SS&C Intralinks®

Artifical Intelligence:
4 Key Benefits for Non-Performing Loan Investors

November 2020

Introduction

Banks are bracing for a surge of non-performing loans (NPLs) resulting from the pandemic-induced economic downturn. With more than USD 2 trillion in credit losses expected for 2020 and 2021 — more than double what banks experienced in 2019[1] — a new wave of NPLs will present a significant strain on banks, particularly those in Europe which still have pre-COVID NPLs on their balance sheets. Governments will feel the pressure as they may need to bail out banks should the stock of NPLs worsen[2].

While macro factors — government stimulus packages, monetary policy and banking supervision enacted by central banks, and a second wave of COVID-19 — will impact the timing of that impending NPL wave, companies will be expected to leverage the debt markets to grow and/or stay afloat. Financial institutions will need to be prepared to quickly structure NPL deals and put them in front of prospects to maximize returns. Investors will be challenged to make decisions amid the usual challenge of navigating data-quality issues. Keep in mind all of this will happen in a scenario of uncertainty and a minefield of risk.

With the fallout from the credit crisis looming and the elephant in the room in plain sight, how can NPL investors create efficiencies to gain a competitive advantage? Enter artificial intelligence (AI)-powered solutions, a set of technologies whose promise brings resource savings, next-level reporting and business intelligence to NPL transactions.

Due diligence around NPLs is known to be particularly challenging and document-intensive. Combined with virtual data room (VDR) technology to support the secure sharing of large volumes of files, AI can help time-strapped, yield-seeking investors work swiftly and more efficiently to achieve better outcomes. AI is already supporting many facets of your daily life, from composing and sending emails to e-commerce recommendations based upon your shopping patterns.

Forward-looking companies are leveraging AI-powered cloud-based platforms to bolster efficiency, manage risk and outflank the competition in the remote-work environment. Here are four things NPL investors should know about AI now and in the coming year.

[1] S&P Global Ratings, July 2020
[2] Bloomberg, October 2020

01

Intelligent automation

AI includes multiple technologies. The most notable among them are machine learning, deep learning and natural language processing. By enabling the processing of large volumes of data, AI enhances our ability to make better decisions when the information is not clear — or the situation is too complex — so that investors can make quick, smart decisions to enhance returns.

The NPL industry is notorious for the poor quality of data available for valuations. It's also characterized as having significant barriers to entry, as the ability to effectively value impaired assets and assume the costs of intensive due diligence are limited to a few large investors[3]. AI helps solve these challenges by (1) organizing and simplifying volumes of data, and (2) essentially opening up the market to a broader base of investors who may not otherwise have the financial and human resources to pour into tax, legal and financial due diligence and valuation.

COMPETITIVE ADVANTAGE

AI doesn't make an investor smarter — it is a source of support to help them make important decisions. Combined with one's own experience, AI reduces analytical burdens.

"The lack of information about an NPL portfolio that goes on the market often leads to reduced offers or even a complete lack of buying interest."

— Tassos Kotzanastasis
CEO, 8G Capital Partners

[3] European Central Bank, Financial Stability Review, November 2017

02

Extract critical, quality data

While it makes for sensational headlines, artificial intelligence is not science fiction. It is not "robots taking over the world" but rather machines or computer programs that mimic human intelligence to identify complex patterns, analyze them, "learn" from them and make suggestions. This is a tremendous benefit to the NPL industry, as valuations of NPLs need qualitative information extracted from volumes of documentation such as the following (in the case of a commercial real estate NPL): loan agreements; title deeds, policies and exceptions; mortgages; leases; planning permits; floor plans; zoning reports; surveys; property condition reports; and more.

All of those documents should be housed in a secure VDR to allow access by NPL sellers, brokers and purchasers[4]. Next, AI extracts critical qualitative information, analyzes and presents it in a standardized format for review by prospective investors. For example, AI could highlight the information informing the legal standing or relationship between the borrower and lender, and the condition of the underlying collateral. When AI is applied consistently and frequently, the standard of information and analysis generated will improve over time and lead to even better NPL valuations leading to optimal investment decisions.

COMPETITIVE ADVANTAGE

AI allows investors to harness the full potential of data. Estimates predict professionals will see up to a 40 percent increase in productivity from AI tools by 2035. These gains will come from combinations of time savings and new ways of understanding and interacting with data. In addition, AI allows teams to automate mundane tasks and focus on higher-value work.

[4] JD Supra, April 2020

03

Facilitates faster decision-making

Massive amounts of data are being created every day in a quantity never before available. While the abundance of data allows for the assessment of opportunities at a much more granular level during due diligence, many investors struggle with the sheer volume and ability to extract value from it. Standardization of data is famously lacking in the NPL industry. Portfolios are extremely diverse, especially those involving corporate and commercial property businesses. Loan tapes, data definitions, and the scope of data collected and analyzed can vary across banks, leaving investors to face another set of challenges when transacting with a new bank.

AI can help overcome these challenges by implementing a standard scope, data definitions and templates, making the investors' evaluation process more efficient and better informed.

COMPETITIVE ADVANTAGE

AI can look at an NPL portfolio of commercial properties and use predictive forecasting to illustrate potential leases and rent revenue based on historical performance, yielding a much more accurate view for the investor than was possible just a few years ago.

04

Streamlines due diligence

Investors need as much information as possible to determine whether a deal fits within an overall strategy. They also need to verify if the credit quality of the underlying assets is as the seller portrays them to be. The outcome of the due diligence process needs to close the bid-ask gap: The price an investor is prepared to pay for NPLs versus the bank's asking price.

There are challenges in the due diligence process, given the data-quality challenges inherent in NPL assessment.

Significant information is often missing or incomplete. It's labor-intensive, time-consuming and costly for the buyer to manually identify information gaps and ask the seller to track down the necessary information.

COMPETITIVE ADVANTAGE

AI can automate content organization, identify variances in information and manage the process while tracking the activity of diligence team members for transparency into status and progress.

"Better insights drive superior value, faster. And faster, better insights are what AI and data analytics bring to deal teams."

— Accenture

Conclusion

Now is the time for active buyers of NPLs to recognize gaps in their process. More deals conducted in a remote-work environment will mean more time and effort spent on due diligence. The inability to freely travel and conduct physical assessments — particularly critical when evaluating distressed assets — will add friction to getting deals done.

As government-backed relief schemes wind down and banks face trillions in loan defaults over the coming years, significant NPL activity is certain to occur all over the world. Yield-seeking investors can expect a steady flow of NPL deals, but only the best-prepared buyers will be able to leverage opportunities in the market. Is your organization ready to tackle the increased volume of NPLs? The window of opportunity to prepare won't be open for much longer.

SS&C Intralinks provides NPL investors with the tools to stay ahead of the changing landscape and leave less time for market factors to disrupt the deal. The Intralinks DealVision™ solution is purpose-built for participants on the buy-side of an NPL transaction. It features automated document classification and file recommendations from the Intralinks virtual data room to review based on the investor's checklist items or questions, and real-time dashboards show how the project is progressing.

Accelerate due diligence and stay ahead of the evolving NPL landscape

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