Lending

tools of the trade

Banks and credit unions live and die by their accountholders' experiences. As you strive to improve that experience, you will either succeed or fail based on which systems you decide to implement, which vendors you choose to trust, and how well you educate and train your staff. This eBook will explore ways for you to improve the borrower experience and – ultimately – improve profitability in a post-pandemic world of financial services. ICBA Chairman Robert Fisher stated, "Customers' willingness to change in terms of online banking and technology is speeding up, and I don't think that's going to change after we get back to normal."

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Section 01

improving the digital banking experience

Banks and credit unions were heavily influenced in the early 2000s by the rise of online mortgage lenders, mainly Quicken Home Loans. The wave of online lending for consumer loans began as early as the late 1990s, also spurred on by fintech investment in the sector. Both areas are now entering a stage where the emphasis is on enhancing the accountholder experience even further due to the pandemic, through more streamlined processes, electronic financial records delivery, electronic signatures, mobile delivery, and more.

So, what exactly can you do to enhance the accountholder experience, grow revenue, and increase efficiency?

Deliver a quality online application process for your customers. Digital service delivery – both in consumer and business lending – was accelerated by the shut-down of early 2020. Many of the habits adopted during that time will be with us permanently. A recent survey by Bank Director, highlighted below, points to the key objectives driving technology strategy for financial service executives. This survey, which reviews institutions below and above $10B in assets, highlights the importance of the digital experience in enhancing client experience and reducing operating costs.

In response to the 2020 pandemic, banks and credit unions across the U.S. are being encouraged by regulators to increase the availability of small business loans. That is why we see the migration toward online commercial lending as an unstoppable wave that will continue to follow the trends we have seen during the last decade on the consumer side. The market is demanding it, and, at the same time, it increases efficiency and profitability for financial institutions. The only remaining consideration is accountholder experience – and it is, in fact, a huge consideration.

Top Three Objectives Driving Technology Strategy[1]

Bank Asset Size	>$10B*	$1B – $10B	$500M – $1B	<$500M	Total
1. Creating a more efficient operation	50%	70%	67%	78%	70%
2. Improving the customer experience	75%	60%	79%	70%	68%
3. Improving online and mobile offerings	63%	32%	29%	35%	34%

1. *2021 Technology Survey*, Bank Director, accessed April 8, 2022.

**Indicates a count of less than 10 within a category.*

Section 02

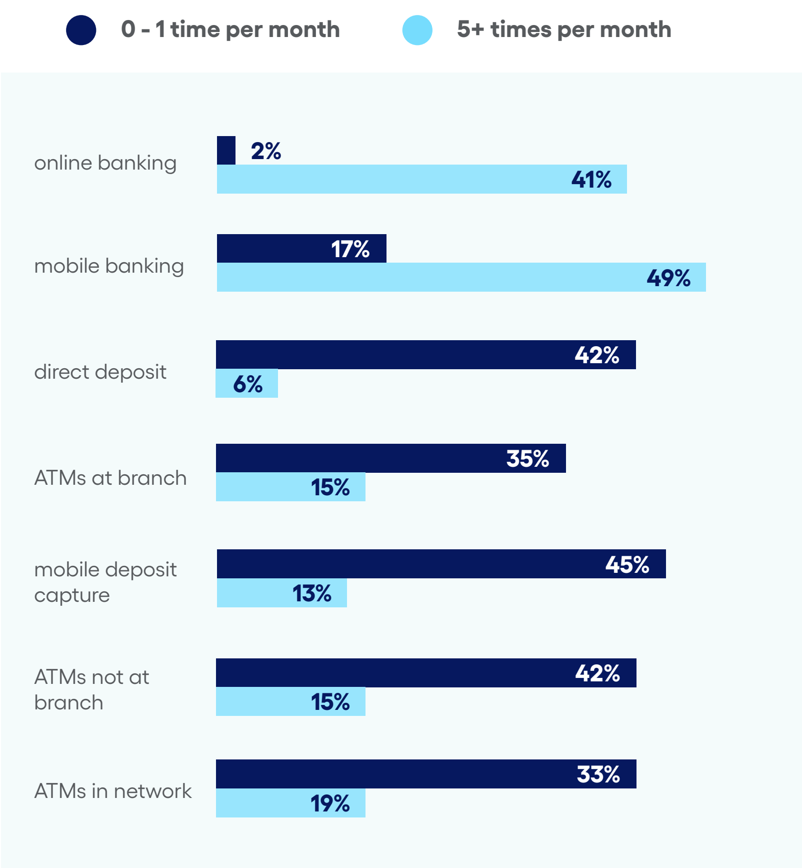
using a digital delivery channel to create the ultimate accountholder experience

One of the most important topics of conversation among community banks and credit unions in recent years has been the issue of delivery channels.

Want to know where to spend your marketing and technological resources? Look at the demographics of the communities you're hoping to serve over the next 10 to 20 years. Chances are, you'll find an even mix of age demographics along with an even mix of delivery preferences – and those delivery preferences run the gamut from branch banking to online banking and everywhere in between.

Above all else, financial institutions should first focus on accountholder experience – so it's important to determine how you want your customers to feel when they're interacting with your institution, no matter which method they choose. You don't want your customers and members left confused or frustrated. You want them to feel valued and heard.

How frequently Americans use remote banking channels[2]



2. Cocheo, Steve. *How to Reboot Banking Channels As Pandemic Restraints Are Eased*, The Financial Brand, accessed April 8, 2022.

How can you get from the delivery channels you have today to the delivery channels you want to offer?

follow these five steps:

1. Let the desired accountholder experience drive your strategy. This is your yellow brick road or your north star. Follow it all the time.

2. Understand the changing market demographics for your region. Then get to know their preferences better than your competition knows them.

3. Understand who you want to serve. Really devote time to defining your target market.

4. If you did a good job on steps one through three, the path is now simple. Build (or buy) systems that will serve your defined target market.

5. Don't stop with your clients. You must also make sure these same systems support your employees. Think about specific interactions your employees have with your customers and members and consider whether your technology supports or threatens the success of those interactions.

Section 03

using loan origination strategies to increase efficiency & more

Recent trends in technology have fostered a renewed interest in lending technology. Origination systems are now built with the intent of improving efficiency, eliminating redundancies, and creating the optimal user experience for both lenders and borrowers.

As you consider an upgrade of your own origination system, or enhancements to your existing technology, it helps to break the origination process down to its component parts. Each of the following steps represents a point where technology can have an impact on your users' experiences:

Application

- Delivery and completion of the application itself, whether written or electronic
- Delivery and receipt of historical financial data (including tax returns)
- Authentication of financial data

Underwriting

- Financial spreading
- Ratio analysis and stress testing
- Loan structure development (finding the best solution for the client)
- Capacity evaluation
- Collateral evaluation

Loan decisions and communication of offers or declinations

- Credit memorandum development
- Approval methods (automated, electronic, and manual)
- Offers and term sheets

Closing

- Preparation of documents
- Preparation for loan closing
- Closing and signature (live or electronic)
- Recording of lien positions

The difficulty for most institutions is evaluating current workflows and determining where and how to get the most value from investments.
Consider these nine points as you review potential new investments:

1

Will the new technology enhance existing workflows?

2

What will the new process feel like to potential borrowing clients?

3

What will the experience be for my lenders and credit administration staff?

4

For both borrowers and staff, does the technology allow omnichannel access to the technology (online and mobile)?

5

How much does the new process vary from current practices, for both lenders and applicants?

6

Does the new technology fit our culture?

7

Is the new technology flexible? For example, does it allow for small dollar loans to be treated through different protocols? Does it offer a path for loan denials?

8

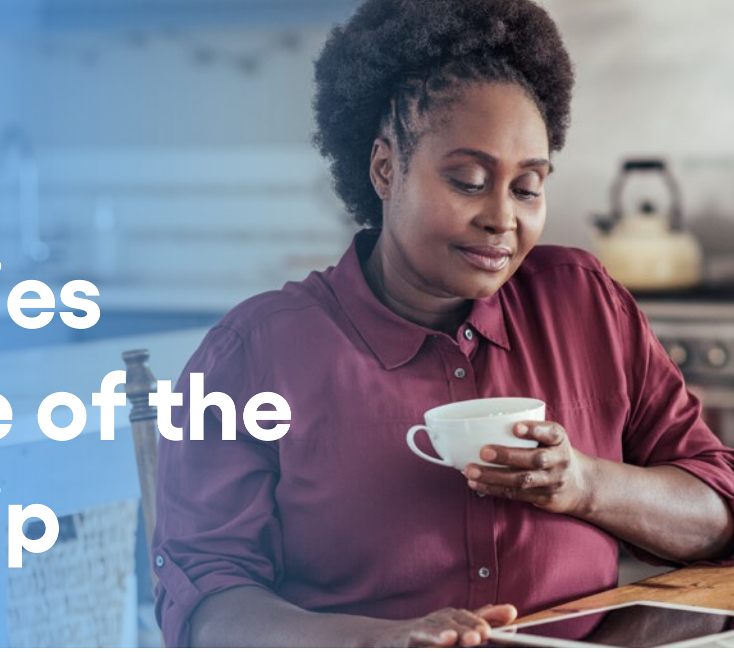
Will the new technology be integrated with my core processing system? What about my doc prep system?

9

Are there open API connections to other information sources I utilize when underwriting? These might include credit bureaus, peer group analysis, flood determination tools, tax evaluation tools and more.

Section 04

creating efficiencies throughout the life of the lending relationship



Most of the recent technological investments made in lending have been directed at loan origination, but that's just the beginning. So much more can be done to create efficiencies throughout the life of the lending relationship. Here's a look at specific areas of portfolio management that are being reshaped by new and emerging technology:

Covenant Tracking

The best loan origination systems allow for the establishment of covenants. When these are interfaced with the portfolio management system, covenant triggers begin to provide an early warning system for credit administrators. The system itself should identify the issue and notify all key employees through the relationship management system.

Financial Data Collection

More and more systems are now allowing for borrowers to send data directly from their own accounting systems. Other technologies are allowing for smart scanning of documents, contracts, tax returns and more. Just as credit files have migrated to electronic formats, so will all other financial data that feeds those files.

Collateral Management

For working capital facilities, this would include detail regarding the status of accounts receivable and payable as well as physical inventory. Lenders will still have to ensure the validity of this data through the process of field exams, but the delivery and storage of the information itself significantly reduces the chance of delay as well as human error.

Risk Rating Migration

The real time savings comes from the resulting systems analysis. For financial records, this creates an environment of automated continuous underwriting of each relationship. With fresh financial data constantly being introduced and compared to prior year statistics, lenders will be closer than ever before to clients. This will streamline the process of loan renewals and new loan requests.

Profitability Analysis

Financial institutions rarely understand how much time lenders and credit administration staff spend on relationships. Better data can drive much more realistic profitability analysis. When loan origination and portfolio management systems are integrated with profitability management systems, you can track lender workflows, allowing for more accurate accounting and more efficient lender time management. Ultimately, a better understanding of profitability creates more realistic loan pricing, which allows your team to be more competitive.

Predictive Portfolio Analytics

This leads to the natural next step, knowing what a client needs before they themselves know it. In the years to come, portfolio management systems will harness the power of financial data, peer group analysis and business lifecycle analysis to help lenders identify which clients are the best fit for lending products within their organization. This will take your sales efforts to a new level and encourage strong business retention.

Section 05

financing accounts receivable

Most small businesses in the U.S. (26.5 million out of 32.5 million) are non-employer firms while another 5.4 million have fewer than 20 employees. Why are these numbers significant for community-based financial institutions? Because these are your prospects for the next five to 10 years. As these businesses grow, many of them will seek financing.

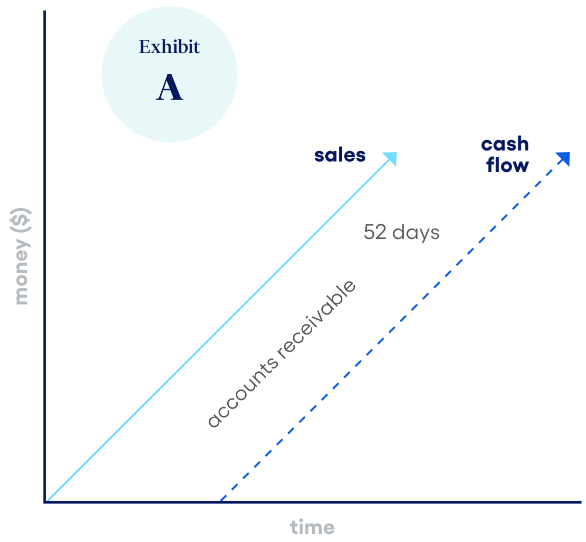
Given that the first request for financing is often a line of credit, your institution should have a clear strategy for how you would structure such services.

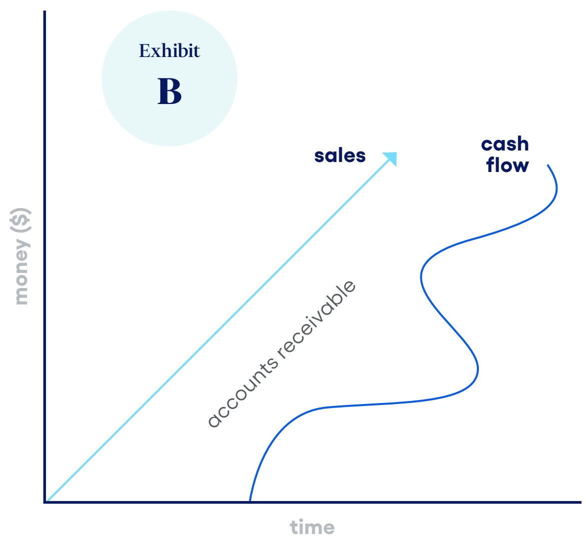
There are three primary metrics that drive businesses to seek accounts receivable (AR) financing.

1. **How much AR do they carry?**
2. **How fast are they growing?**
3. **How quickly and consistently do their customers pay them?**

The fluid nature of accounts does not allow for that level of predictability, which drives businesses to seek AR financing to fill the gaps and to help fund growth spikes.

There's also a big difference in how cash flow pressure "feels" depending on which desk you occupy. To the average young commercial lender who's never run a small business, it looks something like *Exhibit A*. To the small business owner living the daily realities of cash flow, it's more like *Exhibit B*.





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Leverage Technology

When deciding which credit structure is the most appropriate, you need to weigh the benefits to the potential borrower against the credit controls that should be in place to manage risk.

Every credit structure has seen significant enhancements in technology in recent years, as it relates to an institution's ability to track collateral values, covenants, and exceptions relating to loan agreements.

Which financing method is best for the business?

The final decision regarding the method of financing used should be made after joint consultations between the lender, the business owners and key members of the business' advisory team, including the CPA. All the factors mentioned to the right should be considered.

There's significant opportunity for businesses and financial institutions to work together in this area of finance. You'll also find that handling the working capital component of your clients financing needs opens the door to the rest of the relationship.

Consider these factors:

- The pace of growth
- The size of the credit need
- The financial strength of the business
- The financial strength of their customers/account debtors
- The number of transactions created monthly by the business
- The cost of the financing method as compared to the expected benefit

Section 06

automating loan renewals for future growth

The act of renewing a loan or line of credit represents the continuation of an existing relationship. This is especially true for your business relationships.

Most analysts agree that the typical small business loan renewal costs your organization somewhere between $2,000 and $3,000. For every 100 facilities you renew annually, that represents an added cost of $200,000 or more. But if you've been using the tools mentioned in this eBook, you can reduce that number by as much as 80%. This can be seen when you break down the process of renewing each loan:

Using these tools, you could reduce your small business loan renewal costs by as much as **80%**

1. Notification to the borrower and the credit officer that the loan is approaching a renewal event. This task can now be fully automated.

2. Collection of all financial documents required to underwrite the renewal. As discussed in volume four, the act of updating financials is now electronic and can be initiated during step number one above.

3. Collection and confirmation of all collateral valuation documents needed to approve the renewal. This too can be automated to a significant degree.

4. Underwriting of the renewal by the credit officer or centralized approval areas in your organization. This was also discussed in volume four of this series. The concept of continuous underwriting changes the discussion regarding renewals.

5. **Approval of the renewed facility** – By borrowing from new loan origination systems, the process of signing off on renewals can be done electronically. For facilities that must go to a credit committee, the process can still save significant time.

6. **Documentation of the renewal** – Integration with loan documentation systems now automates the renewal process.

7. **Loan closing** – In many cases this can be done through electronic signature.

8. Recording documents and updating internal systems to reflect the renewal terms. Integration with core systems creates the time savings for this step.

How Automation & Technology Can Speed the Renewal Process:

Most of these steps can and should be automated to the point that they simply enter a work queue for your team to act on so that they get resolved quickly. When these systems are implemented, your savings should be at least 50%, but more likely 70 – 80% on the average loan.

1. The system pulls a maturity report, so you know which loans are up for renewal.

2. Requests for updated financials are automatically sent to the client.

3. The system reviews and approves files with convenient renewal status updates automatically sent to the client.

4. Clients can digitally sign documents right before the system files them in the repository.

5. Loan information is updated and then sent to your portfolio management system and your core platform.

Section 07

simplify the loan trading process for portfolio diversification & growth

It's no secret that asset/liability structures have recently shifted. From massive Paycheck Protection Program (PPP) funding levels to the stress placed on CRE portfolios to unprecedented levels of forbearance on commercial and consumer loans, the months and years ahead will bring both challenges and opportunities for bank and credit union executives.

Incorporating loan participations into your long-term growth strategy presents the opportunity to supplement organic growth while more effectively managing your balance sheet.

The current annual loan trading volume in the U.S. is $500B – $1T, involves approximately 20,000 organizations, and is brokered entirely through personal networks by phone. This antiquated system is time-consuming, manual, and lacks the transparency needed for efficient monitoring.

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When considering ways to leverage innovative technology to simplify the loan trading process, consider better preparing for credit quality challenges (e.g., understanding the market demand for assets, preparing and providing easier access to diligence documents). You can also look at using innovative tech to better reposition for regulatory and strategic thresholds (e.g., deciding which loans to offload, participating loans due to segment or borrower concentration concerns).

Cloud-based platforms make selling and trading easier – so you can manage your loan portfolio more strategically.

- **Diversify your portfolio** by geography, industry, and/or loan type.
- **Reduce risk by identifying deterioration early** and moving assets off the balance sheet.
- **Expand your peer network** beyond current regional and economic limitations.
- **Better serve the needs of your community** by fielding requests that may lie outside the scope of your current business model.

Loan Trading Turnaround Time – Then vs. Now

Technology can help you find the loan trades that best fit your portfolio – in minutes instead of months.

Traditional Process	vs.	An Online Loan Marketplace
2 - 5 Days • Manual upload • Manually massage tape • 10s of emails	**Tape/Data**	**Minutes** • Core integration creates listing in just 5 clicks
1 - 6 Months • Manually contact personal network • Deals shown to selective clients • Low access to community FIs	**Counterparty Search**	**Weeks** • Network of buyers and sellers automatically targeted • Non-biased access for buyers
7 - 14 Days • No pricing transparency • No market discovery • 10s of calls, 100s of emails	**Price Negotiations**	**3 - 7 Days** • 100% transparency • Access to counterparty • Central communication
10 - 21 Days • Manual downloads/uploads • Manual packaging and sending • Dozens of email threads, calls	**Due Diligence**	**15 - 16 Minutes** • Integrated LOS/Doc storage • Automatic document pulling • Centralized communication
5 - 10 Days • Dozens of email threads • Unorganized version history	**Agreements**	**3 - 10 Days** • Centralized communication • Version history • E-signature
5 - 10 Days • Manually import loan data into buyer's core • Manually coordinate with servicer	**Closing**	**Minutes** (coming soon) • Automatically import loan data into buyer's core

Summary

tools to take home

When it comes to lending, it's important to understand that you're in the relationship business. And effective relationship development takes time. When you implement systems like the ones discussed in this eBook, your staff can focus more on nurturing those relationships while spending less time on processes and paperwork. Ultimately – by focusing on the borrower experience, you'll make a significant impact on your bottom line as well as your ability to attract and retain customers, members and employees.

unlock your potential

Learn more about our digital lending tools and technology.

For more information about Jack Henry, visit **jackhenry.com**.

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