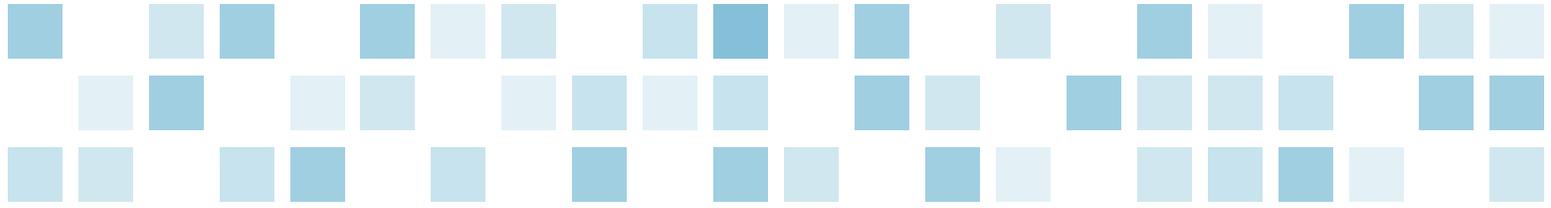


Identifying loan process enhancements to contain costs and enhance revenue



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With the slow pace of economic recovery and the subsequent thin margin environment, banks and credit unions are under increased pressure to do whatever they can to increase revenue and control operational costs. While larger banks may find opportunities to reduce expenses through branch consolidation and staff reductions¹, this option may not be available to many institutions where resources are already stretched to the breaking point.

So where do financial institutions look to find those innovative ideas that control expenditures and lead to growth? Before considering downsizing, management should look into some “on the shelf” initiatives within reach that have considerable potential to contain costs, enhance performance, and as a result, have a meaningful, positive impact on the financial performance and growth of the institution.

There are a number of institutional procedures where expense “leaks” may occur. Broadly speaking, these leaks, or unnecessary expenditures, may be found in paper handling, underutilization of software or a wide array of nonvalue-added or decentralized activities. Some opportunities may also be hidden within day-to-day operational activities. Often, a comprehensive assessment of existing processes can help identify where the leaks are – and how to plug them – as well as uncover those hidden opportunities.

The impact of inefficiency

Inefficient processes do not only have an impact on operating costs; they can also result in lost revenue opportunities. Unfortunately, the symptoms of inefficiency aren’t always obvious.

At a retail-focused financial institution, for example, a process-improvement assessment identified a low pull-through or “look to book” ratio (that is, the number of funded or closed loans as a percentage of applications taken). Further analysis revealed that 54 percent of loans approved by the institution were never closed. While many institutions monitor pull-through rates, they fail to consider the number of those unfunded loans that were approved. A low pull-through rate may simply mean that a large number of applicants were unqualified. A high rate of approved, unfunded loans, however, may actually be a symptom of a larger process issue.

The ripple effect of an inefficient loan origination process can spread across an institution, and its impact may be felt in operations, quality and growth.

¹ Soukup, R. et al (11/8/2012) *High efficiency ratios across industry could prove stubborn*, SNL Financial

Inefficiencies in steps to originate, underwrite, close and service a loan may lead to increasing lag time. Backlogs and slowdowns can result, and a competitive advantage may be lost. With many options available to highly qualified borrowers, and with the accelerating pace of technology, potential borrowers quickly lose patience with slow turnaround or the multiple requests for information and documentation that can result from inefficient processing. These potential borrowers will apply for loans at a number of institutions to find the one with the best rate, as well as the fastest response time. If an institution can't provide the service they expect, borrowers can simply go elsewhere.

Clearly, if an institution is spending time and resources to attract borrowers, process applications and underwrite loans, there should be a good return on its investment.

Opportunities for process improvements

Although each institution is different, there are some common opportunities for loan process improvement that, when addressed, can make a significant difference in an organization's results:

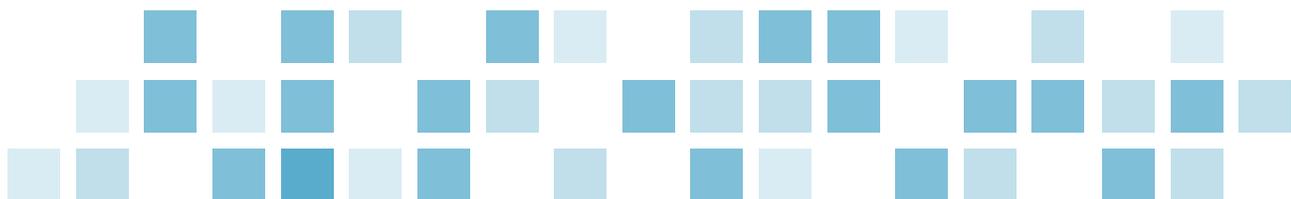
System integration — The constant evolution of borrower needs, ever-changing regulatory environment and accelerated adoption of new technologies has created an environment in which financial institutions find it difficult to adapt. Often, the result is implementation of a number of disparate solutions that, over time, create a complex and disjointed technology environment that adds unnecessary risk to the process. It is not uncommon to find multiple, overlapping technology solutions – hardware, software and outsourced services – have been implemented by individual lines of business or departments to address specific needs without consideration for how these solutions would work together.

In one community-based financial institution, a lack of system integration resulted in customer information, lender notes, credit report data and information already stored in the core system being entered multiple times – first to perform credit analysis, then to create loan documentation and a third time for servicing. Naturally, this manual approach included quality control steps to ensure accuracy – all of which added time to the loan process that would have been unnecessary had the systems been integrated.

When institutions consider system integration, the cost often seems high. However, the return on the investment of this one-time cost can be significant when compared to the ongoing costs of the time required to enter the same data repeatedly, additional audit and review steps required to identify errors and the rework required when errors are identified. These extra steps also add to loan application response time, resulting in lost revenue when applicants lose patience with the process and obtain credit elsewhere.

There are several ways to address lending system integration issues, which vary in effectiveness and cost. Organizations with a high degree of internal technology capability can sometimes design and implement integration using developer tools provided by existing system vendors. Other organizations find it more practical to work with the vendors to design interfaces between their products. Still others decide to evaluate alternatives to existing systems that provide a fully integrated solution. Whichever path is chosen, it is important that the cost/benefit analysis includes identifying all the process inefficiencies associated with the lack of integration.

System optimization — When there is a lack of trust in technology – or a lack of training or proper configuration – the system's capabilities will not be fully utilized. This can result in inefficiencies, such as additional nonvalue-added review steps, extended processing time and opportunities for error and re-work throughout the process. This issue surfaces in lending most often in the configuration and implementation of automated loan decisions.



Many institutions make use of an automated decision support (ADS) system that reviews credit information, performs analyses and provides a credit decision based on a set of business rules defined by the institution. Although ADS systems have been around for many years, institutions are often cautious during initial implementation, setting conservative rules with the intention of tuning the system over time. In many cases, however, the rules aren't reviewed and adjusted after implementation. The conservative configuration of the automated decision system may lead to unnecessary review of loans, thereby increasing costs and delaying responses to well-qualified borrowers.

In one institution, for example, 83 percent of the loans referred to an underwriter by the ADS system were subsequently approved. The ultimate approval of a high rate of referred loans is a sign that the system configuration may be overly conservative. By updating the rules to reflect the institution's underwriting policy, qualified borrowers receive approvals more quickly and the underwriters can focus their attention on more complex credits.

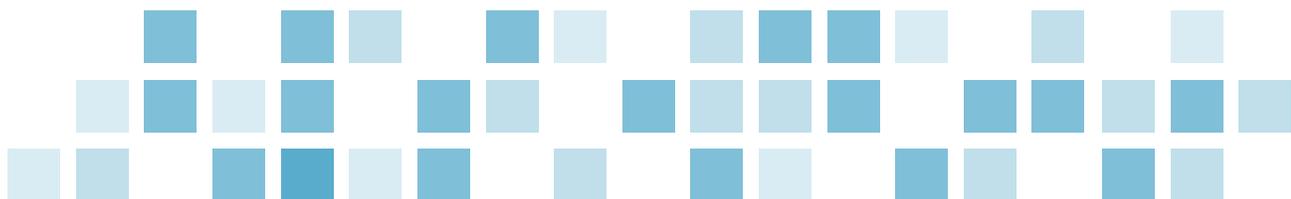
If the ADS results deviate significantly from the overall results, the system is probably not configured most effectively. Likewise, if overrides of ADS system recommendations exceed 10 percent, adjusting the rules is likely to yield better results. Finally, if a high percentage of the loans referred to underwriting by the ADS system are either declined or approved through a manual process, or the results of the manual review don't closely mirror overall approval or decline rates for the loan category, adjustments may be necessary. Financial institutions that regularly review and validate their ADS parameters are able to achieve the greatest return for their investment.

Paper handling — A certain amount of paperwork is to be expected in any lending process. Yet at some institutions, documents, spreadsheets and other reference items are still being printed and filed in paper form unnecessarily, even when an imaging system has been implemented for electronic document management. This traditional approach not only wastes time in the Digital Age; it creates unnecessary work downstream and limits access to those who can get to the physical file.

Although many loan documents begin life in a digital form, they are often converted to paper during the lending process, then scanned and returned to digital form for transfer to another location or for archiving in the imaging system. This transformation can happen multiple times for a single item as it makes its way through the loan process. Often, the generation of paper isn't part of the "official" process, but evolves over time in response to specific situations or personal preferences, and persists even after implementation of digital replacements.

Although the effects may seem inconsequential when viewed individually, the cumulative effect can be expensive, creating backlogs and delays, and generally having a negative impact on service. At one institution, a credit report was printed and scanned three times during the loan origination process, even though the electronic version of the credit report was attached to the loan request in the automated loan origination system.

Scanning paper documents – such as tax statements, financial statements or proof of insurance – makes them immediately available, so activities can be started sooner and performed simultaneously to improve turnaround time. Many document management systems allow users to add notes to scanned documents online. Comments typed online are easier to read than hand-written notes, less subject to misinterpretation and available to all those who are involved in the process.



Observation of loan requests in progress is often the only way to identify unnecessary paper handling. It is particularly helpful to perform this type of audit several months after implementing new technology to identify any actual or perceived system issues causing employees to revert to paper-intensive activities.

Nonvalue-added activities — Over time, it is common for activities to be added to a process to address changes that occur in response to a specific incident. However, these activities are rarely discontinued once they are added, even if the original reason for adding the step has been forgotten or is no longer valid.

At one institution, for example, the loan processing manager compared the “boarding sheet” for each loan closed the previous day to the data in the servicing system. Although the loans were automatically uploaded from the loan origination system to the servicing system, the manager felt the loan records had to be reviewed to ensure that all the data was transferred correctly. As it happened, the manager had not identified an error during his review for at least one year. It was discovered that a software update had once resulted in some data being intermittently omitted from the automated upload. Even after the software correction was implemented, the review process continued.

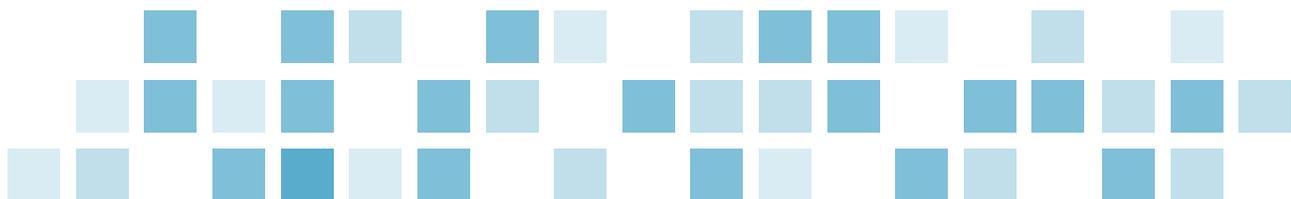
An objective analysis is required to identify nonvalue-added activities. People involved in the process often have difficulty recognizing when an activity is no longer valid or adds unnecessary complexity to a process. In addition, some activities may be required for regulatory compliance, so it is critical that someone with knowledge and experience in the specific lending process is involved. Finally, it’s helpful to include someone with process design experience to help define nonvalue-added activities.

By identifying actions that can make better use of existing resources, financial institutions can enhance their loan processing performance and avoid making less-attractive choices to reduce expenses.

Implementing loan process improvements

As with any effective improvement process, it all starts with a plan. Here are some guidelines for successfully implementing loan process improvements:

- **Document existing loan origination and underwriting process.** Review existing policies and procedure documentation. Take a borrower’s perspective and perform a walk-through of the origination, underwriting, funding and boarding processes.
- **Identify process breakdowns, bottlenecks and inefficiencies.** Compare existing processes to peers and best practices. Identify overlapping roles and responsibilities, redundant data entry, opportunities for error and other process inefficiencies.
- **Evaluate information technology.** Analyze the effectiveness of existing technology deployed in the process and examine leveraging opportunities for existing systems and applications. Look for manual efforts that can be automated.
- **Determine process improvement opportunities.** Establish key metrics and performance measures to be used to monitor process improvements. Define end-to-end solutions that incorporate business processes, information technology, internal controls and compliance considerations. Most of all, be sure to collaborate on the process changes.
- **Identify short- and long-term improvements.** Prioritize short-term, “quick hit” process changes that can be implemented with low investment and a minimal impact on the organization. At the same time, categorize fundamental changes that require investment and a longer timeframe to implement, but will have a significant, positive impact on the process that will make other changes possible.



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