Private credit: how technology can drive efficiencies

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We've seen the growth in the private credit market, what are some of the key drivers?
In 2012 private debt Assets under Management were US$370 billion. At the end of 2022, that figure had risen to US$1.4 trillion and is expected to hit US$3 trillion in the next three years. The asset class has been on an extraordinary growth trajectory since the Global Financial Crisis (GFC). Regulatory legislation, such as the roll outs of Basel 3 and IFRS 9, has been the underlying driver. Balance sheet efficiency has become the primary focus for banks across the globe who have retrenched from specific lending areas as a result, exiting activities or geographies deemed subscale or non-core.

Regulation is important, but what impact have you seen technology play within private credit?
When we're thinking about what motivates banks to sell loans it would be naïve to assume that they only consider capital efficiency and profitability. Whilst RWA and ROE are clearly important metrics, it can often be overlooked that technology is also a big factor.

European banks spend huge sums of money on technology. As one would expect, the larger the bank, the larger the spend. For instance, UniCredit and BBVA expect to spend between €1-2 billion every year on IT. If anything, the relative cost is far higher for smaller institutions and, critically, much of this spend is likely directed towards new lending, with legacy systems often falling further down the priority list; in turn, precipitating asset disposals in preference to investment in replacement software.

That's interesting, so how can LCM help when it comes to technology? What's your edge?
As a specialist buyer, that's exactly where we can step in. Through our servicing platform, we have 2,000 people in 25 offices and 11 countries across Europe. We're not just a financial partner to a bank. We can also be an operational partner. We can take the place of their back-office and we can do it more cost-effectively.

The operational piece is interesting for us because it's a point of differentiation. The better we are at the operational side, the better the solution we can offer to the financial institution. The more efficient we are as an organisation, the more likely we are to be able to offer superior returns to our LPs. It's why solving complex and large-scale portfolio migrations and supporting borrowers long into the future is our edge.

That makes sense. The sellers benefit from LCM's technological edge, but can the borrowers see any tangible impact when you acquire a portfolio?
It's not just the banks that benefit from technology. It's equally important to listen to the customer. Borrower behaviour is changing rapidly in a predominantly digital world. That means making considerable investments in the customer experience. The landline no longer exists and people are far less likely to answer a call to their mobile. A recent survey found that a quarter of people aged between 18 – 34 never answer the phone and 70% prefer a text message to a phone call. So it's all about automated voice and digital contact methods to stimulate inbound calling or self-service through online portals, though always with the option of speaking to an actual human! It's quite a big shift and investment but ultimately will bring costs down dramatically.

LCM has a fiduciary duty to its investors, who include some of the world's largest pension funds. How do they play into this dynamic?
For us, our investors are at the heart of everything we do. Limited Partners benefit from cost efficiencies and access to transactions created by our technological advantage.

Let's use robotic process automation (RPA) as an example. RPA software mimics the activities of an employee performing high volume and repetitive tasks. We operate at the granular end of the market, managing approximately 7 million underlying consumer and SME accounts. We have a huge quantity of data to manage and that's exactly what these BOTS are good at; data collection, validation and processing. They can reconcile thousands of customer payments in minutes whilst simultaneously flagging those accounts that need human intervention. The use of Optical Character Recognition (OCR) can massively speed up the reading and interpretation of correspondence, invoices or legal documentation acting as a triage and first stage processor for an employee to sign off on the recommended action.

What's more, these BOTS don't make mistakes. They work 24/7 and they enhance the quality of human jobs by freeing up time for people to work on more value-added tasks.

Technology is also pivotal to our deal team during the investment process. Our in-house developed analytics tools help us to assess new portfolios using information from our data-warehouse, enhancing our pricing and making our servicing strategies more targeted and effective.

Looking forward, what role do you expect technology to play within private credit?
Artificial Intelligence is rapidly transforming the private credit landscape by enhancing efficiency, improving risk management and providing deeper insights into the underlying investments. But our approach is to proceed with caution. New technology is coming out at an increasingly rapid pace. We have to ensure that we fully trust any new AI-based software and be certain that it meets our compliance standards before rolling it out in our investment and servicing processes.

Some of the predictions of the impact of AI are truly astounding so it seems bound to play a much bigger role in what we do. Our pan-European platform is a competitive advantage and we are going to leverage that footprint by continuing to evolve our technology as we have done for the last 26 years. We are a solutions provider and the banks need our help more than ever.

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