KPMG

Commercial lending transformation: more than technology—a market scan

KPMG 2022 Commercial Lending survey

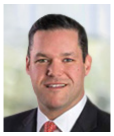
kpmg.com/us

This survey, which was completed by 106 commercial lending leaders at 106 U.S. and Global financial institutions, was designed to bring a perspective on how institutions view credit transformation, and where they are on their transformation journeys. This survey tackled some of the hottest topics in commercial lending, including technology, AI, Big Data and automation, but also probed into how lenders are considering process and importantly, its people within this transformation.

In the KPMG 2022 Commercial Lending survey findings, you will gain insight into how commercial lending leaders:

- Define and prioritize facets of transformation and key drivers for change
- Factor operating model, process, people, data and technology into their strategy
- Assess where organizations are today and how they have progressed in their transformation journey given market demands
- Envision the evolution and future of commercial lending.

Authors



Clay Gaitskill
Principal, Modeling & Valuation
T: 919-995-4334
E: cgaitskill@kpmg.com

Adam Levy
Principal, Modeling & Valuation
T: 312-665-2928
E: adamlevy@kpmg.com

Bruce Erb
Director, Modeling & Valuation
T: 914-582-2357
E: berb@kpmg.com

Contents

Introduction

Transforming technology and operations

Transformation. It's a buzzword you'll hear at most any financial institution. But ask what exactly transformation entails, and you're likely to get many different answers.

Most often, leaders equate transformation with highly complex technology initiatives designed to radically change the way work is performed or how a service is delivered. While leveraging technology and reaping its benefits can be a critical component of transformation, it's much more than that. Making targeted adjustments to an operating model or finding ways to empower employees to do things better and faster can also constitute very meaningful transformation.

Today, commercial lenders are facing a number of pressing and complex challenges, including the remaining effects of COVID-19, constantly evolving regulatory requirements, increased competition, and the high demand for talent. Commercial lending leaders can also look to countless opportunities to transform how they do things with an aim of being better positioned to meet those challenges.

These solutions range from new loan and sales platforms, integrating automation and/or complex artificial intelligence, and data strategies (including big data), to redesign or reconfiguration of lending operating models.

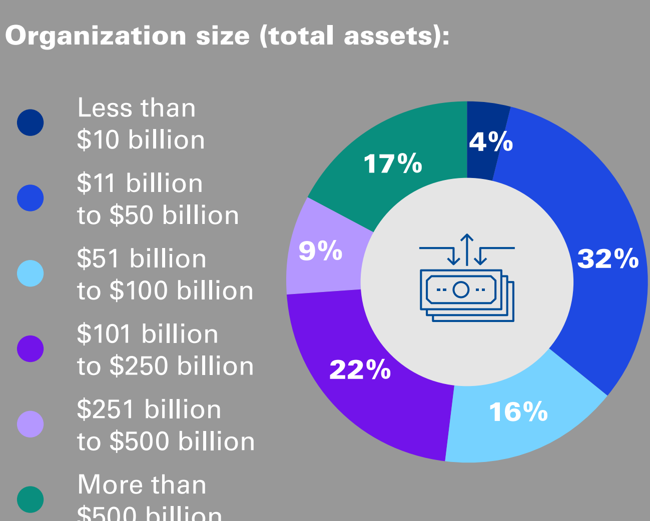
KPMG surveyed executives at more than 100 financial institutions that operate across the United States and internationally to learn more about how commercial lending leaders are viewing transformation, benefiting from transformation, and prioritizing their efforts to continue transformation.

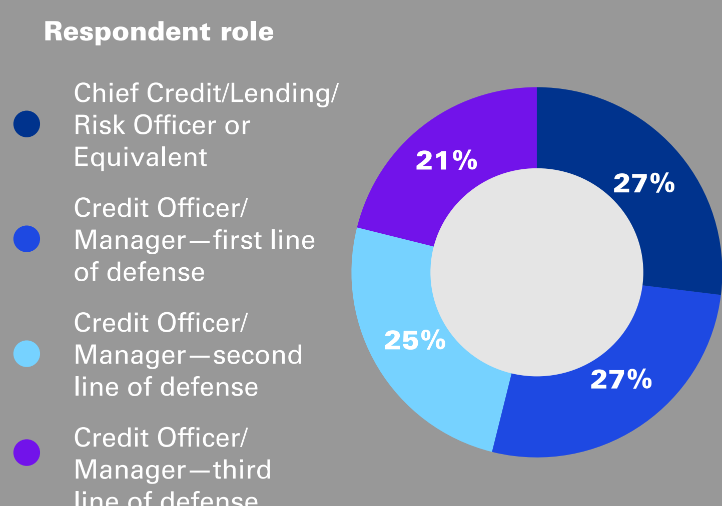
But business leaders beware: complex initiatives that result in significant change can lead to significant disruption that can create more problems than they solve. Commercial lenders that are able to prioritize spending and efforts on the right components of their business and considers the holistic impact of an initiative on its people and its delivery model, have been best positioned to succeed in their transformational efforts.

In the following pages, we provide a summary and analysis of the survey results.

About survey respondents

Responses were sourced from leaders at a diverse set of organizations and leaders across the credit lifecycle.





Transformation redefined

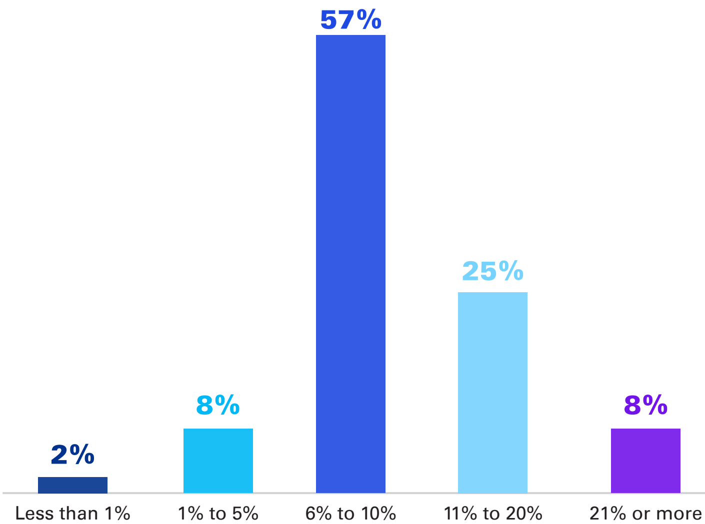
Prioritizing operating model along with technology

Transformation can mean different things to different organizations. When it comes to what commercial lenders deem as their priority area for transformation, respondents are much more likely to identify data optimization, technology, and automation as being "very important" over operating model and people/workforce. To that end, we see that organizations are likely to allocate a significant portion of their operating budgets for transformation on technology-related initiatives.

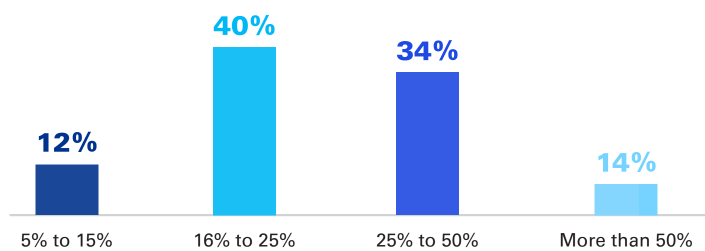
In terms of priorities for transformation, respondents were much more likely to identify data optimization (48%) and technology (41%) as being "very important," over operating model (25%) and people/workforce (35%).

However, this priority given to data and technology represents a paradox: An organization relies on its people to gather clean data, and technology and automation will likely change how those people work. That means the operating model is likely to have to adjust meaningfully when new technology and automation are added. In contrast, organizations that prioritize what a technology or data initiative means for their operating model and people may experience the most impactful results from transformation.

Percentage of annual spend for transformational initiatives

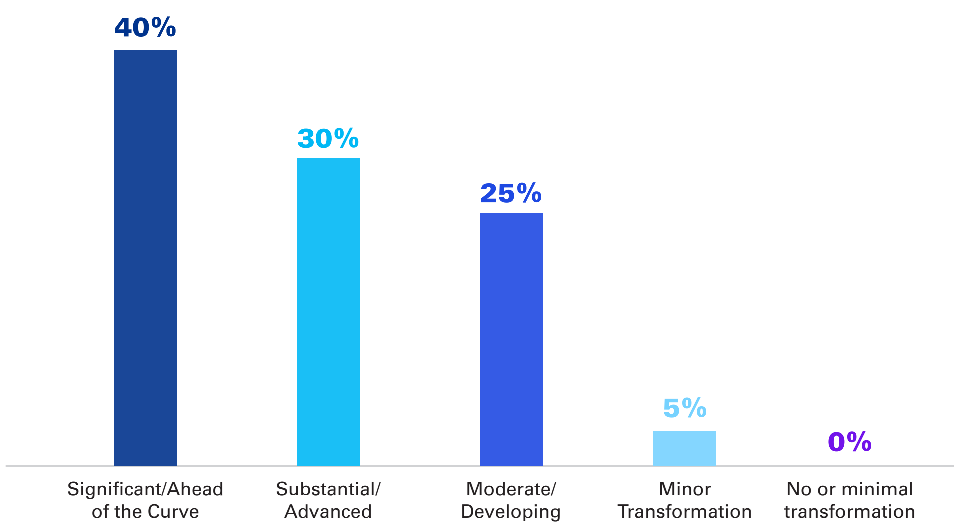


Percentage of annual transformational initiative spend towards adoption of technologies, tools, or automation



To gauge where organizations are in their transformation journey, we also asked lenders how much their credit organization has evolved over the last five years. Not surprisingly, respondents from the largest banks were much more likely to consider their transformation as being substantial versus respondents from smaller institutions.

Level at which the institution has transformed in the past five years to meet current demands of the marketplace



Rethinking the operating model

Adaptability to evolving expectations

The competitive landscape for commercial lending products and services is shifting, with customers demanding a clearer and more transparent experience. Meanwhile, fintechs are other players offering new methods to engage and interact with prospective and existing customers.

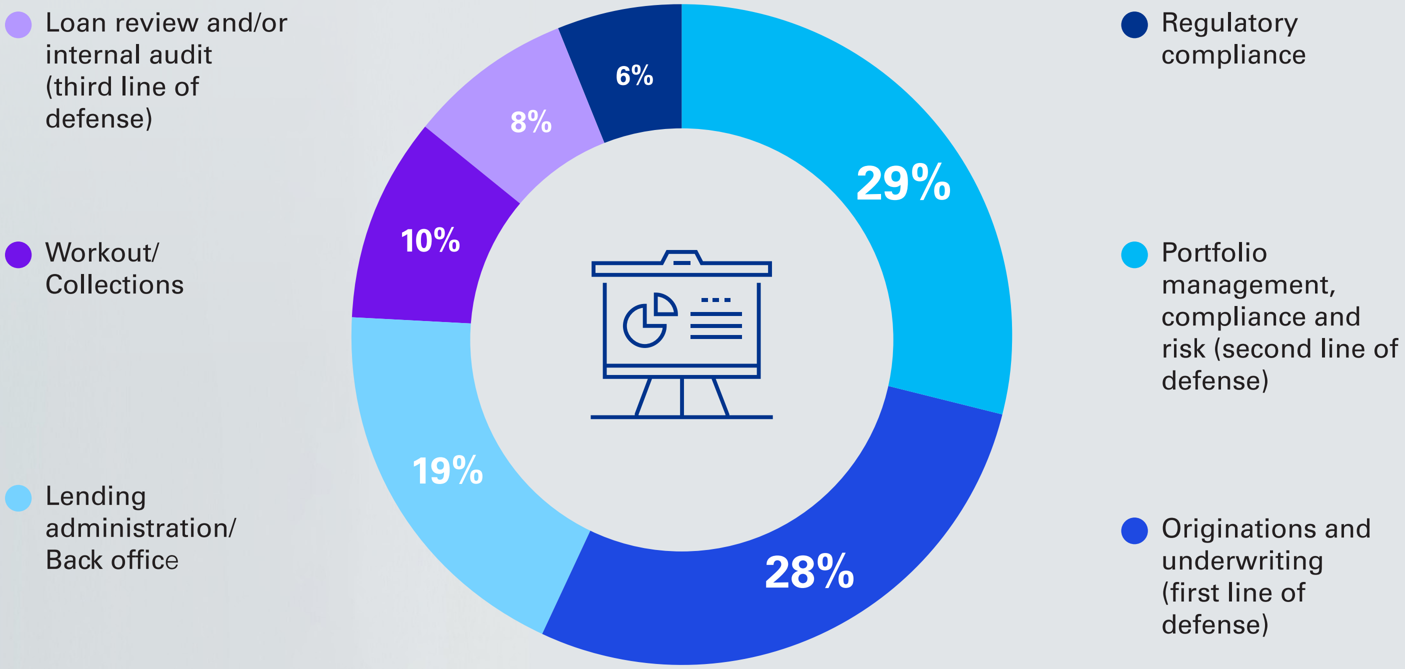
This new technology and way of engaging with customers typically entails new risks to the lender. That means, commercial lenders will need to modify the methods they use to identify, manage, measure, and mitigate risk. **Organizations that refine their operating model to better align their business strategy and risk appetite and enhance the ways credit risk is monitored and controlled, will be in the best positioned to gain efficiency and successfully scale their lending businesses**.

Our survey found that most lenders are adapting their operations to accommodate to the market's new customer centricity and the new risks it entails. Respondents generally identified their organizations as having transformed their operating model—with 29 percent of respondents indicating significant transformation of their operating model and 59 percent of respondents indicating moderate transformation with it being a strategic initiative to continue to transform.

When asked to identify their top transformation priorities, respondents selected improved customer experience (43 percent) as their top response, with and faster approval and closing times also among the most common responses (cited by 24 percent or respondents)—perhaps an indication of the competitive pressures forcing lenders to rethink how to retain and keep customers. However, respondents also keenly aware of the new risks to their loan portfolios. **Among transformation priorities, loss mitigation was the second most common response (41 percent), and when asked where in their commercial lending organization continued transformation was most critical, approximately two-thirds of respondents identified key loss mitigation functions including portfolio management, loan review, and workout**. (see next page)

When considering the commercial lending organization's priorities in transforming its operating model and processes, what are the most important drivers of this transformation? (Select up to three)

Areas of credit risk management that are most critical for transformation

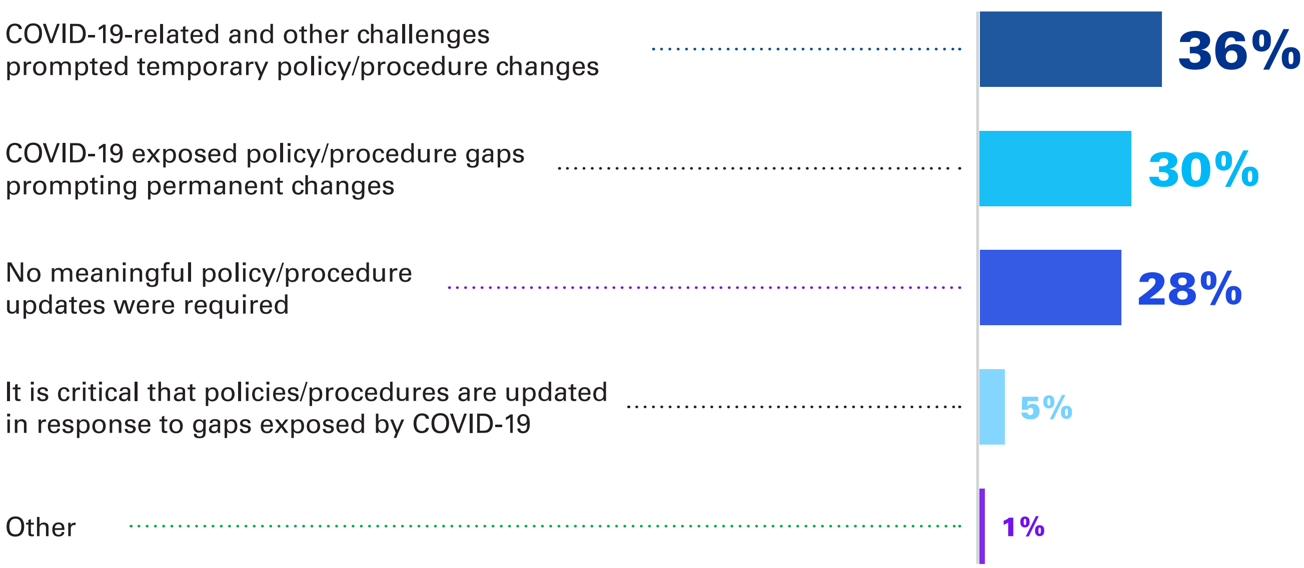


Effects of COVID-19 on operating models

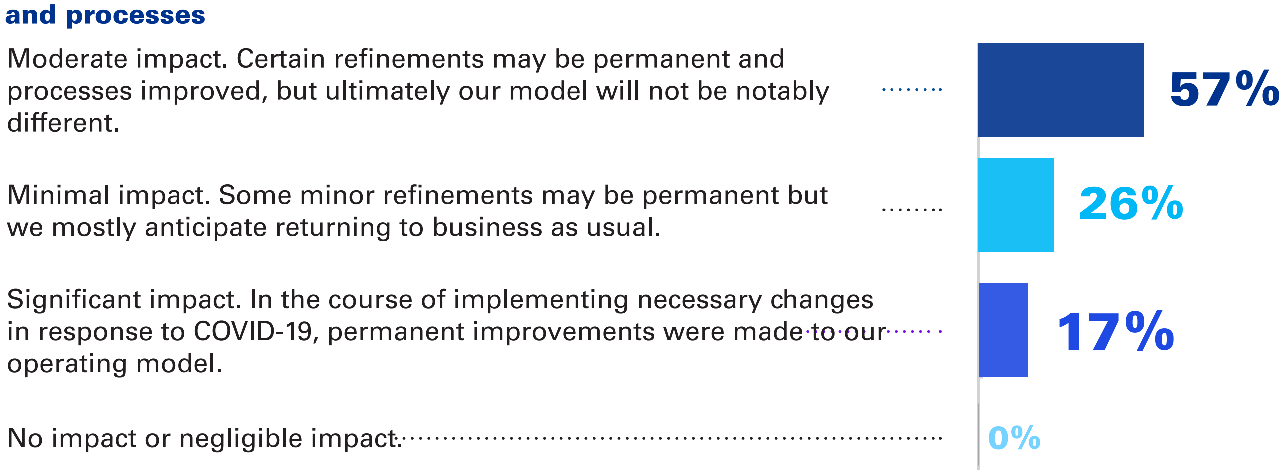
The global pandemic clearly impacted commercial lenders, as lockdowns and other containment measures temporarily or Even permanently affected borrowers in certain industries and regions, increasing default risk. In addition, lenders had to comply with legislative requirements and regulatory guidance and meet demand for relief via payment deferrals and loans under the Paycheck Protection Program and Main Street lending programs. Overall, the pandemic event tested the resiliency of lenders to manage risk in the face of a major credit event.

But in our survey, only 17 percent of respondents indicated that COVID-19 will have a significant impact on the organization's operating model, while 35 percent of respondents indicated that COVID-19 exposed procedural or governance gaps that necessitated or will necessitate meaningful updates to credit policy and procedures.

Assessment of credit policy transformation due to COVID-19 and other recent operational challenges



The level of impact anticipated when evaluating the process or operating model refinements employed to meet the pandemic demands placed on your commercial lending risk model and processes



ESG to affect commercial lending

Environmental, Social, and Governance (ESG) concerns are a rapidly evolving topic, and how they will ultimately effect commercial lenders remains unclear. What is clear, however, is that lenders will be impacted in some way, with legislative bodies and banking regulators beginning to take positions about what will be expected of banks around ESG. Commercial lenders are not only being challenged to understand the expectations of the marketplace and shareholders but are also evaluating how to institute policies and processes to be best positioned to comply with forthcoming requirements.

In our survey, nearly all respondents (98 percent) indicated that ESG has or will need to be considered in its commercial lending process, with 38 percent of them saying that ESG is considered broadly in their organization's process and 40 percent indicating that it is considered in some areas of the process. The areas of focus for ESG within credit risk frameworks were diversified:

Commercial lending frameworks respondents plan to implement in the next 12 months

Risk Ratings	60%
Portfolio management and/or Loan Review	54%
Internal Audit	52%
Policy	47%
Underwriting/ Credit Decisioning	46%
CECL	42%
Governance	42%
None of the above	2%
Other	1%

KPMG

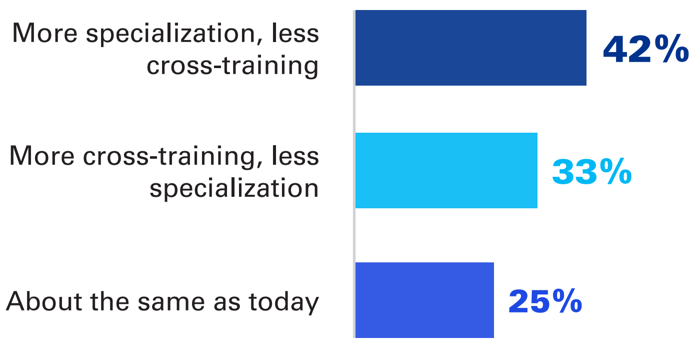
Where do our people fit in transformation efforts?

When organizations focus on transformation, it is often people who are impacted the most. Any change in the way an organization does things starts to change the day-to-day experience of the people executing on the strategy. **Organizations that can assess the impact of operational and technological change on their people will be better suited to identify ways to empower their people by giving them the right skills to ensure their transformation efforts are successful**. While most of our survey respondents indicated that reskilling would be necessary, there was some variance about which skills would be the most valuable in the future.

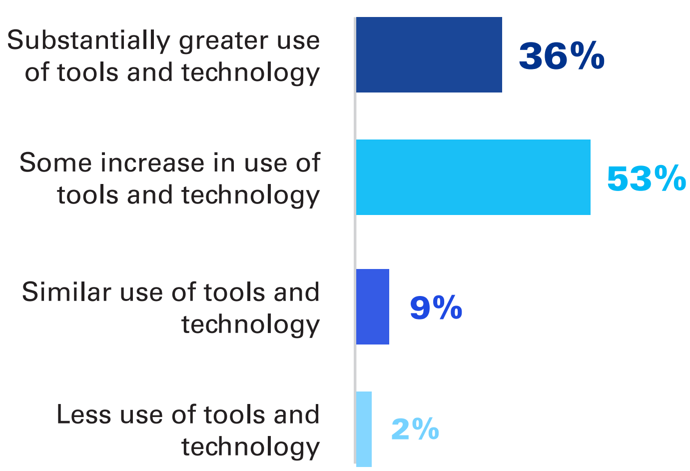
We asked respondents to consider the current skill sets and domain knowledge of their people to get a sense of where organizations may need to focus to enable their people to successfully navigate this change and meet the demands of a transformed commercial lending function.

Looking ahead to the near future, how do you envision the evolution of the skill set needed by your commercial lending professionals to meet the dynamic business needs of the banking environment?

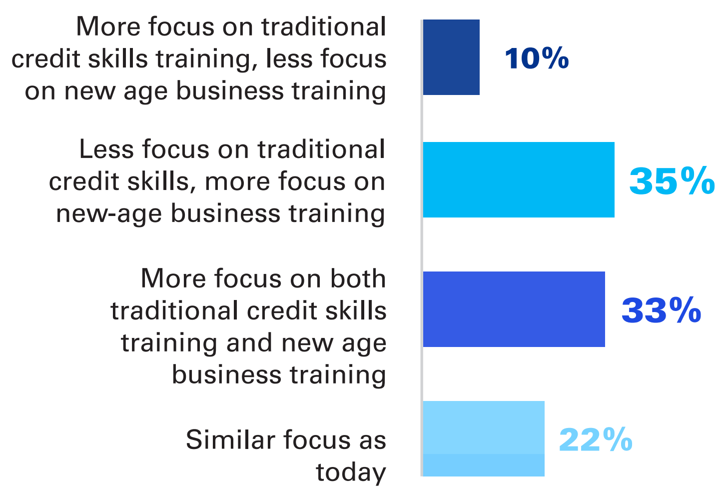
Specialized skills versus broader skills



Use of tools and technology by your people



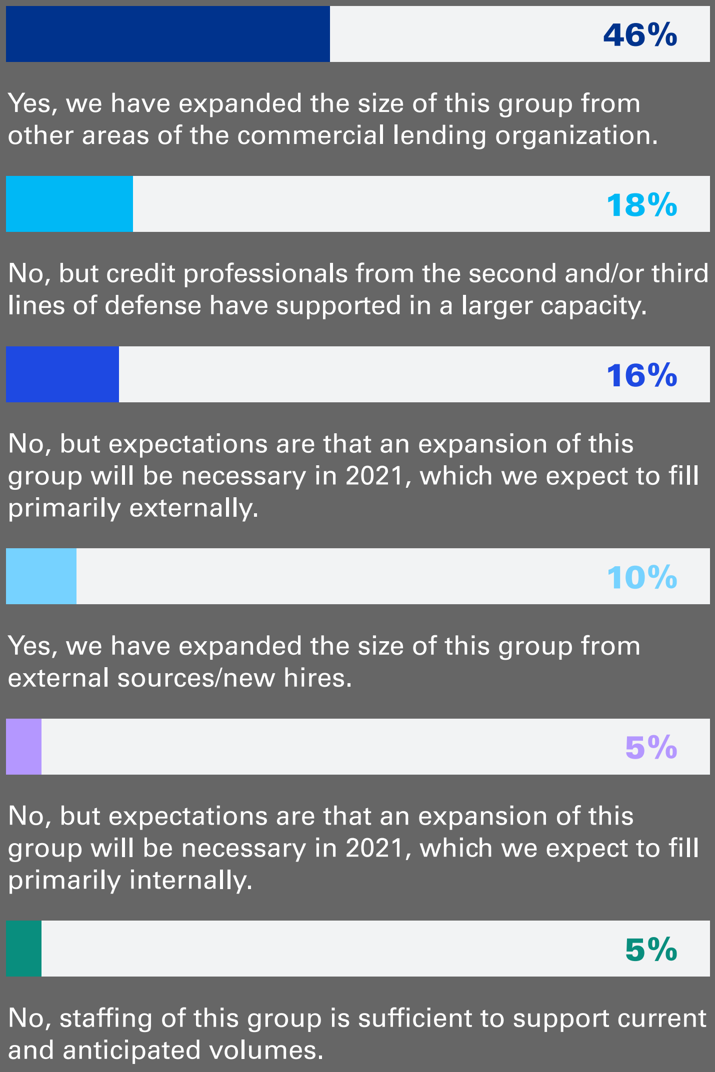
Traditional credit skills versus new age technology skills

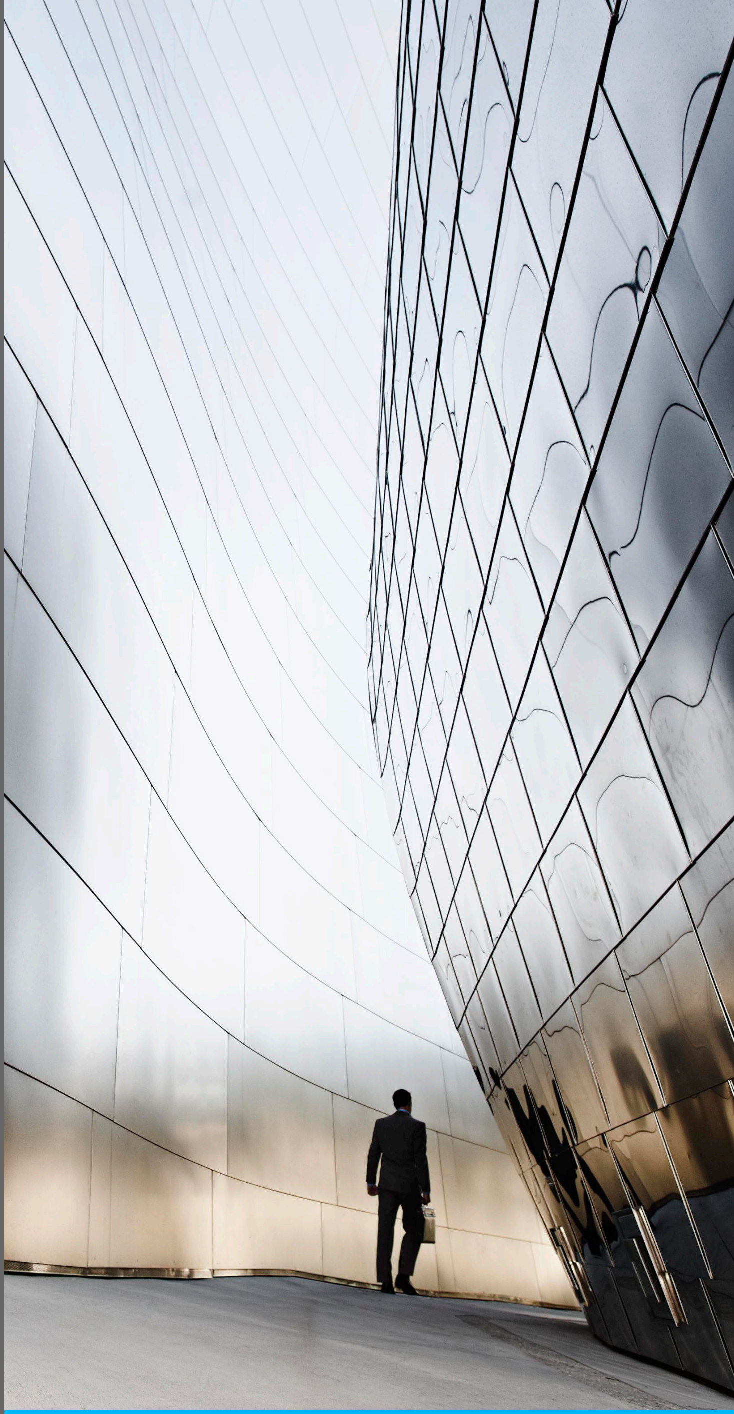


As shown above, there are differing views on the skill sets that credit professionals will require to be successful going forward, but clearly, a general consensus is that there will be changes in the skills its professionals need to succeed.

Significantly, 52 percent of respondents noted that there was some gap in the skill sets of its current credit professionals from the past, and an additional 19 percent responded that credit skills of their people may be lower, but they are improved in other skill sets. If this knowledge gap persists, credit organizations may have to reimagine the ways they manage credit risk in a complex market environment. **For instance, COVID-19 and other challenges in 2020 and 2021 increased the burden of loss mitigation functions to manage the myriad of borrowers requiring attention and the increase in potential problem assets.**

Implementation of staffing or structure change of their asset recovery/loan workout group due to the global pandemic/other factors



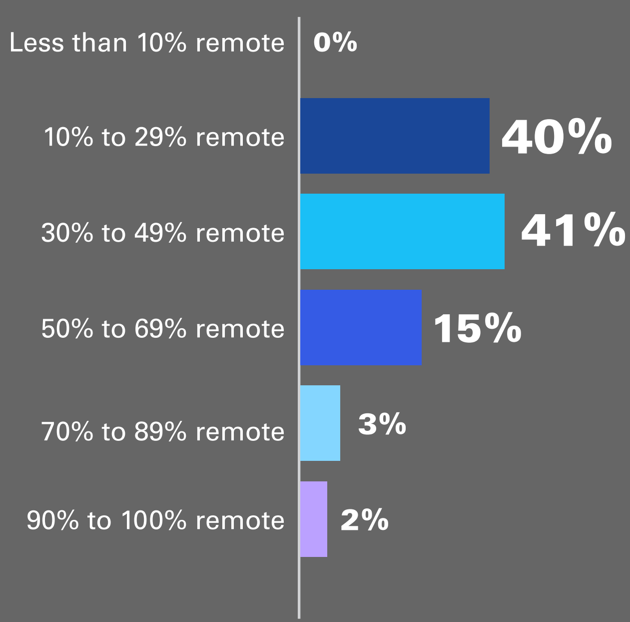


Most respondents agreed that the size of their workout functions had increased or will need to increase, and that there will be more of a reliance on individuals in other loss mitigation functions than on new hires, potentially speaking to the changing demand and supply for credit talent and the corresponding need of existing credit professionals to be more broadly trained.

Work from home: here to stay

Our survey found that nearly all respondents had instituted some degree of remote working in response to the pandemic. At the time of the survey, nearly all (99 percent) of respondents indicated that their nonclient-facing professionals were operating in some type of hybrid work environment, with 50 percent of respondents indicating remote work of 50 percent or more. While respondents expected that, moving forward, less of the work would be remote, all respondents indicated remote work of 10 percent or more was likely.

Target work arrangement for the majority of commercial lending professionals



Data

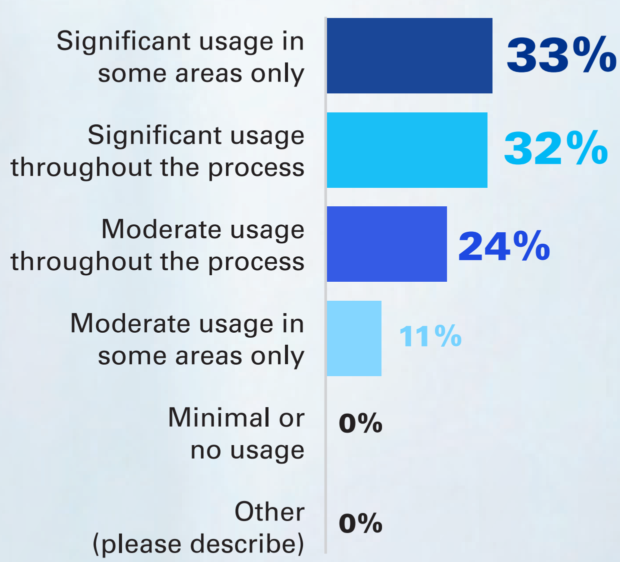
Do we have it, is it good, and what can we do with it?

In this highly competitive environment, lenders are looking for ways to get an edge. Fintechs are innovating in the ways they are using data-driven approaches to replace the traditional, deep-dive, high-documentation customer evaluation underwriting for risk review activities. Lenders may have ambitions to better leverage data to become more competitive and efficient but may find that the quality of the data available to them is insufficient. And efforts to improve that data may be constrained by an operating model that does not facilitate the data collection.

Lenders that embed clear frameworks and processes to collect data in the ordinary course of business, and maintain governance over that data in keeping with its broader strategy to leverage data, can achieve the most meaningful change.

In our survey, 90 percent of respondents indicated that their organization has an internal function dedicated to data strategy and optimization. In addition, 79 percent of respondents indicated that they have implemented strategies designed to get benefit from big data (voluminous amounts of structured and unstructured data to anticipate both internal and external behaviors).

Role external data sets (market, economic, performance, etc.) play to inform credit decisions, monitor credit risk, and set risk ratings

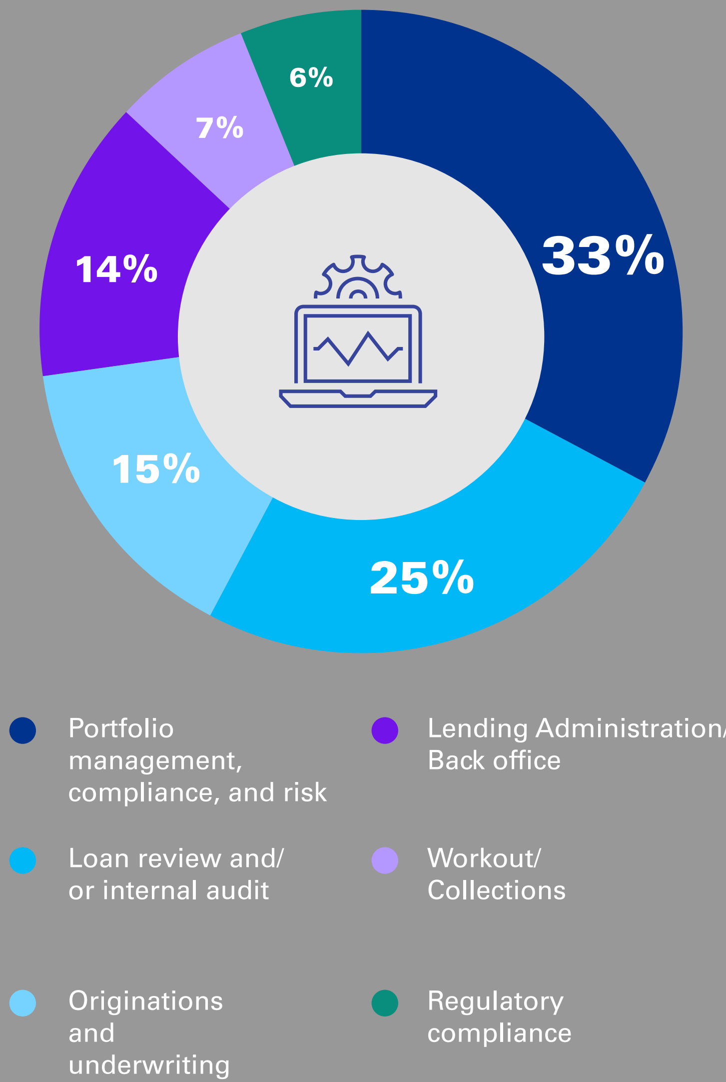


Data (continued)

Adoption of big data strategies to inform credit risk decisions or future operating model changes

Similar to the responses on priorities for operating model transformation, respondents were most likely to identify loss mitigation functions as the areas that could best leverage data in their process.

Enhanced quality and quantity of data would be most beneficial in these credit risk management areas



Another way that lenders are leveraging data is in auto-adjudication, where lenders are relying more on data to predict the likelihood that a borrower will default on a loan. In fact, 87 percent of respondents indicated their organizations are using auto-adjudication somewhere in their underwriting or review process.

As data sets become more robust, some lenders have concluded that these methods can predict risk nearly as well as a skilled credit professional and are testing the limits of exposure that can be managed in such ways.

Leveraging auto-approval models or frameworks in underwriting or annual review processes

33%

Yes, in our underwriting

29%

Yes, in our annual reviews or independent loan review

25%

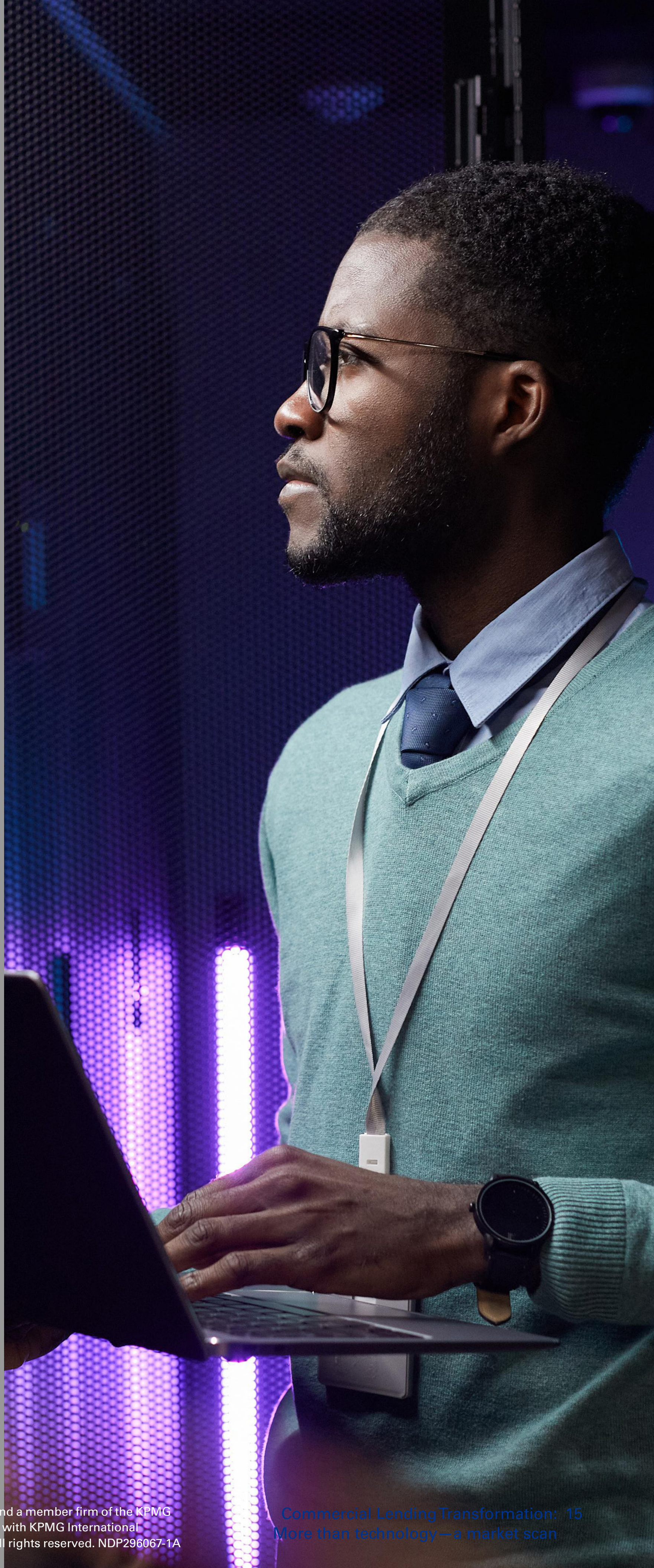
Yes, both in our underwriting and annual reviews or independent loan review

12%

No, but there are current plans to evaluate

1%

No, and no plans to evaluate/not appropriate for our business



Clean and reliable data is key

The ability of lenders to utilize data is limited by their ability to collect clean and reliable data. The ability to collect data goes back to the core review processes, and many respondents indicate that this process remains inefficient. Commercial lending typically requires the review of significant unstructured documents, with data extracted into unstructured review templates and most data not available for reuse. Some lenders are employing updated templates, tools, and even artificial intelligence to make it more efficient to gather data; however, only 36 percent of respondents indicated their organization had deployed a strategy to collect more data in review processes.

Does the commercial lending organization have a strategy for collecting more data from borrower documents collected for review processes, either digitally or with other methods, so that more of this data can be leveraged to inform future credit decisioning or risk management?

36%

Yes, we have implemented processes to collect more data from the documents and information our clients provide.

52%

Yes, we are planning to implement tools or strategies to be able to reuse more data.

12%

No, we do not have a current strategy, but consider this an important initiative.

0%

No, we do not consider the benefit of this data to be worth the cost of implementation.

0%

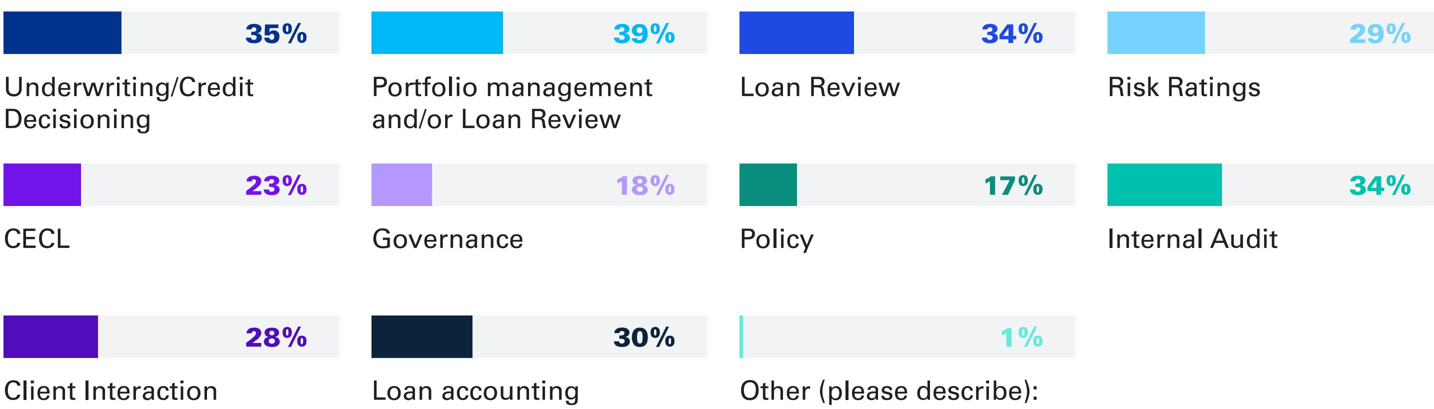
Other (please describe):

Technology and automation

Essential elements of transformation

Technology will always play a pivotal role in the transformation of a commercial lending organization. Loan payment and management systems along with content management systems support the critical journey of documents and data through the lending lifecycle. Tools and digitized solutions are considered to bring process and consistency to work activities. Different tech-based solutions are used for activities such as financial statement spreading, collateral monitoring, risk rating, and other areas. More recently, advancements in areas such as robotic process automation, natural language processing, machine learning, and artificial intelligence are prompting lenders to evaluate the possibility of automating meaningful portions of review, analysis, and reporting procedures. **Ultimately, the ability of technology and solutions to transform credit processes depends on whether tools and technology are facilitating achievement of a target state, or if the target state is being built around tools and technology**.

Areas of the commercial lending organization and its processes that most benefit from new tools and technologies—select up to three.



Characterize your commercial lending organization's transformation in how it is leveraging technology (tools, platforms, systems).

	Total	$100 billion or less	$101 billion or more
Significantly transformed, it has been a strategic initiative to transform in the ways we leverage technology to enhance our operations and decision-making.	39%	31%	49%
Moderately transformed, and it is a strategic initiative to transform further in this area.	52%	55%	49%
Moderately transformed, but we don't view continued transformation as a priority in this area.	5%	7%	2%
Not notably transformed but it's a strategic initiative to transform in this area.	4%	7%	0%
Not notably transformed, and we don't view transformation as a priority in this area.	0%	0%	0%

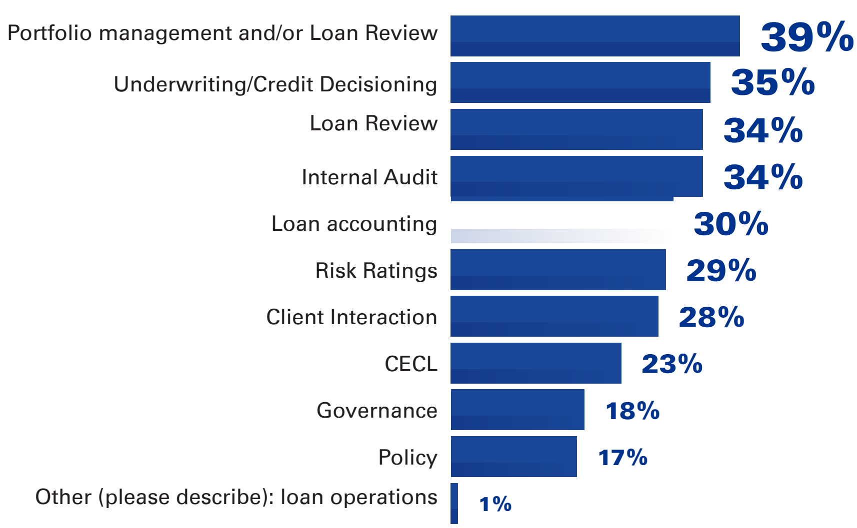
Characterize transformation in the employment of automation to automate, replicate, or augment processes or decision-making in connection with credit evaluation and credit delivery from how it was previously employed, if at all.	Total	$100 billion or less	$101 billion or more
Significantly transformed, it has been a strategic initiative to leverage automation in our credit process and delivery.	30%	18%	43%
Moderately transformed, and it is a strategic initiative to transform further in this area.	59%	62%	55%
Moderately transformed, but we don't view continued transformation as a priority in this area.	8%	14%	2%
Not notably transformed, but it's a strategic initiative to transform in this area.	2%	4%	0%
Not notably transformed, and we don't view transformation as a priority in this area.	1%	2%	0%

Generally speaking, how do you view your commercial lending organization's appetite for adopting new tools and technologies into its current processes?	Total	$100 billion or less	$101 billion or more
We are early adopters and consistently evaluating new technologies and how they can transform our business.	31%	20%	43%
We are consistently evaluating new tools and technologies but typically are not early adopters.	33%	35%	31%
We evaluate new tools and technologies only when there is a critical business need.	29%	35%	24%
We have already adopted new tools and technologies, and do not anticipate the need for further transformation in the near or medium term.	5%	7%	2%
We have not historically adopted new tools and technologies, but currently recognize the need to transform in this area.	2%	3%	0%
We focus on traditional methodologies and approaches and view technology as an impediment to our goals.	0%	0%	0%
Other (please describe):	0%	0%	0%

Not surprisingly, larger organizations with larger operating budgets generally consider themselves more advanced in the area of technology and are more likely to be early adopters of new technology. Facing innovation from the top of the market from larger banks and innovation from fintechs is making it easier and faster for businesses to get funding. **Community and smaller regional banks will need to remain nimble and consider other approaches to differentiate themselves, potentially from other means than technology**.

As with operating model and data optimization, respondents were most likely to identify loss mitigation functions as being areas that would most benefit from technology. Technology investment is often most likely to be directed toward revenue generating and first line of defense activities, and often the methods for performing review activities within the second and third line of defense haven't materially shifted.

When evaluating your end-to-end process for commercial loan evaluation and delivery, what areas of the commercial lending organization and its processes would likely most benefit from new tools and technologies? Select up to three.



Automation gains ground in commercial lending

Automation is an area that continues to gain attention in the commercial lending space, as technological developments in the use of robotic process automation and cognitive technologies have been considered within a commercial lending context. This is allowing organizations to consider how to automate repeatable manual tasks and also to look at using more advanced solutions to search and extract information from large volumes of documents, to monitor external data and events for early warning indicators, or even attempt to replicate or improve upon human judgment. These initiatives have had varying levels of success, and often, organizations aren't realizing the value it targeted. **This speaks to the fact that commercial lending involves a significant amount of human judgment, divergent methodologies, dynamic data points, and inconsistent nomenclature, all of which make bringing automation highly complex. Automation is a disruptor to the way people work, and there is an interaction of that disruption with other processes that must be considered in order to achieve benefits**.

As shown below, most banks have groups dedicated to automation initiatives and are using automation somewhere in their current process.

How would you describe your commercial lending organization's appetite for the adoption of automation in its processes and decision-making?

58%

We are utilizing some basic automation to facilitate decision making and/or make processes efficient, and plan to evaluate how to leverage more complex automation solutions and/or AI in our process.

25%

We are utilizing complex automation, including AI, in our analysis and decision-making.

15%

We have adopted some basic automation, but do not intend to prioritize more complex automation initiatives in the near future,

5%

We have not adopted or adopted very little automation in our current process, but automation will be a strategic initiative within the next three years.

0%

We have not adopted or adopted very little automation in our current process, and automation is unlikely to be a strategic initiative within the next three years.

Within your commercial lending organization, is there a group dedicated to automation initiatives?

56%

Yes, we have an automation group, which primarily works with outside vendors to bring relevant solutions to the business.

34%

Yes, we have an automation group that internally initiates many use cases for the business.

8%

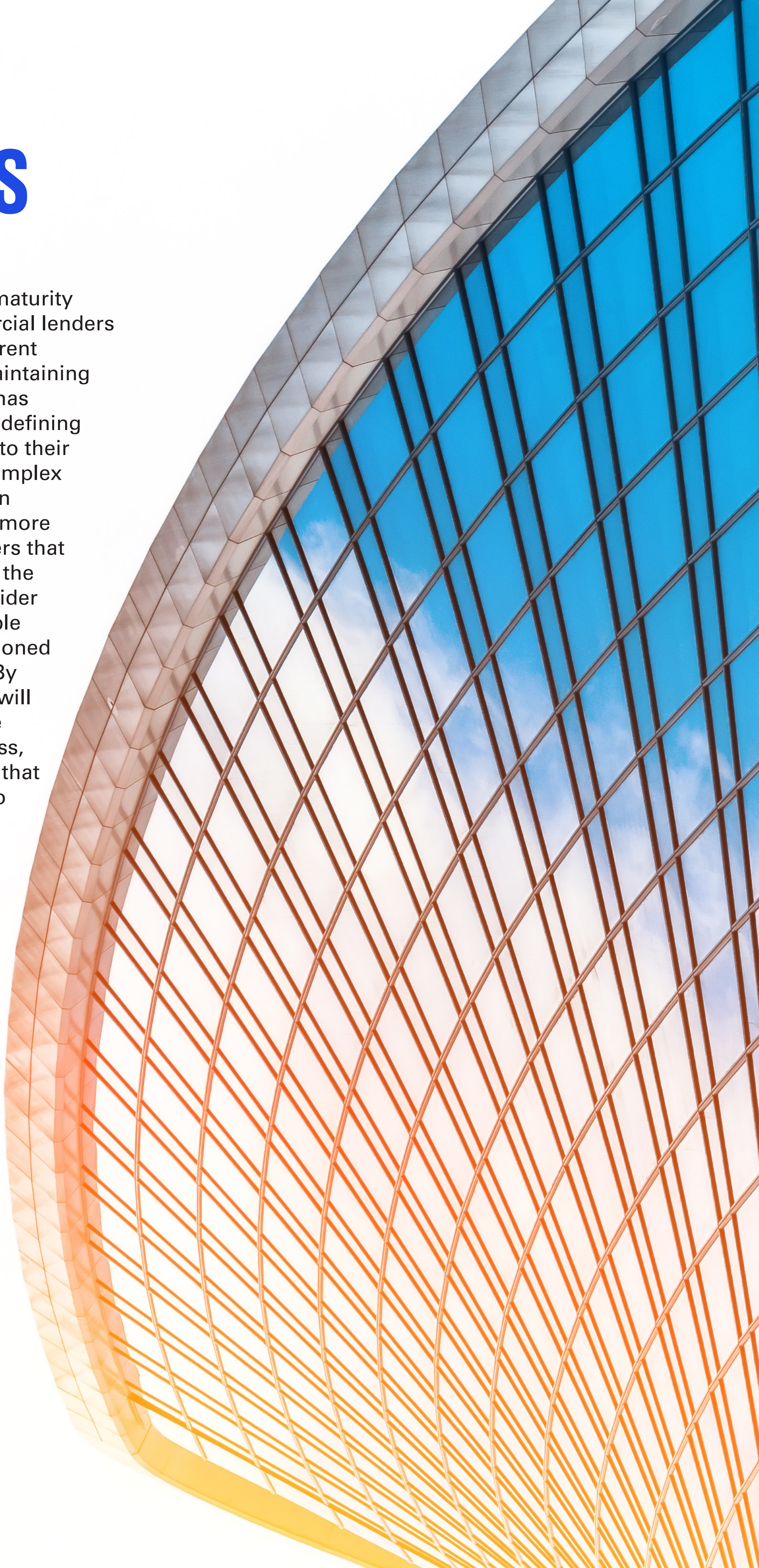
No, we do not have an automation group, but work with external vendors for our automation initiatives.

1%

No, we have not historically leveraged automation.

Final thoughts

Organizations are at varying stages of their maturity levels on transformation efforts, but commercial lenders are evaluating, strategizing, and testing different methods to lend faster and smarter while maintaining effective risk cultures. While transformation has different meanings, lenders should consider defining it as what gets them from their current state to their target state. But business leaders beware: complex initiatives that result in significant change can lead to significant disruption that can create more problems than they solve. Commercial lenders that are able to prioritize spending and efforts on the right components of their business and consider the holistic impact of an initiative on its people and its delivery model, have been best positioned to succeed in their transformational efforts. By evaluating how a transformational initiative will impact the process, the people executing the process, the data requirements of that process, and any technology used in the execution of that process, an organization is best positioned to realize that transformation.



How KPMG can help

Financial institutions are seeking solutions that will deliver an immediate transformational impact without materially disrupting their operating model, while developing a strategy to advance to their target state.

Deep, hands-on commercial lending experience
The KPMG Commercial Credit Risk team is not only composed of industry specialists but also former practitioners who understand the day-to-day challenges faced by our clients. We have direct experience helping transform critical lending processes toward an identified target state. And we understand how process, people, data, technology, and governance must be considered to achieve operational excellence.

Highly relevant delivery experience
Our Commercial Credit Risk team helps clients clean critical data elements, advance processes, systems, and policies to industry leading practices, benchmark to competition, and develop strategies for operating model improvement. We also have opportunities to support our clients' goals to enhance credit risk operating models by assessing current-state and supporting strategies for transformation.

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/socialmedia