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The Credit Issue

INCREASED OUTSOURCING OFFERS LENDERS EFFICIENCY, BUT REQUIRES RISK MANAGEMENT

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OUTSOURCING TREND CONTINUES AND EXPANDS

Outsourcing business functions has increased significantly recently, and this trend continues within banking. Outsourcing is no longer limited to certain IT services, but also includes critical payment and administrative services.

Banks constantly face requirements to reduce overhead costs and increase operational efficiency. By contracting out certain day-to-day banking activities to an external provider, banks reduce their cost of operation, access specialized skills for enhanced service quality, increase customer satisfaction, and can focus more on the core banking business.

Banks have typically leveraged on outsourcing in the following key areas:

- Information and Communication Technology (ICT) services
- Payment services
- Loan servicing management and agency functions
- Reporting, finance and treasury services
- Mortgage, security and collateral management
- Deposit and escrow services management
- Know your customer (KYC) and anti-money laundering (AML) support
- Cash management
- Default management

Outsourcing is however expanding by way of increased outsourcing also of critical services within these categories. According to the European Central Bank's 2023 outsourcing survey, more than 80 significant banks in the EU now also outsource critical payment and administrative services, and more than 50% of the banks outsource some of their lending and investment services.

WHO'S DORA? IDENTIFYING AND MANAGING OUTSOURCING RISKS

The 2023 European Central Bank survey also indicates that not all banks are managing outsourcing risk appropriately. According to the survey, more than 10% of outsourcing contracts fall short of regulatory requirements, and of these 20% have not been risk-assessed in the past three years and 60% have not been subject to an audit.

One of the new regulatory requirements in the EU is the Digital Operational Resilience Act (DORA), which will apply beginning January 2025. It is intended to serve as a binding and comprehensive information and communications technology (ICT) risk management framework. DORA requires banks to assess and categorize suppliers of critical or important ICT services, and the requirements are not necessarily "cut and paste" from regulatory guidance on outsourcing. In addition, in contrast to the current regulatory guidance on outsourcing, DORA will be a legal requirement with linked penalties for non-compliance. Because financial markets are globally interconnected, financial institutions, fintechs, and other tech companies will need to comply with DORA to do business in the EU.

CARBON CREDIT COMPLIANCE

Alongside new regulatory requirements, there are also technological developments, evolving environment, social and governance (ESG) standards, and new customer obligations that require banks to continuously reevaluate their outsourcing strategies.

One example is the carbon credit markets that are expanding to meet a growing need for ESG-friendly assets. EU Allowances and UK Allowances are becoming portfolio mainstays as part of a multibillion-dollar compliance carbon sector. In this sector, there is an increasing outsourcing trend of custodian services for carbon credit. These voluntary credits are issued by verified greenhouse gas crediting programs and overseen by independent third-party custodians who offer enhanced transparency and trust. Custodians take ultimate control over compliance and voluntary credits to minimize potential conflicts of interest by asset originators or funders. This detached, independent custodial status provides reassurance to all parties.

BALANCING KYC AUTOMATION AND PERSONAL SERVICE

The loan agency service industry is increasingly investing in technology to provide more efficient and convenient solutions which will, for example, streamline the KYC process for faster onboarding. While being in full compliance with all applicable AML laws and regulations, some service providers are able to collect and analyze customer due diligence in a much more efficient manner allowing for effective execution of time sensitive transactions.

Yet operating in a highly regulated industry with strict legal requirements will involve human judgment, expertise, and customer service. Therefore, focusing on the overall customer experience with more personalized and tailored services continues to be paramount to success for all—lenders, borrowers and service providers.

AGENCY ALSO FOR CREDIT FUNDS AND NON-BANK LENDERS

Banks continue to rely on external providers for specialized services to save on infrastructure, personnel, and training costs. Over the past 15 years, the makeup of loan agency service providers has changed significantly. The global financial crisis of 2008 led to increased regulatory oversight and scrutiny of the financial industry, directly impacting large, bank-led credit facilities. This resulted in greater demand for independent third-party service providers, such as loan agency firms, to assist the massive growth in alternative lenders like credit funds and other non-banks and their handling of the agent role. Agency services is an area that remains high on banks' outsourcing lists.

NON-CONFLICTED IN TURBULENT TIMES

Over the past decade, the shipping and offshore markets have been turbulent, with considerable changes, consolidations, and debt restructurings. It's important for borrowers and lenders to choose a loan agent and security trustee they are comfortable with in both good times and bad. During a bankruptcy or restructuring process, an agent needs to be truly independent and conflict-free, highly responsive, and ready to process any amendments or other changes within a moment's notice. For the parties involved, it remains essential to work with a trustworthy partner who fully understands the markets, industry, and regulations, as well as the needs of that specific credit facility.

About CSC

CSC® is a leading independent provider of an extensive array of services tailored to meet the unique needs of banks, borrowers, corporates, funds, and private equity firms worldwide.

About the author

Ylva C. Axelsen has more than 20 years industry experience in advising lenders, funds and large corporates. Prior to joining CSC, she has been a law firm partner, general counsel of an oil drilling company, and spent nearly a decade at Nordea Bank in structuring, syndication and agency of global maritime loans.

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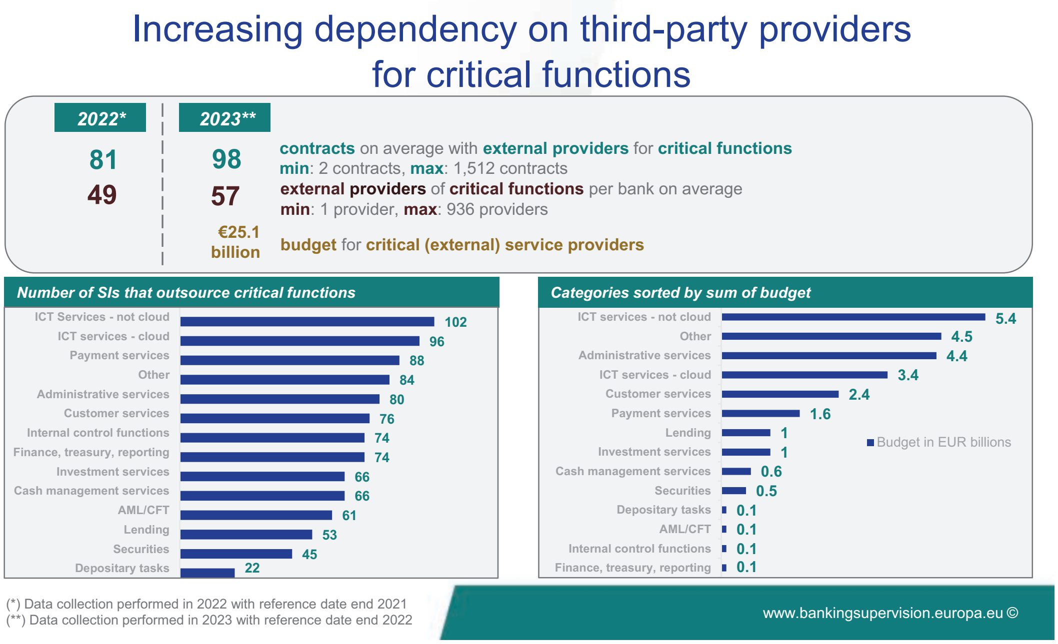

(Source: ECB Main Highlights of 2023 data collection; Outsourcing register - annual horizontal analysis (europa.eu))