EMIRATES NBD Q3 2020 RESULTS ANALYSTS & INVESTOR CONFERENCE CALL & WEBCAST
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CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Ladies and gentlemen, welcome to Emirates NBD's Results Call and Webcast for the Third Quarter of 2020. Today's call is being recorded. Please note that this call is open to analysts and investors only. Any media personnel should disconnect immediately. I will now pass the call over to our host Mr Shayne Nelson, Group CEO of Emirates NBD.

Shayne Nelson

Thank you operator, and welcome everyone. Joining me as usual are Patrick, the Group CFO and Paddy, our Head of Investor Relations. Before we go through the results for the first nine months of the year in detail, I will update you on operational developments within the Bank and the economic environment.

Over the last three months we have seen the economies we operate in gradually reopen. The way we work and do business has changed dramatically. We have coped well with the recent challenges and demonstrated great versatility by providing a full banking service whilst a large number of colleagues have continued to work from home or from contingency sites. During this time, more customers have utilised our digital banking offering as a secure and safe banking platform. As branches and offices reopen, we have maintained and enhanced deep cleaning and sterilization protocols and provided training in precautionary measures to frontline staff.

Emirates NBD has remained strong throughout this year and we have used that strength to support our customers affected by the severe disruption caused by Covid-19. Our philosophy has always been to support customers now in order to minimise credit issues arising later. At the beginning of Q3 we provided 8.3 billion dirham of interest and principal deferral relief to over 90,000 customers. During the third quarter, we granted a further 225 million dirhams of interest and principal relief and nearly two billion dirhams of relief was repaid. To date we have helped nearly 100,000 customers. So far there has been a modest deterioration in credit quality, but as I mentioned last quarter, it will take several more quarters before the true credit picture becomes evident.

Turning to the economy, the UAE Government have issued clear, prescriptive and measured guidelines to reopen the economy with safety continuing to be the top priority. UAE Economic indicators show that business activity improved slightly in September while new orders remained flat and companies reduced their headcount in a bid to curb costs. We have a strong balance sheet and we will use this to actively play our part in supporting economic development in the coming quarters.

Turning to performance, total income grew 18% as the contribution from DenizBank helped offset margin contraction due to falling interest rates. Non-funded income improved in Q3 as activity picked up post-lockdown. Costs remain under control but the increase in impairment allowances resulted in operating profit being 24% lower than last year.

The Bank's capital ratios remain strong and well above minimum requirements. We have maintained healthy coverage levels in anticipation of any deterioration in credit quality in the coming quarters. The bank continues to have a strong liquidity profile supported by a stable deposit base and good access to the capital markets. During the last quarter, Emirates Islamic successfully issued a benchmark Sukuk at competitive pricing, and DenizBank were able to issue a number of private placements from their recently established MTN programme.

I will now hand you over to Patrick to go through the results in more detail.

Patrick Sullivan

Thank you, Shayne. I will walk through the performance for the first nine months of 2020, which is set out on page 4 of the presentation, and the third quarter, which is detailed on page 5.

So, starting with page 4, total income improved 18% year on year, now this includes DenizBank income 5.9 billion dirhams in the first nine months of 2020 versus 1.3 billion dirham contribution for the two months since acquisition July 2019. Net interest income improved 21% and Non-funded income improved 9% y-o-y including the DenizBank contribution. Excluding DenizBank, net interest income declined 11% y-o-y due to lower interest rates and non-funded income declined 19% y-o-y as a result of lower client activity during the acute disruption from Covid-19 in the second quarter.

Costs increased 23% y-o-y with the inclusion of DenizBank for the full period. Excluding DenizBank, costs were 5% lower with the Q2 cost management actions taken effect in Q3. The cost to income ratio for the first nine months at 31.8% is within guidance and these combine to deliver an improvement in the pre-provision operating profit up 15% y-o-y.

In the third quarter there was a modest increase of 0.2% in the NPL ratio, increasing to 6.0%. The credit impairment charge of 6.4 billion dirhams represents a 131% year on year increase and has helped strengthen the coverage ratio to 119.6%. Now we continue to maintain healthy coverage levels due to the uncertain credit environment. However, we expect the impact of Covid-19 on credit quality will not really be fully evident until future quarters as forbearance rolls-off, and I will elaborate on this shortly.

The increase in provisions has resulted in a 24% fall in operating profit YTD. Reported net profit fell by 55% as last year's results included a 4.4 billion gain on the disposal of Network International shares. Excluding the NI disposal, net profit was down 30% year on year.

Net loans have grown by 1% during 2020 and deposit balances are down 3% mainly due to Turkish Lira depreciation. The Liquidity Coverage Ratio of 161.7% and the Advance to Deposit Ratio of 96.6% continue to demonstrate the Group's strong liquidity profile. We have a strong diverse funding base which we have used to support customers through these challenging times.

The profile of the quarterly results is set out on page 5 is affected by the same drivers as I just outlined so I don't propose going through each line item. There are a number of points to note briefly. In Q2 we had seen a 17% drop in income over Q1 but in Q3 the quarter over quarter drop is just 2%. Within that, non-funded income grew 10% q-o-q due to the gradual increase in business volumes during Q3, almost offsetting the continued reduction in Net interest income. Q3 cost were down 7% over Q2 as management actions took effect. And Q3's impairment allowance is higher than the preceding quarter as we keep up our strong levels of provisioning and partly because of the benefit of restructuring recovery in Q2.

Slide 6, that our Net interest margin trend over the quarters, at the bottom left we see the year on year, lower interest rates adversely impacted loan spreads by 132 basis points and this was partially offset by a 86 basis point improvement in deposit and funding costs. Excluding DenizBank, margins would have finished at 236 basis points but the 37 basis point contribution from DenizBank lifted margins to 273 basis points for the first nine months of 2020.

The chart on the bottom right shows the margins in the Group contracted in Q3 as lower interest rates impacted loan spreads by 52 basis points reflecting the fall in one- and three-month EIBOR rates of over 170 basis points during 2020. This is partially offset by a 30 basis point improvement in funding costs and a modest contribution from DenizBank in Q3.

We have maintained NIM guidance at 2.55-2.65% we expect to be nearer the top end as we anticipate a smaller impact on loan yields in the fourth quarter as recent declines in EIBOR rates have been less than in earlier quarters. The full year NIM even if it were nearer at the top end does imply that the Q4 NIM will be lower than in Q3 and its also assumes no further FED or CB UAE rate cuts.

Turning on slide 7, we see that the Bank continues to operate with strong liquidity. We have 95.8 billion dirhams of liquid assets which covers 16% of total liabilities and 21% of total deposits. The Liquidity Coverage Ratio remains healthy at 161.7% while the Advances to Deposits ratio was 96.6% at 30 September. As with Q2, we have not seen any material increase in EIBOR rates towards the end of Q3. This is a good barometer of interbank liquidity and indicates that banks were not aggressively paying up for liquidity over quarter end. The measures introduced by the UAE Central Bank earlier this year have helped ensure orderly and stable liquidity within the UAE banking sector.

In 2020 year to date, we issued 17.1 billion dirhams of term debt in seven currencies with a 9.8 year weighted average life. This includes three benchmark senior public bond and Sukuk issues and private placements with maturities out to 30 years. This covers not only 100% of the Bank's maturities in 2020 but approximately a 1/3rd of 2021 maturities. DenizBank has also been successful in issuing a number of private placement under its newly established EMTN programme.

The pie chart on the bottom left shows that customer deposits continue to make up three quarters of liabilities. And that leads nicely onto the profile of deposits on the next page. On the bottom right of slide 8, we see Emirates NBD's deposit mix continued to improve in the third quarter, with CASA growing by 6 billion dirhams, essentially replacing the 7 billion dirham reduction of fixed deposits. As I noted earlier, total deposits are down year to date mainly due to Turkish Lira depreciation.

CASA across the entire Group represents 50% of total deposits. The domestic CASA engine for Emirate NBD remains strong and represents 58% of domestic deposits. Gross lending increased 2% in the first nine months. Within that, Retail gross lending grew 1% during 2020, Corporate lending grew by 3% and Islamic Financing grew by 7%. DenizBank's gross loans and deposits grew by 22% and 15% respectively in local currency but declined in dirham terms due to currency depreciation.

Slide 9 shows the diversity of the loan portfolio, particularly with the addition of DenizBank. The UAE comprises 76% of loans with International and GCC making up the remaining 24%. And at the segment level, 34% of loans are sovereign, 60% retail. Corporate is 37% and Islamic represents 13% of gross lending. The pie charts on the righthand side shows the diversity of the loan profile by sector and is broadly the same as H1.

On slide 10, as mentioned earlier, the NPL ratio increased slightly by 0.2% in Q3 and 0.4% YTD to 6.0%. It is still too early to predict the level that NPLs will rise to, but in anticipation of a weakening in credit quality, we continue to maintain a strong coverage level. Coverage has risen by 7.3% to 119.6% in 2020. The Bank has taken AED 6.4 billion dirhams of impairment allowances.

Now this equates to an annualised cost of risk of 176 basis points, with DenizBank continuing to boost coverage through an annualised cost of risk of 408 bps for the first nine months, and Emirates NBD's comparable cost of risk of 125 basis points is up from 91 bps in 2019. Overall coverage remains strong in the third quarter as impaired loans increased by 0.8 billion dirhams compared to a 1.7 billion dirham increase in provisions. We will continue to review the overall level of provisions as the impact of Covid-19 becomes more apparent in subsequent quarters.

Turning to slide 11, this provides more detail on our levels of Stage 1, 2 and 3 coverage. As with our H1 results, for Q3, the macro-economic variables forecasts have been updated to reflect the impact of Covid-19, and our scenario weighting continues to be 40% baseline, 30% upside and 30% downside scenarios.

The Group has also applied portfolio-level, ECL adjustments to wholesale exposures based upon affected geographies and sectors, as well as to retail customers taking up deferrals based upon employment status and level of salary inflows. The Group continues to assess individually significant exposures for any adverse effects of Covid-19.

The chart on the top right shows that Stage 1, 2 and 3 impairment allowances have grown in total by a net AED 4.8 billion since the end of 2019 to 34 billion. Stage 1 ECL allowances increased by 0.4 billion dirhams to 5.1 billion dirhams. And this increases stage 1 coverage to 1.2% on 88% of total gross outstanding loans. Stage 2 ECL allowances increased by 1.9 billion dirhams to 5.5 billion dirhams. And this increases stage 2 coverage to 20.8% on 6% of total gross outstanding loans. We have increased stage 3 ECL allowances by 2.5 billion dirhams during 2020, giving a strong 86% stage 3 coverage.

And finally, just touching on deferral and the TESS or Targeted Economic Support Scheme. We have provided details of deferrals in note 25 of the financial statement. But in summery: We have provided AED 8.5 billion of deferred principal and interest repayment support to our customer and clients. Customers have repaid 1.9 billion dirhams of support, meaning that as at the 30-September the Bank was still providing 6.6 billion of support to customers.

During Q3 Emirates NBD repaid just over 900 million of TESS zero cost funding to the Central Bank of the UAE and continue to utilise 6 billion of TESS zero cost funding. Most of the repayments have come from Corporate and Institutional banking clients. And total principal related clients with supporting with deferrals is AED 49 billion, or 11% of total UAE lending. We continue to be vigilant and take a cautious approach to our provisioning and we will keep you up to date as the credit profile of the loan book evolves in coming quarters.

I will now hand you over to Paddy to take you through the remaining slides.

Patrick Clerkin

Thank you, Patrick. Slide 12 shows that core gross fee income for the first nine months improved 15% year on year due to the full year inclusion of DenizBank. Core gross fee income for the third quarter improved 24% over the previous quarter on increased activity but remains 7% below the level recorded a year ago.

Income from Foreign exchange, Rates and Trade Finance all improved quarter on quarter reflecting increased activity. Fee income also delivered a quarterly improvement on higher retail transaction volumes and increased investment banking activity. Income from Property shows a modest loss as we continue to write down the remaining inventory. Income from investment securities was also lower as Emirates Islamic revalued its investment portfolio.

On slide 13, we see that costs for the third quarter improved 4% year on year despite the inclusion of one additional month of DenizBank costs, as the results for Q3-19 included two months of DenizBank costs following the acquisition. Looking at Emirates NBD only, costs improved 12% year on year due to lower staff and operating expenses. Following earlier cost management exercises, Costs improved by 7% over the previous quarter on lower staff and operating expenses and lower costs from DenizBank.

The cost to income ratio of 32% in Q3 is back within the management range of 33% and gives an average cost to income ratio of 31.8% for the first nine months. We expect the cost to income ratio to increase towards the 33% due to lower expected income during the final quarter. This is not surprising given how rapidly global interest rates fell earlier this year, and the immediate impact such cuts have on income but the impact will be somewhat tempered by the earlier cost management action.

Slide 14 shows that the capital ratios strengthened between 0.3% and 0.7% in the third quarter. The Common Equity Tier 1 ratio rose 0.3% to 15.6% due to retained earnings and a 1% reduction in risk-weighted assets. The Tier 1 ratio rose by 0.7% and the Capital Adequacy ratio rose by 0.6% in Q3 as both also benefited from the issue of a $750m Additional Tier 1 perpetual note in July which more than offset the call on a $500m old-style AT1 note in September. The reported capital ratios for 2020 include an add-back for incremental Stage 1 and 2 ECL allowances as permitted by the UAE Central Bank. Excluding this add-back, the Common Equity Tier 1 ratio is at 15.1% and the capital adequacy ratio is at 18.6%.

TESS offers Banks relief on capital buffers until 31-Dec-2021 without supervisory consequences. Hence Emirates NBD's current minimum Common Equity Tier 1 ratio is 8% and minimum CAR is 11.5%. Even excluding the add-back, Emirates NBD's actual capital ratios are over 7% higher than these new minima.

On slide 15 we see that RBWM, year on year revenue fell by 7% due to lower fee income as volumes were impacted by lower activity due to Covid-19. Customer advances reduced by 1% and deposits grew by 6% supported by a successful marketing campaign. Year-on-year, the first half cost-to-income ratio for RBWM improved by 2% to 25.5%.

Emirates Islamic grew Financing and investing receivables by 9% in the first nine months of 2020. Customer accounts increased by 1% and EI has a healthy 70% of deposits coming from CASA accounts. During the third quarter, EI returned to the capital markets with a successful 500 million dollar 5-year Sukuk issue.

On slide 16, we see that the Corporate and Institutional Banking income fell by 6% year-on-year as the 9% decline in net interest income was partially offset by an increase in investment banking activity. Loans grew 3% and deposits increased by 9%.

Global Markets & Treasury revenue declined 204% as net interest income was adversely impacted by lower interest rates. Non-funded income was also lower primarily due a mark to market movement on hedges relating to term funding although the credit trading desks continues to deliver a strong performance. As Patrick already mentioned, the Global Funding Desk has fully covered term liabilities maturing this year and one-third of next year's maturities.

Slide 17 shows DenizBank had a good first nine months, delivering nearly 6 billion dirhams in revenue and a net profit of 1.2 billion dirhams. DenizBank continues to take significant provisions to boost its coverage level.

Margins contracted 12 basis points during the third quarter to 4.28%. The NPL ratio for DenizBank improved by 0.6% during the year as loans grew by 22% in local currency terms and the credit performance on newly originated business remains healthy.

With that I will pass you to Shayne for his closing remarks.

Shayne Nelson

Thank you Paddy, and to summarise:

The positive income contribution from DenizBank has helped offset a decline in net interest income from lower interest rates and lower fee income due to the impact from Covid-19. The decline in NIMs is starting to flatten out and we expect NIMs to close the year at the top end of guidance. As activity picked up, non-funded income improved 24% in the third quarter on higher volumes, but is still 7% lower year-on-year.

Earlier cost management action has brought the cost to income ratio back within the 33% management range. Liquidity and credit coverage ratios remain very healthy and we delivered a further improvement in capital ratios. We have provided support to one-tenth of our customers primarily through the deferral of both interest and principal for periods of up to six months. In addition, we have waived certain fees to help individuals and business cope with the disruption. The number of retail and corporate customers who regularly use our digital platform continues to grow. Emirates NBD delivered a net profit of 5.6 billion dirhams for the first nine months of 2020 and this, coupled with a strong balance sheet, provides a platform to continue supporting our customers.

With that I would like to open the call to your questions. Operator please go ahead.

QUESTIONS AND ANSWERS

Operator

Our first question comes from Mr Hootan Yazhari of Bank of America. Please go ahead.

Hootan Yazhari - Bank of America

Hi there, gentlemen. As ever, thank you for the call. I have a few questions. First of these really focuses around asset quality. We saw some big ECL model changes in Q2 given the disruption in economic growth expectations. Yet we are facing Q3 with yet another big provision charge which obviously negatively surprised the market. So the key question I guess is how long can we expect an elevated cost of risk to persist particularly in Turkey? And what are the key trends that you're seeing in the corporate market in the UAE? It seems as if though the retail market benefited from some write-backs that you were talking about on the restructuring side. But maybe you can talk about the outlook for the corporate and the retail side in the UAE just so we can have an understanding of when this high level of provisioning could potentially abate if ever?

The next question I have is really regarding cost. You did a very good job in pulling costs down in Q3. Given that you have reassessed the growth outlook for 2021, how are you thinking about the cost base? Are you now in a position to further rationalise your cost base or do you feel that the activity that you've taken are already optimal?

Patrick Sullivan

Hi, Hootan, Patrick here. Maybe I'll just take the first part of that to start with. So you have the question of how long do you expect the impairment fee elevated. We were strong coming out of the blocks in Q1 where we made a AED 2.6 billion provision. We had weighted our ECL scenario to a 100% on the downside. I think we are one of the banks being able to update the macroeconomic variables. And then in Q2, we had a AED 1.7 billion impairment and that did have a benefit from a restructuring recovery in that. So at AED 2.2 billion for Q3, we are maintaining a level of provisioning that is probably less than what it would have been in the previous quarter. I think I have said in the previous quarters as well that we do expect it to be particularly through this year still elevated. In Turkey, we have been going through the portfolio and making sure we have the right levels of impairment and building the coverage in Turkey closer to the overall group levels as well. So we're doing that consciously. And…..

Shayne Nelson

If I'll just say on Turkey, Patrick, because I think it's a good question. You remember from our discussions on previous quarters on Turkey that we took a long time to close this transaction. And part of the SBI that we had with the Sberbank was that we looked at every significant file as it was coming through for approval or renewal. So because that the whole process took so long, we looked at every file of significance in that book. Plus, we did two credit due diligences on the portfolio. So I think it's fair to say that if we look at the risk profile that we expected is what we got. And new problem formation that we've had there has being fairly low.

However, having said that, obviously if they were – if that loan was in the tourism area, that has been more adversely affected than others. So I think it's fair to say that some of the stuff that we forecast as a problem has deteriorated at a faster rate than we would have anticipated there. But our push in Turkey is we want them to get their ratios up to the group standard of where we actually have our ratios. So Turkey has been outperforming the acquisition model on revenue. It's got a better cost-to-income ratio than our acquisition model. And we have been – and that's enabled us to accelerate the build of provisioning there quite aggressively in Turkey. And we'll continue to do that whilst they have the room there on the revenue side.

Patrick Sullivan

Thank you, Shayne. And Hootan, you also had the question on costs. Yes Q3, they're down. We had management actions in Q4 last year. So that benefit's also coming through, and then in Q2 we took further actions to manage the cost base. We think it's in good shape. It's partly accelerated. But the accelerated digital agenda, some of those benefits are also coming through. So they're always looking at the cost base to run as efficiently as possible. We are below 33%. So that's already running very lean. But as far as the 2021 outlook goes, we'll be updating our guidance in January next year.

Shayne Nelson

There was also a question on the retail side, and how that's performing. So if I just go through it by product by product as to where we are, mortgages surprisingly are running at a better rate than they were in the first quarter. So we've fully recovered on that side. On the credit cards, we're probably writing about 75% of new acquisitions that we work. And interestingly, the August numbers showed that we were number one and number two with new credit card acquisitions for Emirates NBD and then Emirates Islamic in the UAE market.

Personal loans are getting close to above 80s, and car loans sort of in the 60-70%. So I think it's about the numbers. So the market has bounced back probably stronger than we would have anticipated. And when we were looking at – when we did the reshaping of the costs, we were sort of thinking that 60-70% would be the right range as to what recovery would be in the third and fourth quarters. Well, we've actually blown through that far sooner than we thought.

Spending on credit and debit cards locally is about 95% of where it was. So there's been quite – the spending patterns have come back quite strongly. Obviously, online is very strong as well. But yeah, we have seen a recovery in the spending patterns of our customers on both debit and credit. Hopefully that gives you a good view.

Hootan Yazhari - Bank of America

Yeah, thank you. That was clear. If I can just take you back to what we were saying with regards to Turkey, and how you want to get its coverage in line with the rest of the group. What I'm ultimately trying to understand is at what stage can we start to see that coverage being reached? And then cost of risk coming through, what is going to be a more normalised level? And the ROE, the underlying ROE of the bank, more reflective of what the bank can do in the mid-cycle environment. Or I'm also trying to understand that this is the way it's going to be for the foreseeable future and Emirates NBD is going to be generating high single digit, low double digit ROEs for the foreseeable future. That's what I'm really trying to get at.

Shayne Nelson

I think from our perspective, the issue with any of this is how long is the piece of string. If you can tell me how long COVID will keep lasting and affecting the economy in Turkey, I could probably give you a better answer. But I think for us whilst we've got the above-budget revenue coming through that franchise, we think it's prudent to cover what we can. And I think that's the prudent measure that we always do from history, how conservative we are on the provisioning side. And we continue to build both here and in Turkey and in other franchises.

Patrick Clerkin

Thanks Hootan. We've a couple of questions coming through on the webcast. So I'll field a couple of those and then we'll open the call up for further questions. There's been a few questions on cost of risk. I think we've covered that and that's the difference between Turkey, UAE, etc., when we expect things to normalise etc, we've really covered that. Patrick just more impairment charge – are more impairment charges expected in Q4 given that we've already had – we already have a high coverage level and why have risk-weighted assets reduced by 1%?

Patrick Sullivan

Paddy just on the first part, I think the answer is yes, we will have more credit impairments in Q4. I'd like to see a bank that doesn't let's say so over-provided previously. As we have suggested before, it probably will be – remain relatively elevated given the environment that's out there. Probably too early to tell what that holds for next year, but as we know we like to make sure we're well covered for the credit events that have occurred already. And with IFRS 9, running the models to make sure that we are taking into account most of the factors for that Stage 1 and 2 level provisioning. Even if something moves from Stage 2 to Stage 3, there is always a delta on the impairment on that. So far, we haven't seen the NPLs step up. So really we'll have to see towards the end of the year how the NPLs are looking and the relative provisioning required and the coverage for that.

Just on the second part there, how have the risk-weighted assets reduced by 1%. The main impact has really been the Turkish lira depreciation. So when risk-weighted assets in Turkish lira translated back to AED, that really comes through, and that we could see that in the deposits and the lending side as well that we showed you on slide number 8.

Patrick Clerkin

Great. There is a follow-up question on NIM compression. And is it fair to say post Q4 2020 that there would be further minimum NIM compression if there's no further rate cuts?

Patrick Sullivan

Well, we have benefited this year from lower cost of funding, so a part of that depends on the profile of your funding base. So we'll see what the exit rate is at the end of Q4. I think we've given you enough information that you can pretty much calculate what that is, and we'll update the guidance for next year as a whole when we come back in January.

Shayne Nelson

The only comment I would make on that one would be as rates rise in Turkey – well, it's not a rise. There is a lag effect in Turkey between, deposits there are pretty short versus the repricing of the loans. So you could see some compression coming out of the Turkish market if rates start to rise quite rapidly in Turkey.

Patrick Clerkin

And Shayne, a question from Vijay. Are you seeing any indications of green shoots of recovery anymore in the economy, any specific sectors?

Shayne Nelson

Green shoots of recovery. Well, I suppose spending has been a good surprise. We wouldn't have thought it would be back at 95% domestic spend when we were talking to the analysts last quarter. So I think that is a good thing. Housing, I'm not sure. I mean I'm not sure that on – for example just because we're running at over a 100% of what we are writing in housing loans in the first quarter is a reflection of a recovery in the property market. I think that's more that there was quite a few projects finished, and clients needed to finance them. So I don't necessarily see that's a drive into demand for property at the moment. I think that was contractual, but they needed to.

But I think if I look at the volumes that we're writing, I think it's far better than we anticipated. But it's still not what it was is the truth. And I think we do need tourists back and the economy firing again to really get that big pickup that we're looking for. I think alternatively if you look at the growth that we've had in Turkey in lending and deposits, if you look at in local currency terms. If you look at Egypt, it still continues to perform strongly. So some of our offset strategies with acquisitions in Egypt and Turkey have actually – I think they've got better shoots of growth at the moment than we have here.

Operator

Thank you. Our next question comes from Shabbir Malik of EFG Hermes. Please go ahead.

Shabbir Malik - EFG Hermes

Hi. Thank you very much. Two or three questions from my side. Now that you have had about six to nine months to go through your loan portfolio, what do you believe are the sectors that are probably most under stress? And what actions have you taken to mitigate risks coming from these sectors?

My second question is on your upgrade of the core banking system. According to some press reports and some anecdotal evidence, there were some teething problems on the consumer banking side. Did it have any material impact on your financial performance in the third quarter?

And one last question, in terms of the data that you've given in terms of deferrals, it seems like your group 2 exposure has gone up in the third quarter relative to the second quarter. I think it's now AED 1.4 billion versus AED 700 million in the second quarter. Any comment on that will be very helpful. Thank you.

Patrick Sullivan

Maybe I'll take some of those in reverse order. Just on the deferrals, we have set out the staging of the deferral by CIB and retail on page 37 of the account. So it shouldn't be much of a surprise that there has been a movement between some of the stages between the 12-month and the ECL. So the migration to Stage 2 is not necessarily an indication of potential NPL as we've at all. So you can also see that there's been a movement going the other way from Stage 2 to Stage 1 as well. So there will be movements between the stages. But overall, they aren't large amounts considering what's going on in the environment.

The financial impact from the system upgrade, and whether that changed the financial performance. No, that did not impact the financials themselves. And your first question was around stress in the various sectors. Now obviously, there's probably not a sector not under stress in this environment. So we are having to be very vigilant across all of the sectors with our underwriting standards and our risk review processes as well. Where there are some particular levels of stress where it might be those in deferrals that have less salary coming into their accounts. We have made sure that we have made some adjustments to account for some of those specific stress points.

Shayne Nelson

Just on the system thing, I'll just say that any of you out there that are in the UAE and bank with us, my apologies on the system outages. It's pretty disappointing for us. Even though it didn't cost us money financially, reputationally we're pretty disappointed because we have been the leading digital bank in the region. And we had those teething problems when we cut over to what was a new core operating system. So this was a heart transplant for us. It didn't go as smoothly as we wanted, nor as we obviously planned. And I'm pretty disappointed with the outcome, but we recovered pretty quickly. It's all systems going. At the moment, we're on track with our transformation journey. But it was even though financially it didn't hurt us, reputationally we're pretty disappointed because certainly reputationally, it's hurt us.

Operator

Thank you. Our next question will come from Aybek Islamov of HSBC. Please go ahead.

Aybek Islamov - HSBC

Yes, thank you for the conference call. I just have one question. You report as Group 1 and Group 2 loans they're quite interesting disclosures. So according to that Group 2 loans which is structural credit risks still remain low as a percentage of total, so Group 1 loans is the majority, right? And Group 1 is loans which have temporary liquidity issues rather than any structural credit risk. So if that definition, if I follow by that definition does it mean that if you provide new financing to your customers you provide additional liquidity? You can actually avoid a lot of formation of Stage 3 and Stage 2 loans in 2021. And if that's the case, how much liquidity do you think you need to extend to your troubled customers, so they avoid any structural credit issues next year?

Patrick Sullivan

Thank you for that. So the disclosures we have in there are based on the definitions from the Central Bank of the UAE. The key part there is the staging under IFRS 9. About that really show the risk level, so the 12-month no credit deterioration and then the lifetime ECL where there has been a downgrade. So if something has been downgraded to Stage 2 and you have to lend some more, then that would also be in Stage 2 as well. Maybe I've missed the nuance of your question, but yeah….

Shayne Nelson

I think what he was trying to say is well can you artificially lend more money to keep something in Stage 1 for example that should have migrated further down?

Patrick Sullivan

Well, the answer has to be no, because you have to follow the IFRS 9 staging criteria. So if there has been a deterioration, if that goes 30 days past due or have had a credit downgrading of it in the corporate sector, then you have to downgrade that. And if you lend more, then that goes along with it and you get a lifetime record on that. So I don't think you can artificially avoid any staging downgrading because it's IFRS 9 determining those stages.

Operator

We'll take our next question from Waruna Kumarage of SICO Bank. Please go ahead.

Waruna Kumarage - SICO

Thank you for this opportunity. I have a follow up on the earlier question on deferred accounts. So as you mentioned, now there is a shift a bit from Group 1 to Group 2 which is more severely impacted during the third quarter. I think the gross increase is over above AED 1 billion, the total. These are not the deferred amount, but the total exposure. And at the same time, the retail accounts which are enjoying the deferrals has also again increased from I think about 90,000 to about 98,000. So I mean how do you interpret in terms of – I mean does it mean that going forward I mean these accounts would create more – result in more provisions and ECL provisions going forward?

Patrick Sullivan

Yes. Could you point perhaps to which particular numbers you are looking at specifically?

Waruna Kumarage - SICO

I am looking at the Group 2, the total value of the accounts which are enjoying these deferrals in Group 2, both retail and corporate. So total of which I think has grown from AED 1 billion in June to about AED 2.2 billion in September. So that is the number that I was referring to. And if you net off the ECLs in that group, the net exposure is about from AED 0.5 billion, it has grown to about AED 1.2 billion. So I want to understand what potential implication of this can have going forward into cost of risk, going forward.

Patrick Sullivan

Okay. Regardless of those grouping, the key thing is that whether it's in Stage 1 and Stage 2. If it's being downgraded, whether it goes to stage 3 and has specific impairment against it depends on the credit factors. In retail if it's then gone past 180 days past due, then we have a charge-off. In the corporate lending, it's more of if there is a downgrade or specific event, that means it needs to go to Stage 3. But I think as I said before, and it's not surprising through this period of time there will be a migration from Stage 1 to Stage 2. The good thing you should note from this is that even though there is the credit deferrals, we are still applying the downgrade criteria that you're supposed to, and not in some way retaining them unnecessarily in Stage 1.

Shayne Nelson

I think that's an important point. Yeah, I'm not sure all the analysts get that that we are not taking those deferrals in the way we calculate the staging. Hence we're quite conservative there.

Operator

We will take our next question from Alok Nawani of Ghobash Trading & Investments.

Alok Nawani - Ghobash Trading & Investments

Good afternoon, gents. And thanks very much for the call. Just one broad question from my side. The cash deferral duration if you could just remind us about where it stands for retail and corporate customers, when it ends, and at the point in time when it does end, how do you expect your ECL models to react? And then finally, has there been any discussions or perhaps your view on a possible extension of the test programme in terms of durations of deferrals beyond what's in place?

Shayne Nelson

I'm going to take the TESS one. You take the cash deferrals. On TESS, there has been certainly lobbying from the banks to extend the TESS programme. As you can see from our comments, we're already getting customers paying down. So, what we have outstanding is actually reduced. But certainly, I think the banking industry as a whole there's a – TESS was an important part not only for the customers, but for the banks because it provided liquidity at zero cost.

So the other thing was the – so are the ratios. And most importantly for us was the CRR ratio, the Cash Reserve ratio. In the UAE that was 14%. They halved it to 7%. That's still actually about double what most markets have even at 7%. But that provided a lot of liquidity, so I think from – the important factor to us and TESS besides the customer impact which supporting customers in this environment is obviously critical is the liquidity it provides to the system. And what the Central Bank has provided, both through TESS and through the CRR and some other relaxation of ratios is better liquidity in the market which for us has been important. So we hope they do extend it, but at this stage we have got no clarity on whether that will happen.

Patrick Sullivan

And just on the first two parts that you asked about the timing of the deferrals and then how we expect the models to behave once the deferrals finish. So, on the retail side, there were up to three months interest and payments relief. A substantial amount of that deferral period from Q2 has expired, and therefore customers have resumed repayments. It stays as part of the deferred or forborne facilities in total until the loan is fully repaid. So, it could be one, two, three, four, five years depending on which product that relates to. But from a model behaviour point of view, as they resume those payments, as what IFRS 9 requires, if that hits 30 days past due on the retail side, then it would be downgraded to Stage 2. And when in Q1 when globally regulators were looking at IFRS 9 and what that might mean for the models, they were encouraging everyone not to be too mechanical about it and to use judgments and overlay to make sure at that point in time the provisions really weren't overdone.

So that – and it's basically also saying that just because there's a deferral, it doesn't mean that there's been a significant increase in the credit risk. But once our customers have started repaying, yes, if they hit 30 days past due we then have that observable point, so you'd be able to do the staging determination at that point.

On the CIB or the wholesale side and the corporate, a number of the payments were out to six months. So a substantial amount of those balances are still under deferral. We did note earlier that almost AED 2 billion has been repaid of the actual deferred amount. That's not the gross lending. That's actually the deferred amount. So that's quite a positive sign from that point of view. But we'll have to see what that looks like in Q4. Having said that, actually if a corporate client is downgraded and its credit rating actually downgrades, then the models and the IFRS 9 ECLs will also downgrade that by staging. So deferrals is not really meaning that everything is sitting in Stage 1 if there has been a credit downgrade.

Patrick Clerkin

I believe that's all the questions on the lines. There's one further question on the web. And do you have any exposure to Arabtec or related contractors? Patrick, do you want me to take that or do you want to answer that, yeah?

Shayne Nelson

I'm happy to take it because we can't answer it. As you know, we're not allowed to talk about individual customer exposures, and apologies. But what I will say is our concentration in the contracting industry is pretty small especially in the civil contractors. So we don't have high-risk concentrations in that sector. I can't really say any much more than that.

Patrick Sullivan

Yeah, and just to add to that, the economic activity, so the various sectors are shown in the financial statements in note 6 and note 7. So I believe that's all the questions.

Shayne Nelson

Well, if there's no other further questions, I'd like to thank you all for joining us here today and participating in today's call. As per usual, you all ask good hard questions. And I'll now hand you back to the operator. And if you have any further queries, you can also come back to Paddy at investor relations. Thank you, operator.

Operator

For any further questions, please contact our Investor Relations department whose contact details can be found on the Emirates NBD website, and on the results press release. A replay of this call and the webcast will also be available on the Emirates NBD website next week. Ladies and gentlemen, that concludes today's conference call. Thank you for your participation.

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