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Loan Loss Analyzer Platform Automates Lenders' Allowance for Loan and Lease Losses, Enables Easy Transition to Current Expected Credit Loss

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"By providing all this educational information, we become more in tune with what lenders need and how to enhance our technology to address those needs."- Dalton T. Sirmans

CEOCFO: ***Mr. Sirmans, what is the focus at MainStreet Technologies today?***
Mr. Sirmans: Our primary business is developing financial technology for community banks and credit unions that automates complex credit risk-related activities. Mainly, we target the allowance for loan and lease losses, which is the reserve that every financial institution that lends money has to set aside to cover loans that might go bad. It is a highly regulated, intensive calculation, has a lot of moving parts. For the last 10 years, we have been developing and enhancing this technology to meet changing and expanding needs of financial institutions in this area so critical to their bottom lines. Recently, we established a new division, MST Advisory, to provide consulting services to lenders as they deal with increasingly complex regulations relative to their reserves. Our first business was developing and providing technology to government agencies, primarily county clerk of court offices, to help them organize and provide access to data and documents requested by their constituents.

CEOCFO: ***Other than scale, what are the challenges unique to community banks as opposed to larger regional or the big banks?***
Mr. Sirmans: It is Interesting that you mention "scale," as that has a lot to do with the challenges community banks and credit unions face today. The majority of banks manage less than a billion dollars in assets, yet they must comply with the same regulations that govern the largest banks. As you might imagine, the small banks have substantially fewer financial resources and less manpower. Regulatory pressure is compounded by an economic environment that has interest rates at all-time lows, so they are not nearly as profitable as before the financial crises of the mid-2000s. Those factors are driving consolidation, the larger banks buying smaller community banks. It is something we are likely to see continue over the next few years.

CEOCFO: ***How does MainStreet Technologies make it easier?***
Mr. Sirmans: Our software allows the institution to manage its loan level data in a way that allows it to analyze the information and reach conclusions about how it should reserve for loan losses to accommodate accounting rules and regulatory directives. It's not as simple as saying looking at an historical loss rate for a type of loan and applying the same loss rate going forward. There are so many other factors that figure into the equation, and new regulations are adding more factors and much more complexity to the process. The industry is in transition to a new accounting standard that makes it nearly impossible to estimate an allowance manually, as many small banks have done in the past. You need some sort of automated system to crunch all the different data and greater volume of data that will be required.

On average for a $2 or $3 billion bank, our software has reduced the allowance estimation process under the current, less complicated regulatory edict from a two or three month process to a few minutes. So our clients spend their time analyzing the results and using them for decision-making as opposed to calculating. It is life-changing technology, giving lenders the ability to manage their business through the numbers, not just fulfill a regulatory obligation.

CEOCFO: ***Are you providing raw data that needs to be put together, or are you showing conclusions or making projections?***
Mr. Sirmans: Community banks have an abundance of data. They have many customers, commercial and individual accounts, that have provided a lot of information. You probably know that if you've ever applied for a loan. Think of all the background information you had to provide. Then they have at their fingertips FICO scores, credit histories, peer data from banks in the same market or of the same size. Now, under the new accounting regulation that requires them to look forward and predict future losses, they have to factor in a whole new set of information, like economic indicators that help them understand how their loans might perform in the future.

We take all that loan data they have amassed over time, clean it and organize it – most banks have not done a particularly good job of organizing and ensuring the accuracy of their data historical data – and we warehouse it in our system. Then we add the external data that correlates to their loans, and data on such things as trends and loan concentrations. The data is organized in a way that gives them a full grasp of the information within their institution and an understanding of how the external factors might impact their institution. The software allows them to see how the various factors work together, to create and study what-if scenarios, and in the end, to be more competitive because the more usable information they have, the better decisions they can make about the products, types of customers, industries, markets that will deliver profitability and stability to their institutions.

CEOCFO: ***What might you bring in that would not necessarily be thought of as important but adds value?***
Mr. Sirmans: One of our newest developments is a product we call the MST Virtual Economist. We are leveraging the various sources that aggregate economic data: the Federal Reserve Economic Data, a repository from the Federal Reserve in St. Louis; the Philadelphia Federal Reserve, which provides leading and coincidental indicators, state by state; and the Federal Open Market Committee, which predicts the likely path of our economy for the next three to five years. All this data is available at no cost. But most small lenders don't have the expertise to pull this in and correlate it to their portfolios. The Virtual Economist helps them identify the economic indicators most likely to impact their loans and how changes in those factors will impact their performance. One of the things we have learned is that the user experience is critical, that is, how easily can you take your information, combine it with external information and see how they work together to help you manage better.

CEOCFO: ***How are you reaching out to banks or are they coming to you?***
Mr. Sirmans: One of the distinguishing characteristics of MST is our focus on education. We give away a lot of educational material in the form of articles, white papers, blogs, etc. And we do an annual national conference. It's strictly educational - no trade shows, no displays, no sales pitches. We bring in industry experts for three days to speak on the day's most critical topics related to bank reserves. We also do training through the Risk Management Association and American Bankers Association. We have spent a great deal of time and money establishing ourselves as the industry's source of expertise on the allowance for loan and lease losses.

We offer bankers deep, objective educational information that is actionable, which in turn has created a community of bankers that look to us for the answers. So we learn their questions, the problems they are facing, which helps us then develop more solutions for them. By providing all this educational information, we become more in tune with what lenders need and how to enhance our technology to address those needs. We have improved our product\, our systems, our processes through our commitment to educating the industry.

CEOCFO: ***Competitive landscape for you?***
Mr. Sirmans: We have a couple of key software competitors. Most banks still use Excel to manually calculate their allowance. And then you have some that use accountants or other outside resources. But the new accounting standard, current expected credit losses, now commonly referred to by its acronym CECL, will require lenders to fundamentally change how they estimate their reserves. That is driving a lot of interest and business our way – and also creating new competitors, like some of the core banking software providers. We feel we are strongest provider, having pioneered automation in this space 10 years ago and maintained our focus on this one aspect of banking ever since.

CEOCFO: ***What are the products that you offer?***
Mr. Sirmans: Everything on the financial institution side of our business is rooted in a platform called the Loan Loss Analyzer. The LLA brings together all the processes and data necessary to estimate an allowance: what happens in worst case, best case and most likely scenarios; next quarter, next year, whatever. But the LLA also includes several tools for specific functions, like the Virtual Economist, which as I mentioned leverages economic data and allows an institution to compare that economic data to its experience; or the Shadow Loss Analysis, which allows institutions to begin testing

methodologies for CECL; and Review, a workflow tool that moves documents smoothly through the organization allowing and tracking notations and comments. There are several tools like that. All relate to estimating an accurate allowance, but also create information and reports that can be used to support enterprise-wide management.

CEOCFO: ***Would a customer purchase these tools separately or are they all part of one solution?***
Mr. Sirmans: If a lender just wants to calculate the allowance under the current incurred loss accounting model, it can purchase the base software, then add those tools as it finds them helpful. As we are getting close to implementation of CECL, lenders may want to add the Shadow Loss Analysis so they can test some of the methodologies that are more appropriate for estimating under CECL

CECL has also increased the call for advisory services specific to the allowance. We have steered clear of that in the past because we are a software provider and the education we provide is by leveraging expertise from the top accounting firms, regulators, and others in the industry. But there is very little specific advisory service available for this transition to CECL. So we have established MST Advisory to help institutions prepare for and shape a proper model to comply with CECL. We have brought in expertise, consultants from major auditing and accounting firms experienced in the allowance to complement our internal expertise. We are now working with institutions to help them begin modeling and determine which is the best route for them to become compliant with CECL. That is what banks need, that is what credit unions need now, in the transition, somebody just helping them understand what they need to be looking at and which direction they will take. Once they have decided what they will do, then we can help them with automation.

CEOCFO: ***How do you stay ahead of the regulatory issues?***
Mr. Sirmans: FDIC, the OCC and the Financial Accounting Standards Board, which developed CECL, are pretty good at telegraphing what they are looking at and it takes them a little time to move, to actually make a change happen. We are able to attend meetings and webinars and even participate in some of those sessions to provide input. It is better than you might think; they are a little more open, and they want the input. That gives us time. We just stay as close as they will allow us to what they are working on, then we disseminate that information and a likely timetable to our clients and the industry in general as we work on solutions to address the changes.

The federal regulators and the Financial Accounting Standards Board are driving this. State regulators are very much following what is going on at the federal level. For those institutions doing work in other countries, there is a different set of requirements to adhere to from the International Accounting Standards Board. We also work closely with the accounting firms that advise banks in this area: Grant Thornton, Crowe Horwath, KPMG, Dixon Hughes Goodman – their people are great to work with and keep us informed on what is going on, not just nationally but internationally.

One thing about financial institutions: They don’t pioneer too many things, because if you get out front too much, there is a possibility that a field examiner or an auditor will say, “This is not what we are seeing your peers do,” or, “We are not really comfortable with this.” So they move slowly as well, which gives us time. It also means our sales cycle is a little longer, but building trust for long-term relationships is key to our business model. So it all works pretty well.

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