CORNERSTONE ADVISORS

PART ONE OF A THREE-PART SERIES

Evaluating Commercial Loan Origination Systems

Defining Performance Drivers and Financial Impacts

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The decision to evaluate and implement a commercial loan origination system (CLOS) is a big one for a financial institution, potentially enabling it the opportunity to leapfrog its competition and truly transform its commercial lending processes for its borrowers and employees.

What distinguishes a successful evaluation and selection project? Cornerstone Advisors has identified four critical success factors: 1) documenting needs, 2) aligning stakeholders, 3) effective change management and 4) measurement tracking and planning.

Documenting Needs

Many community-size financial institution CLOS evaluations don't start with a baseline for desired improvement, i.e., defining the problems to be solved, the CLOS functionality needed to address the problems, and what metrics will be used to measure success. There are a number of outcomes that a financial institution might look to a CLOS to achieve:

ELIMINATE

- Multiple platforms supporting the same process
- Duplicative processes and platforms resulting from an acquisition

REDUCE

- Origination processing cycle time (from deal request to loan closing)
- Instances of incomplete or incorrect data and missing required documentation
- Manual or redundant processes to require less staff
- Nonperforming/charged-off commercial loans

IMPROVE

- Loan spreads/pricing and loan fee income
- Third-party vendor (e.g., appraisal, environmental, search) efficiencies

MEET

- Growth objectives at existing staff levels

FIs should clearly document their specific needs for a CLOS to address in order to fully realize the value of the undertaking. Surprisingly, this often isn't done to any significant extent—if at all. The documentation process requires a true understanding of the objectives and underlying needs that are driving the CLOS initiative, and clear consensus and articulation of these objectives across the institution.

Aligning Stakeholders

Only once all stakeholders are aligned can the project team effectively define how to achieve the objectives set forth in the documentation process. Each stakeholder must be aligned to do what is best for the borrower and the institution—and not individual silos.

A CLOS purchase decision must clearly have an "owner" or primary sponsor, with all evaluation criteria developed by a multi-faceted team that is guided by desired outcomes, and not by how things are done today. It is always problematic when the sponsor has sole or predominant oversight of the evaluation and selection process. In a situation such as this, key aspects of life of loan processing are invariably given insufficient consideration, which can lead to inadequate upfront configuration, interfaces, workflow considerations and other issues. The end result: underutilization of CLOS capabilities and underachieving a return on investment (ROI) and key performance indicator (KPI) objectives.

Additionally, external stakeholders (borrowers, vendors) must be fully considered during a CLOS evaluation. Vendor capabilities need to align with the long-term strategy of the organization, and an open mind must be kept to leverage CLOS capabilities and eliminate existing platforms or processes where possible and warranted. Critically, the experience an organization wants for its customers should to be a key factor in deciding which initiatives and transformations best align with the organization's strategic roadmap.

"We had a number of executives who were questioning why we needed something like this—they didn't know what the system could do for us. So we started with facts showing how we lagged out peers.

"Once they saw the statistics, the resistors realized they had to do something. As the selection process progressed, they warmed up to the change and saw how it could help us get deals done faster."

—BANK CEO

Effective Change Management

Developing a baseline for desired improvement by documenting the problems that are sought for remediation and defining quantitative measures to assess current versus post-CLOS implementation performance are key. Executives shouldn't assume that technology will address all of the inefficiencies in the current processes, however.

A CLOS implementation is a golden opportunity to transform an institution's entire commercial lending process. Many FIs waste this opportunity to critically assess their life of loan lending activities, from how they interact with the borrower early in the deal process; to duplicative processes to enter borrower, collateral and various data used in evaluating a deal; to how they obtain the needed post-approval due diligence by interacting with the borrower, third party vendors and loan documentation platforms. To become more efficient, FIs must critically assess each component of their life of loan processes in order to reduce both "idle" time (e.g., waiting on borrower, analyst, vendor information and processing) and the time actually spent processing the deal.

Huge synergies can be afforded by a CLOS to streamline numerous historically manual processes, eliminate duplicative ones and newly introduce automation to reduce human error and ensure credit policy adherence. Each life of loan activity in an FI's commercial origination and portfolio monitoring processes should be examined to determine what specific activities, procedures or policies are inefficient/duplicative and sought for CLOS efficiency gains.

It is important that the financial institution has a common understanding of what wasteful activities that add no value to the customer look like, as well as the language used to describe them, and develop a disciplined approach to continuously remove them and keep them from creeping back in.

"We created an implementation team that was different than the selection team, but with some overlap. To ensure that our associates had a positive first experience, we weren't aggressive about the speed of the rollout.

Checking with Ron to see if we can break this quote into two pieces—taking the second part to the next page—and attribute them to two difference generic people.

—SENIOR BANK EXECUTIVE

Managing the digital and technology change management process, not only during implementation but also during a system evaluation effort, requires an effective governance structure. The selection committee should oversee what the desired solution will deliver in terms of business, technology, benefit, cost and timescale, and make the strategic and tactical decisions required to ensure that the selection effort does not become a “moving target” of requirements. The committee will also streamline communications among stakeholders in business, technology and other functional areas, ensuring transparency regarding how evaluation scope changes are initiated and managed throughout the evaluation effort.

An effective change management program will manage action items, changes, milestones and risk/issue mitigation during a system evaluation effort. It can also ensure processes are in place to manage potential issues for escalation and remediation. Change management must ensure appropriate communications to ensure impacted parties are aware of actions they need to take and when. Stakeholders must be clear on the responsibilities and action items required to support the CLOS evaluation and selection process.

Measurement Tracking and Planning

Successful community-size financial institution CLOS evaluations start with a set of metrics and baseline measurements for desired improvement. Too many FIs make the mistake of skipping this important first step.

Additionally, FIs need to calculate the ROI that a CLOS represents. Well-defined future state target operating models should incorporate all desired improvement areas and ensure that the overarching focus remains on solving current problems in the origination and servicing of commercial loans.

Each of the previous examples can and should be defined via quantitative measures to assess current versus desired performance levels upon CLOS implementation, with the following examples of KPIs or other measures:

- **Cycle time,** or measuring the number of calendar days needed to fully process a commercial request, can be defined on an overall basis (from application data receipt through loan closing) or incrementally by origination work stage based on where the FI's problems are focused (e.g., from deal identification to underwriting analysis initiation/completion, from analysis completion to decision, from decision through post-approval due diligence completion).
- **Incoming quality** as measured by the number or percentage of incomplete items or defects being passed downstream in the process
- **Net interest margin and loan fee income** as measured at the loan, product and/or line of business level for new versus renewed/modified loan
- **Actual third-party vendor costs** incurred versus borrower reimbursements on closed loans, costs versus reimbursements on declined loans or those approved that didn't close for any reason
- **Cost per commercial loan originated:** measuring total commercial loan origination and fulfillment-related expenses incurred as compared to the number of loans closed/funded over the same timeframe
- **Commercial loans outstanding per commercial lender:** measuring the production of commercial lenders and the success of loan origination processes resulting in outstanding commercial loans
- **Commercial non-accrual and charge-off rate** is a lagging indicator of commercial loan underwriting quality and the overall risk associated with commercial lending practices. A CLOS can offer uniform application of commercial underwriting criteria, credit policy, due diligence requirements, risk rating determination, and loan and fee pricing application.

Once a baseline has been established for these KPIs, aggressive but realistic improvement targets should be established and agreed upon. These measures, among numerous others tailored to address an FI's specific needs, can offer measurable ROI criteria to project (for CLOS evaluation) and measure (post-implementation) the impact of a CLOS on the organization.

However, numerous qualitative measures that impact borrower and staff satisfaction are critical to define and assess both the evaluation and post-implementation of a CLOS. KPIs should be measured and improved upon continuously, and their interdependence should be recognized (e.g., increasing cycle time but assuming notable additional compliance risk).

Recommendations

Careful planning and execution are key components of every successful CLOS evaluation, selection and implementation. These nine key takeaways will help an institution ensure its CLOS capabilities are strategically aligned with its overall roadmap.

1. Document all life of loan commercial lending problems that you're trying to solve and identify quantitative measures to assess current versus desired performance upon CLOS implementation.

2. Review your program and project management areas, including system administration, to ensure that the appropriate structure is in place to support initiatives that align with the institution's long-term strategy and roadmap.

3. Maintain focus on the needs that are driving transformation and clearly elaborate the objectives and improvement targets across the enterprise.

4. Design processes based on what is best for customers and the enterprise—not on individual silos.

5. Exercise disciplined scope management to prevent knee-jerk reactions that can sidetrack the program.

6. Use well-defined future state target operating models that are aligned with overall transformation business case objectives—not technology solution features and functionality.

7. Initially define and continually assess a unified data strategy to support current and prospective reporting needs.

8. Maintain data integrity throughout the life of a loan.

9. Develop a realistic strategy to achieve fully integrated straight through processing.

As financial institutions evaluate their current commercial loan origination systems and explore options for the future, talking with other institutions is a best practice. As one bank CEO related to us: "We spent a lot of time talking with other banks, asking them questions and picking their brains. We can't recommend enough doing this. Better yet, go out and visit other institutions."

Improving the user experience and differentiating the institution's competitive positioning should remain key considerations in any CLOS evaluation.

About This Report

This report is one of a three-part series on Commercial Loan Origination Systems, including:

PART 1

Evaluating Commercial Loan Origination Systems:
Defining Performance Drivers and Financial Impacts

PART 2

Selecting an End-to-End Commercial Loan Origination System:
A Proactive Approach Drives Superior Results

PART 3

Implementing a Commercial Loan Origination System:
Seven Common Pitfalls and How to Avoid Them

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Over the course of his career, Joe Ganzelli has helped financial institutions identify process efficiencies, realize enterprise-wide revenue accretive strategies, and evaluate and implement commercial and small business loan origination systems. Before Cornerstone Advisors, Joe was a deposit operations manager, commercial credit analyst manager, commercial lender and senior credit officer. He has also held senior consulting and project management positions with two major software solution providers and a consulting firm

Joe facilitates Cornerstone roundtables for chief lending officers and chief financial officers and speaks at industry trade events. He is a contributing author for *GonzoBanker*, Cornerstone's blog, has been published in *The RMA Journal* and has authored several articles on commercial and small business lending best practices.

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Ron writes a weekly column for *Forbes*. He is the author of the Amazon best-selling book *Smarter Bank* and is the purveyor of fine snark on The Financial Brand's *Snarketing* column and the Fintech Snark Tank podcast. Ranked #2 on Bank Innovation's list of 30 Innovators to Watch, Ron is frequently quoted in major industry outlets and is in great demand as a speaker.

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About
CORNERSTONE ADVISORS

Cornerstone Advisors takes financial institutions from strategy to execution through an array of Solutions in areas including fintech, contract negotiation, delivery channels, lending, mergers & acquisitions, payments, performance, strategy and technology.

Cornerstone hosts executive roundtables and publishes GonzoBanker, a blog, and commissioned research on topics impacting the industry.

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nCino is the worldwide leader in cloud-banking. Its Bank Operating System improves employee efficiency while enhancing the customer experience for onboarding, loans and deposits across all lines of business. Transforming how financial institutions operate through innovation, reputation and speed, nCino works with more than 1,100 financial institutions globally whose assets range in size from $30 million to $2.3 trillion. A proven leader, nCino is part of the Forbes Cloud 100 and was named the #1 "Best Fintech to Work For" by *American Banker*.

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Have questions about this report?

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