CAPCO

PAYMENT HOLIDAYS:
THE GOOD, THE BAD AND THE UGLY

INTRODUCTION

One of the new norms of the COVID-19 environment has been the state sanctioned use of payment holidays to provide consumers with immediate financial relief. Initially intended to run for just three months, these will now be available until October 2020. Some customers will have taken advantage of six months' worth of payment holidays before they contemplate resuming mortgage payments.

However, payment holidays have a hidden cost to the consumer. In many cases, for a customer at risk of hardship in normal circumstances, a bank would not necessarily see a payment holiday as a good solution to meeting the needs of customers on the cusp of financial hardship.

ECONOMIC IMPACT & BACKGROUND

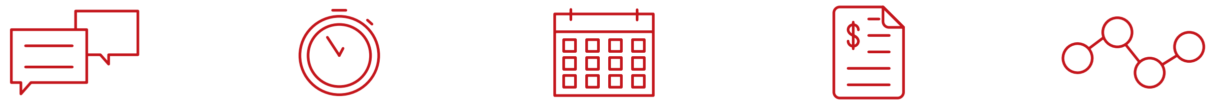
The economic impact caused by COVID-19 is undeniable. With 9.3 million people furloughed[1] and many businesses forced to close, the economy shrank by a record 20.4% during the month of April compared to March[2]. The financial services sector reacted quickly to the economic fallout caused by the pandemic-induced lockdown. Not only did they scrap billions of pounds in dividend payouts and abandon all share buybacks to conserve capital, they have also offered generous schemes to those hit hardest by the pandemic.

1. https://www.gov.uk/government/collections/hmrc-coronavirus-covid-19-statistics
2. https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpmonthlyestimateuk/april2020

THE BANKS' RESPONSE TO COVID-19

Payment holidays allow homeowners to defer payments for up to three months without impacting their credit rating, and more than 1.8 million people have taken this offer up from their banks to date[3]. This provides a much-needed respite for homeowners facing a liquidity crisis caused by the lockdown. However, it is not without its drawbacks.

These payments will still have to be made once the holiday window ends and, over this time, interest will still be accruing. As a result, homeowners will ultimately pay a larger bill. That said, mortgage rates are relatively low, and the Bank of England's base rate has been cut to a record low of 0.1% - a cost saving that will be passed to the consumer. Furthermore, the cost is spread over roughly 25 years which makes repayment more bearable, so it is still a useful tool for some homeowners. Other forms of help include temporarily interest free overdrafts and credit cards. Again, these provide a quick short-term liquidity boost to those suddenly out of work.



Step 1: Speak with your lender about how COVID-19 has impacted your financial situation. Mention you want a payment holiday

Step 2: Banks will handle next steps on their end – there are fast tracks in place so you won't be waiting to find out if you're eligible or not

Step 3: You will not have to make mortgage payments for three months; but interest will still be accruing

Tip: It is in your best interest to start repaying your mortgage as soon as you can afford to

Tip: If you find yourself struggling with payments but the end of the initial three months – you can apply for a further three months of payment holiday by following steps 1 - 3

Figure 1: The payment holiday customer journey

As shown in Figure 1, banks have put their customers first in their response to COVID-19. The process to getting a payment holiday is swift and only requires one conversation from the customer's perspective. Furthermore, these conversations are conducted online or over a phone which makes it even easier for customers. As easy as this process is and regardless of how much it prioritises customers, it creates a potential for downside impact and negative consequences to those it is intended to help.

3. https://www.gov.uk/government/news/help-with-mortgages-to-continue-for-homeowners-affected-by-coronavirus

POTENTIAL UNINTENDED CONSEQUENCES OF THE BANKS' RESPONSE

Banks must consider how they best support customers in receipt of payment holidays. They need to work out how the payment holiday impacts their systems, processes, and procedures both in the immediate aftermath of COVID-19 and in the longer term.

The overarching concern for those who were involved in remediation exercises post the 2008 financial crisis is whether the necessary ingredients for a perfect remediation storm are in fact present. The economy has experienced a large shock, consumers and banks have had to adjust to a new financial reality and the consequences of some urgent policy changes have not necessarily been fully modelled or yet played out. This inevitably means some of the customers that the policy changes are intended to help will in reality almost certainly be worse off.

This will mainly be caused by poor product design; it is difficult to know the effectiveness of products *a priori* and not all customers' needs will be met by one product. Overall, the fluidity and uncertainty of the environment in which we currently find ourselves makes it very difficult to design effective products.

Having covered the benefits and costs of taking up these holiday offers, it is worth considering the potential impact of such schemes. When assessing the total impact, it is important to look at the short term, medium term, and long-term impacts.

One immediate impact of such generous schemes is that many people might think they are an opportunity to secure cheap or free credit and potentially abuse the offers. The more naive might buy products without appreciating the true scope of the actual repayments and find themselves with a large debt and mounting interest at the end of the grace period. This could lead to large and costly remediation exercise that is undesirable for banks and consumers.

March / April 2020	May 2020 – Dec 2020 (Today)	Jan 2021+
A – Keep servicing customers (Day 1)	**B** – Interim customer support (Day 2)	**C** – Define future BAU (Day 3)

Figure 2: High level plan of how banks should operate in the COVID-19 environment

As shown in Figure 2, the customer journey can be broadly broken into three stages – the moment COVID-19 happened, the remainder of 2020 and the journey towards the 'new normal', and the landscape once COVID-19 has passed. Each of these stages poses different hazards for the bank and the customer and means that a flexible tiered approach is needed to mitigate the long-term risk to the customer. Banks can take steps today to support their customers.

SHORT TERM ACTIONS

As with most cases, prevention is better than a cure. It is imperative that banks are clearly outlining all the terms of these schemes from the outset and assessing the circumstances of the customer in a holistic fashion, including their creditworthiness, potential future earnings and broader environmental factors (e.g. life circumstances). Through careful consideration of the customer's circumstances, the bank will reduce the probability of default in the long term and ensure the customer is supported in a way which meets their immediate needs. This also reduces the long-term risk of mis-selling and the potential for fraud. As part of the customer journey, all checks and communications must be clearly documented for an evidence trail in case there is ever an issue for the customer.

Educating your workforce on the importance of selling products correctly is also vital. The more your employees know about the product and the target consumer, the lower the chances of mis-selling products and facing a remediation program. Banks should be checking the conduct of employees and monitoring customer outcomes. This can be done by empowering managers to implement effective governance by having product and behaviour specific training sessions completed on time with regular refreshers and checks.

MEDIUM TERM ACTIONS

In the medium term, banks can monitor the financial situation of their affected customers and adjust the offering to best suit their needs. For example, a lot of people are back into work and earning again. It would be unnecessary and ill-advised in some cases to continue offering payment holidays – it will only work out more expensive in the long run. It will also deprive those who require capital the most. Overall, banks should closely monitor the liquidity status of their customers so they can tailor their solutions. Customers coming to the end of a payment deferral period will be in different financial circumstances. What is fair treatment will differ according to these circumstances and banks should take a holistic approach (figure 3).

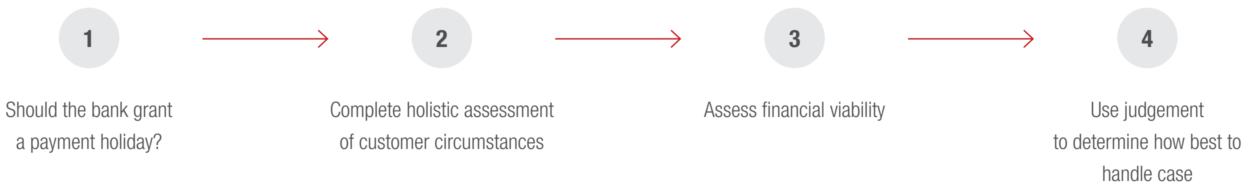


Figure 3: Process steps to handle a customer case

LONG TERM ACTIONS

In the long term, banks will have to assess the impact of their offerings on their customers' debt position and size. There will of course be positives to consider from increasing liquidity access. But in some cases, customers will be worse off. Banks will have to identify these cases and offer compensation where mandated. Even if not mandated, banks could offer reduced interest payments to those most adversely affected as a goodwill gesture. This will reduce long term default rates and keep customers loyal in an age where switching banks is easier than ever. They should also take time to reflect and improve their offerings to factor in future sudden shocks to the economy. Any improvements made in evidence storage and data analysis because of COVID-19 should persist in the long term as well.

NEXT STEPS - CREATING A PLAN OF ACTION

At this stage, it is unclear whether there will be a mandatory remediation exercise post-COVID-19. This remains an open-ended issue but, as discussed, there is a potential for it. Fortunately there are steps banks can take today to mitigate the size of potential remediation payouts in the future. It is valid to be concerned that pre-emptive action against remediation payouts could be an unnecessary cost for banks to bear, especially during a pandemic with huge economic impact. However, the steps suggested, if taken, will not be futile in the case where there are no mandatory remediation payouts. This is because providing sensible products to those who require them at appropriate rates will mean that customers are more able to repay their loans plus any interest accrued. In the shorter term this will decrease default rates and this benefits the lender.

Furthermore, establishing a customer-focused culture in your workforce will serve your bank well in the future because customers are more likely to stay loyal to a bank that suits their needs. All improvements in processes around data gathering and storage are also benefits to be reaped from this exercise.

If remediation payouts are eventually to be made, not only will your bank's bill be smaller because of actions you took today, but you will also be in a better position to identify and payout affected customers from the data you stored. In essence, take pre-emptive actions like those listed in this article to best help your bank and more importantly, your customers.

For further information on how Capco can help you best prepare for any post-COVID-19 remediation exercises, please contact Howard Taylor, Managing Principal at howard.taylor@capco.com

CONTACTS

Howard Taylor, Managing Principal
Howard.Taylor@capco.com

Richard Plumb, Executive Director
Richard.Plumb@capco.com

AUTHOR

Akbar Ali, Associate
Akbar.Ali@capco.com

ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward.

Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and asset management and insurance. We also have an energy consulting practice in the US. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

To learn more, visit our web site at www.capco.com, or follow us on Twitter, Facebook, YouTube, LinkedIn and Instagram.

WORLDWIDE OFFICES

APAC
Bangalore
Bangkok
Gurgaon
Hong Kong
Kuala Lumpur
Mumbai
Pune
Singapore

EUROPE
Bratislava
Brussels
Dusseldorf
Edinburgh
Frankfurt
Geneva
London
Paris
Vienna
Warsaw
Zurich

NORTH AMERICA
Charlotte
Chicago
Dallas
Houston
New York
Orlando
Toronto
Tysons Corner
Washington, DC

SOUTH AMERICA
São Paulo

WWW.CAPCO.COM

CAPCO

JN_2298