The 2020 Business Lending Readiness Survey

Preparing Now for Economic Uncertainty Ahead

MARY ELLEN BIERY, ABRIGO

abrigo™
make big things happen.

Table of Contents

Executive Summary

Financial institutions face numerous challenges in their lending and credit functions. According to Abrigo's survey of more than 300 lenders, credit analysts, chief credit officers, chief risk officers, and other professionals involved in lending and credit risk at banks and credit unions, many are working with processes that create inefficiency, which can add costs and delay turnaround times. Bankers at plenty of financial institutions also battle processes that promote inconsistency in pricing and risk management, which can be two of the biggest dangers going into an economic downturn. By examining these processes and taking steps to automate and improve them now, financial institutions can prepare for eventual environmental changes and remove obstacles to success.

INTRODUCTION

Many community bankers expect a recession will start by at least mid-2021, according to the most recent Community Bank Sentiment Index.

Financial institutions seeking to maintain a healthy share of commercial real estate and business loans in their portfolios through rougher economic seas want to be in the best position possible ahead of any storms. They will need to be able to compete effectively for fewer borrowers and be able to spot and manage any increased credit risks arising as conditions change. This means having processes and people in place for bringing in applications, identifying the right loans to book, pricing them correctly, and closing them quickly and efficiently enough to meet customer needs and institutional goals.

In Abrigo's 2020 Business Lending Readiness Survey, more than 300 lenders, credit analysts, chief credit officers and chief risk officers, as well as other professionals involved in the lending and credit risk process at banks and credit unions painted a picture of the challenges they currently face related to driving loan growth and managing credit risk.

Many respondents' institutions have processes that add costs, delay turnaround times, and can lead to inconsistency in pricing and risk management, or worse yet, unhappy customers and staff. Consider the following:

- Nearly a third of those surveyed said closing a commercial loan takes 5 to 7 weeks at their bank or credit union, and 9% said the turnaround is 8 or more weeks.
- About 1 in every 5 respondents whose institutions have more than $500 million in assets said staff enter and re-enter the exact same data 6 to 10 times for each commercial loan.
- 42% of bankers are still using manual data entry to create credit memos.
- More than half of bankers at the smallest institutions (those with assets below $500 million) said their bank or credit union manages the borrower pipeline using an Excel spreadsheet.
- 20% of all respondents said their bank or credit union doesn't offer an online application for a commercial loan or member business loan, and it doesn't plan to offer one in the future.

"I'm surprised at how inefficient and poorly automated things are," said David O'Connell, Senior Analyst with research firm Aite Group, after reviewing the survey results. Lending, he noted, is the "tip of the spear" – the activity that gets a financial institution into a business, allowing it to deploy its capital and create a profit through lending as well as cross-selling other products or services that can carry high margins, such as treasury management, corporate cards, or wealth management services. This "tip of the spear" role means lending and credit risk management are essential operations at most financial institutions.

However, efficiency in lending and credit risk management is also essential – for a good customer experience, for quality control, and to meet institutional financial goals. Efficient processes ensure the numerous lending and underwriting requirements are met at the right time and with discipline. "Standardizing inconsistent processes is an easy win for productivity," added Alison Trapp, Director of Client Education at Abrigo. "It lets everyone know what they need to do and allows people to focus on accomplishing that, rather than figuring out what they need to do next."

Fortunately, financial institutions can take steps to address challenges that have the potential to exacerbate lending and credit issues in an economic downturn – and some banks and credit unions already have. Digital technology automates many of the tasks causing the biggest headaches and delays to loan turnaround times. Efficiency-generating solutions that banks and credit unions can implement across the life of the loan are able to help identify the riskiest borrowers and revamp loan decisioning processes that some bankers acknowledge currently fail to align with institutional growth objectives.

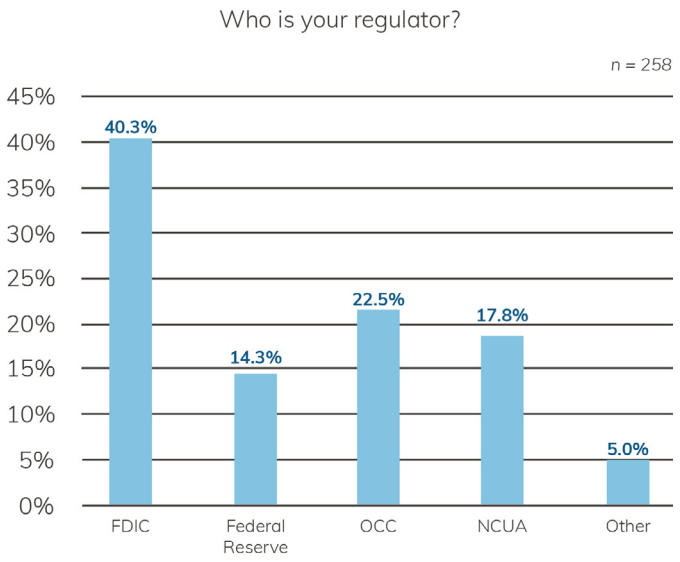
THE SURVEY

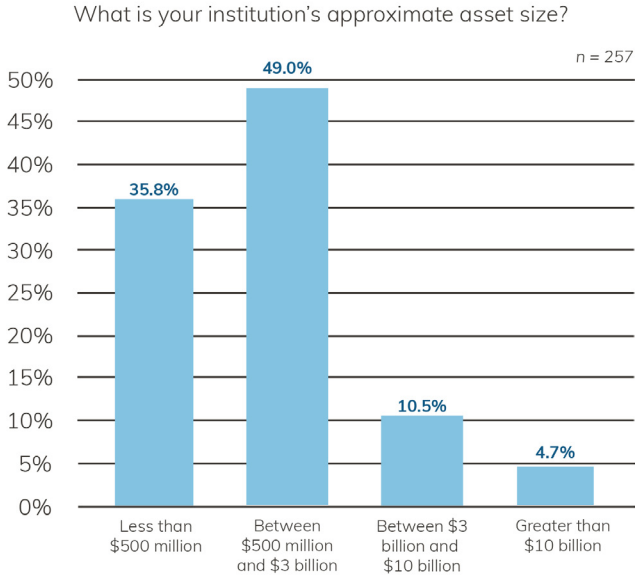
Abrigo asked 15 questions in an online survey from Nov. 21, 2019 – Jan. 10, 2020, to help financial institutions benchmark many of their commercial or business lending processes. The survey was made available to Abrigo customers and non-customers, who were offered the chance to see survey results once completed and a chance to win a limited number of Starbucks gift cards. It drew 303 respondents, with some respondents declining to answer certain questions or failing to complete the full survey. The sample, while not necessarily representative of the entire universe of U.S. financial institutions, provides a detailed look at challenges faced by a large number of lending and credit professionals. Each chart shows the sample size (n) for that question, excluding respondents who skipped the question. Across the survey, between 252 and 303 respondents answered each question.

About those surveyed

Banking professionals surveyed included lenders, credit analysts, chief credit officers, and chief risk officers, as well as other professionals involved in the lending and credit risk process. FDIC-regulated banks had the largest representation, followed by banks regulated by the Office of the Comptroller of the Currency. Forty-six respondents, or 18%, worked at credit unions.

Community banks made up the bulk of respondents, which is not surprising, considering they make up the majority of FDIC-insured financial institutions in the U.S. About 85% of those surveyed represented institutions with $3 billion or less in assets. Institutions topping $3 billion in assets made up 15% of those surveyed, including only 12 respondents, or less than 5%, who said assets topped $10 billion.

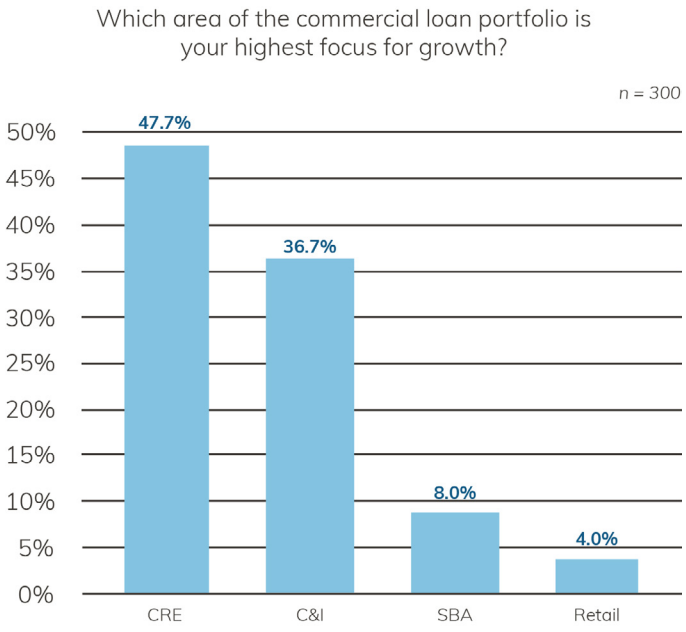




PORTFOLIO FOCUS AND RISK APPETITE

Financial institutions' focus on a specific type of business loan can play a role in their lending and underwriting processes. The focus can also shed light on financial institutions' strategy as the economic expansion enters its 11th year.

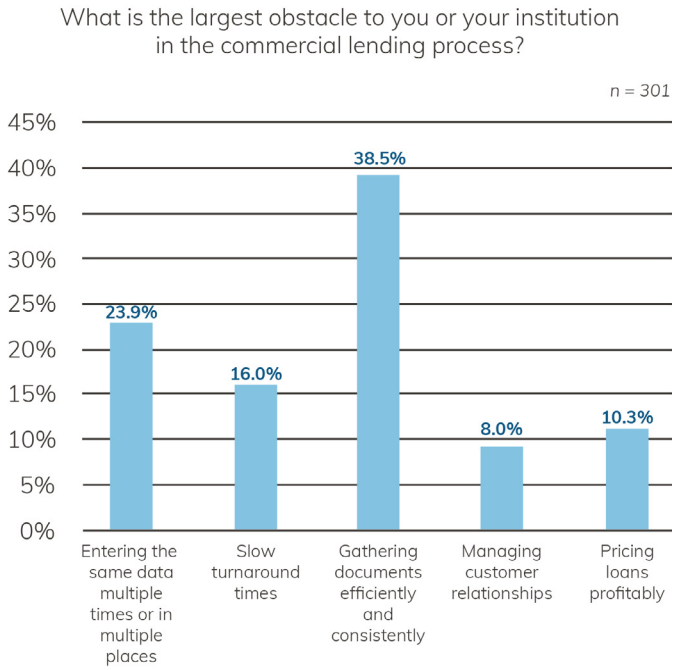
Almost half of respondents said commercial real estate had the highest focus for portfolio growth at their institutions, while 37% said commercial and industrial loans were the top priority. Only a few dozen respondents named SBA lending and retail loans as areas of highest focus. Respondents from credit unions predominantly (76%) identified commercial real estate as the portfolio focus, compared with only 41% of respondents from banks.



Risk appetites among respondents' financial institutions were heavily clustered among the answers "somewhat conservative" and "moderate," each of which drew 37% of respondents. Only 16% described their institutions' risk appetites as very conservative, and barely 10% labeled risk appetite as somewhat or very liberal. These answers are in line with the Federal Reserve's January Senior Loan Officer Survey, which found that banks expected to tighten lending standards for CRE and C&I loans in 2020, anticipating loan performance to deteriorate somewhat for several types of business loans.

ROADBLOCKS TO EFFICIENCY

With low interest rates expected in the near-term and slowing growth expected in loan demand, banks and credit unions ideally would be set up to benefit from efficient processes that would allow them to meet institutional goals for customer service and financial returns. Furthermore, institutions would be able to add volume without increasing costs in the form of additional staff. However, Abrigo's 2020 Business Lending Readiness Survey found that lending and credit professionals are dealing with numerous roadblocks to creating such efficiencies.

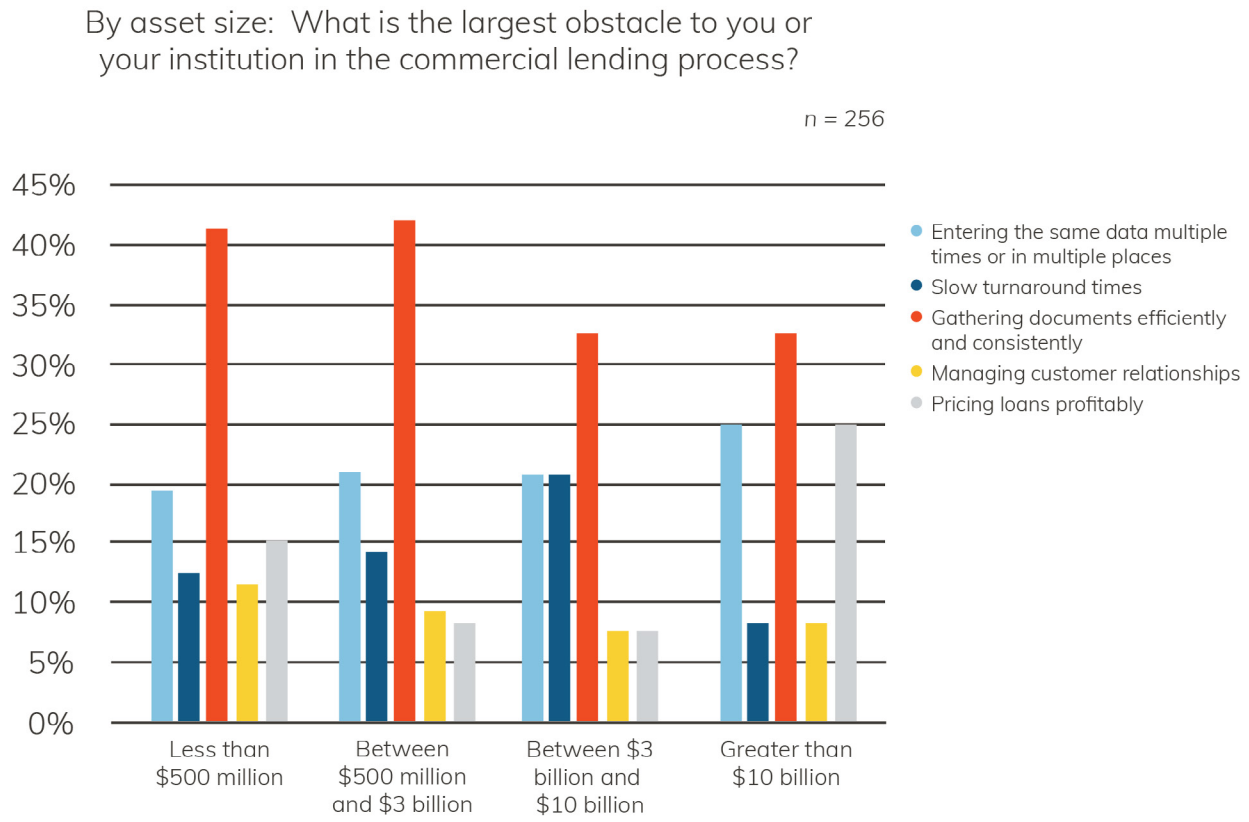


Wrangling documents

The largest obstacle in the commercial lending process, according to respondents, is gathering documents efficiently and consistently. Regardless of their financial institutions' size or business-lending focus, or whether they represented a bank or a credit union, survey participants most often selected this task as the biggest challenge.

The challenge with gathering appropriate documentation starts with a financial institution's credit policy and how clear it is on what documents are required for underwriting, said Alison Trapp, Abrigo's Director of Client Education. "The more leeway there is, the higher the likelihood that staff will need to go back to the borrower for more information."

A clear credit policy on what's required for underwriting also paves the way for the financial institution to set customer or member expectations that application processing cannot begin until all relevant or required documents are submitted. Abrigo Credit Consultant John Millman, a former credit union Senior Portfolio Manager, noted that document problems often surface as a credit analyst is reviewing financials during underwriting. That forces the analyst to "stop in their tracks, go back to the loan officer and explain that they need a document, then the loan officer contacts the borrower and asks for the document," he said. "Finally, and then worst of all, the borrower gets frustrated."



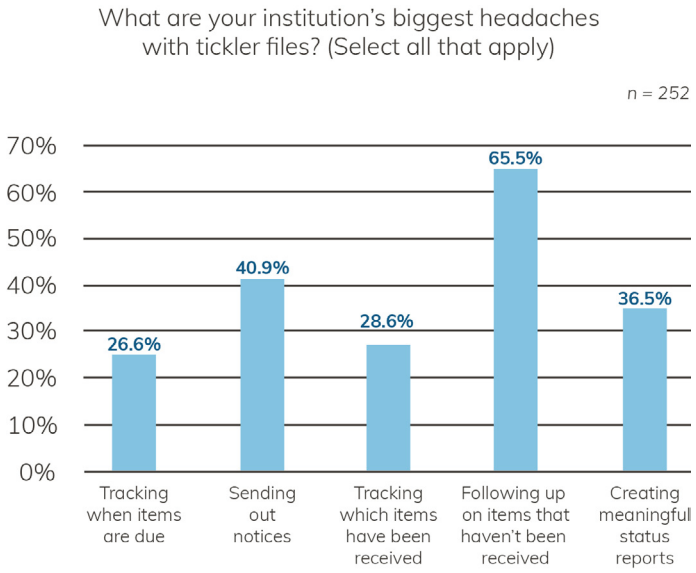
"If you can set expectations upfront in the form of application requirements, that will create a lot of efficiency, and the institution can now focus on reviewing complete loan packages, which should improve turnaround time," he said.

An additional challenge of document gathering is the logistics of collecting documents in a form most useful to the underwriter, according to Trapp. "This is where technology can help, although it won't replace a human altogether," she said. Document portals and workflow systems make it easier to collect and track needed documents, as well as notify borrowers of missing items.

A separate survey question dug deeper into the challenges associated with document gathering – specifically, problems with ticklers, or loan-related files like annual financials or tax returns, updated appraisals, etc. Two-thirds of respondents identified following up on items that haven't been received as the biggest headache associated with tickler files. Sending out notices ranked as second-most problematic, followed by creating meaningful status reports and tracking received items and due dates. Again, document portals and workflow systems enable notifications and tracking with less aggravation, and clear policies and setting customer expectations are critical.

Using technology has indeed eliminated document gathering as the biggest challenge for Broadway Bank's commercial lending process, said Matt Newman, Senior Vice President and Regional Credit Officer. His bank uses a customer relationship management (CRM) solution for tracking the lending pipeline, and once a borrower applies, it uses Sageworks Workflow to track outstanding information related to applicants and to document each step of the loan application, underwriting, and approval process.

Broadway Bank, however, seems to be more automated than many survey respondents. While 37% said they, like Broadway, manage the borrower pipeline using a CRM or Relationship Manager software, nearly 43% said their institutions use an Excel spreadsheet. Another 16% said individuals have their own tracking methods. Aite Group Senior Analyst David O'Connell said those using spreadsheets are missing out on vital management information.



"There's no way you're going to do a great job on that in Excel," he said. "You need operational analytics. You want to know things like, how long is it taking us to do a CRE deal? If it's two weeks longer than C&I, that makes sense. But maybe you've got one team of lenders closing loans 1.5 weeks early, and maybe they've got underwriters embedded in their team. If you're [managing the pipeline] in Excel, you've ceded the opportunity to do operational analytics."

Pervasive data entry inefficiencies

Entering the same data multiple times or in multiple places is also a major obstacle to commercial lending operations. One in every 4 respondents named it as the largest impediment. "Everyone complains about entering data over and over," noted Abrigo Senior Credit Consultant Mike McCaffery. When institutions use multiple systems that aren't connected, staff repeatedly enter the same information, wasting time and risking data entry errors.

"Maybe they kick off the data-entry process by having a lender enter customer info into a CRM, but if that CRM doesn't integrate into their core, then someone at the institution has to take that info and enter it in the core system," Abrigo Credit Consultant John Millman said.

"If they pull credit for loans, that same customer info has to be put into whatever system they pull credit from. If they need to look up OFAC separately from credit reporting, then they would pull OFAC in another system. Before closing a loan, they need to look up any outstanding UCCs or liens to ensure the institution is in first position, and this is another system or website where they would search. The list goes on, and we haven't even gotten into creating closing documents or credit presentations. The amount of times in the lending process that the same info needs to be entered could be massive."

Lenders and underwriters deal with pervasive inefficiency, based on how often respondents said their staff re-enter the same data point in another field or system. More than two-thirds of those surveyed said the same data is re-entered as many as five times. At institutions larger than $500 million, 1 in every 5 respondents said staff enter the same data between 6 and 10 times.

Rekeying data "chews up more value" than any other activity in commercial loan origination, O'Connell said. "Still, folks are struggling with that." Eliminating data re-entry is a first-order benefit from commercial loan origination automation, he noted.

"Institutions should be looking for a system with single point of data entry to save as much time as possible," Millman said. "They can have their employees spend their time working with customers and generating more deals, or analyzing loans and creating narratives in credit presentations rather than entering the same customer name and address 11 times."

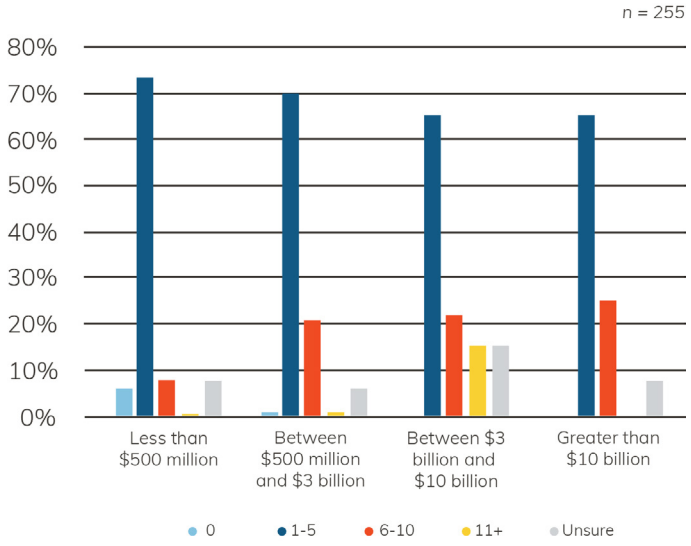
One way to eliminate data entry and re-entry from the start of the lending process is to utilize an online loan application. Twenty percent of those surveyed currently offer an online loan application, but a similar percentage don't offer an online application and do not plan to offer one in the future.

"Having loan applications accessible online is going to move to be the norm sooner than we think," Trapp said. "I wonder about the 20% of institutions that do not plan to offer. How are they planning to stay competitive?"

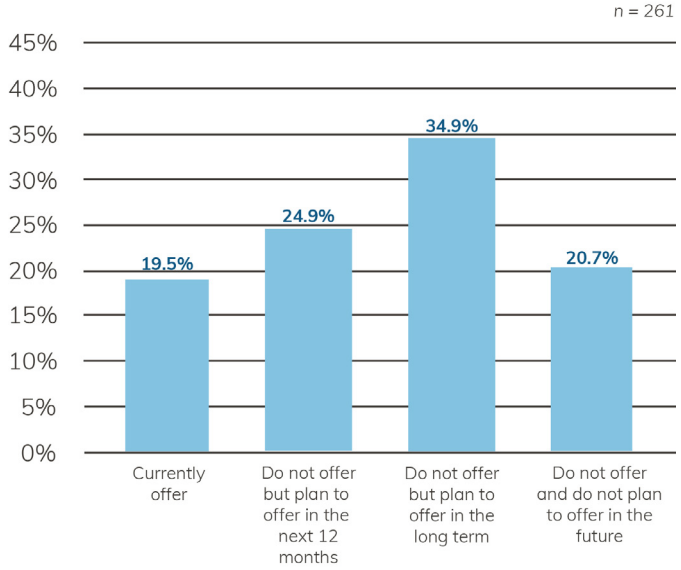
Some commercial lenders are afraid that digitalization will take away their jobs, but those folks are forgetting that Millennials are increasingly populating businesses in general and controllers' offices, in particular, O'Connell said. Fears of digitalization replacing bankers also miss a key benefit of technology. "With more digitalization, they spend less time on the clutter of the day and the 'clutter' of their relationships," he said. They are able to spend more time, for example, helping a farmer avoid a phishing scheme or a hedging risk.

One credit analyst with a credit union in the Northeast said his institution has no plans to have an online commercial loan application, but it has more to do with their lending focus than any fear of technology. "We love technology and we're comfortable with it," said the analyst, who asked not to be identified. "Our customers have online loan apps for our residential and consumer side. And that's 75% of our loans – mortgages and car loans." The credit union might consider an online commercial loan application at some point, but for now, it allows prospects to enter loan information queries online to begin the referral process.

By asset size: Across the entire commercial loan process, how many times might your staff have to re-enter the same data point in another field or system?



Describe your current online loan application process.



Loan pricing challenges

Pricing loans causes some financial institutions headaches, too. While only 10% of respondents named "pricing loans profitably" as the largest obstacle to the commercial lending process, some financial institutions use business loans as loss-leaders, and it can often be difficult to know whether loans are priced to cover the costs of administering the loan and the risk of the borrower. Financial institutions have various methods for setting prices, Abrigo's survey found. About 30% of those surveyed set prices based on lender discretion and negotiation with the client, and another 30% use internal profit measures (ROA, ROE). Twenty percent use credit grade and product type to set loan prices, while 12% price all similar products off competitor prices. Among banks under $500 million, over half rely on competitor pricing or lender discretion.

O'Connell said that with spreads so thin right now, the margin for error on loan pricing is "almost nil," so the percentage of respondents who said institutions are pricing loans based on lender discretion and client negotiation is a little concerning.

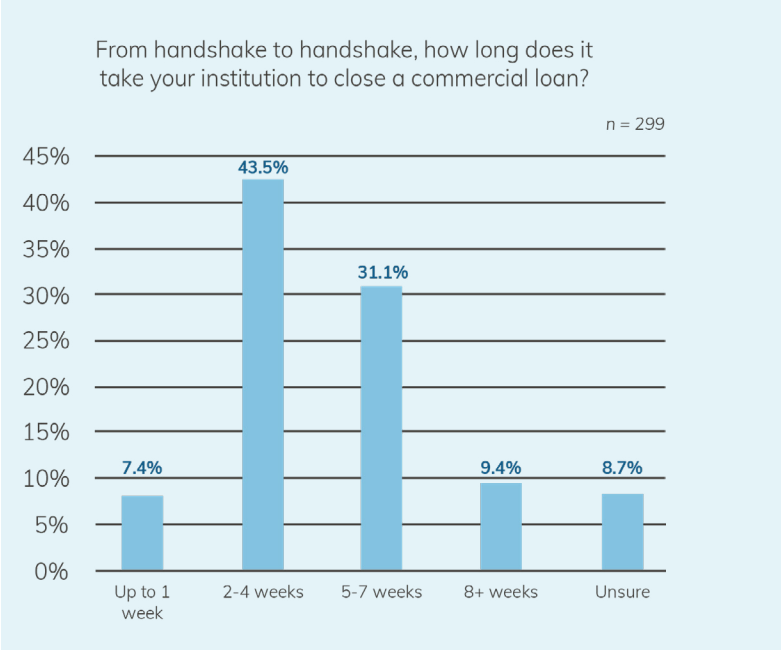
"Banks, in general, do loan pricing badly; individual lenders, even more so," he said.

Abrigo Credit Consultant John Millman agreed that financial institutions walk a fine line with loan pricing. "If you want to manage your risk the most, then using credit grade and product type pricing is probably best, but if you want to be competitive and earn more business, you need to look at competitors and let lenders negotiate with borrowers," he said. "If the institution is most interested in hitting ROA and ROE metrics, then there should be some kind of method in place for this. It's hard to do this all without the help of a solution to organize it all and calculate the right pricing for each loan. There are simply too many variables."

LOAN CLOSING TURNAROUND TIMES

Managing customer and prospect relationships, gathering documents, entering data, and figuring out loan pricing – these challenges all influence how quickly financial institutions can close business loans. And turnaround times clearly matter to business borrowers. Long waits for credit decisions or funding is the top complaint by applicants about large and small banks, according to the 2019 Small Business Credit Survey. Furthermore, "speed of the decision or funding" is the top reason firms applied to online lenders.

Among Abrigo's survey respondents, the largest share (44%) said their financial institution takes 2 to 4 weeks to close a commercial loan, from handshake to handshake. Nearly a third said the process takes 5 to 7 weeks, while 9% said it can take 8 weeks or longer. Only 7% of those surveyed said their institutions can turn around a loan in up to a week. The smallest institutions had the largest share with fast turnaround times; more than half of banks or credit unions with less than $500 million in assets close loans in 2-4 weeks, according to respondents.



Whether an institution focuses on CRE or C&I lending can influence the turnaround time, given that some CRE loans will need appraisals and some asset-based C&I loans need field exams. The chart showing turnaround times for only those respondents saying their firms are focused on CRE or C&I shows some differences.

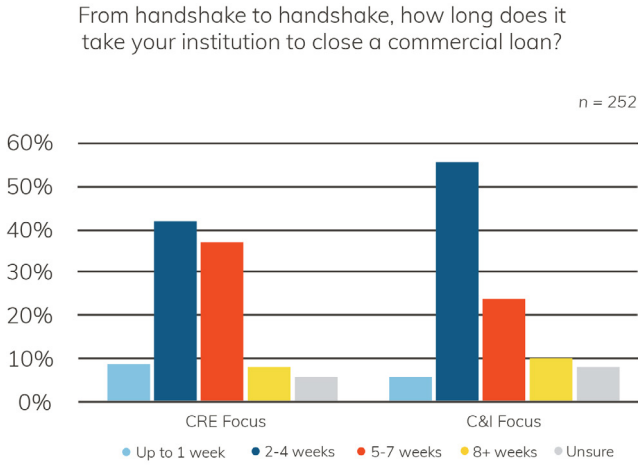
However, O'Connell said that 5 to 7 weeks is still too long of a wait for many CRE deals and may reflect "poor process discipline."

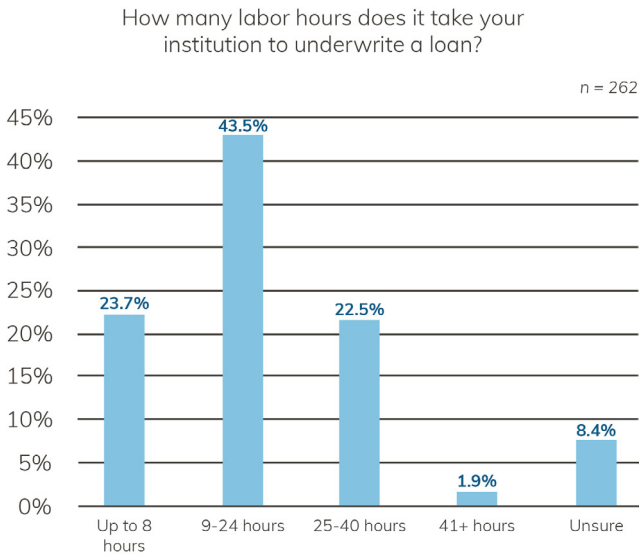
"Things are not being handed off," he suggested. "Maybe the loan officer isn't finding out for a couple of days that the underwriter just finished writing up the deal and they're ready for the edit, or maybe they're spending too long on edits or getting into crazy over-edit mode. Automation doesn't only hand things off and prepopulate fields. It can also instantiate and enforce in the culture service level agreements."

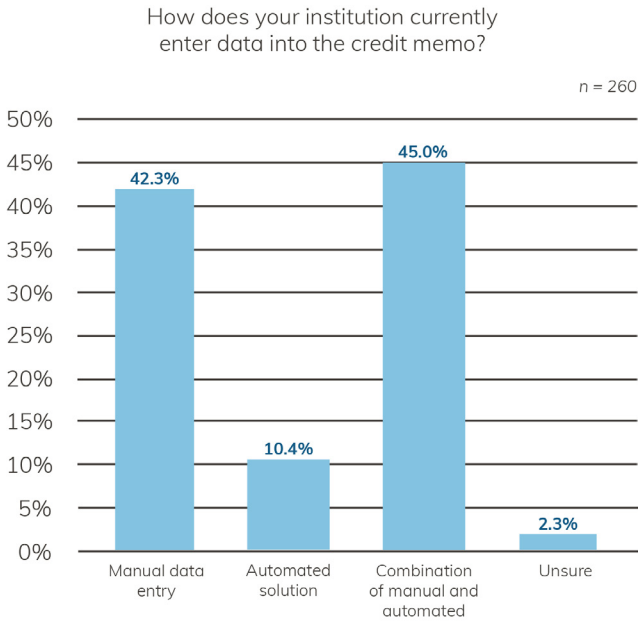
As for the underwriting process specifically, the largest share of respondents (44%) said it takes 9 to 24 labor hours to complete, followed by 24% who said it takes less than 8 hours. Broadway Bank's Newman said his institution can complete underwriting for relationships below $500,000 in about an hour using a scoring system, though larger deals will take 8 to 10 hours, and more complex CRE deals can take longer. "We have service level standards so we can get things turned around quickly," he said.

Certain processes can slow loan turnarounds to a crawl. Consider the credit memo, the critical document used by the loan committee to decide whether to approve the loan. It has data from disparate sources, is complex, and often lengthy. Yet 42% of respondents said they manually enter data into the credit memo. The percentages are even higher among institutions with less than $500 million in assets and those with more than $10 billion in assets. Among all respondents, only 10% used an automated solution.

O'Connell was surprised that the largest institutions are manually creating credit memos. "They've got the budget for automation; what's going on? Either they're not automating, they're automating poorly, or they've got a credit memo that's bloated and complicated."

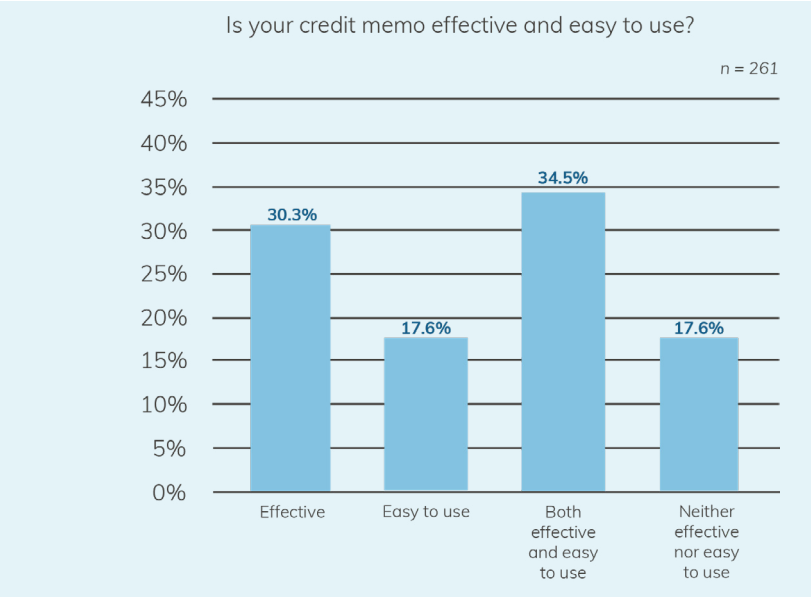






Bloated and complicated credit memos are not only inefficient, they also make it more difficult for the loan committee to wade through the facts to make a good decision. A good decision is especially critical if credit quality is changing. Part of the credit analyst's job is to make sure the approvers know what the key elements are to the credit memo, so memos should be clear, concise, relevant, and organized. It can be hard to do that when working with a bloated legacy credit memo created manually.

Asked whether their institution's credit memo is effective and easy to use, more than a third of respondents said it was both effective and easy to use. Abrigo Senior Credit Consultant Mike McCaffery found that number puzzling. "Usually the banks tell us that their credit memo process is a nightmare," he said.



Inefficiencies like bloated credit memos and rekeying data multiple times are why it costs too much money to underwrite each deal, Aite's O'Connell said. Many of the processes that could be automated are also causing delays.

"When things are really well automated and folks aren't rekeying data and they're focused on the right things, and it only takes two weeks to turn around instead of a month and a half, then you can do things like … grow your loan portfolio by 30% and grow your headcount by only 5%," he said. "That's scale. You can't achieve it if you leave things manual and inefficient. You also can't achieve it if you automate and you automate poorly, or you just automate lots of broken processes and you still have lots of inefficiency."

INCONSISTENCIES WITH MANAGING RISK

The survey revealed interesting information about other processes tied to managing credit risk. Risk ratings and risk rating matrices, or scorecards, help provide consistency in underwriting. Consistent and accurate risk ratings help financial institutions accurately price loans and account for risk in the portfolio, yet many financial institutions struggle with maintaining and applying objective risk ratings. A common question of bankers is how many risk ratings are sufficient. More than three-quarters of respondents said their risk rating scale had 4 to 9 categories. Eleven percent said they have more than 10 categories, while 5% said they have 1 to 3 risk rating categories. Another 7% were unsure.

"If institutions have 1 to 3 risk rating categories, they do not have enough granularity, and I'm surprised that regulators haven't questioned that," Trapp said. "It's almost a check-the-box exercise at that point."

Trapp said the large percentage with 4 to 9 ratings was in line with her expectations, based on her work with financial institutions. Having more than 10 categories could be satisfactory, depending on the institution. The main issue there is to make sure staff who are classifying loans all have the same direction on how a risk rating of 6 is different from a 5, for example.

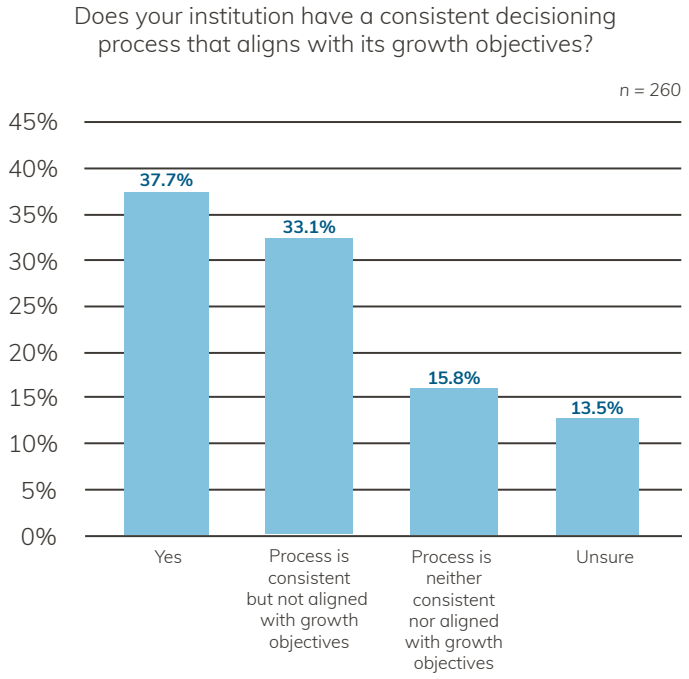
As for scorecards, 44% of those surveyed said that at least half of the factors included are quantitative, in line with Trapp's expectations. Twenty percent use quantitative factors almost exclusively. Those bankers should consider other elements that cannot be distilled to a specific number, such as the quality of management or the industry outlook for a borrower. Qualitative factors should still be written with specific definitions to help narrow the variation that might occur among analysts scoring loans, Trapp said.

Automation can help financial institutions standardize their loan rating systems while producing the extensive reporting to document risk ratings and rating changes. Consistency is vital, but it's also important that loan approval processes align with financial institution growth objectives. This is apparently not the norm among financial institutions.

Slightly more than one-third of respondents (38%) said their institution's decisioning process is consistent and aligned with its growth objectives. However, a third said the decisioning process is consistent but not aligned with growth objectives and 16% said it's neither consistent nor aligned with growth objectives. Fourteen percent weren't sure how to answer the question.

Institutions with consistent processes but not aligned to growth could benefit from thinking about employing underwriting guidelines that are updated more frequently than policy, but that help encourage or discourage certain types of loans, depending on the institution's objectives, Trapp suggested.

O'Connell said that such a large share of respondents see their decisioning process as neither consistent nor aligned with growth objectives should catch the attention of financial institution leaders, especially because of what it implies for employee morale.



"At a high level, I am concerned with an apparent lack of [process] discipline and speed and an apparent lack of automation," he said. He believes bankers who fail to automate will miss other opportunities – opportunities to move up the hierarchy of needs in terms of requirements they're fulfilling for borrowers and to have more relationships.

O'Connell recounted learning recently about a bank from which its dairy farmers were seeking an employee assistance program. Dairy farmers were undergoing hard times, and some were encountering mental health issues, including suicide among family and business members, so they turned to their local bank for help.

"Do you really want to be like this old school diplomat, go-between process handler?" O'Connell said. "Or do you want to be a trusted advisor with a capital T and a capital A?"

CONCLUSION

Community financial institutions have a long tradition of relationship lending, making sure that the local community's financial resources are put to work to foster economic growth. Lending and credit professionals may be grappling now with numerous processes that cause them headaches, create delays for loan decisions, and create inefficiencies as well as potential credit or pricing risks. The Abrigo 2020 Business Lending Survey outlined several of them. But lenders, credit analysts, and executives can take numerous actions to examine the processes, automate them, and improve them. Here are a few:

Lenders and analysts:

- Explain application requirements up front to customers.
- Examine the credit memo with a fresh eye. If the institution has been re-using the same basic credit memo for years, it may be time for a fresh review with an eye to trim the bloat and check for redundant language.
- Start tracking redundancies and bottlenecks in the lending or credit analysis process. When new technology is simply layered onto an old, broken process, the technology cannot be as effective. By identifying redundancies and bottlenecks in the process, the institution can make changes now and when new technology is adopted so that processes are truly streamlined.
- Lean into the automation your leaders have bought. Nothing is more inefficient than having some staff's work automated and others continuing to perform tasks manually.

Executives:

- Ensure credit policies clearly describe what documents are required for underwriting. Provide online portals so that customers can easily upload documents 24/7, and utilize workflow solutions that aid in tracking and notification for missing documentation.
- Dig into why staff see a disconnect in decisioning and growth objectives.
- Consider a lending solution with a single point of data entry so that once an application is received, basic borrower information flows through to financial spreading, analysis, the credit memo, and so on.
- When implementing technology, leverage executive support to make sure staff are fully engaged and utilizing the investment.

Efforts to overcome lending and credit challenges now will help financial institutions drive growth now and better prepare them for when the economy eventually turns.

ABOUT THE EXPERT

Mary Ellen Biery
SENIOR WRITER
ABRIGO

Mary Ellen Biery is a Senior Writer and Content Specialist at Abrigo, a leading technology provider of solutions that community financial institutions use to manage risk and drive growth. She is a former financial reporter for Dow Jones Newswire whose work has also appeared in The Wall Street Journal, Accounting Today, and on CNBC.com, Forbes.com, and numerous banking news sites.

Graphics by:

Kylee Wooten
CONTENT MARKETING MANAGER
ABRIGO

Kylee Wooten is a content marketing manager at Abrigo, a leading technology provider of solutions that community financial institutions use to manage risk and drive growth. Her work has appeared in ABA Banking Journal, Bank Administration Institute (BAI), and many other banking news sites.

ABOUT ABRIGO

Abrigo is a leading technology provider of compliance, credit risk, lending, and asset/liability management solutions that community financial institutions use to manage risk and drive growth. Our software automates key processes — from anti-money laundering to asset/liability management to fraud detection to lending solutions — empowering our customers by addressing their Enterprise Risk Management needs.

Make Big Things Happen. Get started at abrigo.com.

abrigo™