How Does a Leading Regional Bank Improve Commercial Loan Growth in a Stagnant Market?

Key Highlights

- Headwinds are gathering that are slowing commercial lending.
- Syndications became the primary engine for commercial loan growth in the current expansion cycle.
- Syndications have exhibited stronger credit risk characteristics than bilateral loans.
- Three key success factors will drive a successful syndications loan growth strategy.
- AFSVision® provides technology capabilities that optimize those success factors.

The Market Context

In the current "uncertain" economic environment, growing top line commercial loan revenue can be a vexing challenge. The aggregate growth rate for U.S. commercial lending has been slowing since mid-2018, and came to a virtual standstill in the second quarter of 2019.

Competition remains fierce from commercial banks, emerging fintech companies and other "nonbanks" alike. Fluctuating interest rates, the impact of trade tariffs, fears of an impending recession, and other headwinds have all slowed down loan demand from businesses throughout most areas of the country.

Over the past few months, the AFS Business Intelligence team worked with a group of clients—all large regional banks—to explore potential strategies to buck the trend of slow to flat commercial loan growth. AFS analyzed the banks' portfolios and credit performance metrics over the most recent five years.

By leveraging its market-leading commercial loan database, with more than $1 trillion in committed exposure, AFS has been able to identify multiple proven options for banks to grow commercial loan revenue without sacrificing their credit risk appetite or risk tolerance.

Client Profiles

The clients AFS worked with are all large regional banks ($100–$500 billion in total assets) that have had long and successful histories of strong returns and low commercial loan losses. Their balance sheet strategies are largely conservative, and can be described as an "originate-to-hold" commercial model.

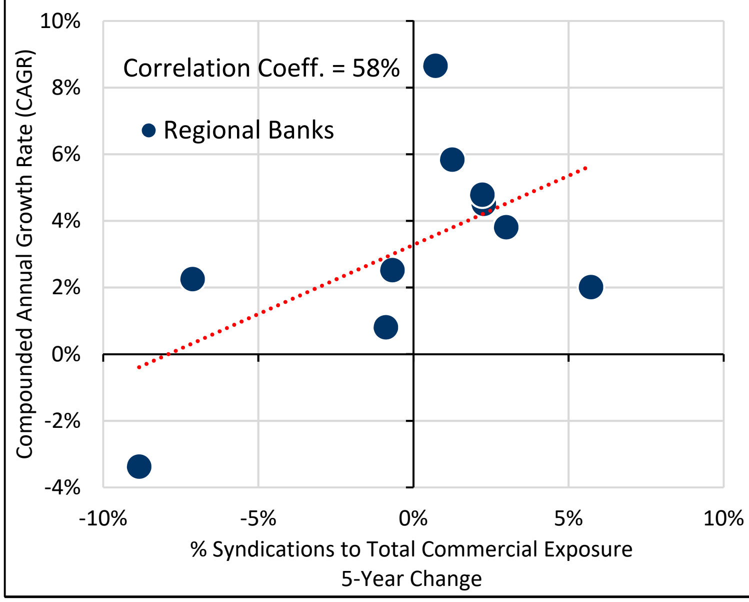
They tend to have risk-averse credit cultures, but some had been experiencing declining growth prospects in key geographic markets or industry segments.

Key Findings

Finding 1: Banks with higher growth rates invest more in syndications versus their peers.

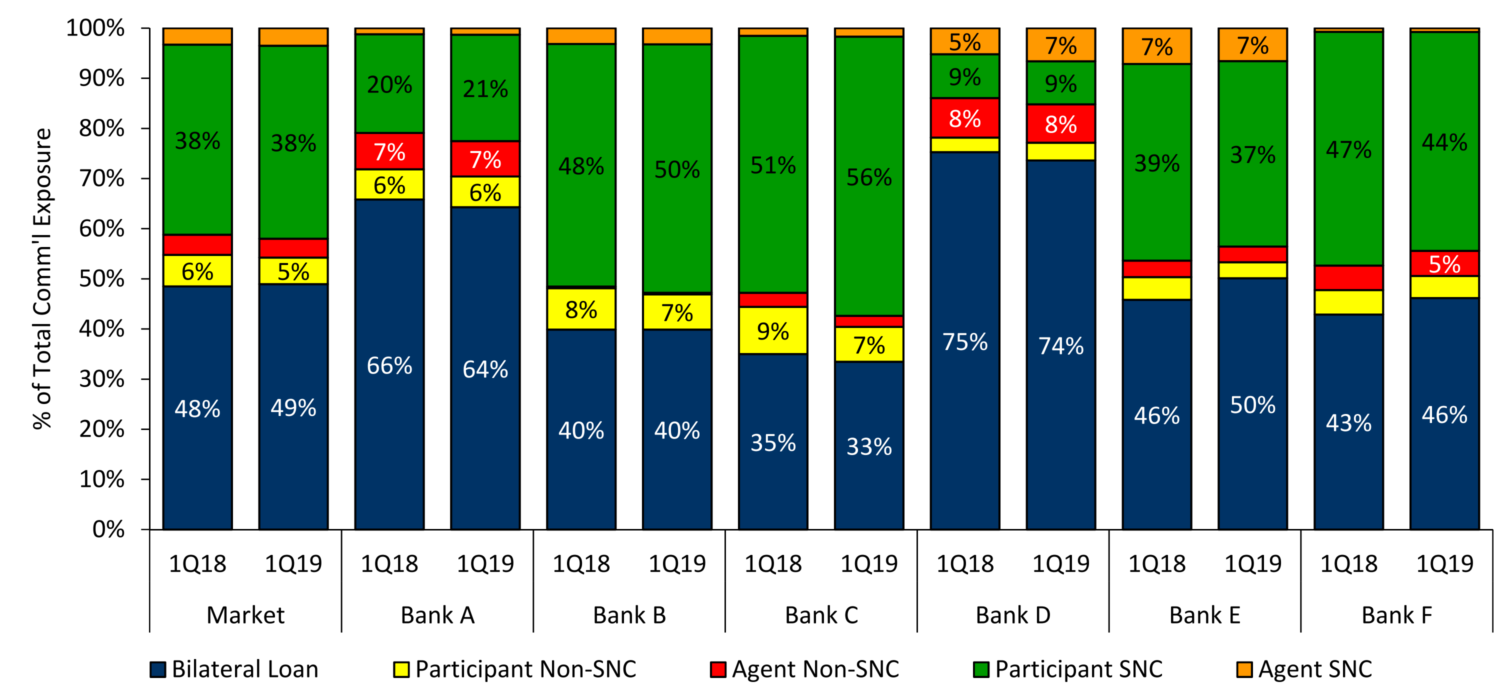
When comparing commercial loan growth rates among the benchmarking group, some banks clearly trailed the others on an aggregate five-year basis. When we correlated the growth rates of those same banks with their commercial loan portfolio composition, we noticed a distinct trend: those banks that were more heavily weighted in syndicated loans, with a smaller proportion of bilateral loans, also tended to experience higher loan growth rates (see Figures 1 and 2). In fact, many of the banks' peers had significantly altered their balance sheet over the prior years to take advantage of the growth differential between syndicated and bilateral loans.

Figure 1: Commercial Portfolio Composition vs. Loan Growth



This observation led AFS to examine whether syndicated loans across the overall industry have exhibited higher growth rates compared to bilateral and other loans. We found that banks have indeed benefited more heavily from the larger loans and higher growth rates offered by the syndicated segment of the market.

Figure 2: Commercial Exposure Split by Participation Flag



Finding 2: Syndications have been the leading engine for commercial loan growth throughout the current expansionary cycle.

A defining characteristic of the most recent economic recovery and business expansion has been the divergence in loan growth between bilateral loans and syndicated lending. Over the last five years, total syndicated commercial loan balances increased at a compounded annual growth rate (CAGR) of 9.12 percent. Total loan growth for bilateral loans, by contrast, was relatively sluggish, with a CAGR of "only" 3.83 percent over the same five-year period.

Figure 3: Outstandings Growth from 2013

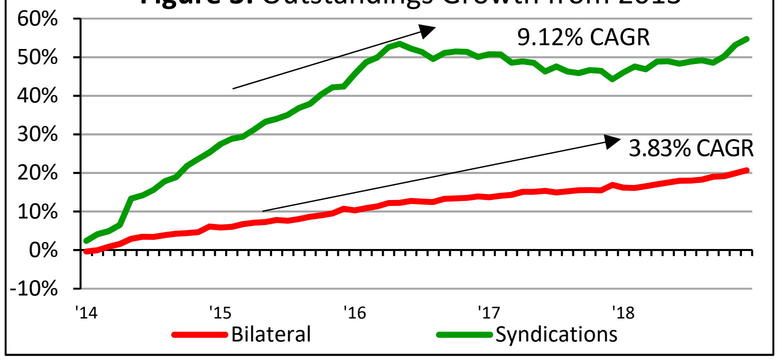


Figure 3 illustrates this disparity in growth rates between bilateral loans and syndications.

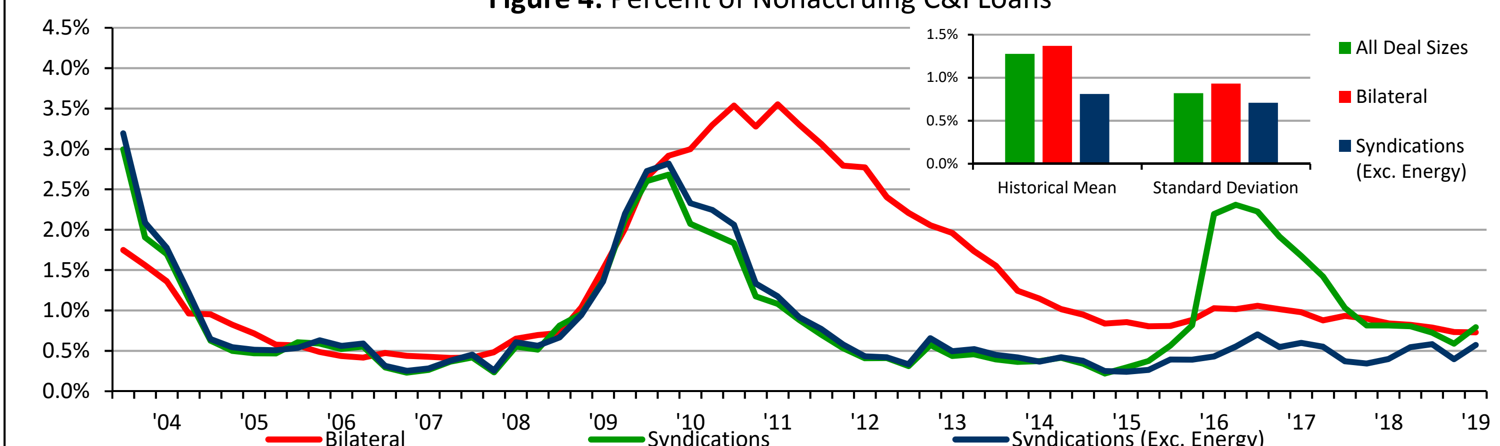
While these two findings in isolation might encourage banks to adopt a strategy of shifting large portions of their commercial loan portfolio away from bilateral loans and toward syndications, we needed to evaluate whether such a move would entail an increased and undesirable risk in credit policies, by introducing loans with lower risk ratings and jeopardizing credit performance.

Finding 3: From a credit risk perspective, syndications outperformed bilateral loans during and since the last recession.

We found, fortunately, that such was not the case. Underpinning the significant balance growth in syndications are strong risk-return fundamentals that render this segment of the market attractive from a credit risk management and capital allocation perspective. Viewed historically, syndications have outperformed bilateral loans across several important credit risk indicators since at least the financial crisis. According to data collated by RMA and AFS, syndications display a lower historical average nonaccrual rate as well as a lower standard deviation, a measure of trend volatility, versus the same statistics for the C&I loan market as a whole. Furthermore, syndications offer lower relative costs of delivery, greater liquidity, and broader fee-income opportunities than smaller, bilateral loans.

Figure 4 contrasts the nonaccrual trends between bilateral loans and syndications.

Figure 4: Percent of Nonaccruing C&I Loans



The Solution: A Case Study

Armed with these findings, management at one bank decided to expand its Capital Markets activities and alter its balance sheet by focusing more on syndicated lending. While the analysis revealed a significant data-driven opportunity for the Bank in the syndicated loan space, legacy systems severely hindered this institution's desire to lead and participate in more syndicated deals.

Syndicated loans are not only typically much larger than bilateral loans, they have more complex deal structures, administrative record-keeping requirements, and extensive reporting and compliance needs. These mandate a technology solution capable of not only more advanced and real-time automation, but also scalable efficiency, flexible configuration, and superior data integrity and reliability. Three key success factors are necessary in order to fulfill and optimize the opportunity provided by a larger investment in syndicated loans:

1) ***Highly Scalable and Flexible Automation.*** The need to systematically propagate transactions and automatically generate notices was clear. With its legacy systems, the Bank would have to make significant staff increases in order to service the desired growth in its syndicated portfolio. Additionally, such changes would introduce reputational risk from the probability of human error associated with the volume of manual activity. Consolidating syndications and bilateral loans on a single platform provides the most efficient solution.
2) ***Integrated Technology Architecture*.** To leverage the benefits of a new system's automation capabilities, that system needs to integrate with the rest of the Bank's corporate ecosystem in real-time to share data seamlessly, send notices to participants, and generate the many payment wires associated with servicing syndicated deals.
3) ***Timely and Transparent Data Integrity.*** To manage growth in its syndicated portfolio, and to ensure "one version of the truth," the Bank needed features that would not only capture robust and high quality data but also make it accessible in real-time. Waiting for a batch cycle to run or for an extract to generate with yesterday's data would leave the Bank at a competitive disadvantage. Having real-time online access to data as well as the ability to expose it through standard server-to-server communications methods was necessary.

Lacking a system with the capabilities to handle the complexities of syndicated lending reliably left the Bank with the choice either to incur higher costs and risks or to invest in a new system. Management made the decision to invest and selected AFSVision as its new commercial loan system. Their decision paid off. The Bank leveraged the real-time capabilities and integrated workflows that AFSVision provides in order to service and manage its growing syndicated portfolio along with its bilateral commercial book. The result was a tightly integrated, data-driven ecosystem that managed risk and reliably supported explosive growth in syndications.

Figure 5 indicates the comparison in loan growth rates (CAGR) over a seven-year period between the Bank and the rest of the commercial lending market.

Figure 5

Loan Type	Subject Bank	Market Exc. Subject	Difference
All Loan Types	6.88%	4.90%	1.98%
All Syndicated Deals	15.16%	7.84%	7.32%
Bilateral Loans	-1.06%	3.98%	-5.04%

Net Benefit

From a financial standpoint, the correlation is clear: AFSVision banks have grown their syndicated portfolios and seen significant improvements in profitability metrics. On average, banks that have implemented AFSVision for their syndicated and bilateral portfolios have seen a 101% improvement in net income and a 50 basis point improvement in ROAA since going live.

See how AFSVision can enable your organization to capitalize on the opportunities in the syndicated lending space.

About Automated Financial Systems, Inc.

Automated Financial Systems, Inc. (AFS) is the global leader in providing Commercial lending solutions to top-tier financial institutions. We work with a majority of the world's 50 largest financial institutions to build lending processes based on a straight-through model and on-demand technology and services. We partner with client banks around the world to understand their organization's strategic goals and work proactively to achieve their business, regulatory, and technology objectives.

AFS is headquartered in Exton, Pennsylvania, a suburb of Philadelphia; its European subsidiary, Automated Financial Systems GmbH, is based in Vienna, Austria.

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