

## WHITEPAPER

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# Five Indispensable Insights For The Evaluation of a Commercial Credit Origination System

## Introduction

Even for the most experienced Chief Technology Officer (CTO) or Chief Risk Officer (CRO), the decision to invest in a credit origination system can seem daunting. While there is no shortage of research available on this subject from a retail credit standpoint, in the domain of commercial and corporate lending the treasure chest of useful hints and tips to guide the prospective purchaser is far more elusive.

Moody's Analytics has more than a decade of experience with credit origination solution implementations, with banks of varying sizes, complexity, and geography. Over this time, we have observed five key steps that financial institutions must consider when evaluating a credit origination solution.

## First, Take a Step Back to Move Forward

Many financial institutions start a project to automate their credit origination systems in an attempt to gain efficiencies through standardization of their existing processes and workflows. Process change is not the focus here, rather automating the existing process to make it more efficient. Many banks have been driven to implement solutions in recent years by an imperative to reduce costs in their commercial lending activities, and by the emergence of more nimble, tech-savvy competitors not burdened by costly and cumbersome existing systems.

Other banks might approach their origination solution search as part of a larger change management project, typically aimed at a broader re-engineering of traditional business processes. Often, enhancing the customer experience is the goal of these projects, alongside efficiency-led, bottom-line improvements, and better data governance and business insights.

In all these scenarios, the institution is seeking to adopt new technologies to solve long-term, existing problems. Leaders often believe that the software solution they select will transform the way things are done and deliver economically for the organization. They are disappointed to learn, however, that implementation of the new tool rarely achieves their desired outcomes. The only way to achieve those outcomes, is to first establish the required business uses, and identify the underlying business challenges, that the tools seek to resolve.

Before the evaluation of any potential solution, financial institutions must first perform a detailed business needs assessment. This assessment provides the necessary guidelines for the transformation project. Some of the questions the organization might want to consider are:

- » What are the challenges with the current credit origination workflow? Can they be resolved through other means, for example training or alternative working practices?
- » How many of the existing challenges are the result of inefficient internal processes? Can the processes be improved by re-engineering business work flows?
- » Has the existing credit origination system been thoroughly evaluated to identify possibilities for configuration to meet current and future needs? Is the system being used as it was intended and is it being used to its fullest extent?
- » What about the human element? Is there agreement among the main stakeholders on the type of change required and the underlying issues to be tackled? Do all main stakeholders share the vision of the desired outcome?
- » Only when the bank is confident in its answers to such questions, and that a new origination system will form all or part of the solution, should it begin the evaluation of the vendor platform landscape.

## Current versus Aspirational Requirements

Implementing a new automated credit origination system is the perfect opportunity to review current business processes and to anticipate future requirements of the institution's origination framework.

Planning must take place early in the process and involve a methodical assessment of the institution's business goals from a functional, technical, and resource perspective. This early evaluation process can take several months, but is necessary to determine the agreed vision that incorporates buy-in from all stakeholders.

Establishing a dedicated, full-time project team is an essential component in this exercise. An experienced external consultant can often help the organization define its requirements and prioritize them with senior

management well before the assessment of credit origination solutions begins. An external consultant might also be able to more easily navigate internal politics. They come with no vested interest other than the success of the overall project. For some lenders, this expertise often resides in-house already and can be assembled from interested parts of the organization.

The first task of the project team is to formalize system requirements. This task can be done using an evaluation checklist, where higher weight is given to those areas the bank has identified as mandatory. One consideration might be to prioritize regulatory and risk management requirements ahead of other, purely process-based, requirements. Part of these deliberations can include a phasing of the overall project into logical parts over a defined time.

At this early stage, the project team must also assess the need for integration with the organization's existing systems, considerations include:

- » Alignment - do the integration requirements align with the firm's functional goals, budget, resource availability and overall IT strategy?
- » Continuity - what level of business disruption is likely and is this manageable?
- » Needs assessment – can one platform meet all the requirements or are multiple tools or platforms required?
- » Implementation plan - alternatives include a phased adoption, for example by geography or business unit, versus a single implementation. Banks should also consider whether to appoint implementation project champions across the business to act as change agents, or rely on centralized communications about the project.

Implementation of an origination solution requires a systematic approach. The tasks, business actions, and events all must be adequately identified, scoped, and coded into predefined processes up front. This stage of the project is the best time to identify and plan for the impact, so the potential solutions can be assessed fully.

### Beyond Workflow and Business Processes – What must a Solution Do?

Many banks believe that the need for a credit origination solution can be fulfilled with a workflow system. Indeed, many solution vendors offering a Business Process Management and Notation (BPMN) tool position themselves as loan origination solution providers, regardless of their expertise in credit assessment and the attendant process workflows.

In our experience, looking for a credit origination solution with a workflow-first mindset can sometimes lead to a prescriptive and rigid solution. For example, such an approach might over-emphasize performing core tasks, such as traditional point-to-point, or task-based process-oriented flows. The resulting solution might not keep pace with the new generation of lenders who embrace open, collaborative based deal flows or fail to accommodate complex transactions. Many of today's lenders are looking for solutions that easily facilitate teamwork and empower relationship managers to be closer to their clients, rather than confined to their desks preparing traditional credit documents. These expectations are driven in part by a dynamic and competitive deal structuring environment that must be addressed by the proposed solution. A highly competitive market demands that the solution enhance an institution's ability to react quickly to the customer.

An optimum solution must allow for users from both the business and risk management to access a single, consolidated platform. This platform must spread borrower financials, derive ratings, onboard a complex deal structure, and validate compliance to exposure limits and other policies within the financial institution. This same solution must pinpoint deals in the pipeline, and identify bottlenecks.

Beyond a workflow system, the solution must also offer insightful portfolio analysis. For example, it must offer deal analysis, data analysis, service level analysis, monitoring capabilities, and an actionable output to augment process efficiency initiatives. To reduce credit analyst time identifying financial statement and other data input errors, the solution must also provide value-added risk assessment of the financial statements and obligors.

One item for further consideration would be to look for a solution that offers proactive credit event monitoring capabilities to alert risk management and operations before material events occur. For example:

- » Can the solution account for all borrowers' covenants?
- » How many of these covenants are validated automatically by the system?
- » Is compliance monitoring intuitive?
- » Does the solution provide actionable and meaningful data?
- » Does the solution enable prompt monitoring of periodic credit reviews?
- » Does the solution incorporate the financial institution's risk appetite framework?
- » Is checking of exposure against limit appetites at origination and on-going intervals built into the system?

Another complex feature for consideration is deal pricing. The solution must be able to price loans using predictive models that analyze potential risk and profitability or be capable of incorporating the institutions proprietary pricing tool.

Lastly, a credit origination solution must enable the user to see an accurate record of the loan portfolio, broken down by borrowers' risk profile and outstanding exposure across all business areas. The solution must provide a single and consistent source of truth, built on an underlying data structure governed by validations and rules to ensure high integrity.

### Future Proof Your Investment – Go Configure

Vendor credit origination solutions must have the capability to be configurable and scalable to meet the bank's future requirements. After all, an investment of this nature must be seen as a long-term commitment.

However, be aware of the difference between these terms: configuration, configurability, and customization. The terms can have varying definitions depending on the vendor, so the bank must investigate thoroughly what they are getting. Generally speaking, customization refers to a solution requirement, update, or amendment that requires the vendor to make the modifications on behalf of the bank. Configuration, on the other hand, typically refers to changes the bank can make itself, usually by a system administrator. However, some configuration features can still require a high level of vendor effort and proprietary skills, and some vendors might only have the configuration capability to manage minor business requirement changes. For example, in the management of data lists, larger or more complex business requirements can sometimes incur a high cost, as they require more proprietary skills to configure or code the requirements into the system.

Another consideration for banks is how robust are the configuration tools provided by the vendor? For example, can the solution keep up with ever-changing business requirements, policy amendments, and recalibration of model requests?

Aside from the product configurability implications, there is also a need to consider how solution upgrades are managed as the technology landscape evolves. Here, it is beneficial to validate with the vendor's existing customers and obtaining references from other market players. Does the solution have a sophisticated customer base that influences its evolution? Also assess how the vendor intends to upgrade their tools, does the upgrade process require a whole application upgrade?

### Do your Vendor Homework

It sounds like simple advice, but often an evaluation can center too heavily on the capabilities of the solution itself, and fail to investigate the actual provider. A software tool is often a means to realize the strategic future state of the organization. However, when evaluating such tools, the financial institution is also assessing the accumulated experience that a vendor can offer in realizing that strategic vision. It is natural, therefore, to ask some pointed questions.

Time spent evaluating a vendor is rarely wasted. Financial institutions might want to consider a third-party consultant to provide an unbiased assessment of their vendor options. Of course, meeting with the vendor's reference clients is also important. Vendor and solution assessments are available from specialist industry analysts and are a valuable source of information on the market.

In addition to asking questions about the proposed solution, your checklist should also include questions about the vendor's implementation experiences. Specifically:

- » What is the typical size and profile of the vendor's past implementations compared to yours?
- » What is the strength of the project implementation team?
- » How is the implementation team employed by the vendor or a partner organization?
- » Will you have dedicated resources and for what period?
- » What form of support is provided, including tools for remote support and what percentage is onsite versus remote?

Some vendors are able to provide regionally specific advice but do not have experience at a global level. Which might not be important depending on the bank's own footprint.

Evaluate, too, whether the tool and the vendor can help with a wide range of requirements that are applicable to all wholesale/commercial borrower segments, trading, corporate, and small business origination needs. For instance, there are many vendors who designed their product for retail lending and have subsequently adapted it for wholesale lending requirements. This approach does not guarantee the product is robust enough to stack up against the more complex deal structuring and monitoring needs of corporate lenders.

For complex origination requirements such as syndicated lending and wholesale credit, a best practice approach is to conduct a hands-on Proof of Concept (POC) exercise. The POC exercise must go beyond a product demonstration. The aim is to eliminate vendors who simply 'tune' their system to specific scripts or workflows and consider the needs of commercial lending versus small business lending. Through a POC exercise, the bank can provide each vendor invited to the process with its own business scenarios that represent its portfolio and have these scenarios demonstrated by the system.

An origination system can be used by a large number of users across multiple departments and roles. Invite working level participation to these demo sessions – people who are going to use the system every day – in addition to the decision makers or executives whose role is to sign off the investment. Exclude systems that are not well designed from a usability standpoint. Recognize the value of a well thought-out system

design and how intuitive and efficient it is to use. Be cautious of a solution that locks users into hard-coded processes or routines that do not provide flexibility.

During these hands-on sessions, financial institutions might also be able to test key requirements that are not demonstrable through vendor-led sessions. A critical component of a loan origination solution is data governance, to manage the quality of data processed and made available to downstream systems. During a POC exercise the firm can explore how data governance is deployed in the solution, how the out-of-box automation and validation rules align with the bank's data quality management policies, and how they can be configured.

Finally, an assessment of the vendor's solution roadmap is vital. Qualify existing customers of the shortlisted vendors by the version of the product they use, and the effort invested in each major version upgrade. These questions can provide insights to the maturity of the product and the likely vendor experience.

### Conclusion

A successful implementation of a credit origination solution can assist the financial institution at being more efficient and make better risk decisions. Its benefits will accrue steadily over time and can help the bank achieve the strategic goals it set out during the pre-purchase phase. However, a successful implementation is far from guaranteed. By following the evaluation tips discussed in this paper, a successful solution choice and implementation can be achieved.

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