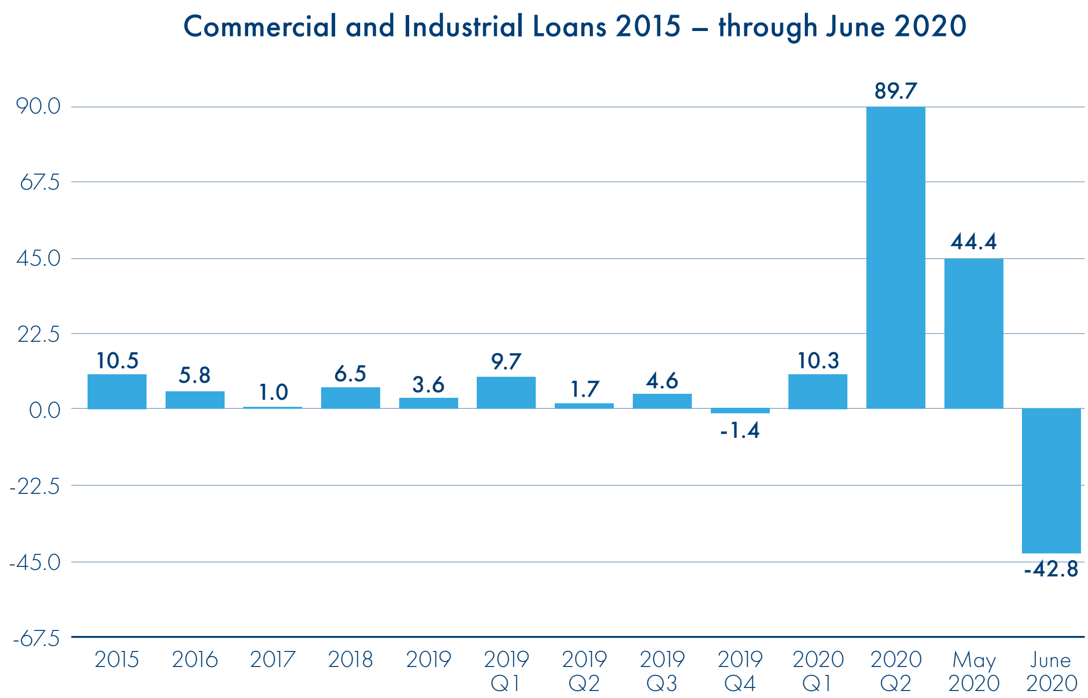
Drivers for Technology Change in Corporate Loan Servicing

Backdrop

For the past 5 years, Corporate Loan volumes have fluctuated up and down depending on business, economic and geographical cycles. These fluctuations have been within anticipated ranges, that is, until the advent of Covid-19, when exponential divergence from normal patterns occurred is the norm.

The drivers for change discussed in this paper were apparent and gaining urgency prior to the pandemic; however, the global impacts have exacerbated the problems and accelerated the need for change.

The graph below shows lending volumes in the US in Q4 2019 were adversely affected as a major problem emerged in Wuhan province. The rise in Q1 2020 shows companies requiring additional funding as the global lockdown halted regular business patterns and disrupted sales and supply chains. Q2 2020 sees an incredible 79.4% increase in new Commercial & Industrial loan volumes as companies availed themselves of government support loans and sought funding to continue operations in the absence of their usual revenues. June 2020 sees a massive decline in the number of loans granted as lockdowns cease and businesses re-open.



Note: Percentage change at break adjusted, seasonally adjusted, annual rate.
Source: Federal reserve; https://www.federalreserve.gov/releases/h8/current/default.htm

These swings in loan volumes pose significant problems for loan servicers. The structure, volume, and complexity of the loans being granted must be serviced over the next decade at a time when operations teams (typically office-based) are working from home, and many have been laid off or furloughed.

The UK has experienced similar trends. The number of companies that have failed or dissolved in the six months prior to October 2020 is 110,000 less than the same period in 2019. In some part, this is due to companies that would have failed being propped up by government initiatives. The additional overhead on lenders to administer and maintain 'problem debt' will place a further burden on already over-stretched credit administration departments. The UK saw a 500% spike in lending volumes in May, June, and July 2020. With Covid-19 acting as a catalyst, the need to update and change the current corporate loan servicing processes and infrastructure is acute.

The current situation

Banks of all sizes typically have a myriad of credit and lending solutions in place to administer their portfolios. The infrastructure tends to be dated, rigid, and inflexible, relying heavily on manual process, intervention and reconciliation, and excel. Little automation is possible, transaction turnaround time and data quality are poor, and there is a heavy reliance on specialist staff to handhold transactions through their lifecycle. The ability to adapt quickly to changing market demands, e.g., Libor transition, bringing new products to market, re-usability of product terms and conditions, is often laborious and requires assistance from IT departments. The need to respond quickly to grant payment holidays, change products and add government subsidies has been especially important during Covid times.

1. https://www.finextra.com/videoarticle/2398/protecting-portfolios-in-a-changing-business--commercial-credit-landscape

2 The European Banking Authority (EBA) said lenders will be allowed to "amortise" or taper the value of software for capital purposes over three years. Anna Menin City AM EU watchdog proposes software capital relief to bolster banks' buffers 14.10.20

The need for personalisation and better service to the Borrower has long been an issue in Corporate Lending, but Covid has forced Borrowers and Lenders to rethink how they interact with each other. The need for digitalisation to serve customers remotely with SaaS and Cloud-ready solutions has never been more prevalent. The reliance by operations teams on credit files, manual processes, and office-based interaction no longer works as working from home is the norm. The pressure to cut costs, especially in cost centres such as Credit Administration, is always prevalent but never more so than when margins are at an all-time low.

Credit Agreements are granted for long periods, and therefore human errors inevitably occur. Multiple systems, different data taxonomies, reconciliation, and inconsistencies lead to poor quality data from which decisions are made. The timeliness, cost of administration, and costs of remediating bad decisions can be substantial. As discovered in the UK, since 100,000 fewer businesses have failed in 2020 than in 2019, the likelihood of increased problem debt that will need to be administered is higher.

Against this backdrop, the ability to actively interrogate the loan portfolio, foresee problems, identify process bottlenecks and opportunities for efficiency gains and automation is limited. Without a single platform with reporting and analytics capabilities, fragmented processes must continue, and the ability to capitalise on new technologies, e.g., Explainable AI is not possible.

Many banks are taking the hard but necessary step of investing in new cloud-ready technology platforms that support remote ways of working. SaaS offerings provide the ability to tailor the costs to the volumes and needs of the bank. The EBA has recently offered some reprieve for banks investing in their platforms as it has announced that lenders will be allowed to amortise the value of their software over three years.

In the aftermath of the credit crisis, banks that invested in platforms emerged as winners as they were able to reduce costs, create efficiencies while also standardising processes and lending products. Because of the advances in technology such as Cloud, SaaS, AI, and single platform offerings, even greater opportunities are available to those who invest in change.

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Temenos software is proven to enable its top-performing clients to achieve cost-income ratios of 26.8% half the industry average and returns on equity of 29%, three times the industry average. These clients also invest 51% of their IT budget on growth and innovation versus maintenance, which is double the industry average, proving the banks' IT investment is adding tangible value to their business.

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