

Market Commentary

Lending in 2021, a year like no other

2020 was certainly a year for the record books with a global health crisis that forced economic impacts across the globe. As we now approach 2021, financial institutions are looking at an era of unprecedented uncertainty in lending, as potential write-offs loom and the effects of a low-interest rate environment inhibit profitability.

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McKinsey & Company

However, the year ahead also reveals some unique opportunities for financial institutions. Looking toward 2021, these are some of the biggest trends impacting lenders and the areas where financial institutions will need to invest for more profitable outcomes.

It's full steam ahead for the Libor transition

As financial institutions face a new economic reality in 2021, LIBOR will undoubtedly be one of—if not the biggest—focus for financial institutions.

In November of 2020, U.S. regulators pressed financial institutions to stop the use of the London interbank offered rate on new transactions by the end of 2021, well ahead of the official transition date scheduled for 2023. The shift is estimated to affect \$200 trillion worth of financial instruments.¹

The transition is complicated by the fact that no global alternative is in sight. While the U.S. appears committed to replacing LIBOR with the new SOFR rate, the European Central Bank seems destined to embrace the new ESTR interest rate benchmark or sterling overnight index average (SONIA).

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With so many systems at play, conversions are likely to be costly for financial institutions of all sizes. As a result, we expect to see renewed vigor around efficiency to gain cost-saving advantages.

Preparing consumers for the changes is another challenge, requiring new approaches to lending. In Britain, for example, borrowers issued loans based on the sterling overnight index average will not know exactly how much interest they owe until they are required to pay it.

Learning from online lenders and challenger banks

Seeking customer loyalty and streamlined cost efficiency, financial institutions could begin looking toward the example set by online lenders and challenger banks. These branchless digital natives have digitized the end-to-end lending process, gaining significant efficiencies from automation.

McKinsey estimates that digitizing the end-to-end lending journey could do the same for traditional financial institutions, delivering a thirty percent efficiency gain.² However, while efficiency can easily net financial institutions significant financial impacts—as much as \$230 million in annual profit for banks with a balance sheet of \$250 billion for example—traditional financial institutions can learn more than operational cues from online lenders and challenger banks.³

According to Deloitte, it's the seamless customer experience that attracts consumers, allowing new digital natives to gain significant market share in recent years. Revolute, for example, offers a suite of banking products built on digital-only access and has garnered 8 million customers in less than five years. Likewise, challenger bank Monzo has seized 4 million of the UK's approximate 70 million accounts.⁴

When it comes to lending, challenger banks are wizards at realizing cost efficiencies while gaining consumer appeal. For example, the majority of consumers prefer to complete the entire lending process online, according to research conducted by PwC.⁵

Much of the allure of online lending lies in the speed and transparency of the end-to-end process. Self-service tools and options make it possible for consumers to keep tabs on the status of a loan application, while also cutting resource costs for financial institutions.

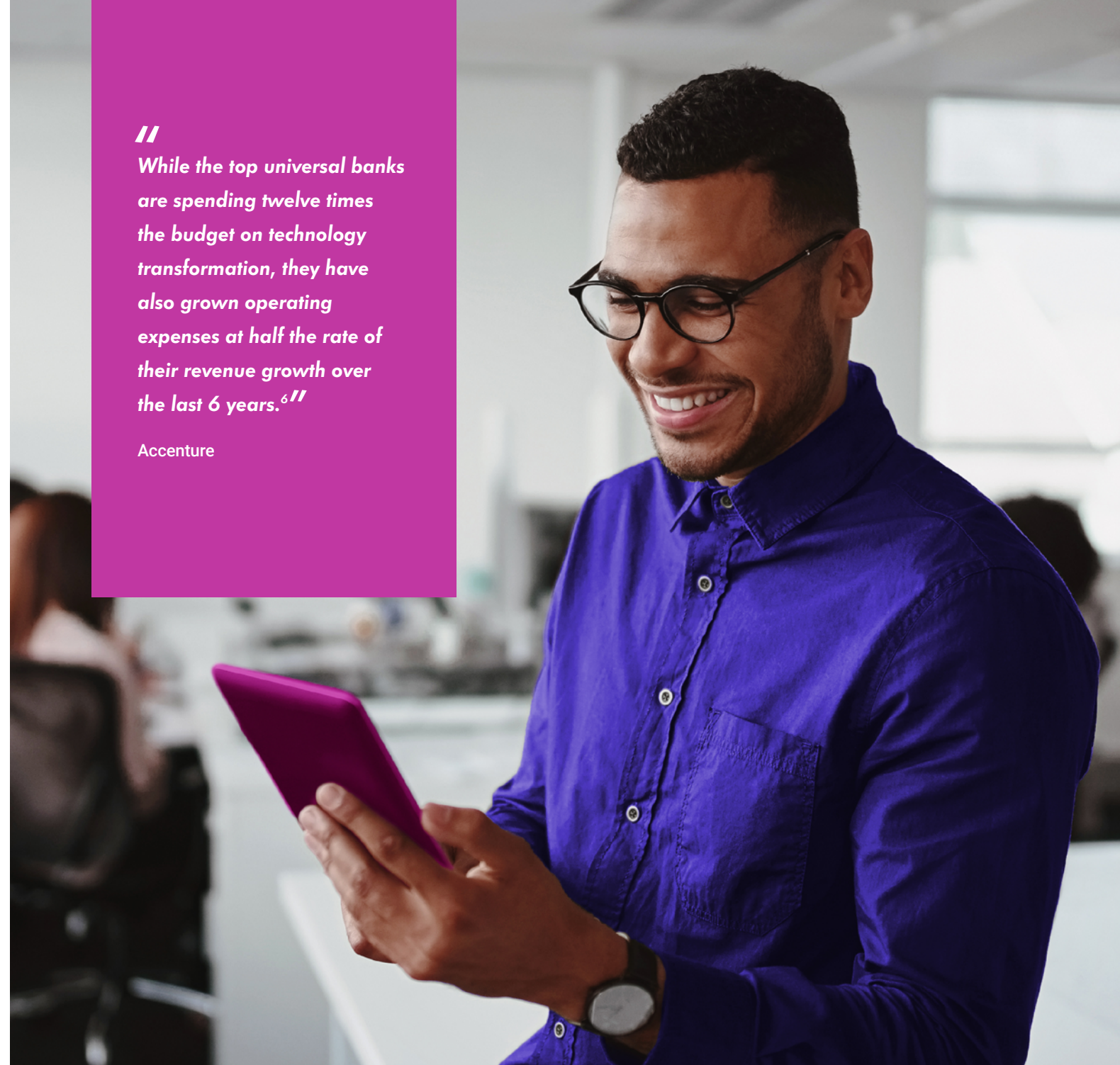
While the top universal banks are spending twelve times the budget on technology transformation, they have also grown operating expenses at half the rate of their revenue growth over the last 6 years.⁶

As financial institutions face the imminent challenges of 2021, realizing cost savings through digital efficiencies should be a top priority.

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Accenture



Adapting to the digital imperative: Carving out profitability in 2021

The Deloitte Center for Financial Services predicts a rough road in 2021 for financial institutions. Financial institutions may need to provision for net loan losses of \$318 billion, representing 3.2 percent of loans over the next two years.⁷ Simultaneously, many economic experts predict a long run for the low-interest rate environment, limiting opportunities for revenue gains.

As revenue outlooks dim in 2021 and pandemic outbreaks continue to force economic closures, financial institutions will look toward digital efficiencies to reduce costs and bring back profitability. While financial institutions have been digitizing for years, a new approach will be necessary in 2021. Financial institutions will need to focus more on strategic adoption of digital assets, reaching toward end-to-end digitization, rather than the piecemeal additions that marked early approaches.

// ***Gaining speed and efficiency could also help financial institutions to move beyond consumer lending to earn a piece of the commercial pie, particularly as twenty-five percent of small-to-mid-sized businesses say they will not make it through 2021 without additional funding.⁸***

Small Business Majority, 2020

Efforts will begin with standardization, particularly in the syndicated lending market, where digitization initiatives may have fallen behind the curve. Once processes and data are handled uniformly from one department to another and across the branch network, financial institutions are ready to gain the speed and efficiency advantages of digitization.

End-to-end digitization relies on automated workflows and a single source of data to connect front and back office operations. Instances of repetitive or non-value-added work are reduced in favor of real-time processing. With real-time processing, financial institutions gain immediate access to data and insights, empowering a faster lending lifecycle.

Capabilities, such as form-free income, asset, and employee verifications, can shave days off the origination cycle, helping struggling businesses to gain a financial foothold faster.

Speed is not the only advantage of end-to-end digitization. Given the events of 2020, inclusivity will play a major role in brand reputation. Two-thirds of respondents to an Ad-Age Harris Poll said they are more likely to work with brands that contribute to combatting racism.⁹

By bringing together workflows from origination through underwriting and reporting, financial institutions have access to the complete lending portfolio. This expanded visibility enables peer assessments and analysis of the market at large. With a better understanding of market risk, financial institutions can easily configure financial ratios to enable assessments that more accurately represent minority communities, while also protecting bank profitability.

Overall, digitization solves an age-old question for financial institutions: should financial institutions be in the business of lending or providers of specialty products. With digitization, it is possible to do both, opening opportunities to build a more robust lending business.

Transitioning to an era of open banking

As financial institutions shift toward a digital end-to-end lending process, they are setting the groundwork for a new era in banking founded on Fintech partnerships and an open ecosystem.

Cloud-based APIs are at the heart of fast and efficient digital transformation strategies. Simple plug and play functionality makes it possible for financial institutions to adopt an integrated environment of applications, all designed to automate critical workflows to return faster credit decisions. Rapid time to funding will be critical to both businesses and consumers as they adapt to the post COVID-19 world and will allow lenders to grow faster with less risk.

This approach also eliminates the challenges associated with integrating in-house and external products. As a result, financial institutions can more easily adopt new technologies, such as artificial intelligence, machine learning and robotic process automation, which can create new efficiencies and value for both banks and customers.

In the end, adoption of cloud-based APIs will usher in a new era of open banking and opportunities for future expansion into a broader ecosystem, where financial institutions can explore offerings and consume them at speed.



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