APPG on Challenger Banks and Building Societies – Coronavirus Survey Report

Why Covid 19 could stymie financial innovation in the UK

The APPG on Challenger Banks and Building Societies conducted an anonymous research survey into how the coronavirus pandemic and the actions of government, regulators, and customers had impacted smaller institutions in the Challenger Bank and Building Society sectors.

The survey received a strong response from a wide range of institutions across the sector and the results are detailed below.

The key findings from the survey were:

The Challenger Bank and Building Society sector was an afterthought:

- Challenger banks and building societies **risked being overlooked** by government and the regulators during the lockdown with policy being shaped with large institutions in mind and the effect on smaller institutions being overlooked.
- **At no stage were Challenger Banks consulted on government** policies that affected them, particularly the mortgage payment holiday scheme.
- The **failure to explicitly identify staff of smaller banks and building societies as key workers** led to police closing one branch and threatening to close others.
- **A third of respondents described the guidance provided by government as "incomplete and vague".** There was particular criticism of government tendency to make snap policy announcements and expect all firms large and small to implement these instantly.
- A third (33%) of institutions have had to furlough staff. Most institutions now have between 50% and 90% of staff working remotely.

The FCA came in for specific criticism:

- The Financial Conduct Authority was considered by many the worst amongst the regulatory community with many organisations forced to rely on their trade associations to interpret their guidance.
- A number of respondents noted that **FCA regulatory staff did not understand how smaller firms worked**. One example flagged by multiple firms was a failure to understand that lenders rates don't simply track the Bank of England base rate.

The public reaction to the crisis:

- A number of respondents noted that **borrowers took advantage of the 'mortgage payment holiday' scheme to improve their personal balance sheets and as a "just in case" measure**. One respond estimated that as many as 70% of the holidays on their books fell into this category.
- Lenders warned that **many borrowers didn't understand that mortgage payments holidays weren't free** and would add an average of £2,500 to the average total mortgage repayment in the long-run.
- Institutions reported that **instances of fraud had increased during lockdown**. They are using a mixture of warnings and education to address this issue.

Recommendations

Following the detailed responses to this survey from across the challenger banks and building society sector, the APPG on Challenger Banks and Building Societies is making the following recommendations to government:

1. Despite challenger institutions and mutuals making up a growing percentage of UK market share there was no government consultation with either the challenger or mutual sector as part of their response to the Coronavirus pandemic. This must change and **we call on the Treasury and other government departments to engage earlier and closer with challenger institutions on future crisis management policies and their financial services policies more generally**.

2. **The FCA needs to issue guidance that is specifically targeted at smaller financial institutions**. Its policy of seeking to regulate both small and large institutions in the same way is no longer fit for purpose in the UK's modern, dynamic financial services sector. We call on the FCA to implement structural changes to enable it to target regulation appropriately at different areas of the market and to give institutions longer notice periods to implement new policies.

3. The impact of the pandemic has been tough on all sectors of the economy but challenger banks and building societies have been particularly hard hit. Some challenger institutions have genuine concerns of the future viability of their business and we **call on the Government to introduce a package of measures to help support smaller financial institutions that may struggle in the coming 12 months and beyond**.

Chairman's Comment:

Responding to the findings of this report, the Chair of the APPG on Challenger Banks and Building Societies, Rt. Hon Karen Bradley MP, said:

"The survey results show that challenger banks and building societies have stepped up to the challenge of supporting their customers during the coronavirus but that government and the regulators have struggled to provide guidance and support for the sector that is fit for purpose for smaller financial institutions. Challenger banks and building societies play a vital role in the UK, supporting both start-up businesses and vulnerable people who often have no other access to banking services. The APPG has long called for bespoke regulation and recognition within government and the regulators and this crisis lays bare why this reform is both needed and long overdue."

A note on our Methodology

The APPG on Challenger Banks and Building Societies conducted this survey anonymously with a wide range of Challenger Banks and Building Societies invited to submit their responses to some or all of the question summarised in this report.

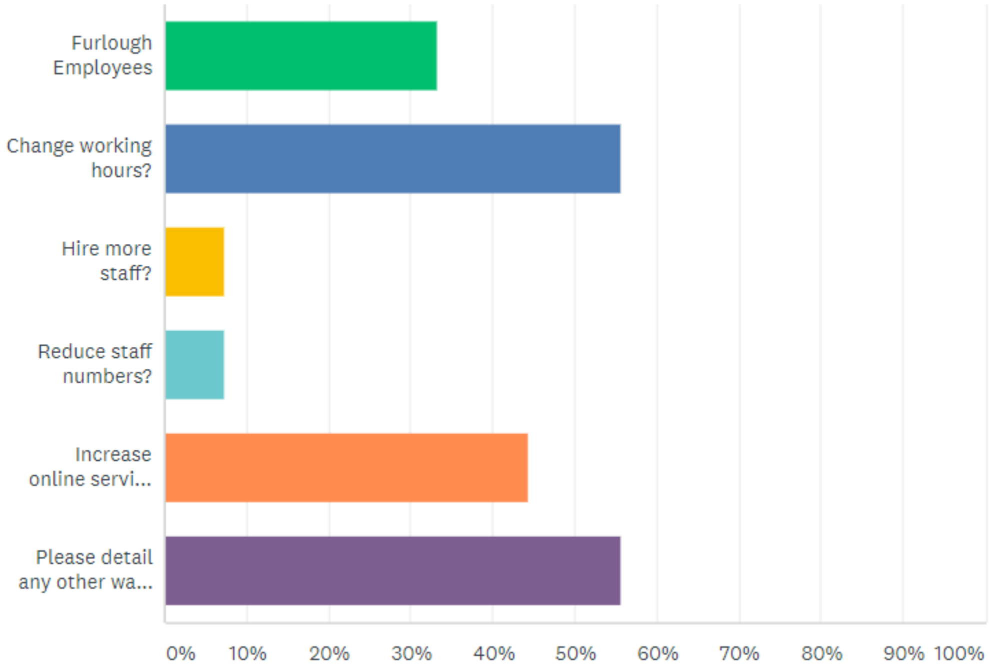
The survey was conducted on an explicitly anonymous basis so that institutions could feed back tom parliamentarians in a full and frank manner. APPG has decided to keep all responses and comments anonymous.

Responses were not limited to one answer per questions, with some respondents choosing to skip some questions and other giving more than one response. This is why the percentage responses do not always add up to 100%.

APPG Challenger Banks and Building Societies – Coronavirus Survey – Detailed Responses

1. **We asked firms whether as a result of the coronavirus crisis has your organisation had to:**

    - Furlough Employees – 33%
    - Change working hours? 56%
    - Hire more staff? 7%
    - Reduce staff numbers? 7%
    - Increase online service availability? 44%



A number of institutions confirmed that they had reduced branch hours and branch operations in order to comply with social distancing and other government restrictions. Several have also increased access to online services as a result.

While a third of those organisations responding did have to furlough staff, a number of institutions managed to redeploy branch staff into telephone and online support. Most institutions reported that between 50% and 90% of their staff were now working remotely. Interesting 7% of institutions reported hiring new staff as a result of the pandemic.

Interestingly, while staff absence rates were reported to have fluctuated a little, most institutions reported that absence rates were fairly low.

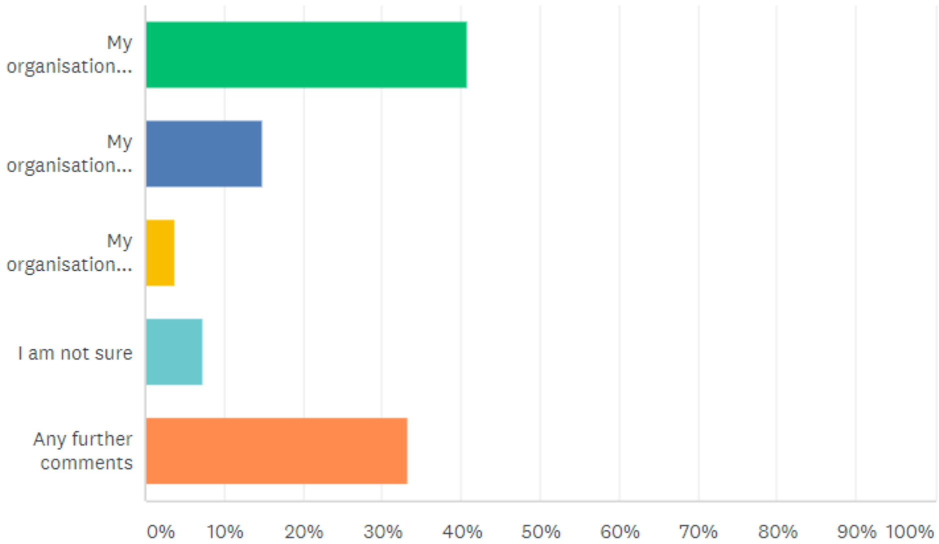
A number of organisation reported putting special measures in place to support vulnerable customers including such things as timed appointments and cash delivery services.

Several institutions also noted that instances of fraud were on the rise and that both staff and customers had been made aware of the risk of potential scams through a mixture of education and warnings.

For lenders, the biggest challenge reported was the setting up and administering of mortgage payment holidays.

2. **We also asked which of these statements is true about your organisation?**

- My organisation has received more applications for business support since the coronavirus lockdown began? - 41%
- My organisation has received fewer applications for business support since the coronavirus lockdown began? - 15%
- My organisation has received about the same level of applications for business support since the coronavirus lockdown began? - 4%
- I am not sure - 7%
- Any further comments:



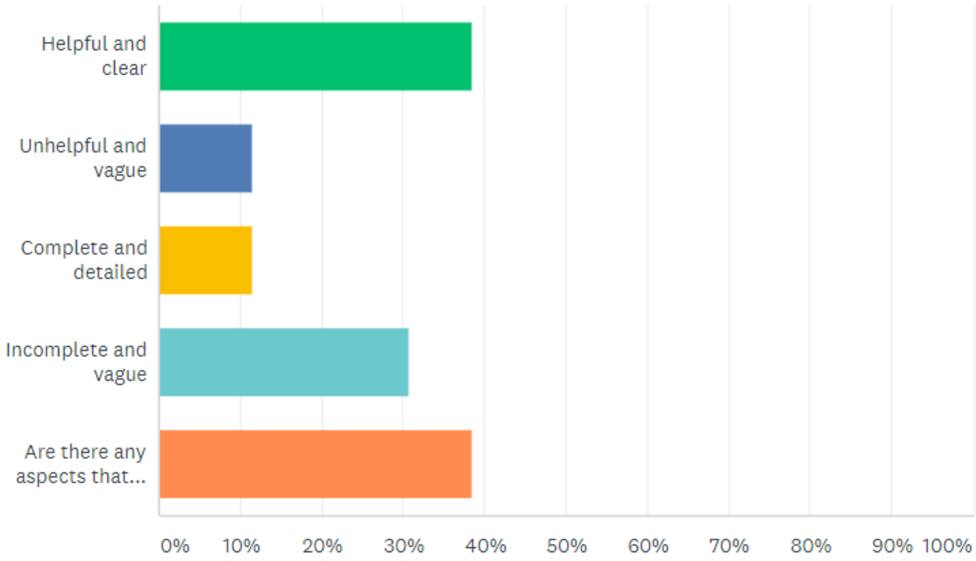
Four-in-ten organisations reported seeing an increase in applications for business support since the start of lockdown. But most respondents said that while the mortgage market remained active, the number of applications they were receiving was down notably year-on-year.

Interestingly, several institutions said they found it much harder to give support to new businesses because of payment delays and other bureaucratic hurdles.

3. **How would you describe how your organisation has found the guidance coming out of central government for financial institutions?**

- Helpful and clear 38%
- Unhelpful and vague 12%

- Complete and detailed 12%
- Incomplete and vague 31%
- Are there any aspects that have been good or particularly helpful?



While more than a third of respondents said that overall, government guidance was 'helpful and clear', just under a third described it as 'incomplete and vague'. Several noted that the quality of government guidance had varied wildly in different circumstances.

Institutions were generally very critical of the governments habit of making sudden announcements. Announcements were often made very late and the assumption was that institutions would be able to implement them immediately. This was, as one institution succinctly put it "ridiculous".

In particular, the mortgage payment holiday proved problematic with the lack of preparation time ahead of this announcement proving a major challenge. Many institutions stated that the lack of any formal consultation was a shame as there were other support options that could have proved more helpful to mortgage holders. The broad consensus among lenders was that a blanket payment holiday made good headlines but was a major headache for the industry.

Two problem identified with the mortgage payment holiday scheme related to how borrowers used the scheme. Several institutions noted that borrowers were using the scheme as a tool to improve their personal balance sheets and as a "just in case" measure.

Meanwhile, the scheme was opened up to 'Buy-to-Let borrowers on the assumption that they would pass these savings on to their tenants. But there was no way for institutions to enforce this, so it is likely that at least some Buy-to-Let mortgage-holders will not have done this.

The failure to classify branch staff as 'key workers' was also an issue with one building society reporting the police as forcibly closing one of their branches because of the confusing and others reporting attempts to do so. This issue caused "considerable stress and business disruption".

There was also criticism of the lack of practical guidance and Health and Safety advice that they received both for offices and branches.

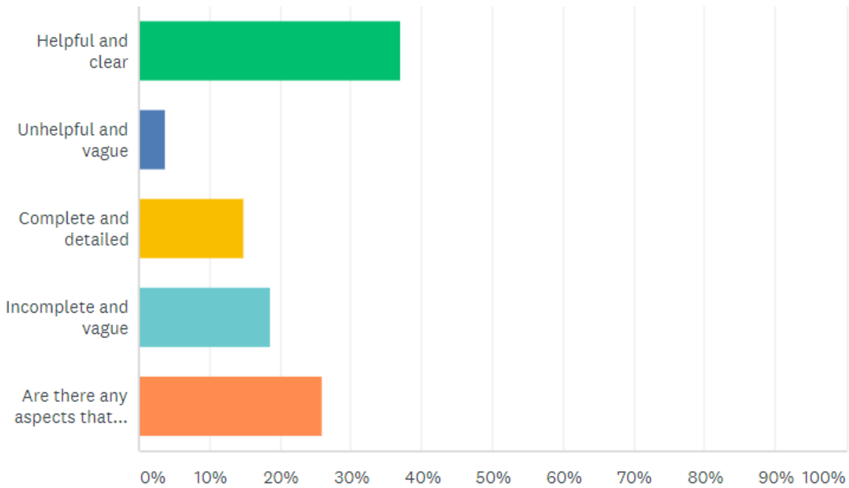
Another criticism was the lack of clarity over whether announcements made by Government applied across the UK or whether power lay with the devolved administrations. One respondent noted that when issues were devolved, it would typically take between 10 and 14 days longer to receive guidance and that consistency would often take even longer.

The absence of any form of state financial support for smaller institutions was raised with some institutions being forced to seek financial support from owners and shareholders. At a time when the UK should be looking to encourage innovation and diversity in its financial sector, this was a big oversight.

Many institutions also noted that the Government seemed to have a bias to engaging more with the larger established banks over the response to the outbreak. The lack of a voice for challenger banks and building societies in the discussions and the response to the pandemic was another big oversight.

4. **How would you describe how has your organisation found the guidance coming out of the FCA and the Bank of England?**

    - Helpful and clear 37%
    - Unhelpful and vague 4%
    - Complete and detailed 15%
    - Incomplete and vague 19%
    - Are there any aspects that have been good or particularly helpful?



The FCA fared a bit better than the government overall, with more than a third describing their guidance over the course of this pandemic as 'helpful and clear' while just a fifth said it was 'incomplete and vague'. But that didn't mean that there weren't a number of specific criticisms.

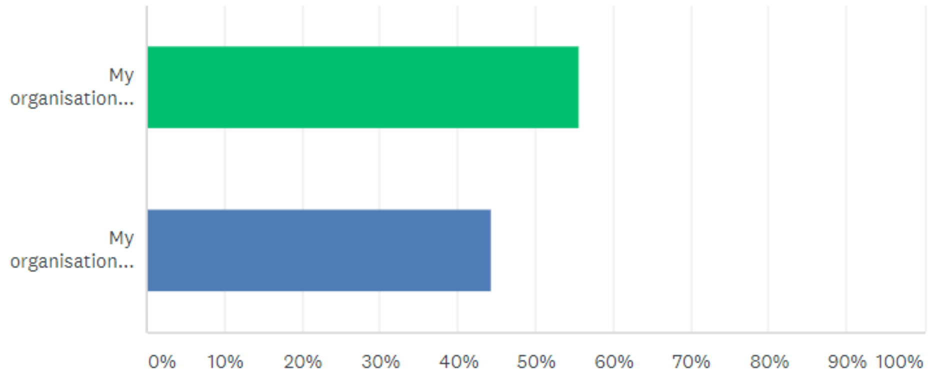
More than one institution suggested that the FCA do not seem to understand that lenders set their own standard variable rates. They are not necessarily linked to the Bank Base Rate and do not follow the Bank Base Rate. This raises questions over the experience and training of FCA staff.

While there was plenty of praise for guidance coming out of the Bank of England, which one institution described as "very explicit and clear (as usual)", many commented that much of the guidance issued by the FCA was vaguely worded and open to different interpretation. Much also appeared to be focused specifically at larger institutions and its impact on smaller financial service providers appeared to be largely overlooked.

5. **Which of these statements do you agree with?**

   My organisation has experienced a difference in approach between government and regulators? 56%

   My organisation hasn't experienced a difference in approach between government and regulators? 44%



Slightly more institutions reported experiencing a difference in approach between government and regulators although the difference was small.

Several different institutions reported a sense that the government and the FCA were not always fully aligned in the announcements and that it has taken industry bodies to help shape their various responses into something more workable across the sector.

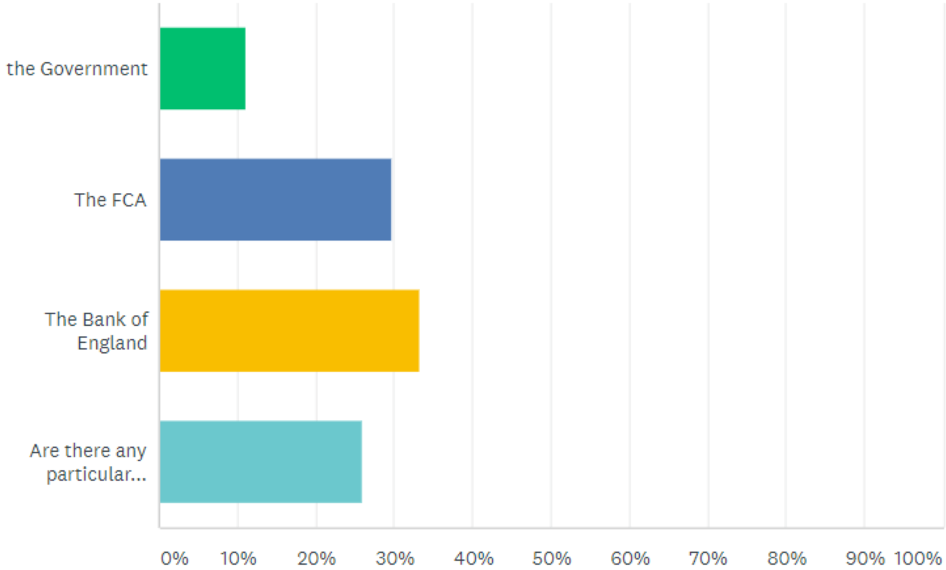
It has felt unclear at times whether the government and regulators are fully aligned in their initial announcements and has taken industry bodies to shape them in to something sensible

While both government and the regulators have had their good and bad moments, the general sense from responses was that the regulator has at least consulted and listened to smaller financial institutions to some extent, even if the industry response wasn't always reflected in their responses.

In contrast, the government has dropped surprise announcements without any industry consultation or consideration about how they would impact smaller financial institutions.

6. **Who has provided your organisation with the better guidance**

   - the Government 11%
   - The FCA 30%
   - The Bank of England 33%

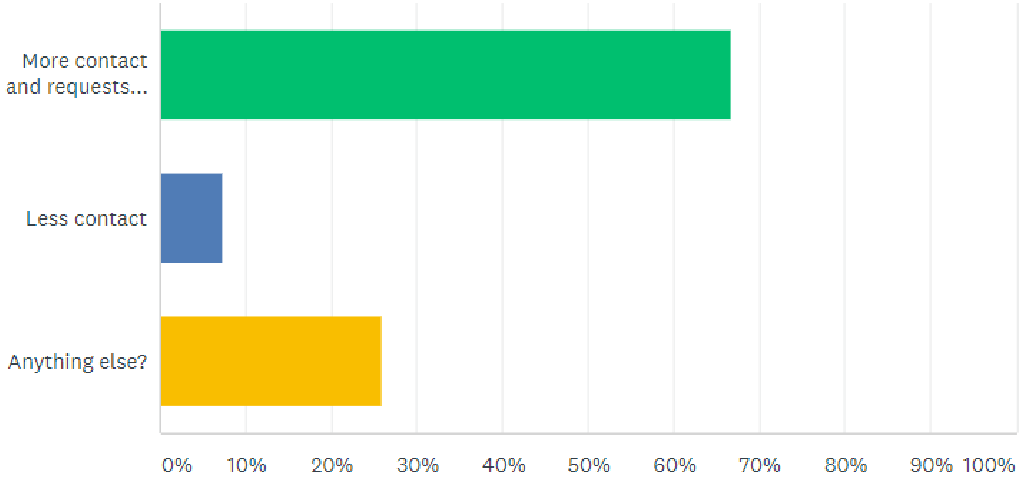


In line with previous responses, a third of institutions flagged the Bank of England's guidance as being the best, with the FCA close behind on 30%. Only 11% said the Government had issued the best guidance.

In addition, there was plenty of praise for the work of trade associations like UK Finance and the Building Societies Association for their work in helping organisation to interpret guidance clearly and appropriately.

7. How have your customers reacted to the crisis?

- More contact and requests for advice 67%
- Less contact 7%
- Anything else?



More than two thirds of respondents to this survey told us they had been in receipt of more contact and requests for advice from customers since the lockdown began. This compared with only 7% who reported receiving less customer contact.

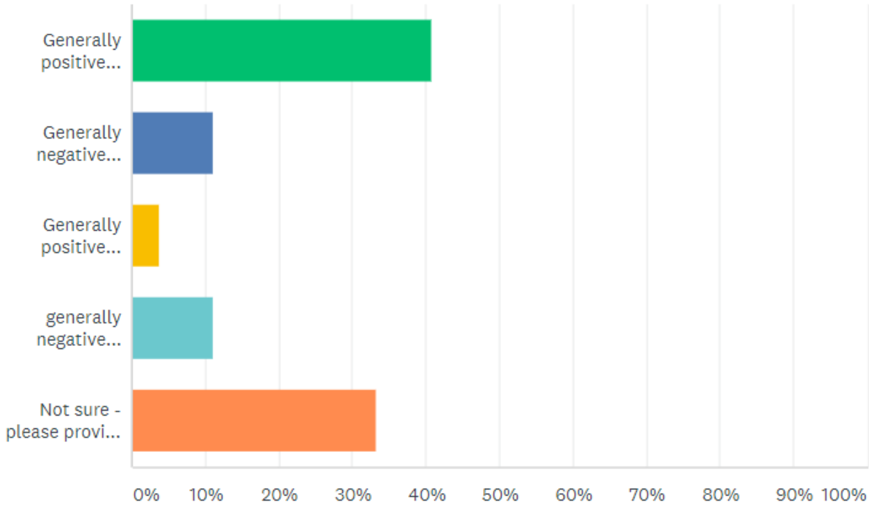
It was notable that this did depend to an extent on the types of products offered. Mortgage enquiries have been far greater, largely due to the mortgage payment holidays, while branch activity has been greatly reduced.

The majority of institutions have encouraged more customers to self-manage their accounts and products online and it appears that a majority of customers have done this.

However, the demand for telephone services has gone up a lot with many calls lasing longer. This has put a lot of pressure on smaller institutions to cope with demand, with a few suggesting they have struggled to cope.

8. If you have received feedback from customers on the advice from government and regulators, how would you describe it?

- Generally Positive in terms of advice from the Government 41%
- Generally Negative in terms of advice from the Government 11%
- Generally positive in terms of advice from Regulators 4%
- Generally negative in terms of advice from regulators 11%
- Not sure - please provide details: 33%



In contrast to the response from the institutions themselves, around 41% said that their customers were generally positive about the government's response to the pandemic and the financial advice and policies they had put in place.

The mortgage payment holiday scheme has proved particularly popular, although a few respondents noted some customer confusion over whether it constituted a 'free holiday' or a payment deferral scheme. There was also some confusion about how the extension to this scheme was being implemented.

9. What does the future look like?

As the first of a series of additional questions, we asked challenger banks and building societies what the future looked like for their business over the next twelve months and beyond.

Needless to say, responses varied significantly from one institution to another, but there were some interesting trends that emerged.

Almost every institution noted that the economic uncertainty was a key factor in their future activity. Most suggested they would be responding cautiously and seeing how the economy moved before making any big decisions.

Many institutions expected to see lower levels of profit and mortgage lending in the short-term future while there was also an expectation that there would be higher levels of delinquency on loans. Management expenses were also expected to increase. Interests rates offered to savers are also likely to be lower than before the pandemic.

A concern raised several terms was how the government exits the mortgage repayment holiday scheme and the potential impact this could have on borrowers and lenders.

There was a general sense that most institutions had far less of an appetite to take risks in the near future and this would be reflected in the products, services, and rates they offered to their customers.

Quite a few institutions noted that they were optimistic that once the short-term economic impact had passed, the future looked bright and they expected to continue to grow.

Worryingly, there was more than one institution that told us they thought their business would struggle to survive in the coming 12 months.

10. Do you have a view on the likelihood of the UK entering a period of recession following the coronavirus crisis? Please give details:

The general consensus from respondents was that a recession in the wake of the pandemic was inevitable. Some suggested we were already in one.

The question many institutions asked was how long the recession would last and whether it would be 'v' or 'u' shaped. It is also currently unclear what government support will be put in place for individuals and businesses to cope with the recession.

Most institutions expected a big impact on consumer confidence, largely as a result of a big spike in unemployment.

When pressed, the majority view was that this recession was likely to be shorter and sharper than the 2008 financial crisis and that recovery should be faster.

11. How in your opinion does the crisis affect the short, mid and long-term outlook for the economy? Please give details:

Most respondents stated that they expected the short-term economic impact to be significant and painful but that the mid and long-term prospects were brighter.

A sizable minority were of the view that the long-term economic outlook was gloomier and recovery would take longer.

Several institutions expressed optimism that the UK's service-focused economy would help to protect it from the more severe impact that will be seen in other countries.

It was also noted that the impact was also linked to the outcome of Brexit trade negotiations and a positive deal would help to cushion the economic impact of the pandemic.

Ultimately, it is difficult to predict the long-term implications until we can be clearer about how long it will take to develop treatments and vaccines and whether we will face a second or even third spike as winter approaches.

Institutions wisely indicated that they were planning for a variety of different economic scenarios and durations.

12. Is there anything you would like to see Government and regulators do now to help your organisation? Please give details:

There were a lot of suggestions made in this section, which can be broadly summarised as follows:

Government

- It was suggested that the government could set up a scheme to help people who will be left in financial difficulty with their mortgage as a result of the pandemic similar to the Mortgage Rescue Scheme that was created in the wake of the 2008 Financial Crisis.
- Government should reduce the waiting time for Support for Mortgage Interest. One suggestion was to decrease it from 39 weeks to 13 weeks.
- An independent regulator is needed for the Insolvency Practitioner firms and their exemption from FCA regulation on matters that would normally fall under the consumer Credit Act should be removed.
- The government should implement the Corporate Insolvency and Governance Bill as is since it offers important leeway for the sector in holding its AGMs.
- The Breathing Space Scheme cannot be implemented on its original timeline. This needs revising.
- The government should implement the Corporate Insolvency and Governance Bill as it offers important leeway for the sector in holding AGMs.
- The Consumer Credit Act needs reviewing in light of the pandemic.
- The government must engage with the Financial Services sector earlier to give businesses the chance to consider, consult and develop any new processes or solution required.
- Government should consider reforming capital rules if the post-pandemic recovery period requires lending into the real economy.
- The government should continue to promote and possibly financially encourage flexible working and home-working through the tax system and other measures.

Regulators

- Regulators should use the pandemic as an opportunity to overhaul the burden of regulation. Less regulation could mean more if done more effectively now that we can break away from the European approach to regulation.
- Regulators need to give longer notice periods for the implementation of new policies and more clarity on guidelines issued.
- The Band of England should widen the Term Funding Scheme with Additional Incentives for SMEs (TFSME) to accept a wider pool of assets, together with loan haircuts. This would enable institutions to pass on a cheaper cost of funding to customers.
- Regulators must not control institutions ability to set prices fairly.

Lenders Only

The final two questions in the survey were only aimed at lenders.

13. **Has there been an impact on the usual asset requirements for your organisations lending?**

    - Yes 13%
    - No 71%

Almost three-quarters of lenders said that the pandemic has had been no impact on their usual asset requirements.

14. What effect are mortgage holidays having on your business? Please give details.

It is clear that the mortgage payment holiday is the one pandemic policy that has impacted lenders more than anything else. There was a big response to this question and some interesting insights.

The general consensus was that most people were using mortgage payment holidays as an opportunity to improve their personal balance sheet. One respondent suggested this was a high as 70% of people taking advantage of the scheme and used the increase in savings they have seen as evidence of this.

A major issue that some lenders foresaw the prospect of some borrowers struggling to resume their payments once the payment holiday ends.

It was noted that for an average customer a three month payment break results in £2,500 of extra interest over the life of the mortgage. Many are already making preparations for this eventuality with Buy-to-Let mortgage holders who have lost rental income expected to be one demographic particularly hit.

The human impact of mortgage holidays was also noted by several respondents. Administering payment holidays has put a big burden onto staff who also have their other professional responsibilities and personal lives to contend with as well. Most organisations felt unable to increase staff numbers to cope with this burden because of lower lending levels and pressure on margins.

While most institutions have taken a hit financially from implementing the mortgage payment holiday scheme, there was also a general consensus that where customers genuinely needed the support, they were happy to offer it.

APPG Challenger Banks & Building Societies
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Further Information and Media Enquiries

Contact **Havard Hughes** at havard.hughes@barndoorstrategy.com or via phone on 07989 345 820