AN INTERVIEW WITH CAPTECH CONSULTING AND MCGUIREWOODS

McGUIREWOODS CapTech

Navigating the Risks of the Current Pandemic Relief Programs:

Guidance for U.S. Financial Institutions

Thought Leadership
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As COVID-19 and the economic downturn continue to evolve, financial institutions are faced with fast-moving – and ever-changing – government relief programs. CapTech Consulting Co-CEO Steve Holdych and McGuireWoods Partner Alex Brackett provide perspective on the current environment and how the industry can prepare to meet a host of potential challenges.

Banks have learned a lot of lessons since the 2008 financial crisis. Have there been changes in consumer behavior that would prompt banks to reassess the operating capacity of certain functions?

Steve Holdych: The banking industry has largely been successful in migrating consumers to non-human interaction channels. Prior to the COVID-19 crisis, only 4% of U.S. consumers had a desire to talk with anybody individually at a bank. Now, as a result of COVID-19, 45% of those same consumers want to talk to a person. This change in consumer behavior results in a massive operational change for banks reliant on automation. Couple that with news reports that one-third of U.S. consumers are worried about paying their mortgages or rent in May could result in banks experiencing a flood of calls over the next 30-45 days requesting mortgage forbearance. This has the strong chance of being cataclysmic. These calls are not going to online channels, which are fine for standard, non-exception-based functions such as applying for a loan or checking a balance. These are high-touch human interactions. Imagine if one-sixth of the country calls the banks in the next 30-45 days. Are banks collectively prepared for five million calls on mortgage forbearance alone?

What's the nature of the risk for financial institutions, legal or otherwise?

Alex Brackett: You're going to have customers who are not going to get through. You're going to have customers who are irate when they do get through after waiting forever. You're going to have customers in a compromised position talking to bank employees who may themselves be in a compromised position – and probably overworked. It's a recipe for error, miscommunication, misunderstanding – all of which can fuel straightforward reputational risk that can quickly transform into litigation risk and regulatory scrutiny in many forms. It's not beyond the realm of possibilities that groups such as the Consumer Financial Protection Bureau (CFPB), the Special Inspector General for Pandemic Relief ("SIGPR") or prudential regulators to latch onto this. We're in a regulatory and congressional oversight environment that does not have a very high opinion of financial institutions. That means it's critical to manage the front-end piece well. There's not a lot of upside for the banks, and there is no opt-out. This has been thrust upon them. They have no option other than to try their best to manage through it.

Holdych: As a bank, you're looking at a money-losing exception request process that's going to drive massive volume. How do you even think about the investment hypothesis involving average handle times, amount of training and the like? Do you say it doesn't matter? I'm just going to forget my balance sheet and fully staff this and shoot for wait times of five to eight minutes, or do I roll the dice and let my average time go to an hour or an hour and a half?

Brackett: It's important to be mindful of how banks are going to be criticized as this crisis unfolds. You're going to have external parties looking for narratives that say the bank either did X or failed to do Y because it was in their best financial interest to do X or to fail to do Y. They were trying to make a buck. They didn't care whether people got hurt.

I've worked with a wide variety of banks in a wide variety of circumstances, particularly in crises. The truth is that it's in their financial interest for their customers to do well so they can pay their mortgages, pay on their loans, pay their credit card bills. The bank's interest and the customer's interest, particularly when it comes to things like loans, tend to be highly aligned and correlated.

There are complex structural dynamics in terms of mortgage-backed security pools, the impact on bonds, and other factors at a macro level. But at a boots-on-the-ground level, what the bank is going to care about doing right now – and what it should be focused on – is getting relief to the most customers as quickly as possible in compliance with applicable regulatory obligations. It's in the bank's best interest to have stable clients in a position where they don't need forbearance, where they don't need a mortgage modification, where they can make those payments. It's about weathering the storm right now and setting aside some of those macro financial considerations for now.

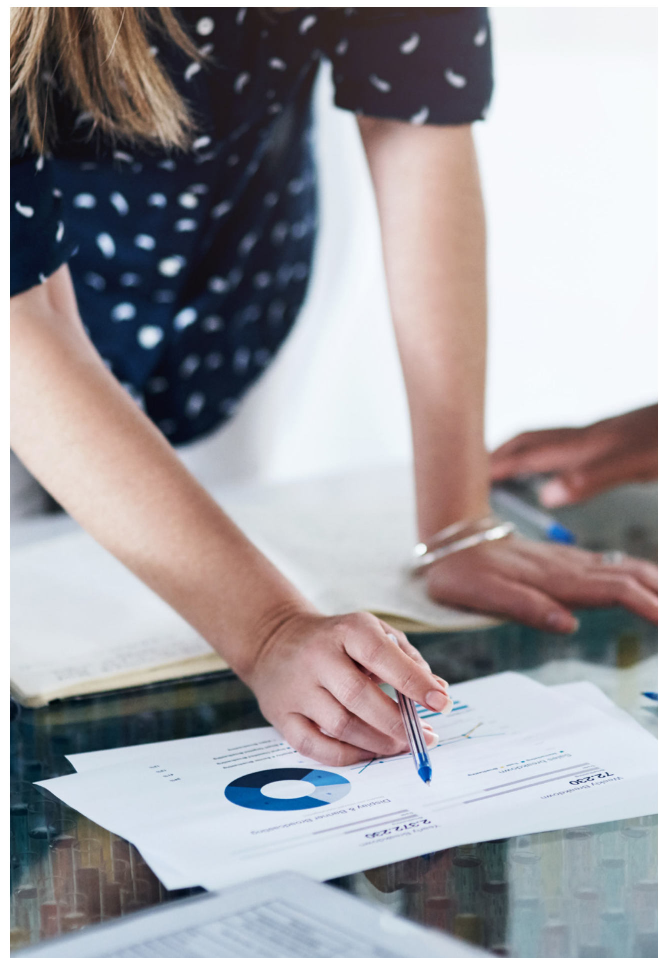
Looking back at the 2008 financial crisis and some of the litigation and investigations arising from it, it appears that some financial institutions put out communications to customers on deliverables or expectations they had difficulty meeting. How should banks think about customer communications today to mitigate the risk of that being an issue down the road?

Brackett: The last financial crisis was the same kind of perfect storm we're walking into now – programs rushed out with the best intentions and then evolving quickly against a backdrop of communications to borrowers dictated by regulatory requirements or by the requirements of groups such as Fannie Mae and Freddie Mac. It wasn't so much that banks weren't communicating accurately to their customers. They were communicating what they were required to communicate. They didn't necessarily have the flexibility to change the messaging. And some of the timelines they were required to communicate were just unrealistic.

This raises a host of questions relevant here. One concern is change management. As these programs evolve and the regulations morph, it can be very hard to keep up with, for example, a 20-page Fannie Mae bulletin with a requirement embedded somewhere in there that you change a paragraph in what you're communicating to customers. In hindsight, their expectation is that you reviewed that bulletin, digested it, and immediately made operational changes to be in full compliance.

Another question concerns your ability to interact with your regulators. Will you be able to communicate with them and help them understand the challenges you're facing and the steps you're taking to address them – not to mention documenting all of it so you can demonstrate you were fully transparent with your regulators?

The final piece concerns resources. The expectation is going to be – fair or unfair – that with a million more calls coming into your call center than the week before that you're going to take your extensive resources and staff up that call center and better leverage technology. And you're going to do the same in hiring the people that you need to handle the inflow into your Paycheck Protection Program (PPP) or your mortgage servicing environment. But it's not that simple a question. You can't just flip a switch. You can't say, "Go hire me a thousand people and put them into a deployed remote work environment and give them the tools they need to do the job safely and effectively. Oh, and make sure they have the training they need to understand what the rules and requirements are, and they've got enough oversight so we can tell whether somebody is up to snuff or not and whether they're abiding by whatever our internal

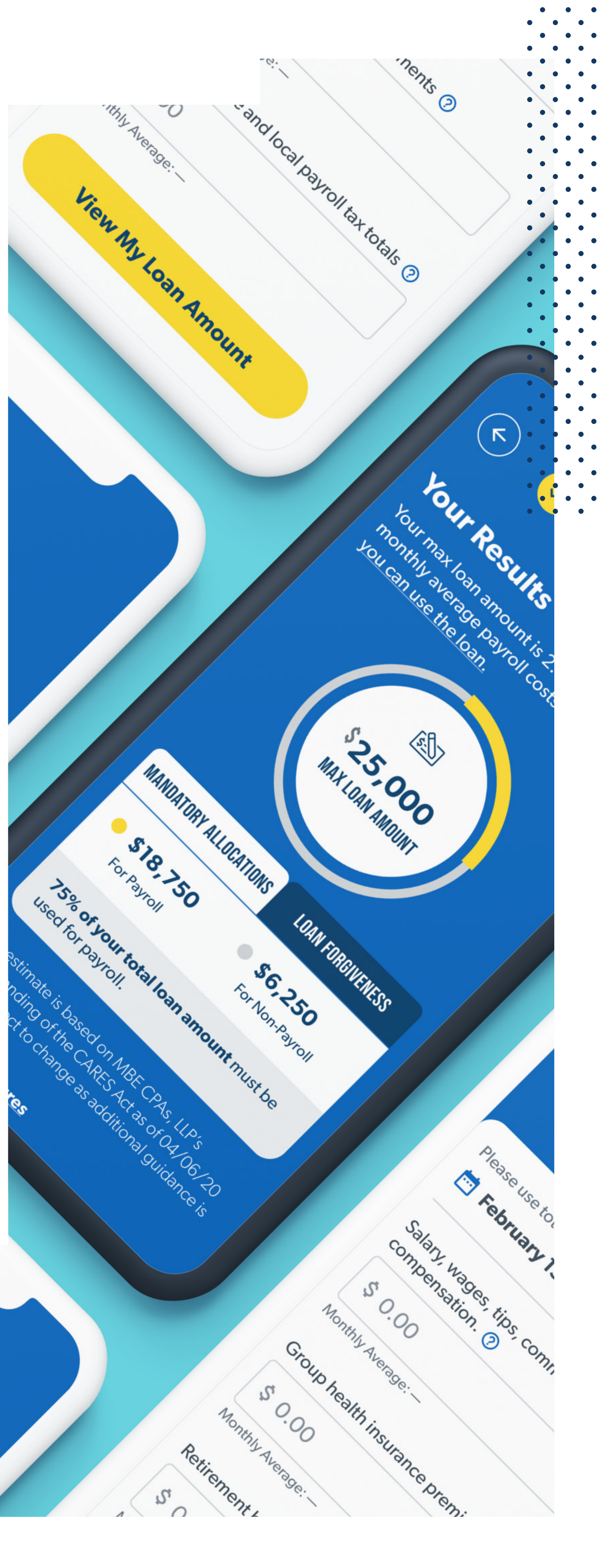


operating procedures are." That's really, really hard to do. You can do more harm than good if you go too fast without the right controls in place.

When banks merge, on day one they know there's going to be a surge of customers who overload the call centers with questions about the transfer of their money. In such situations, they might accept that the average handle and wait times are going to be far higher than standard. Can that approach work today? Or are banks going to have to recognize there is no "day one" and a tail-off, but that this is a sustained period of activity?

Brackett: For banks that have been going through PPP, I think they probably saw a great example of that day one phenomenon because that happened at lightning speed. With the loan forgiveness portion of PPP, we'll probably see a similar phenomenon. It's a good encapsulation of what I think we're likely to see in this crisis – waves and a cascading effect, not just in things like PPP and the Main Street Lending program, but in the mortgage space with different forbearance programs. We are in a marathon, not a sprint, and probably only a few miles in.

I'm convinced that the programs we're talking about today are the first of many. I hope I'm wrong, but I think we need to plan as if I'm right. When we talk about mortgages, we're talking about housing, and that becomes an even more emotional thing. It's not just my money. This is my home, this is my life savings, this is how I was going to finance my kids going to college. And for the last few months, it's been the place I've been stuck. That has to be factored in. There is no greater sensitivity for regulators, law



enforcement, or litigants than making a mistake in connection with somebody's home.

Holdych: The situation for some banks will be that they did their best within a pre-defined cost management framework for investment. This approach is contrasted to those banks that accept that it's going to be tough on their business model in the short-run, but go ahead anyway and put a higher level of investment into this operational challenge. How do regulators think about investment and a bank's demonstration of good will?

Brackett: Unfortunately, and I don't want to be unfair to the regulators, but their mindset will often be that there is a requirement and you have to do whatever it's going to take to hit it. Sometimes that's realistic and sometimes it's not. It often becomes unrealistic in an environment like the one that we're in. But you still want to be thinking, as a financial institution, about how you will justify the decisions made today six months, two years, five years down the line. There's some kind of regulatory review, a congressional inquiry, worst case, a criminal investigation. People are going to look back at every decision and ask who was involved. Who made this decision? What were the considerations that went into it? What were you communicating to your regulator in real time?

That's why documenting those decision-making processes as best you can is important. I've gone through this before, and I have colleagues going through it right now. It can be really hard to piece together an operational decision weeks, months and years down the road to show that you did enough even if, in hindsight, maybe you could have done more, but here's what you were able to see in real time. Here are the factors that went in, it was a reasonable decision, and it was one that you regularly revisited. Are we doing enough? Have our assumptions held? If assumptions are breaking down, where are they breaking down? Should we be doing something different?

In the panel discussion, we talked about data and the importance of data collection, as well as the concept of a "middle office." Talk about that.

Holdych: The middle office is an interdisciplinary team focused on the programmatic elements of these operational challenges. They are highly embedded within the business and understand the business dynamics and changes that are occurring in real time. They're also serving as a listening post and support team for the frontline folks, who are receiving phone calls, addressing things from a planned outcome perspective but also tracking exception cases and scenarios that weren't part of the original plan. The middle office is the sweet spot – an open-channel communication from the frontline to decision-making executives. The middle office is also in a position to go ahead and start building technology. A good example is dashboards. They can build reporting that provides insight into early issues that are emerging. Typically, when one issue manifests itself it starts to establish a pattern of behavior that is important to understand.

From a technology perspective, there are two broad technology tool sets to consider. One is Robotic Process Automation (RPA). From a long-term strategy perspective, there are some architectural concerns about the brittleness of those solutions, but in terms of finding technology that can be rapidly deployed, RPA is a tool set that organizations should be thinking about in this scenario. The second is getting deep into data science. There's going to be a lot of data in the organization and you're going to have a lot of risk within your customer data. This may allow you to prioritize different customer segments based on risk to the organization – whether it's reputational risk, financial risk or operational risk. At the same time, however, you have to be mindful of the data privacy regulations and laws.

Technology adoption must be done through organizational change management. Just bringing technology solutions in with no training, no support, no end-user ability to adapt to the change that technology brings is a recipe for a different type of disaster. As you think about the adoption of technology into these operational groups, make sure you're thinking about change management and the human element.

We're in a regulatory and congressional **oversight environment** that does not have a very high opinion of financial institutions. That means **it's critical** to manage the front-end piece well. There's not a lot of upside for the banks, and **there is no opt-out.**

Alex Brackett
McGuireWoods, Partner

Alex Brackett is a partner at the law firm McGuireWoods and part of the firm's Government Investigations and White-Collar Litigation department, as well as co-head of its Strategic Risk and Compliance team. Alex's white-collar practice includes defending external investigations and conducting internal investigations across a wide variety of subject matters for a wide variety of clients, including extensive work on behalf of financial institution clients. He also devotes a significant portion of his practice to building and enhancing compliance, risk management and crisis management programs.

e: abrackett@mcguirewoods.com **p: 804.775.4749**

Steve Holdych
CapTech, Co-CEO

Steve Holdych serves as CapTech's co-CEO, where he oversees the organization's marketing, IT and other operations. Steve has led CapTech's National Financial Services discipline for the last 20 years. His consulting work in the financial services space, specifically around retail consumers, includes substantial work related to operational issues arising from mergers and acquisitions.

e: sholdych@captechconsulting.com **p: 804.545.8714**

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