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SURVEY INSIGHTS

STRATEGIC DEVELOPMENTS - CORPORATE AND COMMERCIAL BANKING INDUSTRY

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Overview

Globally banks have faced a range of challenges in weathering the pandemic storm and have come out of it identifying pain points and gaps in product and service delivery. To understand the impact of the pandemic, current challenges and new priorities for the industry, Acuity Knowledge Partners conducted a survey of senior decision makers at global and regional corporate and commercial banks and this report summarises the key findings.

Survey highlights: key numbers that tell a story

55% of the respondents believe withdrawal of fiscal stimulus will increase the probability of default (PD) of leveraged companies, while 38% believe loan-loss provisions would help reverse the deteriorating credit quality of loan portfolios

Monitoring credit quality of existing clients emerged as the #1 challenge, with increasing new business and digitalisation at a close second

Unsurprisingly, managing credit risk efficiently is priority, with over 90% of the respondents classifying this as a top three priority. Complying with regulatory requirements and the need to improve internal digital infrastructure remain highly relevant

96% of the respondents consider fragmented systems to be the main hurdle on the path to automation. 82% of them agree the lack of data standardisation is also a major challenge

The decision makers agree on the importance of reinventing the lending landscape with intelligent automation, and a significant 43% of them are actively looking for new opportunities to digitalise. Coming a close second are banks that have lending platforms but work mostly in silos and have significant scope to improve efficiencies

71% of the decision makers are focused on automating the monitoring function first. The second priority is automating loan origination and servicing. Automating credit underwriting, given the criticality and complex nature of analysis, is generally not the starting point in digitalisation and is more often undertaken once systems have been connected, data is standardised and application of AI/ML tools is more feasible

As far as digitalisation strategies are concerned, a majority of respondents agree in building a complete digital platform with a long-term view either by themselves or by bringing in a partner. As digitalisation is now at the heart of business transformation strategy for most banks, a large number of them are open to strategic partnerships.

Survey demographics

Over 50% of the survey respondents held senior positions in credit portfolio management, credit analysis and underwriting. As the charts details, the respondent banks loan-book focus spread across large caps, CRE, ABL and leveraged finance.

Role in the firm (% of respondents)

32% Head of Portfolio Management
29% Head of Credit Analysis/Underwriting
16% CEO/COO/Head of Ops
13% Front-Office Support/Product Specialist
10% Head of Risk Governance, Credit Administration, Controls

Loan book focus (% of respondents)

61% Large companies including syndicated loans

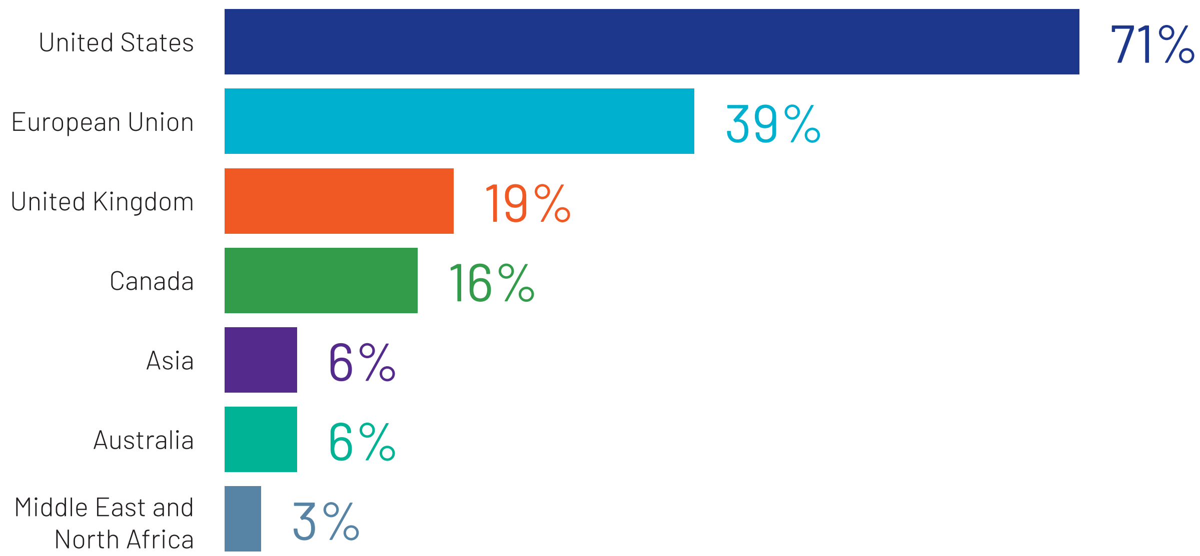
58% Commercial real estate

39% Asset-based lending

39% Leveraged/ acquisition finance

35% SME/small business/ middle market

Geographical breakdown of loan book



Global credit market recovery prospects uncertain

Despite the strong recovery in 2021, the global economy is fragile, with multiple forces at play amid the emergence of new coronavirus variants, supply chain disruptions and accelerating inflation. Elevated global debt and potential stricter monetary policies may lead to credit market volatility. Industry trends have varied significantly, demonstrated by the divergent performances of the manufacturing and services sectors.

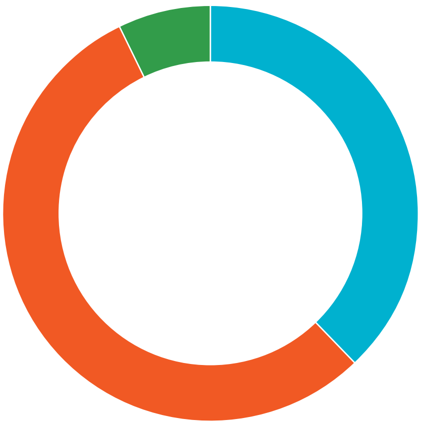
Indeed, while pent-up demand is powering a surge in manufacturing indices, many sub-segments in the services space have still not recovered, notably travel, tourism and educational services. Whether there would be permanent structural shifts within some of these sectors remains to be seen.

The early adoption of viable alternatives appears to be the new normal, and is likely to persist at least in the short term which could ultimately expose lenders to prolonged downside risks stemming from a slower-than-expected recovery of their portfolios. Nonetheless, for banks with diversified portfolios, an overall recovery mitigates these risks somewhat and presents further opportunities to drive loan-book growth as capex returns to normal levels.

We also asked our respondents about the most likely effect of the withdrawal of pandemic-driven fiscal stimulus.

A large 55% believe withdrawal of the fiscal stimulus will increase the probability of default (PD) of leveraged companies since it provided a cushion at the peak of the pandemic

Perceived impact from withdrawal of fiscal stimulus



38% Little effect on credit quality of loan portfolio, as expected loss is provisioned for

55% Increase in probability of default (PD) for companies with leveraged capital structures

7% Significant increase in PD across the loan portfolio

Given debt serviceability is impacted by the suppressed macro conditions, the mainstream belief is that PDs will increase for highly geared companies and not in general across the loan portfolio (only 7% believe this).

38% of lending survey respondents state that loan-loss provisions would reverse the deteriorating credit quality of loan portfolios, pacifying the externalities of the fiscal stimulus

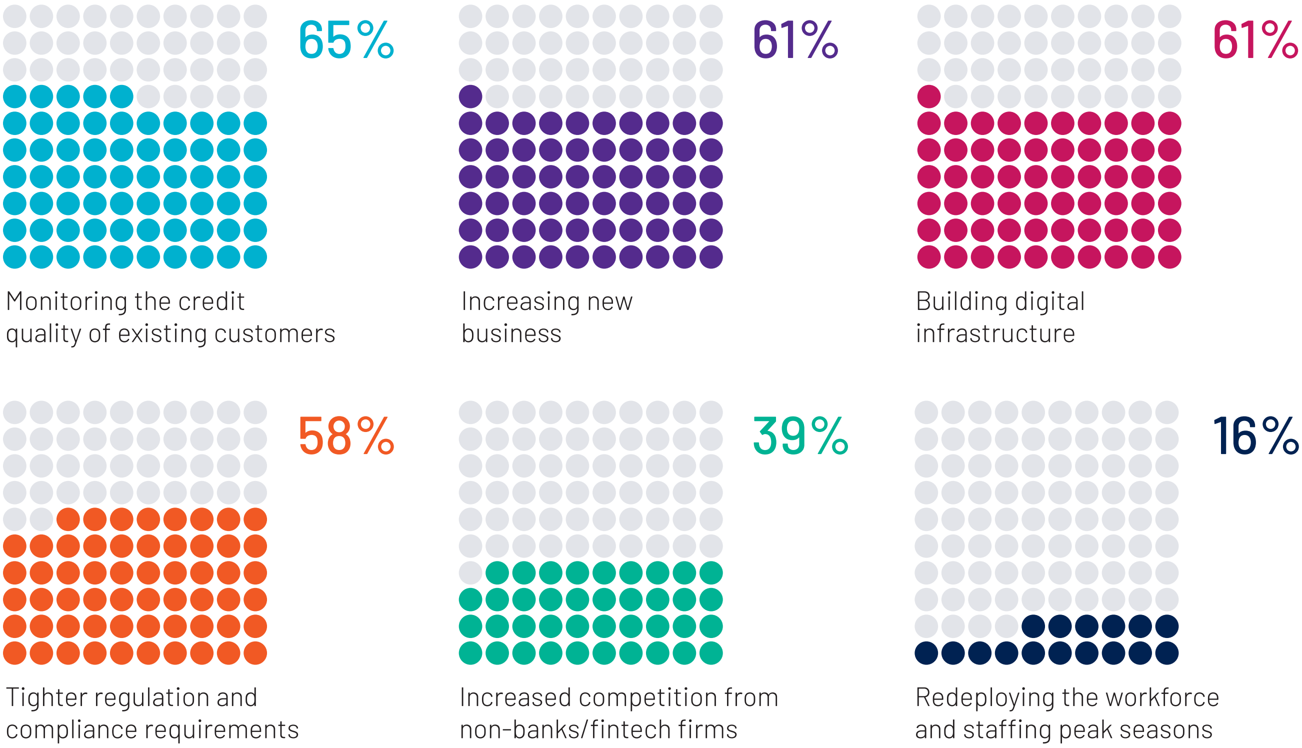
Challenges firms face amid the pandemic

The lending space and the financial services sector as a whole have experienced new challenges as the operating landscape has changed.

Monitoring the credit quality of existing clients is the #1 challenge

As the responses show, an effective operating model for banks and financial services providers would include close scrutiny of client credit quality. Financial challenges faced by borrowers with multi-industry exposure are increasing, raising the stakes even higher for lending firms.

Pandemic-age challenges faced by firms



Increasing new business and building digital infrastructure are the next two main challenges

Increasing new business has become a challenge as more companies face the danger of redundancy, limiting the scope for lenders to strike new deals in a sustainable manner.

Digitalisation, also at #2, is one of the topics discussed the most in the new millennium

With business models created for execution in-office now challenged by prolonged lockdowns, essential services such as banking and ancillary financial services desperately need to convert and strengthen their operating platforms digitally.

Meeting tighter regulations and compliance requirements is the #3 challenge

With structural market changes and the subsequent complexity widening the scope for customer exploitation, regulators worldwide are increasing their examination of aggressive, unethical and illegal business/lending practices.

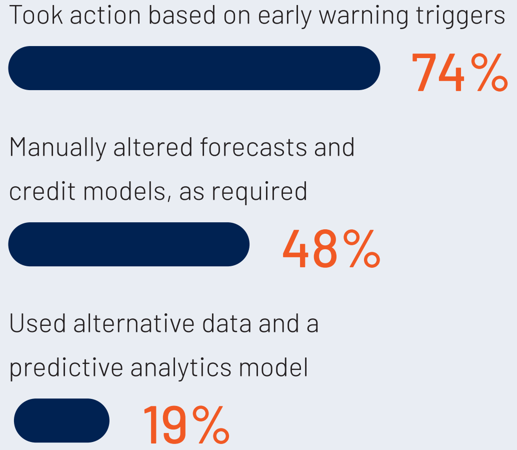
Evolving credit assessment and underwriting methods

Traditional risk rating methodologies, where the credit quality of a borrower is heavily influenced by historical data, are now in the spotlight given the rapid economic deterioration due to the pandemic. Our survey results imply that many such risk assessment frameworks are now redundant owing to their dependence on numerical data that was fast becoming outdated.

Against this backdrop, the respondents believe the use of early warning triggers in credit risk assessment is vital

As the adjacent chart shows, the majority of the respondents identify early warning triggers as a superior indicator of credit quality deterioration.

How credit teams managed assessment and underwriting amid uncertainty (% of respondent)

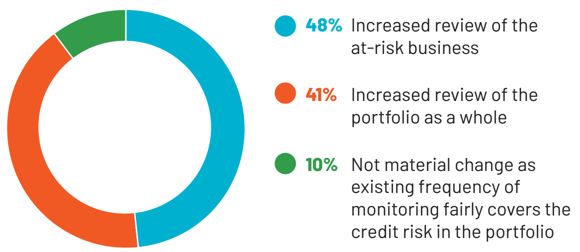


Second, the respondents believe banks have focused on manually altering forecasts and credit models amid the economic downturn

The need to react swiftly has necessitated a more fluid approach to credit assessment; undoubtedly, the process-driven approach of reviewing forecast models periodically has been rendered inadequate due to the highly volatile operating environment. With the lockdowns, most businesses came to a standstill at least at some stage over the past 18 months, resulting in an unprecedented sharp deterioration in credit metrics on a systemic level. The need to look through the cycle and build in a scenario-based approach to credit assessment has never been more important for lending front-office and risk teams that have had to go through several credit model revisions during this phase.

We also asked our respondents how their portfolio monitoring frequencies changed amid the pandemic-induced uncertainty. ***48% of them acknowledged that reviews of risker sectors of their loan portfolios increased.***

Changes in portfolio monitoring frequency



Several global sectors, such as airlines and energy, declined more than others. Our survey results show that lenders have increased scrutiny, especially of borrowers in these troubled or at-risk sectors.

41% of the respondents say their portfolio monitoring frequencies increased, extending beyond at-risk sectors to their entire portfolios. While the majority may not have had the resources to increase monitoring, 41% seem to have taken a more secure and holistic approach.

A marginal 10% say their pre-pandemic portfolio monitoring frequency was adequate amid the pandemic and they, therefore, did not have to materially change monitoring frequencies.

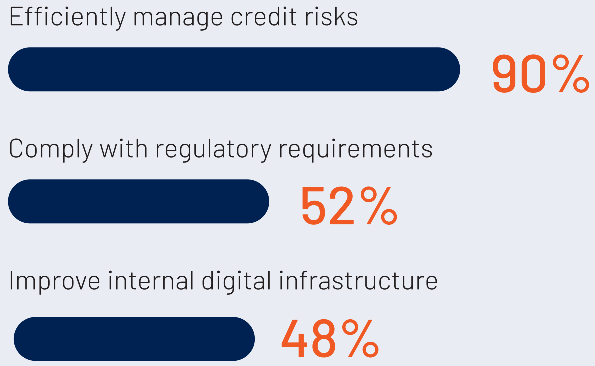
Lenders’ top goals amid the uncertainty

The economic fallout continues. Indeed, a K-shaped recovery pattern has heightened credit risk for lenders, particularly those with exposure to highly leveraged names in the worst-hit sectors such as travel and tourism, energy and entertainment.

Unsurprisingly, our survey shows efficient management of this credit risk is a key priority. What is noteworthy here, though, is that more than 90% of the respondents count this among their top three priorities

More than 60% of the respondents rank this as their #1 priority. Exposure to credit risk is part and parcel of the lending business, which is highly exposed to cyclical downturns. Nevertheless, it is evident from our survey results that lenders will be focused on maintaining adequate provisioning and achieving higher risk-adjusted returns in order to outperform peers in the next 6-12 months.

Top goals (% of respondents)



Complying with regulatory requirements is the #2 priority, and more than half of those surveyed place this among their top three priorities

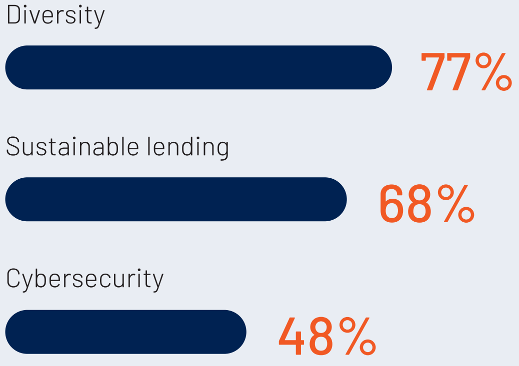
Regulatory requirements are broad-based. In addition to the difficulties faced by banks amid the current volatility, these pressures persist as regulators continue to enforce a number of compliance requirements, increasing compliance costs.

Third, the need to improve internal digital infrastructure remains highly relevant

A prolonged low-interest-rate environment has resulted lower interest margins and reduced operating income. Banks seem to be looking aggressively to offset the impact of this on shareholder returns by reducing costs at every turn. Our survey results indicate the collective opinion that the challenge of reducing costs while maintaining business growth can best be resolved by effective digitalisation. While traditional banks have been slow to digitalise for whatever reason in the past, the pandemic and related countermeasures by central banks are becoming the catalyst for faster adoption of digital infrastructure across the value chain of banking operations.

The rapidly changing operating environment presents several challenges for banks. Competition is rising both within and from outside the industry, with disruption due to the emergence of "challenger" banks and non-traditional competition. Banks are coming to realise they need to be staffed with the right people who are able to innovate successfully, and mitigate risks evolving from these emerging trends. While like-minded individuals from similar backgrounds have built cohesive teams over the years, banks have also begun to realise that a lack of diversity in their teams has severely limited the innovative and, at times, counterintuitive thinking needed to meet the evolving needs of a diverse customer base.

Key focus areas outside financial objectives (% of respondents)



Our survey results clearly show that enhancing diversity is the most common focus area outside meeting financial performance goals over the medium term

The pandemic has also accelerated the need to incorporate an ESG-focused approach into lending.

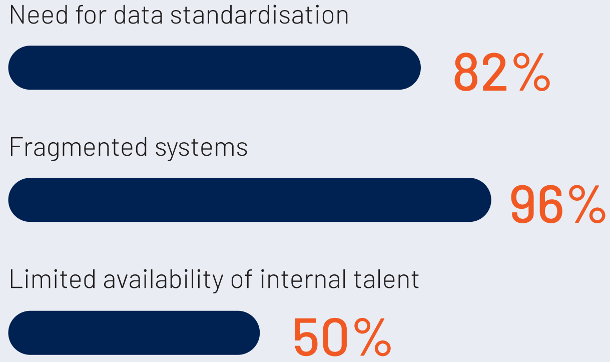
Indeed, sustainable lending is a close #2 key focus area

Sustainable investing and sustainability are being driven by a broad range of stakeholders including governments, regulatory bodies, the investment community and consumers. Consequently, the responses we received appear to indicate that, in general, banks that considered sustainable lending to be an emerging area of growth before the pandemic now single out sustainable finance as a core area of their banking strategies.

The digitalisation story

A number of banks made a concerted effort to transform their lending processes as part of overhauling antiquated systems and processes in the previous decade. The pandemic necessitated technology enablement and accelerated digitalisation of all critical functions along the lending value chain due to the forced lockdowns and significant shifts in customer needs.

Key challenges of automation/digitalisation (% of respondents)



96% of the respondents to our question on key challenges in the corporate and commercial banking space consider fragmented systems to be the main hurdle on the path to automation

Such fragmented systems have vast, extremely variable and unstructured datasets. Banks have to first focus on understanding the complex systems, optimise and collate them and then integrate the information across the various platforms.

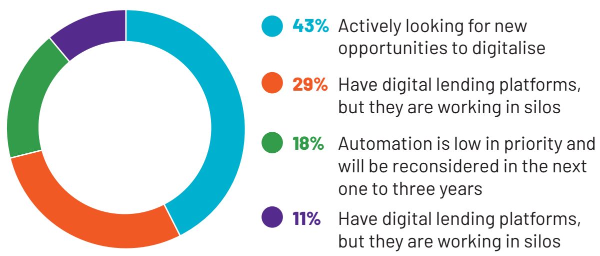
82% of the decision makers agree that a lack of data standardisation is a major challenge

Both decision makers and advisors agree that these two challenges are, to some degree, integrated and addressing them can lead to efficiencies and lay the foundation for automation. Large-scale efficiencies take time to be realised, but the benefits of standardisation, increased front-office bandwidth and improved user interface would be immediate. The closely connected systems would eliminate redundancies, improve agility and increase speed to market, making banks better equipped to absorb shocks such as the pandemic or an economic downturn.

Almost half the respondents think there is limited availability of skilled resources

Most transformation projects require subject-matter experts, and banks rely on their credit and relationship management teams to execute these projects. This adds to already burdened core teams who are now required to balance relationship building with supporting transformation initiatives.

Where we are on the automation journey



The decision makers agree on the importance of reinventing the lending landscape with intelligent automation; a significant 43% are now actively looking for new opportunities to digitalise

With increasing revenue pressures and strained balance sheets , banks are now looking for novel ideas and partnerships that can drive intelligent automation across functions and increase digital ROI.

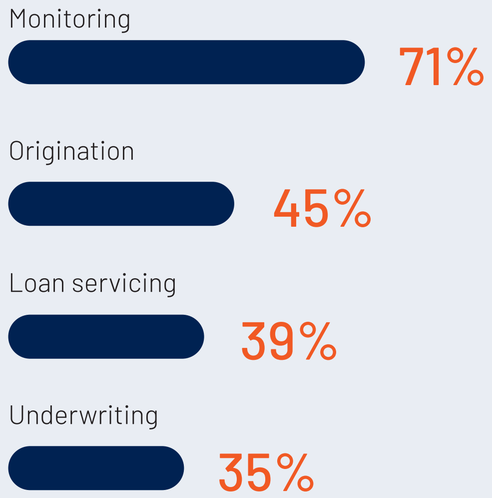
Banks have lending platforms but mostly work in silos, with significant scope for improving efficiencies

These banks are heavily invested in technology and are now looking to integrate and streamline micro-platforms and systems.

Given the advancements in technology, all four areas – monitoring, origination, loan servicing and underwriting – can be streamlined with digitalisation, but 71% of the decision makers are focused on automating the monitoring function first

This is not surprising given this step is the least relationship-based, analysis is repetitive, it requires significant data capture and processing and it consumes a large portion of the time of credit and relationship teams. Banks need to develop and deploy robust and nimble portfolio monitoring systems that share information across platforms so they can quickly identify emerging risks, predict credit deterioration, appropriately price products and improve credit decisions. This would also help banks strengthen management information and regulatory compliance processes.

Focus area for automation/digitalisation (% of respondents)

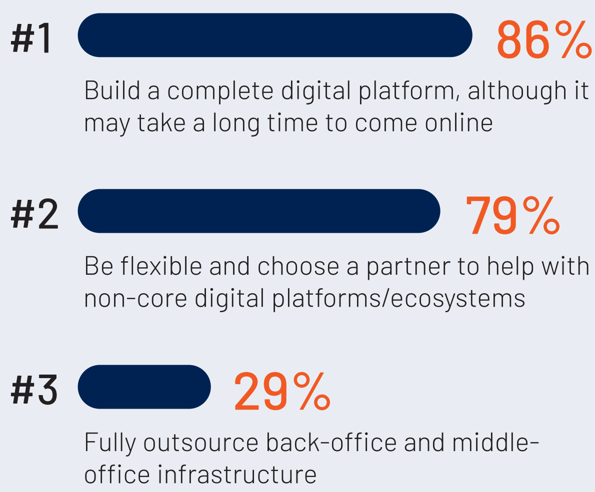


The second priority is automating the loan origination and servicing functions

This essentially entails improving automation of data collection and mining, pre-screen customer and score carding, and rule- and risk-based credit decisioning. With muted loan books and higher non-performing assets (NPAs), a number of banks are now looking for new growth areas, and an agile digital loan origination process could help attract new customers and open up new products/geographies, reduce credit risks and increase profitability.

Automating the credit underwriting process, given the criticality and complex nature of analysis, is generally not the starting point in digitalisation and is more often undertaken once the systems have been connected, data is standardised and application of AI/ML tools is more feasible

Strategic priorities in digitalisation (% of respondents)



Almost all respondents agree in building a complete digital platform with a long term view either by themselves or by bringing in a partner. As digitalisation is now at the heart of business transformation strategy for most banks, a large number of them are open to strategic partnerships. Businesses can benefit from gaining immediate access to a range of tried and tested digitalisation solutions without significant investment in human capital, technology and real estate.

Looking ahead

69% of the respondents already use the services of outsourcing partners in their lending services. They believe the most important attributes of a strategic partner for lending support are domain expertise and breadth of services.

Getting the services of an outsourcing partner can help execute change, as they bring innovation, domain expertise and best practices, without impacting day-to-day business. Outsourcing introduces standardisation to business processes via dedicated resourcing with clear standards of operation and security/compliance protocols in place, saving time and costs for lending businesses.

Strategic partner - key attributes

74%
Cost of service

100%
Domain expertise and breadth of services

96%
Experience and client references

96%
Scalability

100%
Business continuity

The respondents are also of the opinion that business continuity and client references/experience in the outsourcing business go a long way in reassuring them of the viability of the investment in the future.

Scalability remains vital for large lenders given their extensive networks across geographies and digitalisation being an evolving process across business areas with a long-term focus.

How Acuity Knowledge Partners can help

At Acuity Knowledge Partners, our pursuit to drive digitalisation and innovation in the commercial lending lifecycle has led us to integrate our deep domain expertise with data analytics. This has allowed us to provide a robust hybrid model to our clients, helping them reduce costs, increase productivity and improve end-client experience across the value chain – from origination, underwriting and closing to servicing and portfolio monitoring.

We help clients with tasks ranging from the basic to the complex along the lending lifecycle:

	1. Origination	2. Underwriting & Monitoring	3. Credit Admin
CLIENT	» Opportunity assessment » Deal structuring » Pricing	» Approve reviews, ratings & limits » Policy exceptions & management » Manage stressed credits	» Payments & disbursements » Collateral release » Manage special assets accounts
HIGH	» Pre-qualification credit assessment » Thematic/Industry, macro peer comparison studies » Detailed pitch books	» Credit reviews » Risk ratings » Cash flow models » Borrowing base determination	» Collateral release doc. preparation » Loan servicing » Financial booking
LOW-MEDIUM	» Document management » Prospect spreading » Newsletter/market updates	» Financial spreading with projections » Loan watch list dashboards » Periodic limit monitoring » Covenant validation	» Document management » Lending system update » General ledger entries reconciliation » Platform migration support

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With digitalisation initiatives specially designed to automate parts of the credit analysis function, coupled with the flexibility to choose from different engagement models, we enable financial institutions to scale their lending operations while remaining client- and risk-focused.

The recent crisis amplifies the need for robust credit risk governance, including timely monitoring of loan portfolios and early identification of deteriorating credit risks. We partner with lenders globally, helping them maintain the ability to take risks prudently while driving ROI in their lending processes.

To know more, please visit *Corporate and Commercial Lending Services | Acuity Knowledge Partners (acuitykp.com)*

About Acuity Knowledge Partners

Acuity Knowledge Partners (Acuity), formerly part of Moody's Corporation, is a leading provider of bespoke research, analytics, staffing and technology solutions to the financial services sector.

Headquartered in London, Acuity Knowledge Partners has nearly two decades of experience in servicing over 400 clients by deploying its 4,000 specialist workforce of analysts and delivery experts across its global delivery network. We provide our clients with unique assistance to innovate, implement transformation programmes, increase operational efficiency, and manage costs and improve their top lines.

Our expertise includes the following:

» Investment Banking: origination and trading support
» Investment Research support: covering all asset classes in terms of ideation, data science, and research support across the buy side and sell side
» Commercial Lending support: across origination, credit assessment, underwriting, and covenant and portfolio risk for all lending types
» Private Equity: origination, valuation and portfolio monitoring support
» Asset Management services support: across marketing, investment research, portfolio management/ optimisation, risk and compliance
» Corporate and Consulting services: market and strategic research; survey work; treasury and counterparty risk support; and CEO office support, including M&A, FP&A and investor relations support
» Compliance support: AML analytics, KYC, counterparty credit risk modelling and servicing across banks, asset managers and corporates
» Data Science: web scraping, data structuring, analytics and visualisation.

These services are supported by our proprietary suite of Business Excellence and Automation Tools (BEAT) that offer domain-specific contextual technology.

Acuity Knowledge Partners is backed by Equistone Partners Europe, a leading private equity organisation that backs specialist growth businesses and management teams.

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