Gaining Efficiencies in Today's Commercial Lending Environment

A CEB Insight Brief Commissioned by
Moody's Analytics

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WHAT THE BEST COMPANIES DO

Key Findings

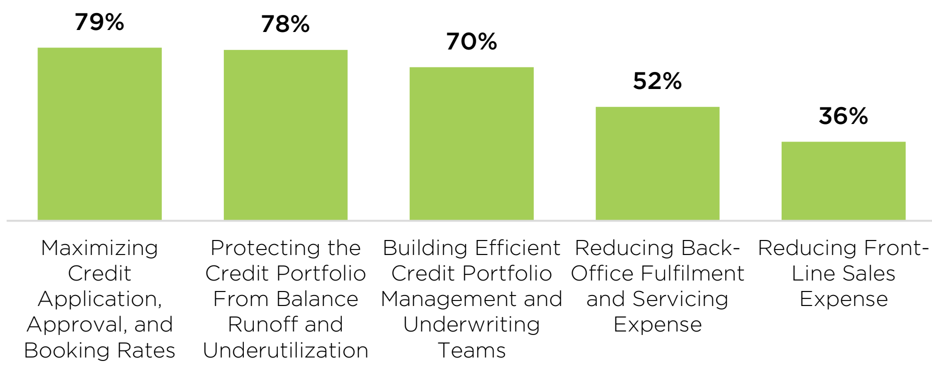
1. Commercial banking executives agree that driving growth through commercial lending is a top priority. However, despite the positive trend in loan growth, a myriad of internal and external challenges prevent banks from maximizing credit growth opportunities.
2. Innovations in commercial lending technology have emerged to address the challenges and enable full credit lifecycle management, empowering institutions to make better credit decisions and provide more efficient credit management.
3. Banks are increasing investments in technology to realize the opportunity of full credit lifecycle management. CEB research indicates that investments in loan origination technologies are expected to grow globally through 2017 and that 52% of banks planned to increase spend on loan origination technology in 2015.

Banks Turn to Commercial Lending to Achieve Desired Growth

CEB research shows that driving growth through commercial lending is a top priority of commercial banking executives. When asked about which activities were of "critical" or "high" importance, commercial banking executives ranked those that deal with credit risk lifecycle management highest (Figure 1). Similarly, when asked what value drivers were most influential in adopting or replacing loan origination technology, executives cited improved services and experience drivers and improved processes as most important (Figure 2).

Figure 1: Primary Commercial Banking Business Focus

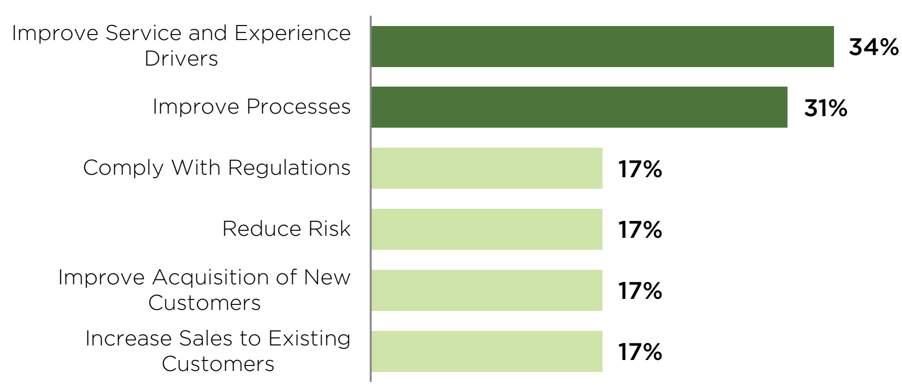
Percentage of Commercial Banking Executives Citing Driver as "Critical" or "High Importance"



n = 113.
Source: CEB 2013 Commercial Banking Leadership Council Agenda Poll.

Figure 2: Value Drivers for Adopting Commercial Loan Origination Technology

Percentage of Commercial Banking Executives



n = 58.
Source: CEB 2015 FSI Survey.

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Challenges Inhibit Efficient Commercial Lending

Despite continued loan growth in most regions of the world, a plethora of challenges—both internal and external—are hindering banks from profitably growing their commercial lending business. The internal challenges revolve around a lack of efficiency from a system, staffing, and credit decisioning perspective while the external challenges stem from increased regulatory compliance demands, heightened competition, and the impact of the prolonged low interest rate environment on margins. The net result is a poor experience for the customer, as well as those involved in trying to sell to and service the customer, and a fragmented, costly process for banks (Figure 3).

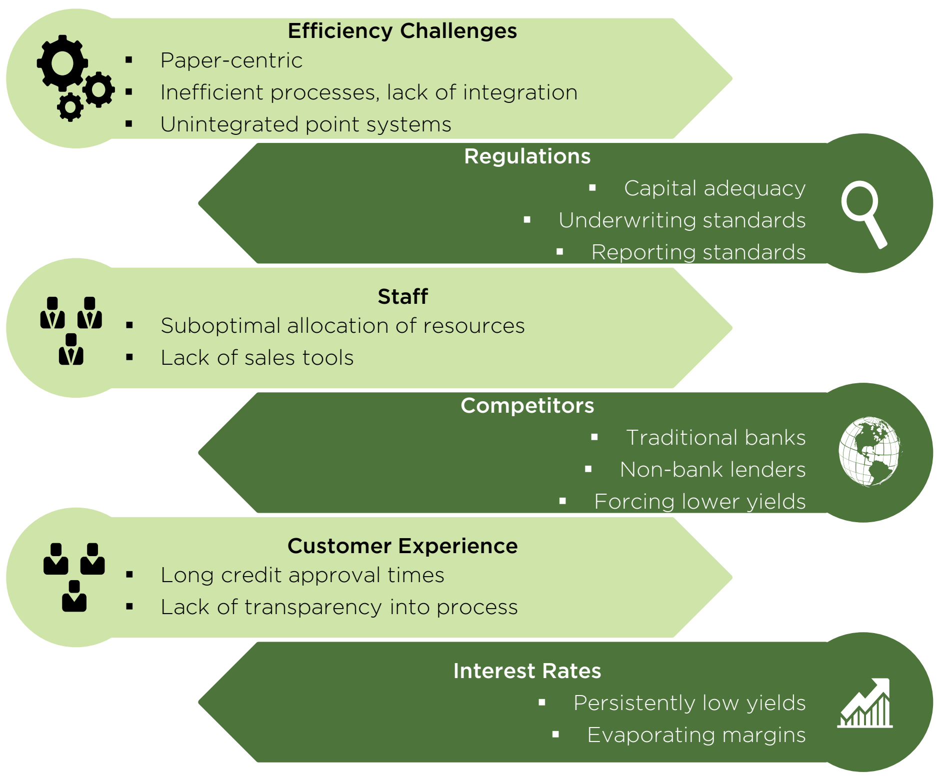
The use of multiple non-integrated systems coupled with manual processes required to underwrite and service loans has been a primary challenge for banks for years. The complexity inherent in making credit decisions and servicing loans requires collaboration across the front, middle, and back office, exacerbating the challenge.

As regulatory bodies continue to place new demands and guidelines on financial institutions, managing risk from a regulatory, credit, and operational perspective has become a burden on firms. As banks strive to make better credit decisions and understand, manage, and report on the risk associated with their loan portfolios, the costs to run the business continue to rise.

Heightened competition from non-traditional lenders, as well as credit unions and larger lenders expanding their footprints, has increased the importance of providing a better customer experience. The often faster and easier application process that non-traditional lenders provide has reinforced the need for change.

Figure 3: Obstacles to Maximizing Credit Growth

Primary Internal and External Challenges



Source: CEB analysis.

Investments in Technology Will Grow Globally Through 2017

Financial services executives plan to increase spend on commercial loan origination technology to overcome these challenges. Over the next two years, 52% of executives are planning on increasing spend, while only 14% are expecting to decrease spend, with the remainder keeping investment levels flat. CEB estimates investments will grow in Asia at a compound annual growth rate (CAGR) between 2012 and 2017 of 4.5% while the CAGRs in North America and Europe are 2.3% and 1.9%, respectively.

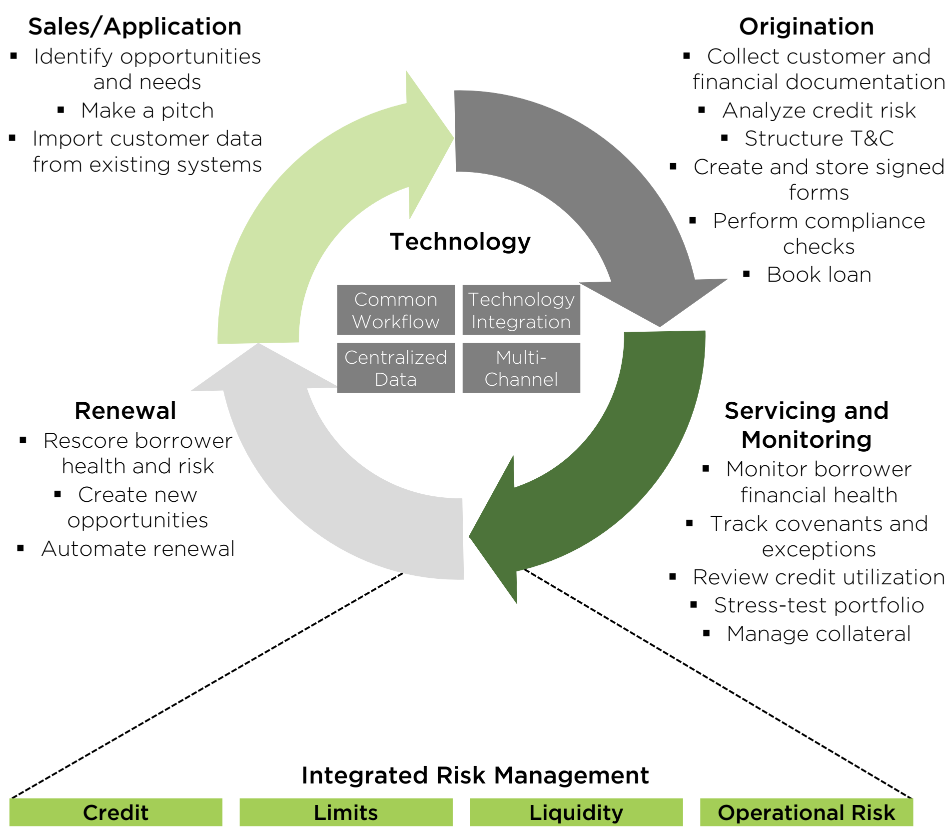
Efficient Credit Lifecycle Management Enables Profitable Growth

In order for banks to make better credit decisions, they need to perform efficiently across each stage of the credit lifecycle; from sales to origination, through servicing, and finally renewal, with several critical activities being conducted in each as shown in Figure 4. The underlying technology enabling lifecycle management depends on a common workflow, integration with internal and external systems such as credit rating agencies, the ability to receive information from customers through various channels, and a centralized data repository as the source of information about each deal throughout the credit lifecycle. Providing a view into overall portfolio positions to effectively manage risk and regulatory compliance is critical. Leading commercial lending solutions can import, manage, and store a variety of data types, model loan performance, and aid in structuring loan pricing and repayment terms.

In practical terms, this involves an underlying data structure that provides all parties to the deal transparency about the transaction. Getting the data all in one place so that the relationship manager (RM) has a full view of the deal reduces time spent by the RM validating data, and provides consistent information being shared back to the customer regardless of whether they are talking with the RM, underwriter, or a servicing agent. Incorporating a workflow that works the way the bank does—involving the right people based on the specifics of a particular deal and providing the right information to those that need it when they need it—enables a better decision-making process. The ability to make better decisions is enabled with integrated spreading, rating, and deal structuring, and allows the bank to monitor the healthiness of existing deals over time via exposure management, scheduled reviews, and covenant tracking. Integration with external sources such as ratings agencies and other proprietary systems also drives automation and straight-through processing.

Finally, the ability to track all activities performed against the loan across the life of that credit and who performed each provides an audit trail and can be an effective tool for risk management teams.

Figure 4: The End State: Integrated Credit Lifecycle Management
Illustrative



Source: CEB analysis.

Conclusion

Financial services executives recognize the need to profitably grow the commercial lending business through credit risk lifecycle management. However, many challenges and inefficiencies inherent in common lending processes and systems prevent banks from achieving the desired growth. Fortunately, the technology exists to combat these challenges. Financial services executives need to invest in lending technology that drives efficiencies, improves risk management, optimizes data and analytic capabilities, and improves the customer experience. Integrated data, flexible workflows, and better credit decisioning will result in efficient credit lifecycle management and enables a transparent and positive customer experience, providing competitive advantage to drive commercial credit growth.

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