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**REAL TIME CREDIT DECISIONING AND  
UNDERWRITING**

## REAL TIME CREDIT DECISIONING AND UNDERWRITING:

### CREDIT CREATION



Credit creation separates a bank from other financial institutions. In easy terms, credit creation is that the growth of deposits. And banks will expand their demand deposits as a multiple of their cash reserves because of demand deposits serve as the principal medium of exchange. In this article, we'll point out credit creation.

Demand deposits are an important constituent of money supply, and the expansion of demand deposits means the growth of money offer. The complete structure of banking relies on credit. Credit essentially suggests that obtaining the purchasing power currently and promising to pay at it slow within the future. Bank credit suggests that bank loans and advances. A bank keeps a definite part of its deposits as a minimum reserve to meet the demands of its depositors and lends out the remaining to earn financial gain. The loan is credited to the account of the receiver. Each loan creates constant deposit within the bank. Therefore, credit creation suggests that growth of bank deposits.

### ASPECTS OF CREDIT CREATION: -

**Liquidity** – The bank must {pay cash} to its depositors when they exercise their right to demand cash against their deposits.

**Profitability** – Banks are profit-driven enterprises. Therefore, a bank should grant loans during a manner which earns higher interest than what it pays on its deposits. The bank's credit creation process is based on the idea that in any amount, solely a fraction of its customers genuinely would like money. Also, the bank assumes that each one of its customers wouldn't turn up demanding cash against their deposits at one purpose in time.

## BASIC CONCEPTS OF CREDIT CREATION

- **Bank as a business institution** – Bank is a business establishment that tries to maximise profits through loans and advances from the deposits.
- **Bank Deposits** – Bank deposits form the idea for credit creation and are of 2 types:
- **Primary Deposits** – A bank accepts cash from the customer and opens a deposit in his name. this can be a primary deposit. This doesn't mean credit creation. These deposits merely convert currency money into deposit money. However, these deposits kind the idea for the creation of credit.
- **Secondary or Derivative Deposits** – A bank grants loans and advances and rather than giving money to the receiver, opens a time deposit account in his name. this can be the secondary or derivative deposit. each loan crates a deposit. The creation of a spinoff deposit suggests that the creation of credit.
- **Cash Reserve ratio (CRR)** – Banks grasp that all depositors won't withdraw all deposits at an equivalent time. Therefore, they keep a fraction of the whole deposits for meeting the money demand of the depositors and lend the remaining excess deposits. CRR is that the proportion of total deposits that the banks should hold in money reserves for meeting the depositors' demand for money.
- **Excess Reserves** – The reserves over and on top of the money reserves are the surplus reserves. These reserves area unit used for loans and credit creation.
- **Credit number** – Given a definite quantity of money, a bank will produce multiple times credit. within the method of multiple credit creation, the whole quantity of derivative deposits that a bank creates could be a multiple of the initial money reserves.

### Credit Creation by One Bank

There is area unit 2 ways that of analysing the credit creation process:

- Credit creation by one bank
- Credit creation by the banking industry as an entire

In a single bank system, one bank operates all the money deposits and cheques. the method of making credit is explained with the hypothetical example below:



Let's assume that the bank requires to maintain a CRR of 20 %.



- If an individual (person A) deposits 1,000 rupees with the bank, then the bank keeps solely 200 rupees within the money reserve and lends the remaining 800 to a different person (person B). They open a revolving credit within the borrower's name for an equivalent.
- Similarly, the bank keeps 20 % of Rs. 800 (i.e., Rs. 160) and advances the remaining Rs. 640 to person C.
- Further, the bank keeps 20 % of Rs. 640 (i.e., Rs. 128) and advances the remaining Rs. 512 to person D.
- This method continues till the initial primary deposit of Rs. 1,000 and the initial further reserves of Rs. 800 leads to additional or derivative deposits of Rs. 4,000 (800+640+512+....).
- Adding the initial deposits, we tend to get total deposits of Rs. 5,000. in this case, the credit multiplier is 5 (reciprocal of the CRR) and the credit creation is 5 times the initial excess reserves of Rs. 800.

### **Multiple Credit Creation by The Banking System**

The banking system has several banks in it, and it cannot grant loans in more than the money it creates. once a bank creates a spinoff deposit, it loses money to alternative banks.

The loss of deposit of one bank is that the gain of deposit for a few alternative banks. This transfer of money within the banking system creates primary deposits and increases the possibility for further creation of derivative deposits.

Here is an illustration to explain this method better:

**Table 1: Credit Creation by Single Bank**

<b>Rounds</b>	<b>Primary Deposits</b>	<b>Cash Reserves (r = 20%)</b>	<b>Credit Creation or Derivative Deposits (<math>\Delta D</math>)</b>
1. (Person A)	Rs. 1000 (Initial primary deposits)	Rs. 200	Rs. 800 (Initial excess reserves $\Delta R$ )
2. (Person B)	800	160	640
3. (Person C)	640	128	512
4. (Person D)	512	102	410
-	-	-	-
-	-	-	-
<b>Total</b>	<b>5000</b>	<b>1000</b>	<b>4000</b>

As explained above, the initial deposit of Rs. 1,000 with bank A leads to a creation of total deposits of Rs. 5,000.

### **Limitations Of Credit Creation**

While banks would prefer an unlimited capacity for creating credit to increase profits, there are many limitations. These limitations make the process of creating credit non-profitable. Therefore, a bank continues to create additional credit if:

- There is a negligible chance of the loans turning into bad debts
- The interest rate that banks charge on loans and advances is greater than the interest that the bank gives to depositors for the money deposited in the bank.

Hence, we can say that the limitations of credit creation operate through shifts in the balance between liquidity and profitability. The factors that affect the creation of credit are:

- The capacity of banks to create credit.
- The willingness of the banks to create credit
- Also, the demand for credit in the market.

### **Capacity to create credit is a matter of:**

- The availability of cash deposits with banks
- The factors which determine their cash deposit ratio.



### **As regards the demand for credit:**

- The demand must exist in the market
- Creditworthy borrowers (to avoid bad debts)
- The amount of loan granted should not exceed the paying capacity of the borrower.

### **LEAKAGES**

- If the banks are unwilling to utilize their surplus funds for granting loans, then the economy is headed towards recession
- If the public withdraws cash and holds it with themselves, then it reduces the bank's power to create credit

### **UNDERWRITING**

Underwriting is that the procedure by that an individual or a corporation accepts monetary risk in exchange for a fee. Most of the time the chance is related to loans, insurance premiums investment. Despite the very fact that the mechanics have evolved through time, underwriting remains a vital role within the monetary trade.



### **Takeaway**

- Underwriting determines how risky an investment in an insurer's business is.
- By suitably valuing investment risk, underwriting aids within the institution of acceptable premiums and also the creation of a marketplace for Securities.
- Underwriting assures that a firm filing for an initial public offering (IPO) can acquire the required funds whereas conjointly paying the underwriters a premium or profit for his or her services.
- The method of underwriting before absorbing a risk, underwriters undertake analysis and assess the degree of risk that every applicant or company brings to the table. This check aids

therein institution of acceptable premiums to adequately cover actuality price of insuring policyholders, and also the creation of a marketplace for securities by serving to to line honest borrowing rates for loans.

- Risk is that the underlying think about all underwriting.
- In the case of a loan, the chance needs to do with whether or not the receiver can repay the loan as in agreement or can default.
- With securities the chance is that the underwritten investment won't be profitable.

### RECENT TRENDS IN PERIOD OF TIME UNDERWRITING



The highest trend in underwriting square measure as follows:

#### 1. How Advanced Analysis is improving Risk Profiling-

The underwriters square measure flooded with an excellent quantity of knowledge due to the modification in technology and magnificence of the planet whereby they'll get a larger quantity of knowledge from social media and the other sites within the digital world, knowledge the info the information} can even embody data that is been collected through the wearables and telematics likewise as customer's history.

There is square measure many ways in which like knowledge analysis, data processing and prognosticative modelling that helps to analyze an outsized quantity of knowledge} and supply correct information concerning the info on a very timely basis, it conjointly appearance into the insights of the customer's risk profile. With the assistance of the previous found knowledge and also the analysis, the underwriters are ready to get or bring out an improved resolution towards the customer's risk profile whereby the ways that square measure utilized in analyzing which



incorporates knowledge analysis and prognosticative models offer and monitor specific patterns and also the trends of the customer's behavior. In the end, the result are an excellent one with a larger set of call makings, acceptable rating schemes and a larger quantity of profits for an awfully long-term.

## **2. How Artificial Intelligence is personalizing services while driving down**

On the opposite aspect, a progressing range of underwriters build use of computer science (AI) that helps in advancing their rating strategy. The policies are often priced, oversubscribed, and sure in close to period of time by fastening up the workflows. trying into the positive aspect of the AI, they'll increase the amount of personalization of client services and conjointly they are doing provide suggestions to the specified customers to cut back their annual premiums and conjointly in addressing key issues.

## **3. How Innovative Business Models are Driving Transformation**

This model that is that the innovative business models Associate in Nursing processes challenge the normal work practices of an underwriter this totally embody fluid fewer underwritings and digital technologies which incorporates Machine Learning (ML) replaces the age and quantity charts and preventive the requirements of the fluid samples that absorb a larger quantity of your time and a larger comfort ability of the shoppers.

## **4. How Increased Collaboration is enabling speed and accuracy**

They are doing use some tools that modify them to extend coordination of various functions, in turn, ends up in effective and economical management of customer's lifecycle these tools embody collaboration tools and platforms that as a result ends up in lesser time overwhelming to supply quotes and herewith will increase opportunities for brand spanking new business enterprises

## **CURRENT TRENDS IN UNDERWRITING**

The long-held promise of huge knowledge, prognosticative analytics, computer science and Machine learning have enraptured past the theoretical stage and square measure being wide implemented in underwriting.

## **FOUR SPECIFIC UNDERWRITING TRENDS WERE SYSTEMATICALLY CITED**



### ➤ **The Evolution of The Underwriting Workforce**

“The evolution of our hands is about to be the single-most necessary success think about serving to North American nation produce merchandise relevant to individuals and to act with customers within the manner they need,” was explicit by Swiss Re's Chris Vitus Behring, chief underwriter for all times and health within the U.S.



This Underwriting revolution starts with knowledge, because it is depending on what we have a tendency to do.

### ➤ **The Rise of Non-Traditional Knowledge and Prognosticative Analytics**

In Associate in Nursing insurer, the insurers will currently customize policy plans by sound into granular client knowledge. they'll gain insights through analyzing historical knowledge to know client preferences, value sensitivity and behavioral signals.

### ➤ **The Wider Implementation of Computer Science and Machine Learning**

(Artificial Intelligence)AI driven underwriting systems assist the underwriters by accurately quantifying unstructured and qualitative knowledge points, like social media and news feeds, reliable statistics from public sources, and third party's convey a comprehensive risk profile to the underwriters in extremely explicable manner.

Machine learning: will facilitate with claims in insurance firms in range of the way, conjointly it are often throughout the claim method. No Machine Language is required within the review of injury, however artificial intelligence method Automation (RPA) can be wont to alter the claim flow to Payment.

### ➤ The Embrace of Telematics in Personal Lines



Not one may be a different idea. every is that the novel use or natural progression of existing tools, or within the case of the evolving hands, an immediate result of them. and every help to extend potency and automation. All four trends square measure interconnected.

### GENERAL UNDERWRITING CONSIDERATIONS

The underwriting and loan approval process should manifest minimum requirements for information and analysis upon which the credit is to be based. Underwriting standards should not only result in individual credit card loans with acceptable risks but should also result in an acceptable risk level on a collective basis. It is through the minimum requirements that management directs lending decisions towards planned strategic objectives and maintains desired levels of risks within the portfolio.

Management initiates the underwriting process when it identifies its tactical plan and in due course establishes the credit criteria and the general exclusive criteria for consumer urgency. Examiners should evaluate whether the banks credit card underwriting standards are appropriate for the risk-bearing capacity of the bank, including any board- established tolerance.



Considerable amount of the analytical tasks of underwriting are performed by technology, that can be through databases and scoring systems. In case the underwriting and loan approval process for credit cards in automated, judgmental, consistent inclusion of sufficient information to support the credit granting decision is necessary. Compared to other types of lending, the underwriting and loan approval process for credit card lending is generally well organized.

- Credit Score card data.



- Collateral identification and valuation, in the case of secured credit cards.
- Card structure and pricing information.
- Verification procedures
- While underwriting is based on payment history in most instances, there are cases, such as some application strategies, in which guidelines also consider income verification procedures.
- Identification and assessment of the applicant's repayment willingness and capacity, including consideration of credit history and performance on past and existing obligations.

The process for altering underwriting terms and standards can involve prominent decisions by management to amend policies and procedures. Sometimes the bank might increase credit limits or target a higher proportion of solicitations to individuals in lower score without reducing the minimum credit score. Furthermore, rising loss rates may indicate a weakening of underwriting criteria. Examiners should also consider that the bank's appetite for risk often involved in easing credit standards. When a good credit underwriting is identified, examiners should evaluate the adequacy of the total strategy. Results of credit underwriting weaknesses are not limited to overhead credit risk.

### **Underwriting Considerations**

#### **Affinity and co-branding program**

Inspectors generally expect banks to avoid changing the write-down standards for corresponding customers and branded cards. Instead, the credit card submission guidelines for affiliate programs should usually be in line with the bank loan policy, strategic plan, and the desired customer profile. If sub-writing procedures differ from standard bank standards, auditors are required to determine the appropriateness of system differences and the overall impact on portfolio quality. They should look to the evidence that management should ensure that simple standards still lead to an acceptable level of risk and that any high risks are handled properly.





### Private Label Program

Inspectors should expect managers to pay close attention to the financial partner of the store partner when deciding to hand out confidential label cards. And they often expect managers to refrain from changing writing standards to manage their sales partners.

A retailer who intends to increase the number of distribution cards may expect the bank to lower its credit limit. When a bank lowers its credit standards, management should ensure that rates remain high and that at any level of risk they are dealt with appropriately.



### Corporate Credit Card Program

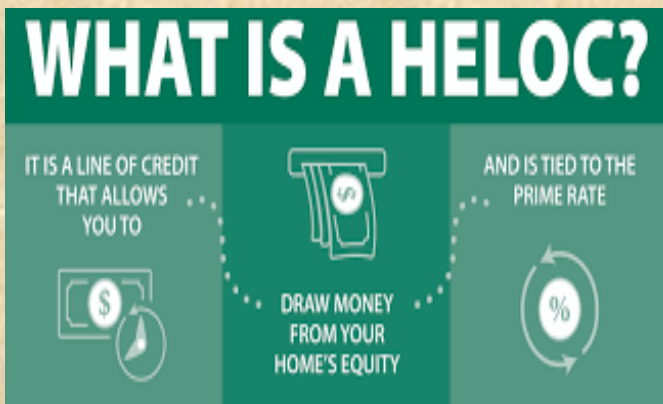
Credit card company schemes may pose a greater risk of commercial credit risk than consumer credit risk because the company may have a greater liability for debt. In cases where the entity is heavily indebted to the debtor, the auditors should expect that the management's decision to provide a credit line is consistent with the lending standards of the business loan. The lending process should also consider the company's relationship with the department of commercial banking. The auditors should review the contractual terms of the credit card business plans in the same way as they would review any other commercial loan file. The documents should include a management review of the company's financial position and its willingness to pay on time. Auditors should also ensure that the bank or business borrower determines which company employees receive business cards. If the borrower decides, the auditors should determine what controls the bank to reduce the risk.

## Subprime Credit Card Programs



A subprime credit card is a type of credit card made for subprime borrowers. These cards issued both by major banks and by dedicated subprime lenders. Typically, subprime credit cards will carry higher interest rates than regular cards, to reflect the higher expected default risk associated with subprime borrowers. Underwriting for subprime credit cards are done by evaluating the credit scores of the borrower.

## Home Equity Credit Card Programs



Home Equity Loan is called in various terms that is equity loan, home equity installment loan, or second mortgage is a type of consumer debt. Home equity loans allow homeowners to borrow loan by mortgaging the equity in their homes the loan is only given after the examiner looks at the risk factors and underwriting guidelines.

## Factors Influencing Credit Decisioning

Credit plays a big part however it is not the sole deciding issue. In today's world, applying for a loan is simply and quickly. Lenders would approve an application supported sure criteria that are arranged out. Since a loan is an unsecured variety of borrowing, the lender's assessment of the borrower's compensation capability is crucial. this is to ensure that people don't neglect compensation.



## **APPROVAL BASED ON CREDIT HISTORY**

A credit history could be a record of a borrower's accountable compensation of debts. The gathered records are then employed by lenders to work out an individual's credit worthiness, that's crucial an individual's ability and track record of repaying a debt. Your credit history could be a record of your ability to pay back your debts, whether or not or not it's credit card bill's student loans, or a mortgage.



Creditors ask for borrowers whose earning power exceeds the stress of the payment schedule. the dimension of the debt is essentially restricted by the out there depends on the arrogance the investor has within the borrower's credit worthiness. Credit goodness that encompasses the borrower's ability and disposition to pay is one among several factors shaping a lenders credit policy. Creditors and lenders utilize variety of economic tools to evaluate the credit worthiness of a potential borrower.

## **APPROVAL SUPPORTED OCCUPATION AND WORK EXPERTISE**

Your work expertise and current employment gauge if your financial gain is steady or not. A stable job means there's regularity in your stream of financial gain. Lenders additionally check out the entity you're used with. the general objective is to make sure that your leader is financially sound. This assures them that your supply of financial gain is reliable. They're preferred sure occupations most well-liked by the banks.

For example, government workers are given priorities as a result of the work is stable. Next blue-chip doctors and firms, lawyers, engineers yet as accountants are most well-liked. folks that are operating in camera corporations yet as are self-employed get low scores. Your profile encompasses a ton to try and do with the choice.





If your profile is stable, you'll be able to in all probability get the lowest rate of interest on a private loan. Another issue may be the number of years of labor expertise you've got. If you've got an extended work expertise, it may be more helpful in reducing the speed. Overall, the soundness and designation of your job matter the foremost.

## **APPROVAL BASED ON THE TYPE OF LOAN**

Loans is utilized for varied things in today's world. It is used for funding a start-up to purchasing appliances for your fresh purchased house. There are differing types of loans out there within the market and their specific characteristics that create these loans helpful to the purchasers.

### **Personal Loans**



Most banks supply personal loans to their customers and also the cash is used for any expense like paying a bill or buying a brand-new TV. Generally, these loans are unsecured loans. The investor or the bank desires sure documents like proof of assets, proof on financial gain, etc. before approving the non-public loan quantity.

### **Home Loans**



When you want to buy a house, applying for a consumer credit will assist you to a good extent. It provides you the backing and helps you get the house for yourself and your wanted ones. These loans typically go along with longer tenures (20 years to 30 years). The rates offered by some of the highest banks in Asian country with their home loans begin at eight.

30% your credit score is checked before the loan request is approved by the investor. If you've got an honest credit score, there's a good likelihood that you simply are ready to fancy lower rates of

interest along with your consumer credit. Home loans are primarily taken for purchasing new homes. However, this loan can even be used for home renovations, home extensions, buying land property, under-construction homes, etc.

### **Car Loan**



Buying an automotive will undoubtedly insert a good sense of joy and happiness in you. A car can stay as your plus and it's planning to be one among the most important investments that you simply create. A consumer loan helps you to pave the trail between your dream of owning a car and really shopping for your car.

Since credit reports are crucial for judgment your eligibility towards any loan, it's smart to possess a high credit score once you apply for a consumer loan. The loan application can get approved simply and you might get a lower rate of interest related to the loan. car loans are secured loans. If you fail to pay your instalments, the investor can take back your car and recover the outstanding debt.

### **Small Business Loans**



Small Business Loans are loans that are provided to small scale and medium scale businesses to meet various business requirements. These loans can be used for a variety of purposes that help in growing the business. Some of these could include purchase of equipment, buying inventory,



paying the salaries of employees, marketing expenses, paying off business debts, meeting administrative expenses, or even to open a new branch or take up a franchise. The eligibility criteria for small business loans varies from lender to lender, but the common ones are the age of the business owner, the number of years the business has been operational, income tax returns, and statement of the previous year's turnover that has been audited by a Chartered Accountant (CA).

### **Agriculture Loan**



Agriculture loans are loans that are provided to farmers to meet the expenses of their day-to-day or general agricultural requirements. These loans can be short term or long term. They can be used for raising working capital for crop cultivation or to buy agricultural equipment.

### **Education Loan**



An education loan is availed specifically to finance educational requirements towards school or college. Depending on the lender, it will cover the basic fees of the course, the exam fees, accommodation fees, and other miscellaneous charges. The student is the borrower with any other close relative being the co-applicant, such as a parent, grandparent, spouse, or sibling.

It can be availed for courses in India or abroad. It can be taken for a wide variety of recognized courses which are either part time or full time. They cover vocational courses as well as undergraduate and postgraduate courses.

### **APPROVAL BASED ON COLLATERAL SECURITY**

The term collateral refers to an asset that a lender accepts as security for a loan. Collateral may take the form of real estate or other kinds of assets, depending on the purpose of the loan. The



collateral acts as a form of protection for the lender. That is, if the borrower defaults on their loan payments, the lender can seize the collateral and sell it to recoup some or all of its losses.

### **How Collateral Works?**

Before a lender issues you a loan, it wants to know that you can repay it. That's why many of them require some form of security. This security is called collateral which minimizes the risk for lenders. It helps to ensure that the borrower keeps up with their financial obligation. In the event that the borrower does default, the lender can seize the collateral and sell it, applying the money it gets to the unpaid portion of the loan. The lender can choose to pursue legal action against the borrower to recoup any balance remaining.

As mentioned above, collateral can take many forms. It normally relates to the nature of the loan, so a mortgage is collateralized by the home, while the collateral for a car loan is the vehicle in question. Other nonspecific, personal loans can be collateralized by another asset. Loans secured by collateral are typically available at substantially lower interest rates than unsecured loans. A lender's claim to a borrower's collateral is called a lien—a legal right or claim against an asset to satisfy a debt. The borrower has a compelling reason to repay the loan on time because if they default, they stand to lose their home or other assets pledged as collateral.

### **Types Of Collateral**

The nature of the collateral is often predetermined by the loan type. When you take out a mortgage, your home becomes the collateral. If you take out a car loan, then the car is the collateral for the loan. The types of collateral that lenders commonly accept include cars—only if they are paid off in full—bank savings deposits, and investment accounts. Retirement accounts are not usually accepted as collateral.

You also may use future pay checks as collateral for very short-term loans, and not just from payday lenders. Traditional banks offer such loans, usually for terms no longer than a couple of weeks. These short-term loans are an option in a genuine emergency, but even then, you should read the fine print carefully and compare rates.

## **Collateralized Personal Loans**

Another type of borrowing is the collateralized personal loan, in which the borrower offers an item of value as security for a loan. The value of the collateral must meet or exceed the amount being loaned. If you are considering a collateralized personal loan, your best choice for a lender is probably a financial institution that you already do business with, especially if your collateral is your savings account. If you already have a relationship with the bank, that bank would be more inclined to approve the loan, and you are more apt to get a decent rate for it.

Examples of Collateral Loans are :

### **Residential Mortgages**



A mortgage is a loan in which the house is the collateral. If the homeowner stops paying the mortgage for at least 120 days, the loan servicer can begin legal proceedings which can lead to the lender eventually taking possession of the house through foreclosure. Once the property is transferred to the lender, it can be sold to repay the remaining principal on the loan.

### **Home Equity Loans**

A home may also function as collateral on a second mortgage or home equity line of credit (HELOC). In this case, the amount of the loan will not exceed the available equity.

### **Margin Trading**

Collateralized loans are also a factor in margin trading. An investor borrows money from a broker to buy shares, using the balance in the investor's brokerage account as collateral. The loan increases the number of shares the investor can buy, thus multiplying the potential gains if the shares increase in value. But the risks are also multiplied. If the shares decrease in value, the broker demands payment of the difference.

## **CURRENT AFFAIRS ON REAL TIME CREDIT DECISIONS**

- **Experian India launches business credit report to help some proprietors.**



With this solution, sole proprietors can gain access to their reports in real time thus enabling fintech partners to provide faster and better access to credit.

➤ **Credit score access trailing personal loan growth by wide margin report.**

As against a 23 times growth in personal loans under Rs.25000 in 2020, as against 2017, the number of consumers checking their credit score has grown only three times in 2020 when compared to 2018.



➤ **Credit Card and Debt Affects Not Only Your Finance but Also Your Health.**

Beyond the worries about repaying debt, one reason for poor health may be that people with high debt have little money left to pay for resources that protect their wealth.

➤ **How is credit score calculated?**

Having good credit score gives you leverage. Your repayment history influences your credit score the most. A credit bureau keeps a month-on-month record of your payments towards your bills and loan repayment equated monthly installment for the past few years.

➤ **How to maintain optimum credit score?**

Though there are different credit cards offered, one should pick that suits the requirements, instead of opting for multiple cards, must choose 1 or 2 that will limit credit exposure and accumulate points every time a transaction is done.

**Today's credit decisions navigating the current complexities.**

Today, after more than a year of irregularity, financial transactions and therefore credit risk decisioning are beginning to return to a recognizable pattern. However, it is increasingly clear to me that the world of credit is recalibrating and that a new path has been forged because of changes in data brought on by the effects of the COVID-19 pandemic.

How can we navigate this new road? By learning more about our clients, being more elastic about our expectations of them in the short term and embracing data and the analytics it produces.



We know far more about how consumers behave during a global crisis than we did before the pandemic. With that information in hand, the unprecedented shifts of the past year can become a long-term opportunity rather than a setback for lenders. In businesses of all sizes, business in current credit risk models declined between June 2020 and January 2021.

The extreme extent of impact to customers from the pandemic has created irrevocable change, and the past is no longer a good predictor of the future.

Banks who invest now will create a competitive advantage to not only aid in navigating the crisis, but to succeed and grow as we emerge from the pandemic.

### **Credit Decision Transformation**

FinTech's have solutions ranging from digitization of customer interfaces to complete automated credit decisioning. FIs will not be able to grow and meet the customer's expectations if they rely on traditional credit decisioning methodologies. FinTech's are already capturing a lot of shares from the banks' portfolios. This is evident from the fact that in U.S., according to Transunion, FinTech's issued 38% of the total personal loans in 2018 while the traditional banks' share has gone down to 28% from 40% 5 years ago. A lot of venture capital deal activities in the FinTech space over the past few years has helped them innovate through end-to-end technology driven credit lending transformation. FIs should start critically looking at their traditional credit decisioning flow - right from data collection phase up to determining whether to approve or reject a credit application of a customer. This would help them uncover opportunities for collaboration for automation via FinTech's' latest technology capabilities such as artificial intelligence and machine learning.



## **THE FUTURE OF CREDIT DECISIONS**

Credit decisioning remains a complex mix science today – lenders simply need to recalibrate the mix to meet new sector and member expectations. The digital first-approach will accelerate, which will make the community-minded history of credit unions even more valuable. What's technology without the heart?

Despite challenges, lenders right now have the perfect opportunity to rethink existing processes and rebuild even better. Credit decisioning now requires more member engagement, and improved data and risk models. For those who recognize these shifts, it's a golden opportunity to shape the future of our industry.

## **CONCLUSION**

Prior to the recent financial crisis, numerous banks revamped their credit underwriting processes with a focus on speed, costs, efficiency, and customer satisfaction. The one thing they forgot to consider was effectiveness, or risk cost, and many subsequently got burned. Several banks are again re-evaluating their credit processes, now with an emphasis on lower losses and streamlined operations. By focusing jointly on efficiency and effectiveness, banks can draw important lessons from the crisis and accordingly adapt to the new dynamics of credit demand and supply. This document outlines the key structural trends that are reshaping banks' credit underwriting processes and discusses practical measures banks should take to extract significantly higher value from lending operations. As the economic recovery continues, demand for credit will rise as corporates pursue investments suspended during the crisis. These projects will be funded mainly through banks, as capital markets' appetite for this type of risk is much lower than in the previous decade.

At the same time, the ongoing repercussions of the crisis will generate a wave of risk-related loan prolongations, and banks will need to evaluate these requests against a significant drop in the credit quality of borrowers. On the credit supply side, banks will bear higher costs for balance sheet usage, as both capital and funding (especially long-term) will be scarcer and more expensive resources in a stricter regulatory framework. In addition to this reduction in credit supply, secondary markets will have less capacity to absorb risk from banks.