of Early Warning System against crises to financial stability of NBFIs**

Dr. Mohammed Omran, Chairman of the Financial Regulatory Authority (FRA) of Egypt, announced wrapping up a four-month stress testing started in April 2020. It aims to gauge the ability of the Non-Banking Financial Institutions (NBFIs) to withstand economic and financial implications of Covid-19. It also measured the impacts of the novel virus on revenues and liabilities of NBFIs, along with their financial position and the scale of potential risks.

Dr. Omran pointed out that results of stress testing and scenario analysis have demonstrated robust financial position of NBFIs. It also highlighted the necessity of developing Business Continuity Plans (BCPs) of the companies operating in the non-banking financial sector and spurring them to push ahead with enhancing digital transformation. This came on the back of social distancing rules and the global inclination to adjust business patterns. Moreover, the findings demonstrated the importance of constantly following up some companies, which have shown more risk exposure with regard to financial adequacy and determining the extent of their need for capital increase over the next couple of years.

The FRA sought to make the first-ever stress testing and scenario analysis as a step towards implementing one of the key pillars of its Non-Banking Financial Sector's Comprehensive Strategy (2018–2022). The move aims to set up a full-fledged system for improving Risk Management and Early Warning System Against Crises to gauge the financial stability of NBFIs. This in turn boosts the crucial role of NBFIs in access to finance, financial inclusion and sustainable growth.

In pursuit of launching an early warning system, FRA is working toward helping NBFIs to understand emerging risks, tackling current crisis at the level of each company, and the board's solutions to address emerging challenges of such crisis in the short and long term. FRA also seeks to enable NBFIs to estimate their Covid-19 induced losses and define whether emerging financial risks require any specific regulatory measures, preventive or protective, to mitigate any potential adverse impacts.

It is worth mentioning that this exercise took into account lessons learned from the 2008-2009 Financial Crisis, comprising stress testing for banks, which managed to overcome the global crisis repercussions.

The stress testing covered majority of entities working in the Non-Bank sector. This includes the entire life and non-life insurance companies; 10 biggest asset management companies that represent around 60% market share of assets under management; 80% of mortgage finance companies representing 97% of market share; 67% of financial leasing companies acquiring around 85% of the leasing market share; and 60% of factoring firms representing 88% of market share. Additionally, the test was conducted to 18 microfinance entities, including 6 companies and 8 associations and NGOs, with a combined market share of 85%.

The FRA has embraced a progressive approach in tailoring stress testing scenarios, starting from the base-case scenario to optimistic and pessimistic ones. These scenarios looked at the impact of Covid-19 on financial condition, liquidity, profitability, and operational efficiency. Furthermore, these scenarios have been altered according to the nature of each NBFI's activities taking into consideration the key risks affecting each activity.

On the front of the insurance activity, there were six scenarios. These scenarios concentrated on measuring economic risks such as key interest rates, stock market indices, and high default rates of reinsurance firms. Moreover, the scenarios entailed risks related to insurance; namely high claims, cancellation of insurance policies, and low reimbursement of reinsurance. The stress testing results found out a low risk level for weak financial position, a moderate risk level for weak liquidity ratios, an acceptable risk level for low profitability, and a moderate risk level for low operational efficiency.

As for the capital market, the test has 9 scenarios focusing on gauging risks such as GDP growth rate, key interest rates, and inflation. The results showed that 90% of companies would not face any risks in case of a 100bp interest-rate change, while 10% of companies may face moderate risks in case of a higher interest rate. Meanwhile, in case of a lower interest rate, 20% of companies may face moderate risks.

Moreover, three scenarios were laid out for the mortgage finance, financial leasing, and factoring activities. The results demonstrated a moderate risk level for those scenarios affecting the financial position of finance companies. Meanwhile, the results of scenarios affecting liquidity ratio and financial hardship had relatively acceptable risks.

As for microfinance entities, several scenarios were set up, ranging from the base-case scenario to moderate and most pessimistic ones according to certain parameters. The results highlighted that weak financial position represents a moderate risk level, while weak liquidity ratios and financial hardship have an appropriate risk level. Low profitability has relatively acceptable risk level, while low operational efficiency, declining portfolio, and high provisions have low or acceptable risk levels.

FRA Chairman said that the final report of the stress testing for NBFIs, which comprises of nearly 100 pages, will be posted on the FRA's website soon for further review and analysis.

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