CORNERSTONE ADVISORS

PART TWO OF A THREE-PART SERIES

Selecting an End-to-End Commercial Loan Origination System

A Proactive Approach Drives Superior Results

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Many financial institutions set a goal for 2020 of selecting— and possibly deploying—and end-to-end commercial loan origination system (CLOS). Then came COVID-19 and worldwide shelter-in-place orders, bringing any forward motion on these initiatives to a screeching halt.

In the second half of the year, with the country slowly returning to a degree of "normalcy," financial institutions are beginning to revive these efforts. As they move ahead with their CLOS selection efforts, the first thing they need to do is clearly define the objectives and target metrics for the new system. Skipping this step vastly increases the chance of a failed implementation.

Begin at the End

Best practice institutions start a CLOS selection by identifying the return on investment (ROI). What is the institution hoping to achieve by implementing a new system? Is it looking to streamline processes? Deliver loan decisions more quickly? Increase the department's overall efficiency? Examples of end results an institution might look to a CLOS to deliver include the following:

- **Elimination** of multiple platforms supporting the same process and any duplicative processes and platforms resulting from an acquisition
- **Reduction** of origination processing cycle time, instances of incomplete or incorrect data or documentation, manual or redundant processes, and nonperforming/charged-off commercial loans
- **Improvement** of loan spreads/pricing/loan fee income and third-party vendor (e.g., appraisal, environmental, search) efficiencies
- **Achievement** of growth objectives at existing staff levels

To realize the total value of the undertaking, it is critical that the financial institution clearly documents the desired end results of the selection. It is equally critical that the team documenting the process fully understands the objectives and the underlying needs that are driving the initiative. Once done, this documentation serves to articulate and justify the project across the institution.

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Lead or Follow?

Even with clearly defined objectives and well documented benefits, there are still many ways the journey to select a CLOS can yield less than desirable results. To ensure the greatest return, the institution must commit to proactive management and a broad level of involvement in the process.

Four key aspects of a selection will determine the amount of success realized between a proactive effort, during which the institution takes control of the entire process, and a reactive effort, during which the institution follows the vendor's lead throughout: 1) purchase drivers, 2) ROI calculations, 3) functionality requirements and 4) participation.

Key Aspect	Proactive CLOS Selection	Reactive CLOS Selection
Purchase drivers	Identified by the institution based on performance improvement goals	Identified by the institution based on vendor's past sales/ case studies
ROI (revenue/capacity/expense)	Calculated by the institution based on established performance targets	Calculated by the institution based on vendor case studies
Functionality requirements	Specified by the institution prior to product demonstration	Influenced by the vendor during product demonstration
Participation	All departments involved in the commercial lending process	Single department within the commercial lending segment

A reactive approach certainly has appeal. It puts fewer demands on an institution's time and team members. And as anyone who has been involved in a system selection knows, free time is in short supply. However, the institution that devotes the energy and resources to a proactive approach will find that being in the driver's seat from beginning to end keeps the project aligned with the communicated objectives and yields far superior results.

Functionality Requirements

After the institution defines its purchase drivers and expected ROI, the next step is to clearly articulate the functionality requirements. A detailed list of the functionality the institution needs in its new CLOS is a make-or-break component of the selection. This list must be comprehensive and illustrate whether a desired functionality will be provided in the new CLOS or by a separate point solution. Knowing whether users of the functionality in the point solution are satisfied with its performance provides a basis on which to explore the merit of keeping it as a standalone platform.

Functional Category	Existing Point Solution?	Fully Utilizing Point Solution?	Satisfied with Point Solution?
Workflow	No	NA	NA
CRM	Yes	Yes	No
Online Application	No	NA	NA
Financial Analysis/Spreading	Yes	No	Yes
Pricing Model	Yes	Yes	Yes
Commercial Underwriting	No	No	NA
Pre-Documentation Checklists	No	No	NA
Commercial Portfolio Management	No	No	NA
Customer Portal	No	No	NA

How Much Do You Really Need?

As the financial institution reviews each of the functional categories, specifics of the requirements in each must be viewed in terms of "must-have" and "nice-to-have." Must-haves are functionality requirements connected to the purchase drivers that allow the financial institution to realize the targeted ROI. Anything beyond that criteria is simply a nice-to-have. In addition to the purchase drivers and the realization of the targeted ROI, a financial institution must ask the following questions when defining the specific functionality requirements:

- How often is the activity related to the functionality requirement actually performed?
- What percentage of the loan production or portfolio requires this type of functionality?
- Is the activity/function part of the financial institution's long-term strategy, or is it related to a legacy product/service that is going away?

Replace or Retain (and Maybe Integrate)?

Because one of the primary benefits of a CLOS is that all data is captured and activities are performed in a single platform, as the financial institution takes stock of the current point solutions being used to support commercial lending, it must ask whether retaining or replacing each solution is the better course of action. Replacing point solutions with the full CLOS will allow the financial institution to:

- Consolidate data capture
- Coordinate activities between the various departments
- Improve reporting
- Reduce data entry redundancies
- Increase process transparency
- Enhance process/data consistency

The decision to replace or retain comes down to the functionality requirements we have been discussing. Again, what are the must-haves versus the nice-to-haves in the functionality requirements. Oftentimes, when the discussion revolves around replace or retain, the financial institution loses sight of the must-haves and simply focuses on specific gaps between the CLOS and the point solution that may be replaced. A feature-by-feature comparison can be like mandating that any new car purchased must have a cassette player because your current car has one. The reality is that many features of point solutions go unused, and to insist that the CLOS has the exact same piece of functionality as the existing solution often causes financial institutions to hang on to the familiar (and comfortable) point solution.

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The following are examples of common point solutions and their unused or under-used features:

CRM	• Cross-segment referrals • Client treatment/management strategies • New product/service strategies
Statement Spreading	• Automated projections • Consolidating financial statements between two entities • Financial covenant compliance monitoring
Pricing Models	• Accuracy of relationship profitability • Routine updates to the profitability model • Enforcement of pricing/profitability requirements

Evaluating whether a CLOS under consideration has a particular functionality is really beside the point. The emphasis must get back to the stated functionality requirements and the determination of must-haves versus nice-to-haves.

Point Solution Survivors

While commercial loan origination systems have come a long way in the past five years, a financial institution should not be surprised if it comes to the conclusion that it must retain a point solution. Once the decision to retain has been made, the next immediate question is whether to require integration with the CLOS.

If there is little data overlap or the usage is not very broad, integration should not be considered a requirement.

These questions will guide the institution in making an integration decision:

- Is there a significant overlap in the data captured/used in the point solution and the CLOS?
- How often is the point solution used in the origination process or portfolio management activities?

If there is little data overlap or the usage is not very broad, integration should not be considered a requirement.

Evaluating the Candidates

After the institution has communicated its functionality list to all stakeholders, it can select candidates and begin the evaluation. Whether the institution uses an RFP, RFI or other process for soliciting bids, the ROI and functionality requirements will be invaluable tools in narrowing the selection to the top three to five candidates. Among the finalists, the institution can analyze the vendors' functional capabilities and off-the-shelf pricing to quickly eliminate those that can't meet the institution's needs or are just too expensive.

Documenting the results of this phase enables the institution to communicate the results to all parties involved at the institution and move quickly to the next step: vendor demos.

Show Time

The demo process is meant to address the following questions for the institution:

- Which platform provides the best match for our required functionality?
- Which platform drives the performance improvement needed to produce the expected ROI?
- Will any process changes required to make a particular piece of functionality work produce an acceptable return in terms of performance improvement?
- If the new system can't deliver the required performance improvement in an area for which we have a point solution, can we fall back on our legacy platform?

Every department or team at the institution that is impacted by an end-to-end CLOS should be represented at the demos and stay engaged until the final decision is made. This includes not only the teams whose performance improvement goals prompted the system selection, but also teams from other departments that feel they are "doing just fine."

Demos should be conducted like controlled scientific experiments. If the number of variables (i.e., functionality requirements) being assessed isn't carefully managed by the institution, vendors will (understandably) highlight *their* functionality strengths, which may not align with the institution's functionality requirements. Successful demonstrations follow a consistent agenda and use consistent data to facilitate an apples-to-apples comparison of systems.

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Keeping a simple scorecard of the overall satisfaction and price of each solution will assist the institution in making a final determination.

If the demo comparisons result in a functionality tie, the ultimate tie-breaker is the cost of the solution. Prior to demos, the institution determined that each vendor's cost was acceptable, so only when all else is equal does it make sense for pricing to be the deciding factor.

Vendor Scorecard

Solution	Rating	Price
Vendor A	☺☺	$$
Vendor B	😐	$
Vendor C	☺	$$
Vendor D	☹	$$$$

Conclusion

Rarely does a single vendor fulfill all of an institution's requirements, but by taking into account the perspectives of different departments on whether each system meets their functionality needs, the institution can determine which platform best supports the full range of functionality required to drive its desired performance improvement and generate the best return on investment.

In the end, it is the functionality supporting the change that makes a solution affordable, not the other way around.

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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Joel Pruis has more than 25 years' worth of expertise in commercial and small business credit. As senior director at Cornerstone Advisors, Joel is focused on commercial credit performance improvement covering policy, process, roles and responsibilities for both loan origination and ongoing customer management. Over the course of his career, Joel has been a credit analyst, relationship manager and underwriting manager. Most recently, he served as a senior business consultant for a leading global credit scoring firm.

Joe facilitates Cornerstone roundtables for chief lending officers and has spoken at industry conferences including the BAI Loan Review Conference, RMA Annual Conference and CUNA Future Forum. He writes for GonzoBanker, Cornerstone's blog, and has been published in American Banker, BAI Banking Strategies, CU Management, RMA Journal and US Banker.

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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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Cornerstone Advisors delivers consulting services, industry insights and executive forums focused on helping financial institutions improve profitability and elevate performance quickly and efficiently. Cornerstone helps clients develop more meaningful business strategies, negotiate better vendor contracts, make smarter technology decisions and strategically re-engineer critical processes.

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