

◆ LamdenCaseStudy

# Loan Covenant Tracking for Comerica Bank

## Lamden applies distributed ledger technology to create business process efficiencies that were previously unfeasible.

We focus on the point where distributed systems technology and business process automation intersect to deliver solutions to previously unsolvable problems. We use the LEAN philosophy to create the most minimalistic solution possible.

Our team is made up of PhD qualified experts in the fields of economics and distributed systems technology. This allows us to propose and implement the best business solutions for your specific processes and needs. To accomplish this, we utilize a state-of-the-art custom blockchain system that delivers high throughput against a rich, smart-contracting environment. Our system has a modular design that allows us to apply extensions and modifications to meet your specific needs quickly, simply, and most importantly, while maintaining cost-effectiveness.

It all starts with a discovery and analysis period where we'll evaluate your current processes and propose technology-enabled optimizations that will help to increase your bottom line. From there, we'll fully implement, support, and manage the solution.

## Loan Covenant Tracking Importance and Challenges for Comerica



Selling a loan and getting it on the books is different than selling any other product. The bank has to control everything until the loan is fully paid, which might be several years from now. In the meantime, anything could happen and a potentially profitable transaction could turn into a total loss. The borrower's ability to pay could change dramatically due to both internal and external factors such as changes in the market, management efficiency, or the global economic environment. Risk accompanies a loan throughout its entire life cycle and that's what makes banking so different from any other business.

While some bankers consider it redundant to monitor stable loans, analysis of banking practices has shown that most problems remain hidden up to a certain point. Often, when those problems finally become clearly noticeable, it's too late to make any changes. Over 38% of middle-market companies have violated a loan agreement without knowing it according to one industry research study. The bank usually doesn't know it either. This is why more and more banks have started implementing consistent credit monitoring – particularly for commercial loans. It helps them to diagnose problems in the early stages and work together with the borrower to mitigate risks. Loan covenants are specific conditions that help with this process.

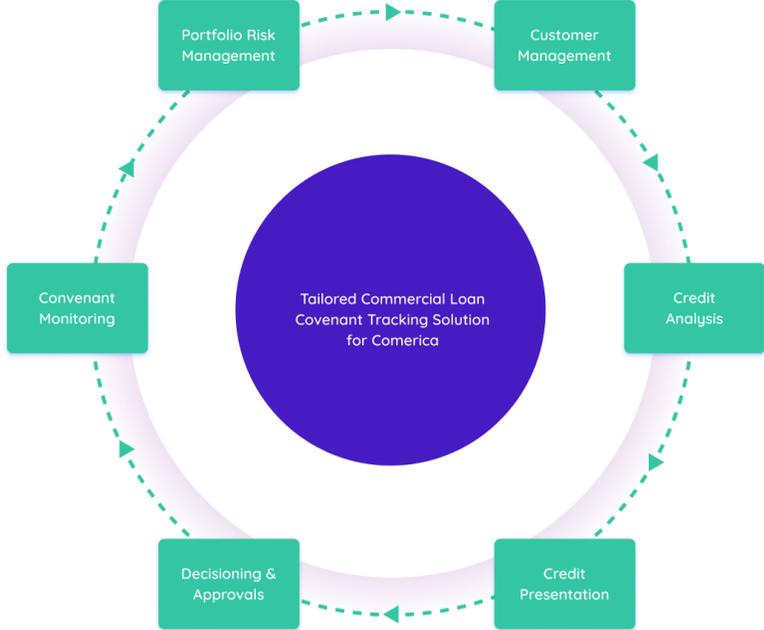
They are essentially the conditions that the borrower must fulfill. They also forbid the borrower from undertaking certain actions or restrict them to specific circumstances when other conditions come up.

Banks invest heavily in streamlining loan processes and replacing legacy systems although loan covenant tracking is often not the first priority for many of them. It is often put on the back burner while the focus is on things like new loans, customer satisfaction, and data security. Effective loan covenant tracking becomes one of the many supporting processes that will be implemented “someday”.

For many institutions, including Comerica Bank, loan covenant tracking and many other loan-supporting processes existed as a series of disconnected, manually processed spreadsheets. Those spreadsheets grew and became complex surrogate

databases with detailed loan details and covenant descriptions. Documents were distributed through shared drives. Control dates were left to become calendar and email reminders – if not forgotten altogether. These manual processes lack consistency, accuracy, and verifiability. Worse, they are both time-consuming and inherently risky.

Comerica Bank began a complex update of its key IT systems, including CRM and data storage, but the new systems didn’t address specific loan covenant challenges. While the new CRM is capable of streamlining the loan issuance process and the industrial-level data storage is a quantum leap forward compared to shared drives, many middle-office tasks are still in need of specific solutions. The existing IT environment also requires a measured and well-thought approach that will be enriched by such solutions, not thrown into turmoil.



## Tailored Commercial Loan Covenant Tracking Solution for Comerica

As Comerica Bank is updating its existing IT environment with the nCino CRM which is capable of streamlining loan origination processes with the powerful IBM FileNet and Amazon AWS storage solutions behind it, Lamden's task was to develop and implement specific solutions that are both powerful enough to support the bank's needs and easily integrate with existing and incoming IT systems that Comerica will be using for other business processes.

Lamden's approach is to automate an existing process after first re-engineering it to achieve maximum possible efficiency and eliminate wasted resources. To accomplish this, numerous functional experts, as well as participants in the existing process, are interviewed. From there, we draft the functional requirements of a solution. The vision of the improved process is then evaluated and discussed with the bank's experts and leadership team to identify any possible weak points, risks, redundancies, or other inefficiencies. We carry out process evaluation using the world's most advanced Lean Six Sigma process improvement methodology. Finally, Lamden presents specific improvement proposals for approval before final functional requirements are presented to the client. Only after this architectural stage of the automation process do we move into development.

Automation allows the bank to implement streamlined commercial loan

covenant tracking processes to provide a reliable, consistent data flow together with enhanced decision-making, auditing, and control capabilities.

The concept of the proposed solution for Comerica Bank is an internal CRM-like system to cover any existing gaps in automation and allow both back and middle-office to take advantage of the same level of automation that the front-office has with its modern CRM solutions.

The system is designed to use existing data uploaded during the loan origination stage, add new data from various sources, including monitoring and analytical systems, and simplify periodic tracking activities performed by loan officers. The system will be able to organize covenants using a unified dashboard, remind each loan officer to perform specific, current tasks, and ensure that nothing is missed. It also automates and streamlines communication with account managers when their participation is necessary – such as getting updated documents from the client and uploading them into the system.

Everything will be managed automatically, switching every step of current processes from manually supported Excel spreadsheets to a flexible set of interdependent workflows. While some covenants still require manual tracking, many could be tracked without the manual intervention of a loan officer. As newer technologies emerge, the goal is to automate tracking as much as possible to improve the overall process as well as the ease of tracking. To enable such capabilities in the

system, Lamden defines a structure that will represent different covenants and break the tracking process down into general steps or algorithms that can be implemented as a tracking software tool.

The structure of a covenant data record typically includes the covenant name,

type, and condition(s) to be tracked. This can take many forms. For example, a financial condition can take the form of a ratio, such as requiring that the debt ratio remains below 40%. Consequently, the implementation of these conditions is heavily influenced by the scope and target use cases.

### Some of the typical covenants that could be tracked are:

- *Timely financial information (monthly preferred, quarterly at worst)*
- *Cash flow (debt service ratio)*
- *Leverage (senior and total debt / EBITDA, debt-to-equity or debt-to-assets)*
- *Liquidity (current ratio)*
- *Collateral value (loan-to-value or net worth)*
- *Cash control – the ability to use proceeds from asset sale / debt issuance and the Ability to control cash out in the form of a bonus*
- *Dividend restrictions (dividend payout ratio).*

*The system is very flexible and allows for the implementation of specific covenants and rule changes easily and without any complex software development.*

## The Result and the Expectations

The described loan covenant tracking system not only automates existing manual processes, but it also streamlines them, dramatically reducing the time required to accomplish many different tasks as well as minimizing the risk of missing periodic checks or losing data stored in unsecured spreadsheets.

A properly implemented commercial loan covenant tracking system significantly reduces the risk of default, the loss if a default does occur, and the net exposure at the time of default. The expected loss rate is about 20% less compared to a situation in which

covenants are either not tracked or tracked poorly. According to industry research, an effective commercial loan covenant tracking system will alert the lender that covenants are not being met an average of seven or more months before delinquency occurs. Seventy-four percent of bankers said the implementation of a central loan administration system has either increased or significantly increased the efficiency of portfolio management. For large portfolios, every percentage point of improvement or lower loss equals multimillions in savings.

We are excited to speak more with you about all of the options we can bring to the table. Please reach out to our team directly at [team@lamden.io](mailto:team@lamden.io).