# THE FUTURE-READY COMMERCIAL BANK


**Ron Shevlin** Director of Research, *Cornerstone Advisors*
**Joe Ganzelli** Senior Director, *Cornerstone Advisors*
**Sam Kilmer** Senior Director, *Cornerstone Advisors*
**Joel Pruis** Senior Director, *Cornerstone Advisors*



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# EXECUTIVE SUMMARY

Commercial lending is a key driver of profits for many banks. Yet many bank executives are concerned that their commercial businesses—lending and treasury/cash management—are not well-positioned for the changes they envision coming down the road in the industry. This report provides a roadmap, set of benchmarks, and recommendations for how banks can address these concerns and become "future-ready" for 2018 and beyond.

# ABOUT THE DATA

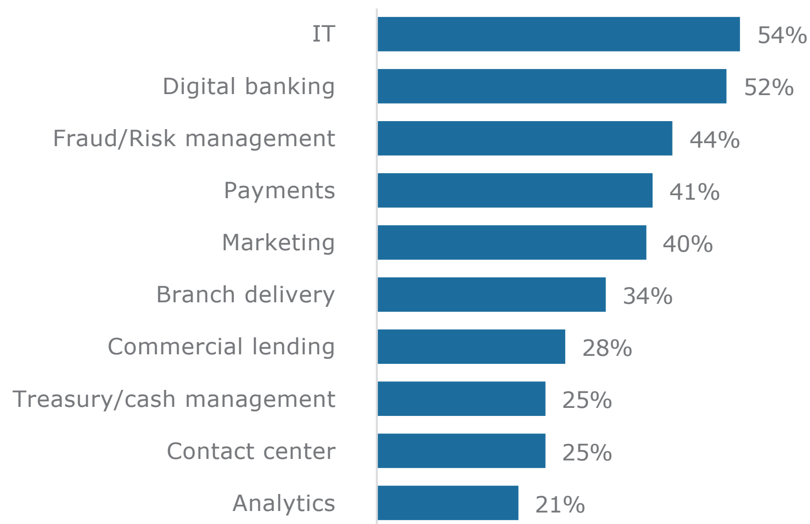
Data used in this study is drawn from a number of sources. In Q3 2017, Cornerstone conducted interviews with senior commercial banking executives at 10 banks, ranging in size from $500 million to $20 billion in assets. In Q4 2017, we surveyed 262 senior executives at community-based financial institutions about a range of business and technology topics. In addition, we drew upon our operational benchmark data, the *2017 Cornerstone Performance Report for Banks*.

# COMMERCIAL BANKING: STATE OF THE UNION

Overall, bankers aren't very comfortable with the state of their commercial banking capabilities. Bankers rate commercial lending and treasury/cash management among the least "future-ready" functions in banks, as less than three in 10 bank executives think their commercial banking functions are somewhat or very future-ready (Figure 1).

FIGURE 1: **Future-Readiness: Somewhat to Very Future-Ready**

**How future-ready are the following areas of your organization?**
(Percent responding "somewhat" or "very" future-ready)




Source: Cornerstone Advisors Survey of 262 Community-Based Financial Institution Executives, Q4 2017

In addition, among the 10 functions asked about, the two commercial banking functions were the ones most cited as "not at all" future-ready or falling behind (Figure 2).

FIGURE 2: **Future-Readiness: Not Ready and Falling Behind**


Source: Cornerstone Advisors Survey of 262 Community-Based Financial Institution Executives, Q4 2017

The executives we interviewed echoed the sentiments of the broader population:

> *"We've done IT readiness reviews, and evaluated our infrastructure and apps. We're not ready for growth in commercial lending."* —Chief Lending Officer, $9 billion bank

> *"We're still doing things we did 20 years ago. We're stuck in an outdated model—heavy analysis, using outdated data. Can't get outside of that box."* —Chief Risk Officer, $25 billion bank

> *"On a scale of 1 to 10, we're a 2. The average age of our lenders is 55, we don't have a lot of new blood. We don't have the training programs we had 30 years ago, either. We certainly have technology issues, but what we've got is a huge skills gap."* —Chief Lending Officer, $1.2 billion bank

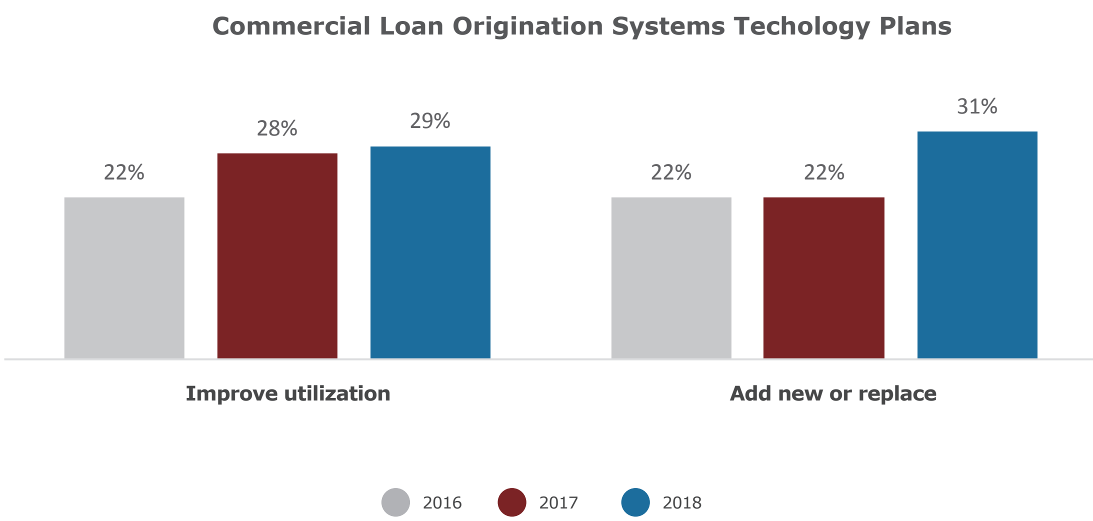
This last quote is especially important as banks have seen the demands, needs and behaviors of commercial banking customers change over the past few years and expect those changes to continue:

> *"The needs of the commercial customer are following the same path as the retail customer—they demand things more rapidly, there's an expectation for quick turnarounds, and we're expected to do more to demonstrate an understanding of risk in specific markets and segments."* —Chief Lending Officer, $4 billion bank

*"We do more work with their internal and external professionals than we used to. It used to be more one-on-one with the owner. In addition, we do far more business with them at their location than our location. Yet, technology access by customers has lessened the in-person touches that we have with our commercial customers."* —CEO, $1.7 billion bank

As commercial borrowers increasingly expect the speed and transparency of retail products, the need for better customer-touching functionality—e.g., applications, real-time loan status, due diligence portal, etc.—is leading more banks to enhance and replace their commercial loan origination system (LOS) (Figure 3).

FIGURE 3: **Commercial Loan Origination Systems Plans**




Source: Cornerstone Advisors Surveys of CEOs, 2016-2017

Customer relationship management (CRM)—and the need for better data access through system integration—is a pain point for many banks, however. As the interviewees put it:

*"We have disparate CRM systems. We don't have a way to tie customer information with the core processing system and have no way to mine the data to determine what the next logical step or product is. Insurance isn't integrated, wealth management isn't integrated. Nothing's integrated."* —Chief Credit Officer, $3 billion bank

*"Other parts of the business have CRM systems, but not commercial—we use Outlook, Notes and Calendar. I'm not sure it matters, because we have cultural barriers preventing the use of CRM, anyway."* —Chief Strategy Officer, $3 billion bank

*"We have a long way to go in many areas, in particular with CRM. We don't have a well-functioning CRM, no history of calling efforts, and we lack the ability to identify the needs of our customers."* —Chief Lending Officer, $4 billion bank

# COMMERCIAL BANKING FUTURE-READINESS

With so many banks struggling to be future-ready, Cornerstone Advisors developed a future-ready framework to provide a roadmap for the commercial banking journey (Table A):

TABLE A: **Commercial Banking Future-Ready Model**

| | LEVEL 1: Reacting | LEVEL 2: Managing | LEVEL 3: Leading | LEVEL 4: Innovating |
|---|---|---|---|---|
| Strategy | Order taker | Niche manager | Relationship manager | Profit optimizer |
| People | Single relationship manager | Specialized skills | Integrated teams | Analytics culture |
| Process/Technology | Manual | Workflow automation | Platforms | Emerging technologies |
| Metrics | Balances and outstandings | Broad profit measures | Dynamic, profit-driver visibility | Relationship-based, risk-adjusted ROI |

Source: Cornerstone Advisors

The model encompasses four levels of commercial banking future-readiness:

- **Reacting.** At this level, banks are order takers, accepting whatever commercial lending and banking business comes in the door. Processes generally require a lot of manual effort, with technology support limited to word processing and spreadsheet tools. Organizationally, banks at this level typically have a single commercial relationship manager covering all relationship and product needs. These banks run their commercial business by looking at portfolio balances and outstandings, and by tracking maturing and expiring loans.

- **Managing.** These banks are niche-managers, focusing on specific geographic and/or industry segments. Banks at this level have some workflow automation, look at broader measures of profitability than the banks at the lowest level do, and have people with specialized skill sets—for example, a dedicated analyst group and/or implementation support.

- **Leading.** Leading banks are relationship managers, managing to transaction, relationship and portfolio risk-adjusted profitability. They have integrated teams with strong relationship management and proactive sales cultures. These banks demonstrate a strong pricing capability at the relationship level, relying on dynamic credit risk models, risk-adjusted return on portfolio (relationship-based) metrics, and strong data analytics.

- **Innovating.** Banks at the highest level of the model don’t stop being relationship managers, but differ from banks at the previous level by their ability to increase speed and optimize profits by using emerging technologies and centralized data repositories. Their culture expands from being relationship-driven to being data- and analytics-driven. These banks manage whole bank pull-through, have an intentional distribution of portfolio, align risk and strategy, tie risk to revenue generation, and have a well-thought out asset investment plan.

## PERFORMANCE BENCHMARKS

We developed the following commercial loan officer (CLO) productivity benchmarks for each level of the future-ready model for banks in the $1 billion to $20 billion asset range (Table B)†:

- **Commercial loans.** At the lowest level of the future-ready model, commercial loan officers have 100 commercial loans in their portfolio. At Leading and Innovating banks, however, commercial loan officers have double the level of the CLOs at the Reacting level.

- **Loans outstanding.** Commercial loans outstanding per CLO at Leading/Innovating banks are 80% higher than at Reacting banks, and 50% higher than at Managing banks.

- **New commitments per month.** CLOs at Reacting banks average $1.25 million in new commitments per month. At Leading/Innovating banks, that metric is nearly two-and-a-half times greater.

- **Commercial deposits.** Commercial deposits per CLO at Managing banks are more than 50% larger than at Reacting banks. Leading/Innovating banks are seeing commercial deposits per CLO of more than 50% greater than at Managing banks.

- **Loan fees.** Annual loan fees per CLO is three times larger at Leading/Innovating banks than at banks at the lowest level of the future-ready model.

TABLE B: **Commercial Banking Performance Metrics by Future-Ready Level**

| | Reacting | Managing | Leading/Innovating |
|---|---|---|---|
| Commercial loans per CLO FTE | 100 | 120 | 200 |
| Commercial loans outstanding per CLO FTE | $50,000,000 | $60,000,000 | $90,000,000 |
| New commitments per month per CLO FTE | $1,250,000 | $2,000,000 | $3,000,000 |
| Commercial deposits per CLO FTE | $12,000,000 | $19,000,000 | $29,000,000 |
| Annual loan fees per CLO FTE | $50,000 | $100,000 | $150,000 |
| Doc packages per loan processing FTE per month | 70 | 120 | 200 |
| Loans serviced per credit administration FTE | 2,000 | 3,500 | 7,000 |
| Commercial loans closed per appraisal FTE | 70 | 120 | 260 |

Source: *Cornerstone Performance Report for Banks*

†Cornerstone calculates a commercial loan officer full-time equivalent (FTE) by determining the amount of time all commercial lenders spend on business development activities and then dividing that amount by 2,000.

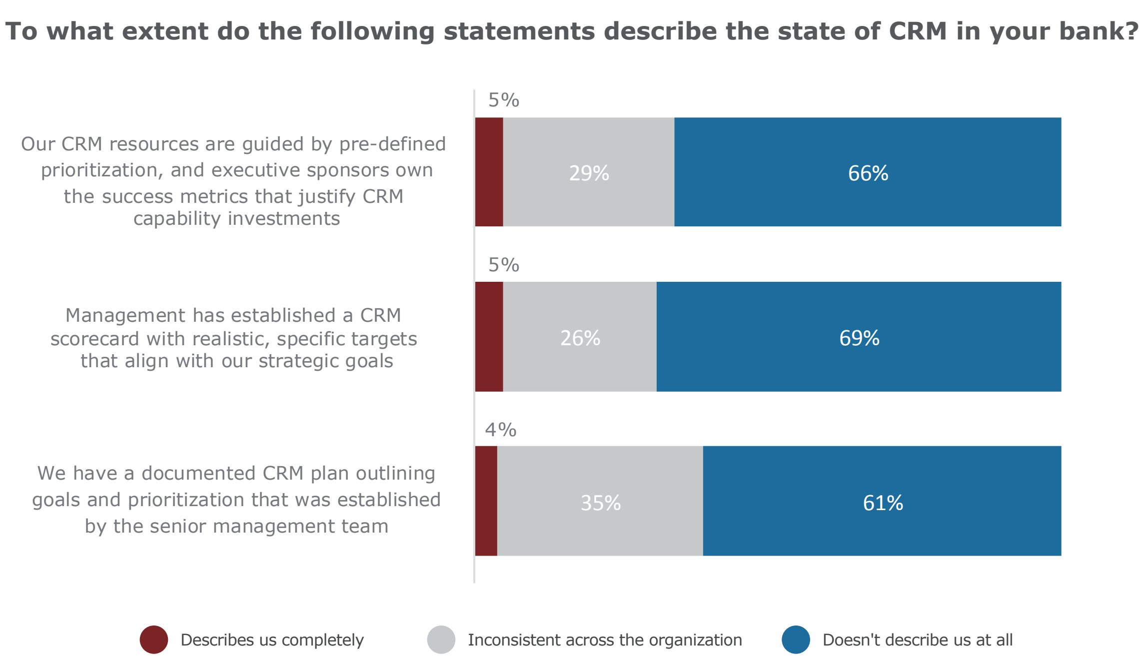
# FROM MANAGING TO LEADING WITH RELATIONSHIP MANAGEMENT

In many respects, it was disheartening to hear bankers talk about their relationship management shortcomings and need to improve CRM tools and processes. After all, how long has the industry been talking about (and investing in) CRM? The stories we heard about the current state of CRM should have come in 2007, not 2017.

Reality, however, is that banks' CRM practices have earned very few a spot at the Leading level of the future-ready model. Few banks have established CRM (Figure 4):

- **Priorities.** Only a third of banks say that, to any extent, their CRM resources are guided by pre-defined prioritization, and that executive sponsors own the success metrics that justify CRM capability investments.
- **Scorecards.** Just 5% of banks have established a CRM scorecard with realistic, specific targets that align with their strategic goals, with a quarter saying that what they've done is inconsistent across the organization—leaving nearly seven in 10 with no CRM scorecard at all.
- **Plans.** Six in 10 banks do not have a documented CRM plan that outlines goals and priorities established by the senior management team. Just 4% believe that they have done this at the entire enterprise level.

FIGURE 4: **CRM Practices**




Source: Cornerstone Advisors Survey of 262 Community-Based Financial Institution Executives, Q4 2017

## CREATING A DISCIPLINED RELATIONSHIP MANAGEMENT CULTURE

We know that our calls for CRM-related priorities, scorecards and plans will fall on deaf ears. Why? There is a long-standing belief among many bank executives that lenders shouldn't sit at their desks entering information, but, instead, be out in the field. The reality is that lenders go out into the field, and valuable information about customers, prospects and the market is never captured and used.

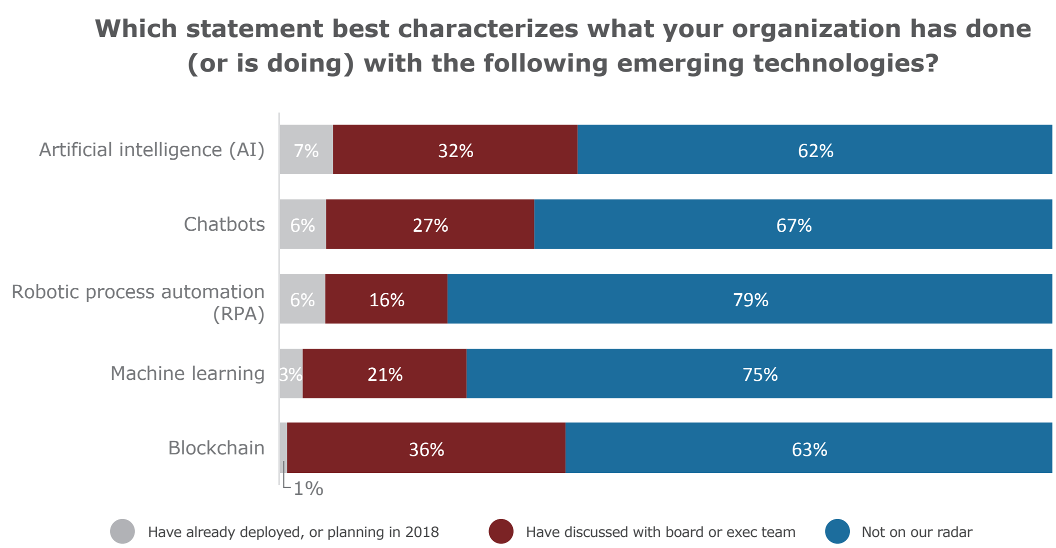
What will change the culture is the pain of losing to faster, more-disciplined competitors. We're starting to hear that pain from banks. We asked bank executives which banks do commercial banking well, and what they liked about them. The answers had a consistent thread (with our emphasis):

- *"Profitable even in down cycles, Bank of Ozarks is disciplined and makes great use of technology and analytics."* —Chief Lending Officer, $9 billion bank
- *"Eastern Bank is at the forefront of technology use and serves its niche really well."* —Chief Lending Officer, $1 billion bank
- *"No one gets the relationship piece right like Northwest Financial. I don't know that it uses more technology than we do, I just think it uses what it has better than we do."* —Chief Lending Officer, $4 billion bank
- *"Pinnacle Financial Partners is very disciplined in the lending process and selective in who it chases."* —Chief Risk Officer, $25 billion bank

# FROM LEADING TO INNOVATING WITH EMERGING TECHNOLOGIES

None of the banks we interviewed have immediate plans to deploy emerging technologies like artificial intelligence (AI), machine learning, or robotic process automation (RPA). It's not surprising—few mid-size banks have plans for these technologies *anywhere* in their organization (Figure 5).

FIGURE 5: **Emerging Technology Plans**




Source: Cornerstone Advisors Survey of 262 Community-Based Financial Institution Executives, Q4 2017

To date, many banks' attempts to automate commercial lending processes have focused on improving loan origination/servicing workflows and implementing customer portals. Workflow tools, however, only provide marginal efficiency gains because lending staff still perform numerous manual tasks.

Banks are missing opportunities to use emerging technologies to improve the efficiency and effectiveness of commercial banking processes. AI, machine learning and RPA can be used to:

- **Identify potential commercial credit request needs.** Public information on geography, industry classification, revenue and collateral filings can be accessed and used more efficiently and effectively to improve commercial banking marketing efforts. Existing customer data—for example, DDA balances, business credit card, revolving/term debt availability and utilization, trade finance, and treasury product usage—can be supplemented with purchased data to feed AI-developed algorithms that identify and prioritize the credit needs of clients and prospects.

- **Spread borrower financial statements.** Many banks still spread financial statements via manual data entry into a financial spreading software. Some loan origination systems provide for optical character recognition (OCR) and document ingestion automation, while others provide for the import of data from accounting platforms such as QuickBooks. Rules-based logic can classify this data into a desired format, with the resulting file imported into a spreading system, with only a cursory review required for validation.

- **Validate credit due diligence items and perform vendor order execution.** Many loan origination systems enable the creation of user configurable rule logic that can generate pre-decision and/or pre-closing due diligence items required to be satisfied before a credit request can be evaluated or loan documents prepared. AI technology can trigger the ordering of flood, property and UCC searches, good standing certs, appraisals/equipment valuations, etc., in addition to confirming what has been received and evaluated.

- **Generate credit underwriting recommendation/decision.** Most loan origination systems provide for configurable rule logic permitting automated credit recommendations and/or decision rendering. Although automated decision rendering is still predominantly used in consumer lending, larger FIs have been using automated decisioning in small business lending for years. Cognitive automation can expand the power of automated decisioning, notably on annual renewals/reviews, using AI, super data sets, predictive analytics and evidence-based learning.

- **Identify problem loans.** Using AI, banks can connect borrower behaviors and economic variables to identify red flags for potential loans. Examples are increased overdraft frequency/amounts/patterns, new/increased credit utilization, past due financial reporting, and significant score changes, among numerous others. Most FIs have barely scratched the surface of using predictive, proactive processes for early problem detection.

Cornerstone believes that the “art” form that commercial lenders practice today will be automated in the coming years. The best credit officers will thrive in a more productive environment, and the banks that make fundamental changes to their commercial lending processes will realize significant gains in both efficiency and, more importantly, portfolio growth.

# BECOMING A FUTURE-READY COMMERCIAL BANKING ORGANIZATION

Cornerstone believes that successful banks will do five things well in their journey to becoming a future-ready commercial banking organization:

1. Build a relationship management infrastructure;
2. Become deal-ready;
3. Consumerize the commercial customer interface;
4. Partner to explore opportunities for emerging technologies; and
5. Diversify funding sources.

## 1. BUILD A RELATIONSHIP MANAGEMENT INFRASTRUCTURE

The concept of "infrastructure" is common in IT. Banks need an IT infrastructure—servers, routers, PCs, printers, etc.—upon which applications run. The IT department also knows that you can't calculate an ROI on the investment in IT infrastructure. The return comes from the applications that use the infrastructure, not the infrastructure itself.

Commercial banking needs a similar construct: a relationship management infrastructure—an infrastructure that enables fast, smart pricing, underwriting, and servicing decisions to be made. In their attempt to achieve process efficiencies through workflow automation (a Level 2: Managing capability), many banks have ignored the need to improve the effectiveness of those processes with a relationship management infrastructure built on CRM technologies. Here are three things we've learned about CRM from being in the banking trenches:

- **Service trumps sales.** Most banking interactions are with existing customers, so it is more important that a system excel at commercial loan renewal than it is to handle the branch-walk-in-prospect-off-the-street, which seems to be the running CRM demo favorite. As you sit through CRM demos, or get internal proposals for upgrading your existing CRM system, ask for specific, detailed service examples.

- **Integration trumps functionality.** CRM system demos focus on functionality, but most of the success from CRM systems comes from data and process integration. Start by mapping out your most common customer processes and integration (or lack thereof) points. It might not even be a CRM system that ultimately tackles your CRM need.

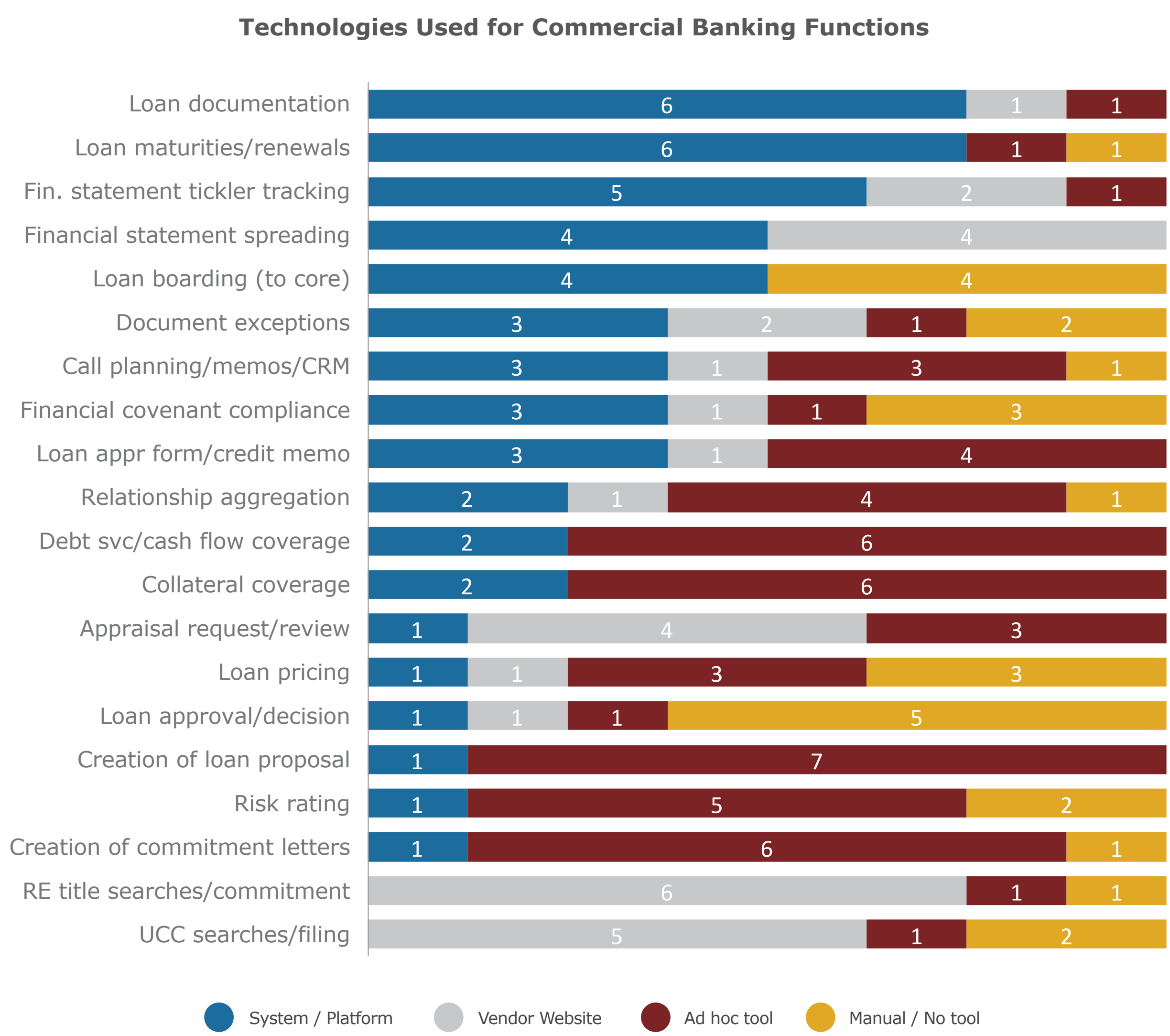
- **Executive involvement trumps everything.** It feels so cliché to say that CRM needs top management support. But we're not just talking about "support" here—we're talking involvement. The executive team needs to be users of the CRM system, not just to demonstrate commitment, but to personally understand the potential opportunities the system offers and the organizational challenges it presents.

## 2. BECOME DEAL-READY

If the return on investment from infrastructure comes from what you do with it—and not from the technology itself—then generating a return on a relationship management infrastructure must come from bidding on, and winning, deals.

The operational capabilities—and supporting technologies—to do that are lacking in many banks, and where not lacking altogether, are often poorly integrated. In an in-depth study of the use of commercial lending technology in eight mid-size banks, Cornerstone found that most were using ad hoc, standalone technologies, or no technology, in more than 10 of the 20 functions (Figure 6).

FIGURE 6: **Commercial Banking Technology Use**




Source: Cornerstone Advisors Commercial Banking Operational Review of 8 Banks, Q3 2015

With this lack of integration and technology, commercial banking groups aren't only not future-ready—they're not deal-ready. What makes them deal-ready is their ability to organize and access information about:

- **Clients.** How fast can you respond to new requests for credit? Often, requests from an existing client still require the details around use of funds, overall repayment capacity, collateral coverage, industry outlook and the like. For existing clients, deal-ready banks have refreshed these items and can jump right into the credit write-up.

- **Prospects.** For prospects, deal-ready banks rely on information collected when there is no formal request. Is data and information about prospects captured in a form that is either ready to go into a credit write-up or can be systematically imported into the final approval document? If a lender looks at collected information on a regular basis as pieces to the credit approval document, how would that change the way data is captured?

Bankers should change their approach from data gathering using the traditional call memos, pipeline reports and basic financial spreads to capturing the same information with an eye toward completing the credit approval document.

Deal-readiness also depends on the ability to use the relationship management infrastructure to effectively prioritize opportunities. The prioritization process should start much earlier than when a request is submitted by the borrower. As bankers maintain existing clients or develop prospects to be in a deal-ready state, they can continually assess and prioritize by determining:

- Does this client/prospect still present an acceptable level of credit risk?

- Is the existing/proposed relationship sufficiently profitable?

- Does this existing/proposed relationship present an appropriate level of growth opportunities?

What's tough is when banks discover that what they thought was marquee business is not the big relationship opportunity they really want. The more objective a bank is in this prioritization process, the better off it will be in its overall production results. Many banks use summary or "pre-flight" memos early in the loan process to quickly assess the potential of more gray area deals. This ensures precious credit resources are not being wasted on deals that don't have a good chance making it to booking.

## 3. CONSUMERIZE THE COMMERCIAL CUSTOMER INTERFACE

It seems like an obvious statement to make, but commercial borrowers are consumers too. So why wouldn't they want the technology-driven conveniences they experience with the retail banks, retailers and other providers they deal with in their commercial banking experiences? They don't turn off those expectations just because it's a commercial loan process.

Many commercial borrowers have stopped using portals because they can't easily view their loan status, perform self-service, and expedite their loan closing. Consumerizing the commercial customer experience —i.e., making the commercial banking experience slick, intuitive and appealing—is an important step in the future-readiness journey.

### 4. PARTNER TO EXPLORE EMERGING TECHNOLOGY OPPORTUNITIES

Here's a prediction about the commercial banking future-ready model: Five years from now, the capabilities that characterize today's Innovating banks (Level 4) will be the characteristics of banks at the third level (Leading) of the hierarchy.

What this means is that today's emerging technologies—AI, machine learning, RPA—will become standard technologies by 2023. But integrating AI-based solutions into the complexities of the existing commercial banking IT architecture (if there is one) will be time-consuming, expensive, and likely beyond the skill sets of most mid-size banks.

Banks will rightfully look to their core (and other strategic) vendors to help integrate today's emerging technologies, but many vendors are ill-equipped to do so today. Finding fintech partners to explore and test opportunities to use emerging technologies will be another important step in the future-readiness journey.

### 5. DIVERSIFY FUNDING SOURCES

Although deposits at banks tripled between 2000 and 2017, there is a longer-term trend that will hamper FIs' efforts to keep up the recent pace of growth. Cornerstone has a name for this trend: **deposit displacement**. Here are four examples of how deposits are being displaced, or redirected away, from the traditional banking system:

- **Health Savings Accounts.** Devenir Research projects that deposits in health savings accounts will approach $45 billion by the end of 2018, up from less than $14 billion in 2012. That's money that has been siphoned away from consumers' primary checking accounts and into HSA accounts that are probably not held at the same bank as the primary checking account.

- **P2P Payments.** According to a personal source, Venmo has $2.2 billion of funds sitting in users' accounts—money that isn't sitting in banks' accounts. Displacement through P2P payments will only increase, as Apple has announced that its P2P payment tool will park users' funds in an Apple prepaid debit card, and not in the users' checking accounts.

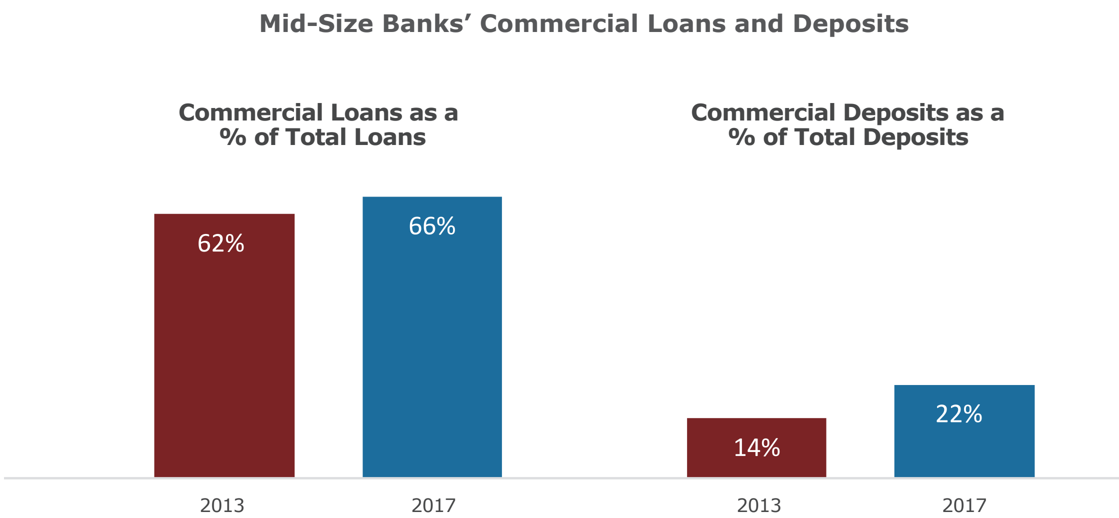
- **Retailer Mobile Apps.** In 2016, *The Wall Street Journal* reported that Starbucks had $1.2 billion in deposits on customers' loyalty cards. As other retailers copy Starbucks' approach to mobile apps, deposits held in retailers' mobile apps will continue to grow.

- **Robo-Advisor Tools.** Consulting firm AT Kearney estimates that assets held in robo-advisor tools will reach $2.2 trillion by 2020. While this might point to a business opportunity for banks, it's also a threat. Kearney believes half of those assets will come from currently non-invested assets—in other words, bank deposits.

Deposit gathering for all financial institutions will become more difficult over the next five years, as this trend toward deposit displacement accelerates. To become (and stay) future-ready, mid-size banks will need to reduce their reliance on retail deposits to fund their commercial lending activity.

We're already seeing this happen. Between 2013 and 2017, commercial loans as a percentage of all loans at mid-size banks grew from 62% to 66%, on average. Over the same period, commercial deposits as a percentage of total deposits rose from an average of 14% to 22% (Figure 7).

FIGURE 7: **Commercial Loans and Deposits**




Source: *Cornerstone Performance Report*

Today, many banks are heavily weighted to commercial real estate (CRE) in their commercial portfolios and instinctively fall back on the excuse that there isn't much in the way of commercial deposit opportunities in the market. It isn't a good excuse—all banks should closely examine and target commercial borrowers, even CRE entities, that do not have a corresponding deposit relationship.

Deposits from commercial cash management and treasury customers will become more important—placing greater emphasis on the need for strong relationship management, pricing and service delivery capabilities—which are hallmarks of Leading and Innovating banks.

**Bottom line:** Progressing up the levels of the future-ready model isn't just a theoretical exercise—it's a competitive necessity and requirement for success in commercial banking.

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www.crnrstone.com
Cornerstone Advisors
@CstoneAdvisors
480.423.2030

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www.ncino.com
nCino
@ncino
888.676.2466

# Have questions about this report?

**Contact**:

**Ron Shevlin,** Director of Research
Cornerstone Advisors

rshevlin@crnrstone.com | 480.424.5849

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