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COMMUNITY BANKING
ADVISOR

IS IT TIME FOR YOUR BANK TO AUTOMATE ITS LENDING PROCESS?

BEYOND COMPLIANCE: TURNING LOAN RATINGS INTO STRATEGIC INSIGHTS

GROW CORE DEPOSITS TO BOOST PROFITABILITY

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COMMUNITY BANKING
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IS IT TIME FOR YOUR BANK TO AUTOMATE ITS LENDING PROCESS?

For years, community banks have differentiated themselves from their regional and national competitors by emphasizing personal service, relationship building and local expertise. But in today's digital age, that may no longer be enough. Increasingly, tech-savvy customers want to conduct banking business, including loan applications, from start to finish without ever having to set foot in a branch. Modern lending systems — which take advantage of cloud technology, artificial intelligence (AI), robotics and other tools to automate the process — make this possible.

Automating the lending process offers many potential benefits for banks. And contrary to what you might think, embracing this technology doesn't necessarily make customer relationships impersonal. By streamlining the lending process and reducing time-consuming manual tasks, automation can free up time for your staff to focus on building personal relationships.

ADVANTAGES OF AUTOMATION

Key benefits of automating the lending process include:

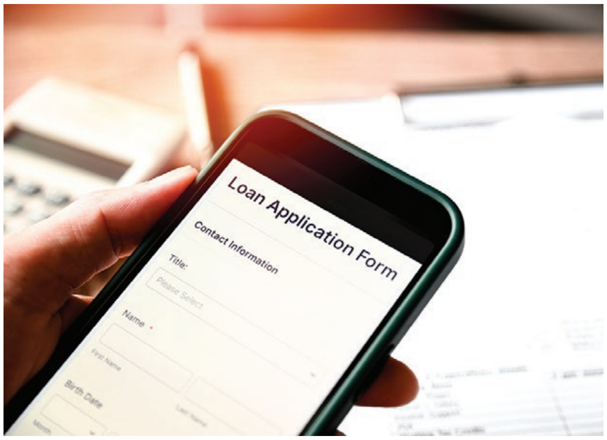
Improved efficiency. Many banks continue to use a hodgepodge of paper loan applications, Word and Excel documents, emails, and phone calls to shepherd a loan from application to approval to disbursement. Automated systems streamline the process by creating a single digital workflow that eliminates the need to enter data more than once. They also help route applications through the various steps in the process, and even generate necessary disclosures.

Reduced errors. By minimizing staff involvement in data entry and reporting, automated systems reduce the likelihood of mistakes.

Stronger regulatory compliance. Automation provides access to vast amounts of data, improves uniformity and reduces errors, making compliance easier and more reliable. AI tools can even prompt bank personnel when specific disclosures are required. They also can spot red flags that may signal fraud more consistently and faster than human auditors. In addition, these systems create a comprehensive audit trail for regulatory review and reduce risk by decreasing the number of platforms a bank uses.

Faster, more consistent underwriting decisions. An automated system streamlines the underwriting process and helps ensure that the bank's underwriting standards are applied consistently. It reduces the need for time-consuming manual tasks and avoids the risk of bias inherent in a manual underwriting process.

Scalability. Automated systems are highly scalable. Unlike manual systems, which are prone to bottlenecks, automated systems can easily keep pace as transaction volumes grow. They also facilitate digital expansion into new geographic areas.



Analytical insights. By collecting and centralizing customer data, automated systems provide insights into the products and services customers use, as well as their transaction histories, demographics and preferences. This allows the bank to tailor products and services to them.

Happier employees. Automation can help banks combat the continuing skilled labor shortage. Enabling lenders to spend less time on paperwork and more time doing deals, advising customers and building relationships makes it easier to attract and retain talent. It also streamlines the process of onboarding new personnel.

Enhanced customer experience. An automated loan process can increase customer satisfaction, especially for customers who demand speed and the convenience of 24/7 access to their loan applications without the need to visit a brick-and-mortar location. It can guide borrowers through the process, pre-fill information, allow for mobile uploads of documents, generate automated reminders and enable e-signatures. This can lead to quicker decisions and funding, thereby improving the customer experience.

In addition, lending personnel spend less time on paperwork and other repetitive manual tasks. So they have more time to provide customers with personalized advice and guidance.

NEXT-LEVEL RELATIONSHIP BANKING

As the business world becomes increasingly digital, community banks that strive to remain competitive and customer-focused should evaluate cost-effective ways to automate their lending processes. Automation isn't a replacement for the personalized service and relationship banking community banks are known for. Rather, it enhances lenders' ability to build relationships by allowing them to spend more time advising customers and less time performing administrative tasks. ■

USING RPA TO BOOST PRODUCTIVITY

In addition to automated lending systems, many community banks use robotic process automation (RPA) to streamline various tasks outside their loan origination systems. RPAs are software tools that automate repetitive, rule-based tasks traditionally performed by people, such as:

Creating invoices. Generating accurate invoices often involves compiling backup information from multiple systems, which is a time-consuming, error-prone task when performed manually.

Opening accounts. RPA can help banks with initial account setup and know-your-customer (KYC) compliance by assisting with such tasks as extracting data, verifying documents, and screening Office of Foreign Assets Control (OFAC) and sanctions lists.

Managing documents. Manual systems are error-prone, and documents may be easily lost or misfiled. RPA can automatically route scanned documents to the appropriate recipients and file them in a centralized, readily accessible repository.

Servicing customers. RPA-powered chatbots can handle routine customer-service inquiries, such as account balances, transaction histories, loan status and password resets.

Closing accounts. RPA can automate the processing of account closure requests, including verifying customer information, processing final payments and updating account records.

These are just a few examples. RPA can be used to streamline a wide variety of financial, administrative and operational processes.

BEYOND COMPLIANCE: TURNING LOAN RATINGS INTO STRATEGIC INSIGHTS

A well-designed loan risk-rating system is a critical component of a bank's risk management program. These systems help management accurately and consistently identify and monitor credit risk in a bank's loan portfolio, which in turn drives various strategic decisions. So, it's a good idea for banks to review their loan risk-rating systems periodically to ensure they're appropriate for the bank's current lending activities.

REGULATORY OVERVIEW

Under guidance from the federal banking agencies, banks should "establish a system of independent, ongoing credit review and appropriate communication to management and to the board of directors." According to *Interagency Guidance on Credit Risk Review Systems*, an effective credit risk-rating framework should include:

- Formal policies describing the factors (such as default risk and possible credit losses) used to assign risk ratings to individual loans and retail credit portfolios or portfolio segments with similar risk characteristics,
- Identification or grouping of higher-risk loans that warrant close management attention or inclusion on management loan "watch lists,"
- A clear explanation of why particular loans received adverse risk ratings or warrant special attention from management,
- An evaluation of the effectiveness of approved workout plans,
- Communication methods to inform senior management and the board about the status of loans identified as warranting special attention or adverse classification, including the actions management has taken to strengthen the credit quality of those loans, and
- An evaluation of the institution's historical loss experience for each segmented group of loans with similar risk characteristics.

A bank's rating system should be commensurate with the size, complexity and risk profile of its lending activities. Banks with small, less complex or low-risk loan portfolios generally can get by with just a few risk-rating categories. On the other hand, larger banks with more complex or higher-risk lending activities generally require a more granular approach — that is, a greater number of more detailed risk-rating categories.

RISK-RATING CATEGORIES

Bank management has some discretion in defining risk-rating categories and establishing the level of granularity. However, for *adversely* classified risk grades, the definitions should closely mirror the federal banking agencies' asset classifications, which are:

Substandard. This means "inadequately protected by the current sound worth and paying capacity of" the borrower.

> A BANK'S RATING SYSTEM SHOULD BE COMMENSURATE WITH THE SIZE, COMPLEXITY AND RISK PROFILE OF ITS LENDING ACTIVITIES.

Doubtful. This indicates an asset "has all the weaknesses inherent in one that is classified as substandard" and "the weaknesses make collection or liquidation in full … highly questionable and improbable."

Loss. Assets with this classification are "considered uncollectible and of such little value that their continuance as bankable assets is not warranted."

Examiners also expect banks to use a "special mention" risk rating for "credits that have potential weaknesses deserving management's close attention but do not yet warrant adverse classification." For loans that aren't adversely classified, the number of "pass" and "watch" grades is left to bank management's judgment. For example, it may be appropriate for a smaller, less complex bank to have one pass grade and one watch grade. A larger, more complex bank will likely need several pass and watch grades.

PROTECT YOUR BANK'S FINANCIAL HEALTH

Given the significant impact of credit risk on a bank's financial health, it's critical to maintain an effective loan risk-rating system that enables management to identify and monitor credit risk. Banks should review their rating systems regularly to ensure that the level of detail continues to reflect the size, complexity and risk profile of their lending activities. ■

GROW CORE DEPOSITS TO BOOST PROFITABILITY

Keeping current with rapid technological changes and dealing with economic headwinds can take up a large share of a community bank's attention. But it's important not to let your bank's core deposits fall through the cracks. Maintaining existing core deposits and attracting new ones are essential to increasing bank profitability over time. Here are some points to help you build core deposits while controlling costs.

LONG-TERM STRATEGIES

Building core deposits is a long-term strategy — there are no quick fixes. Offering above-market interest rates, for example, may attract new customers in the short term, but it's unlikely to support sustainable deposit growth. That's because customers who are attracted to higher rates are more likely to abandon you when a better rate comes along. In the long run, it's better to focus on customers who value service over interest rates.

Many retail bank customers are now digital-only, but they're among the least satisfied, according to many metrics. The most satisfied customers are "branch-dependent digital customers" — those who take advantage of online or mobile banking but also visit a branch two or more times during a three-month period. In fact, it's commonly thought that younger customers eschew branches. It's still the case that most customers, including younger generations, prefer to open accounts at a branch — with personalized guidance — because they find it confusing to do online.

Good service is key. Banks with weaker performance in the areas of communication and advice, new account openings, and products and fees have reduced satisfaction levels among digital-only customers. To attract and retain engaged customers and grow core deposits, banks need to improve communications and provide quality, personalized advice and other services consistently. It's important to make these strides across both digital and branch channels.

COMMUNITY BANKS THAT SPECIALIZE IN PARTICULAR INDUSTRIES OR TYPES OF BANKING ARE OFTEN ABLE TO ATTRACT CUSTOMERS WHO VALUE SPECIALIZED SERVICES OVER INTEREST RATES.

In addition, community banks that specialize in particular industries or types of banking are often able to attract customers who value specialized services over interest rates. The right niche — whether it's health care, professional services, hospitality, agriculture or some other industry — depends on the bank's history and the community's needs.

RECIPROCAL DEPOSITS

In 2018, a provision of the Economic Growth, Regulatory Relief and Consumer Protection Act created an opportunity for community banks to boost deposits by taking advantage of reciprocal deposits. A bank receives these deposits through a deposit placement network in exchange for placing matching deposits at other banks in the network. One advantage is that these networks enable banks to attract large-dollar, stable, local depositors by offering them insured deposits beyond the $250,000 FDIC threshold. (Insurance coverage is increased by spreading deposits among several network banks.)

The 2018 law makes it easier for banks to take advantage of reciprocal deposits by providing that these deposits (up to the lesser of 20% of total liabilities or $5 billion) won't be considered "brokered deposits" if specific requirements are met. Brokered deposits are subject to various rules and restrictions, making them more costly than traditional core deposits.

KEEP REFINING YOUR METHODS

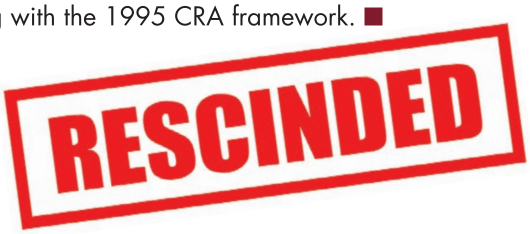
In this increasingly unpredictable and rapidly changing economic environment, community banks need to find ways to not only survive, but thrive. Focusing on growing core deposits can provide both monetary and relationship-building benefits for banks, increasing long-term stability. ■

BANK WIRE

BANKING REGULATORS TO RESCIND 2023 CRA FINAL RULE

In July, the federal banking agencies issued a proposed rule that would rescind their 2023 Community Reinvestment Act (CRA) Final Rule and reinstate the 1995 CRA framework that was previously in effect. The CRA requires federal regulators to evaluate banks' performance in meeting the credit needs of the communities in which they operate. The 2023 rule made several significant modifications to the CRA's application. Among the changes was a controversial provision, effective in 2026, that would have evaluated banks in geographic areas where they didn't maintain physical branches.

As a result of lawsuits brought by several banking trade groups, a federal court blocked the 2023 rule, leading the banking agencies to propose rescinding it. Banks should monitor further developments and, assuming the proposal is finalized, continue complying with the 1995 CRA framework. ■



SHOULD YOU OUTSOURCE YOUR ATMS?

Outsourcing ATM management offers several potential benefits, such as:

Increased efficiency and productivity. ATM specialists generally can manage your ATMs more efficiently than your bank's staff, freeing up your employees to focus on core activities.

Improved compliance. Shifting the compliance burden to a third party can help ensure that you adhere to new ATM regulations. However, this doesn't relieve the bank of responsibility for compliance.

Cost savings. Banks often save costs when they outsource ATM operations.

Improved employee safety. Outsourcing ATM management greatly reduces the chances that an employee will be present in the event of an attempted ATM robbery. ATM vendors typically use armored car services with armed guards to replenish ATM cash.

Access to cutting-edge ATM technology. ATM vendors generally use the latest software and hardware.

Expansion opportunities. Outsourcing can expand your ATM coverage into new geographic areas, reaching more customers. Because the ATM vendor is responsible for servicing, maintenance and cash replenishment, there's no need to send your employees to remote locations. ■

HAVE YOU CONSIDERED A "FRACTIONAL COO"?

Historically, the chief operating officer (COO) position was viewed as a full-time job. However, today, many banks are engaging "fractional COOs." These part-time COOs, typically independent contractors, give banks access to high-level operational expertise to meet specific challenges without committing to a full-time hire. ■

DON'T OVERLOOK THE R&D TAX CREDIT

When looking for tax-saving opportunities, banks shouldn't overlook the federal tax credit for "increasing research activities," commonly known as the R&D credit. Contrary to popular belief, the R&D credit isn't just for scientific research. It may be available for various business activities, including developing or improving internal software, developing mobile banking technology or even automating manual processes. ■

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Community Banks

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