



WHITE PAPER

THE FUTURE OF COMMERCIAL LENDING

How you can shape what happens next

The outlook looks bright for lenders

Although forecasts remain far from certain, the first quarter of 2021 was one of the busiest times for commercial lenders in several years. With banks in many regions warming to new opportunities, the world is getting back in business and economic recovery is in sight. So, globally, the mood of commercial lenders could be described as cautiously optimistic.

But lenders are also staying wary of the risks. With macro interest rates still low and profit margins under pressure, there's a difficult path to navigate and a delicate balance to strike. But with the right approach, there are brighter prospects ahead.

A new world of credit risk

In the general uncertainty of the current landscape, commercial lenders face rising risks from new, unforeseen corners of the portfolio. Credit risk has become a slippery customer, often evading detection from traditional, backward-looking assessment practices.

Fortunes can turn on a dime. Faced with the unprecedented circumstances of national lockdowns and global travel restrictions, many business models that looked unshakeable just two years ago have since crumbled.

While digital-only businesses have been in pole position to thrive, a vast number of firms have relied on government bailout schemes to keep them up and running. But others have been even less fortunate; and failure to move fast and meet evolving consumer requirements can now quickly mean the end of the road.

Historic financials can no longer tell you all you need to know about a business and its probability of default. With safe bets in shorter supply, it's never been more important to understand the credit risks you are facing – nor as hard to predict how those risks might grow.

Lending in the long term

There are also new, longer-term risks to consider. As environmental, social and corporate governance (ESG) grows in importance for businesses and investors, a firm's sustainability will become more critical to not only its reputation but also its credit rating.

Today, for example, oil and gas companies are still among the strongest and most creditworthy in the world. But unless these firms radically change their current business model, who will lend to them on the same scale in ten years' time?

The future of lending is in your hands

As consumer demands and business priorities shift in the pandemic and beyond, commercial lenders must also adapt to succeed – by focusing on changes within their own power.

The key is to accept what you can and can't control, and then take positive, practical steps to address the former.

The future may seem uncertain, but it's also more firmly in your hands than you might think. Whatever happens in the outside world, there's a lot you can do from an operational standpoint to improve outcomes – and income – for your own business.

The blueprint for a brighter outlook

As they nurture their cautious optimism, banks and lending organizations need systems and technology that will help them take a proactive but watchful approach to growth. Focus your investments on three operational priorities to drive profits, reduce risk and gain a greater competitive advantage.

Manage margins with automation and managed services

Margin pressure has long been a problem for lenders. Macro interest rates were already crushingly low before the pandemic – and they're likely to stay that way for some time to support the economic recovery.

Clearly, monetary policy is beyond your control. So, rather than looking to interest income to widen your margins and drive topline growth, you need to focus on taking out costs, increasing productivity and improving your bottom line.

Historically, lending has always been a very costly business to run, requiring hundreds of risk and finance staff to carry out relatively mundane administrative tasks. Many of these employees are highly skilled and should ideally be adding value elsewhere – such as talking to customers about net new business or identifying and resolving problems in the portfolio.

To put these talents to better use and reduce unnecessary operational costs, you need to start stripping out the repetitive, low-value tasks that technology – or technology services – could do faster, more efficiently and often with greater accuracy.

Automate or eliminate?

When you're designing your target operating model, ask yourself which tasks you could do without. Be honest: if an administrative or compliance process doesn't directly differentiate your business, why waste your own human capital on its delivery?

For simple small business loans, you might question the value of manual approval and financial spreading processes. For example, when applications are under a certain dollar threshold and satisfy key criteria, automated approvals can save you unnecessary effort without lowering underwriting standards or compromising the customer relationship. Quite the opposite, in fact, as a faster time to “yes” will only improve your service proposition.

Similarly, in the case of more complex, leveraged or syndicated loans, you could find that dedicating valuable in-house resources to lending reviews, covenant checking and monitoring adds little to your competitive edge.

Whichever processes you identify as non-differentiating, you then have a choice: automate the process yourself with technology, or hand it over wholesale to an expert managed services provider. Either way, you'll lighten the load on your own lending operation.

Before 2020, many firms were already making positive decisions on automation and outsourcing as part of a wider digital transformation. Although some put their plans on hold in the pandemic, others accelerated their implementation of new systems and services, not least to rapidly meet the heavy processing and monitoring requirements of government-backed loans.

With leaner, modernized, more agile operations, the most progressive lenders were already in a stronger position to support their customers through the crisis. Now, they can adapt more quickly to whatever the future brings, too, while continuing to ease pressure on their margins.

Identify credit risk through proactive monitoring

One of the biggest pressures on lenders' resources and margins comes from credit risk monitoring. In Europe especially, many large banks still employ large teams of people across the middle and back office to monitor deals, which has become a slow, unwieldy process.

Today, there's a drive to not only lower the costs of credit risk monitoring operations, but also to speed them up and present results more quickly to the front office. Again, this begs the question: should you automate or outsource some of the effort?

But there is more than efficiency at stake; credit risk monitoring processes should also achieve both compliance and control.

Increasingly, regulation is moving into the governance of banking relationships. Driven by the recommendations of the European Banking Authority (EBA), lenders in both Europe and Asia must now prove to regulators they have the control mechanisms in place to monitor their commercial customers in multiple dimensions, track their financial health and pick up on the early warning signs of defaults.

Plus, in line with new ESG policies, lenders must start showing formally that they are making sufficiently green deals and funding suitably sustainable business plans.

The overarching aim is to hold non-performing loans at bay. But do you have the infrastructure to proactively monitor and keep your customers in check?

Track and act

To meet the EBA's new standards, commercial lenders will not only need to track their customers more closely than ever – and throughout the life cycle of a lending facility – but also show they are prepared to act on what they see.

Broadly, regulators want to make sure that you're on top of a loan's performance. For example, are repayments always made on time? Or, how highly leveraged is the transaction in the context of your portfolio?

And critically, for every early warning sign of a default, regulators now need to see a policy in place. That means demonstrating the measures you will take to manage signals of deteriorating credit, whether a forbearance request or a covenant breach.

This is a step change for banks. Historically, it has taken several weeks for a relationship manager to get wind of a late payment, making it too late to act. In that time, a rival bank with a more vigilant operations team could have stepped in to save the deal, restructure the loan and secure better terms.

Meanwhile, until recently, covenants were viewed as soft conditions and were barely monitored at all. Today, lenders are moving toward formal covenant monitoring, to both protect themselves and, again, get room to set tougher terms.

So, credit risk monitoring systems now have to raise their game – and keep lenders ahead of the pack. It's no longer enough to identify a late payment, or even show how late that payment is; you need to know how likely it is to happen in advance.

Luckily, there's no shortage of data to mine for the purpose. In the credit-sensitive market that the pandemic has created, credit risk indicators can be found at many levels – by continuously monitoring everything from a firm's cash flow, transactions and behavior as a borrower to news feeds and social media for market and sentiment data.

The challenge will be to isolate the intelligence you need from the vast quantities of information that's available. But through a combination of automated rule-based technology and intuitive policies, you can whittle down the number of data points you need to monitor. With alerts to only the signals that really matter to your business, you can proactively manage issues by exception and significantly reduce the operational costs of credit administration.

Differentiate services by increasing insight **Are you ready to look forward?**

Technology does more than just enable lenders to identify credit risk more easily – it's key to improving service. Just like consumers, businesses expect to be able to manage a high proportion of banking processes online, even more so since branches shut their doors or cut opening hours in the pandemic.

But beyond the automation of everyday transactions, there is still a considerable need for human relationships between businesses and lenders.

Commercial and corporate deals can be complex and require further discussion when issues arise. And as the economic recovery unfolds, your customers will continue to present you with highly specific challenges that only person-to-person communication can solve – as well as opportunities that deserve an intelligent conversation.

The good news is that digitalization and human interaction don't need to be mutually exclusive; one can accommodate and complement the other.

Digital systems can help lenders increase efficiency, streamline and centralize processes, and accelerate decision time, while giving customers more convenient channels to engage with. Plus, by automating or eliminating manual tasks, technology wins back more time for you to focus on customers.

But critically, the automated analytics that digital technology provides can also create opportunities for dialogue – whether by flagging up a potential credit risk or identifying a new product or service requirement.

Understand and stand out

Through the power of technology, traditional banks in particular can play to their greatest strength – their ability to build deep, sustainable customer relationships.

Unlike many recent entrants to the lending market, these banks offer a one-stop shop of financial services to commercial customers, from deposit accounts, overdrafts and corporate finance to asset finance and company credit cards. And with digitally-driven insights, it's possible to provide an even better all-around service.

Essentially, the same data set that enables you to identify credit risk can also help you to drive cross-selling opportunities and offer products to the right customers at the right point in their business cycle.

Ultimately, it's about serving customers in the way they want to be served. Whether you're lending to a small business or providing a complex syndicated loan for a major corporation, you can set yourself apart from your competitors by really getting to know your customer's needs.

The greater the insight, the deeper your understanding, the more confidence that customers will gain in your services – and the better relationships you can build in the future.

Whatever the future holds, success is within your power. For every macro trend you can't change, there's an aspect of your business that you can, from your operational overhead and risk assessment processes to your customer interactions.

By helping you streamline your operations, monitor customers more closely and better understand their requirements, a single digital solution for the entire commercial lending cycle is the smartest way to future-proof your business. Just don't tell your competitors.

LET'S SOLVE THE FUTURE OF LENDING.

With FIS' powerful technology and reliable managed services, the future is more squarely in your own hands. We'll help you advance your digital transformation to automate or eliminate low-value tasks, see the earliest signs of defaults and get more insight into every customer and deal.

Now you're in the strongest position to improve your margins, keep on top of credit risk and set your services apart from the rest. And the ability to integrate your digital channels with one-to-one conversations enables you to strengthen relationship banking and open new opportunities for profit and growth.

About FIS

FIS is a leading provider of technology solutions for merchants, banks and capital markets firms globally. Our more than 55,000 people are dedicated to advancing the way the world pays, banks and invests by applying our scale, deep expertise and data-driven insights. We help our clients use technology in innovative ways to solve business-critical challenges and deliver superior experiences for their customers. Headquartered in Jacksonville, Florida, FIS is a Fortune 500® company and is a member of Standard & Poor's 500® Index.

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