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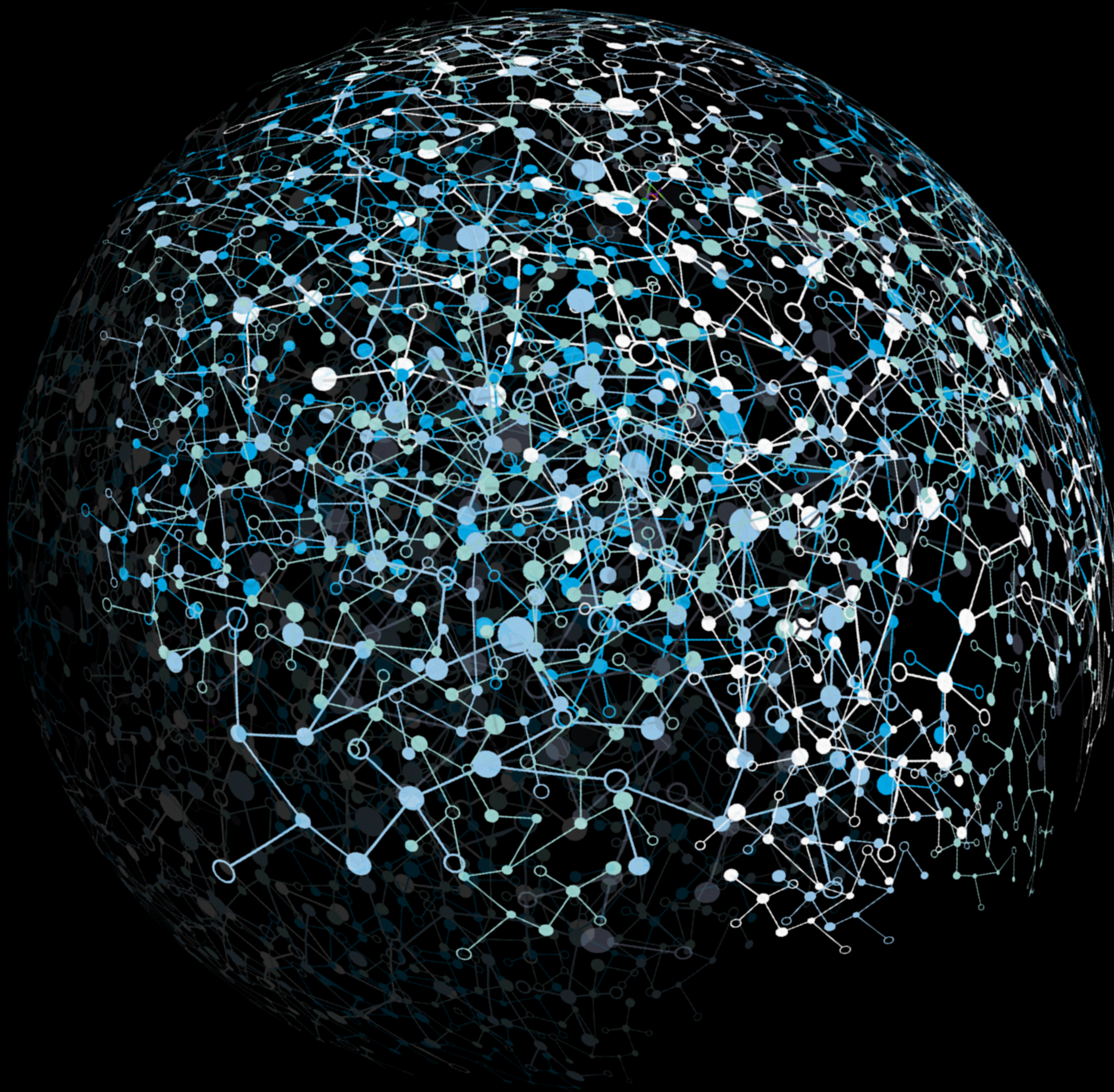


COVID-19

Toward recovery: Six actions for mortgage lenders in Canada

COVID-19 has created an unprecedented level of societal uncertainty.

Decision makers across industries are making material choices every day and must act decisively to ensure the wellbeing of their people, resilience of their organizations, and viability of their enterprises. Deloitte's Resilient Leadership framework defines three timeframes of the crisis: Respond, Recover, and Thrive. As we participate in that effort, Deloitte's Financial Services group will publish bulletins sharing our learnings and perspectives.

This bulletin focuses on the next six to 12 months for the mortgage lending business in Canada and is intended for decision makers in financial services. It is our view that choices made now, during the Respond timeframe, will separate those organizations that accelerate toward the Recovery timeframe from those that risk being stuck in a cycle of reactive decision-making.

Deloitte's Resilient Leadership framework defines three time frames of the crisis

Focus of this document: *Actions for Resilient Leaders with a 6 to 12 month medium-term view*

Canadian lenders—specifically, those in the home-financing and real-estate secured lending businesses—have spent the last several weeks dealing with the significant operational complexity of customer loan-payment deferral and related hardship programs. The Canadian Bankers Association has indicated that as of April 11, approximately 600,000 Canadians[1] had sought mortgage loan payment relief. This represents a potential pool of approximately $4.8 billion in in "freed-up cash" through a six-month deferral window.[2] At the same time, many in the lending community (lenders; originators and aggregators; and intermediated distribution) have acknowledged that application volume and, in select cases, funded volume in March 2020 reached near-record highs. This paradoxical combination only complicates an already challenging environment for decision makers. Anecdotal evidence available at the time of writing suggests that the impact of a much slower purchase market will cascade into origination funnel metrics.

We have outlined six questions and corresponding actions related to the current and prospective group of loans and customers who are participating in, or may participate in, payment deferral programs (we will refer to these to as the "deferred book"). Each of the following prospective actions presents decision makers with choices that must be adjudicated quickly.

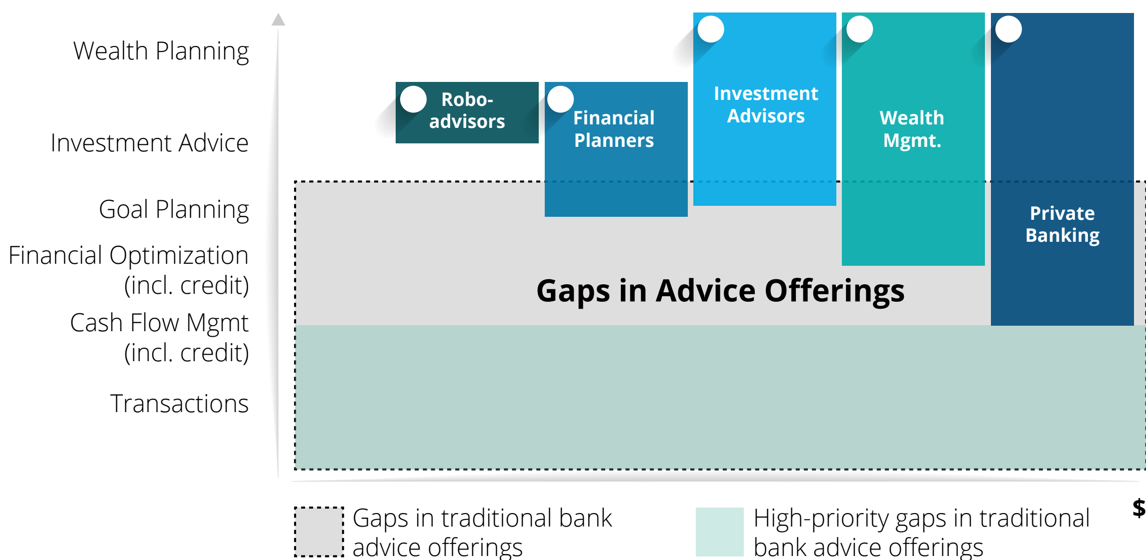
[1] https://www.cbc.ca/news/business/banks-charge-interest-on-interest-for-mortgage-payment-deferral-1.5529399
[2] Assumes a monthly mortgage payment of ~$1300

1. What can lenders do now to proactively manage the flow of customers seeking relief?

Lenders should proactively offer advice now. More than 80 percent of Canadians earn incomes of less than $64,000 and a majority lack material accumulated savings or financial wealth.[3] Recent survey data from Ipsos Reid suggests that almost half of Canadians (49 percent) are $200 or less away from being unable to meet debt obligations.[4] While this figure has increased only slightly from one year ago (48 percent in April 2019),[5] the circumstances impacting this vulnerable population have changed materially. Now, more than ever before, Canadian households need cash-flow advice. Despite a plethora of app-based spend analytics and personal financial management solutions, no Canadian financial institution has meaningfully differentiated with advice focused on effectively managing cash flow. This is a key barrier for many Canadians effectively accessing and using credit, as well as saving over the long term. The existing advice offerings across banks either inadequately address this need or are inaccessible to the customers most in need now. We discuss this topic more fully in Deloitte's *Perspective on the Future of Advice*.

Advice Capabilities

(Degree of Bespoke Capabilities Required)



[3] Deloitte Centre for Consumer Insight
[4] https://business.financialpost.com/personal-finance/debt/half-of-canadians-say-they-are-on-brink-of-insolvency-as-coronavirus-threatens-to-burst-countrys-consumer-debt-bubble
[5] https://www.bnnbloomberg.ca/maxed-out-48-of-canadians-within-200-of-insolvency-survey-says-1.1247336

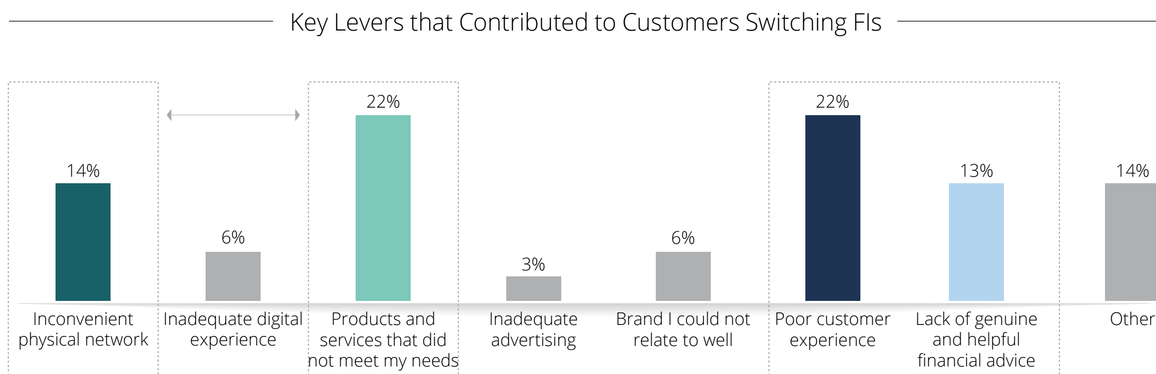
With many banks having both excess capacity among front-line employees and maturing predictive analytics and artificial intelligence capabilities, it is plausible that a bank could both leverage the rich data available (e.g., from payment behaviour and mobile device location) to proactively identify customers approaching financial duress and offer proactive and empathetic outreach from employees. TD Bank, for example, is making use of its Layer 6 artificial intelligence capability to predict which customers are expected to experience hardship—in some cases, even before the customer does.[6] RBC is taking a similar approach, mining customer data to predict cash-flow issues and provide employees with insight to support proactive contact with those clients.

Proactive outreach (and the lack thereof) will contribute to a financial institution's ability to retain and acquire new business. Today, the volume, intensity, and critical nature of customer requests are pressure-testing banks' service capabilities, resulting in the potential for service dissatisfaction. Our research shows that poor customer experience and products, services that do not meet customer needs, and a lack of genuine advice are leading causes for customers to switch their primary banking provider. And while the switching rates in Canada have been very low historically relative to other countries, this crisis is likely to put more customers in motion than ever before as they face challenges getting banks to respond to their needs quickly and effectively. In effect, this is a true moment of truth for customers and banks alike.

Banks that rise to the challenge and demonstrate a proactive, relevant, and authentic desire to support their customers during these unprecedented and uncertain times will be well-positioned to create true brand loyalty, and will also have put themselves in a position to capture a greater share of this increased number of customers who switch providers. Deloitte expects the level of customers switching their primary banks to peak to a record level through the first half of 2021. Proactively managing the flow of hardship requests and perhaps offering an empathetic human touch can be the difference that helps a financial institution be a net beneficiary of the forthcoming flow of customers in motion.

"Which of the following factors do you attribute to no longer using your former FI for your primary bank account?"

Key Levers that Contributed to Customers Switching FIs



[6] *The Globe and Mail*

2. How should lenders configure now to enable persistent customer contact for data gathering and client nurturing during the deferral window?

What about those customers who have already self-selected into the deferred book? As with proactive outreach, we believe it is critical to maintain contact with each customer as a means of fostering a positive experience, confidence, and trust through the deferral period. This is also a critical channel through which to offer advice and gather data to be used as part of analyzing the risk presented by this new book once the deferral period ends (assuming that the answer isn't simply, "well, it goes back to normal"). This requires operational and technical effort and could present an opportunity to leverage automated nurturing/marketing journeys. Again, in cases where there is employee capacity, financial institutions have an opportunity to pair journey-based marketing technology with a human touch to create empathetic and valuable experiences. This may require some degree of employee cross-training, which we observe in adjacent use cases in Canada and across other jurisdictions. For example, JP Morgan and Quicken, two of the biggest mortgage originators in the United States, have cross-trained and reallocated thousands of employees to manage an expected influx of mortgage refinance applications. And the Royal Bank of Canada has retrained more than 200 loan underwriters to focus on developing customized relief plans for customers whose situation suggests that they will face hardship beyond the current six-month deferral window.

To illustrate the insight-generating power of diverse sets of data, Deloitte has created an interactive dashboard powered by Tableau to Predict the Post Pandemic Rebound. Our dashboard offers a live look at health data, commercial and commuter traffic volumes, foot traffic to and through various merchant categories, media and social media sentiment, and traditional economic and financial data.

https://www2.deloitte.com/ca/en/pages/about-deloitte/articles/covid-dashboard.html

3. What actions can lenders take to validate the accuracy of the changes to the payment calculations brought by the financial relief packages?

So far, hundreds of thousands of Canadians are taking advantage of payment deferral programs offered by their lenders, and the lenders are doing their best to intake and process this massive influx of requests. We are seeing heightened attention from customers, media, and regulators on the programs, and it's obvious that the lenders' actions will be closely monitored; the Financial Consumer Agency of Canada (FCAC) has indicated its desire to ensure that the implementation of relief programs are fair and appropriate.

With so much focus on helping customers access these programs, we believe that there is a significant onus put onto, and an implicit level of trust in, lenders to calculate deferrals and other relief packages accurately.

In six months, it will take only a handful of customers to investigate these calculations and check that:

- The **interest** has been accrued properly.
- The **resulting cost** of the borrowing amount and amortization periods have been calculated correctly.
- Their **credit** scores have not been impacted.
- The **property tax** portion of their mortgage payments was applied to the mortgage correctly.
- Their **creditor insurance** (e.g., life, disability, etc.) premiums were dealt with appropriately and coverage still remained.
- Any **promotions** overlapping this period were adjusted correctly.
- Any **cross-sold product packages** where fees were waived or reduced continued to function properly.

If customers find any issues, it is likely that the court of public opinion will not hesitate to find the banks guilty of overcharging or misleading customers during a time of need. This may result in increased reputational impact and significant regulatory scrutiny and fines.

The expectations of both regulators and customers are high, and there are clear advantages to getting this right. Leading lending organizations are proactively monitoring and testing the accuracy of the payments, fees, and any related calculation on lending and related add-on products, such as insurance. Some examples of these initiatives include:

1. **Analyzing** customer complaints coming in now to help identify potential pain points and as an early warning system to identify systemic issues.
2. **Embedding** analytics to bolster quality assurance test plans on system changes by identifying all client scenarios for testing.
3. **Validating** payment calculations through ongoing recalculations or anomaly identification ahead of the payment cycles.
4. **Leveraging** outbound customer support calls to confirm customers' understanding and accuracy of the updated disclosures made to their lending product.
5. **Capturing** and using all of the data collected about the new deferral lending book to inform monitoring and future credit decisions.

In our experience, organizations can begin by assessing their change management across the financial relief lifecycle. Below are some questions to consider:

1. **How** are you validating the accuracy of the data collected by the front-line workers?
2. **How** does the data collected by front-line workers align to the disclosure documents?
3. **Do you** have any early warning detection in place to identify and remediate issues?
4. **Are** your products and systems designed to quickly accommodate changes required to support the relief programs?
5. **Can** your existing quality assurance and testing processes accommodate all newly introduced customer scenarios?
6. **How** will you confirm accuracy of calculations or identify potential discrepancies and systemic issues?

4. What analytical monitoring can be deployed now to offer insight on customers in the deferred book through the deferral window?

The new book is unlikely to perform as the pre-COVID-19 prime mortgage books were expected to perform. This new normal should require a more precise and nuanced measurement of the credit default risk presented by the new book. Projecting and estimating expected losses from the deferred book will be critical, and appears to be an area of divergent perspectives in the industry. Lenders should take the deferred book loans and perform correlation analyses to understand what variables are most predictive of a deferral event. These findings will be critical for banks' near-term responses, but will also prove critical as they emerge from this crisis with a better understanding of their customers and their household-level financial resiliency.

Major banks that have multi-product relationships with their customers can extend this deferred book analysis to credit card transactions, subscriptions, deposit account activities, and registered plan contributions. These analyses can help predict deferral patterns among clusters (e.g., oil regions, gig workers, professions, etc.). The analyses can be expanded by using AI methods to apply customer interactions data, recent call centre log data, email data, location data, etc., to enhance the predictability of these clusters.

Risk management is not the only objective here. Banks can use these insights to identify the needs of each cluster and tailor their offerings accordingly. For example, they could offer different products, loan consolidation, relief in refinancing costs, payment holidays, etc., depending on the cluster that is most likely to respond to the offering.

The above analyses can also be performed to understand whether the deferred book loans originate from similar channels, locations, offers, type of loan, etc. This could inform lenders of specific risks to the origination channel or distribution strategy that were previously not understood.

5. How should collections be reconfigured now to optimize outcomes and optics through the next year?

Recovering from COVID-19 will be a journey that Canadians will share. Unfortunately, this journey will include events such as the loss of a job or even the loss of a loved one. An important and very difficult use case for delivering compassionate assistance to clients through this journey will be collections.

As an early response to COVID-19, some financial institutions temporarily suspended or reduced collections activities. As well, many government agencies, including the CRA, suspended debt collection until further notice. As we begin to recover, a more nuanced approach will be needed.

Financial institutions that have put in place an effective post-COVID-19 collections strategy will be able to manage potential reputational risk while capturing funds that are available and flowing them directly to the bottom line. However, most Canadian banks have limited recent experience with a downturn of this magnitude. As a result, Canadian collections leadership is likely not accustomed to operating in the environment they will soon face.

Even with a good strategy, there will be a challenge to executing effectively. Organizations that have invested in their collections operations will be better positioned to execute effectively on these strategies. Capabilities that will assist in execution include:

- **Effective use** of collections analytics to differentiate between customers in financial distress versus those who are able to pay.
- **Well-trained** agents that can manage effective conversations and choose when to be sympathetic versus when to apply proven negotiation techniques.
- **Available** loss-mitigation tools and the ability to quickly and effectively tailor payment arrangements.
- **Appropriate use** of modern collection technologies including voice analytics, voice biometrics, and machine learning.

Some questions financial institutions should consider include:

- Have we developed a post-COVID-19 collections strategy?
- How mature are our collections capabilities versus those of our competitors?
- What capabilities should be augmented in advance?

6. What investments can be made to derive insights from the deferred book now that can be applied for future use in production?

Pre COVID-19, the prime mortgage books of a lender would have looked somewhat homogenous. While there has always been consideration of type of employment and industry, it is unlikely that lenders would have identified and differentially treated borrowers who today share the exact same credit score but now live in two different books (the deferred book and the "regular" book). How can we use this insight and the data offered by the population who are now in the deferred book to inform new credit risk scores/models that can be applied in the new normal to appropriately price the risk of future events like COVID-19?

To thrive in the post-COVID-19 world, lenders must build models to predict the propensity of a customer to request deferral. This should be supported with improving credit models using transactional data, which can maximize performance of risk-reward and accelerate portfolio growth.

An important thing to note about this deferral propensity model is that scores should have the least possible correlation with FICO credit score and credit approval models. This is because the deferral propensity models are required to capture the risk that is not inherent in credit scoring models. This means that the deferral score to credit score correlation matrix must have diagonal values that are as small as possible.

These models can be used along with the credit models for future loan approvals. For new customers, or existing customers with no lending product, where such a data is not available, the lender will still have to rely on the traditional credit scoring models. But for existing lending customers looking for a new product, lenders can leverage these deferral propensity models for better pricing and limits.

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