How to Work with Banks: Advice to Alternative Finance Companies
By Charles Wendel

In the last two years, there has been a substantial increase in the number of Alternative Finance companies (AF) that seek to lend to the 90% of small businesses that banks either cannot or will not lend to. Yet, while lending to this vast segment of would-be borrowers would seem like "shooting fish in a barrel", customer acquisition remains a major challenge for AFs. So, many of them have turned their attention to the banks as a potential origination channel.

The AFs that have managed to work with banks have partnered with them in several ways, including:

- Obtaining referrals from banks for loans not acceptable to bank criteria ("turn-downs"). In turn, the bank usually receives a referral fee and, more importantly, can capture or retain the customer's business
- Offering their origination, servicing, and risk management platforms as a service to the banks, allowing them to streamline the lending process, lowering their costs and improving customer experience
- Purchasing individual whole loans or loan portfolios
- Providing debt financing to AFs, secured by the AF's portfolio of receivables

Banks are attractive partners because they have two incredibly valuable attributes, (1) a loyal customer base, and (2) the lowest cost of capital. However, working with banks is a long, hard road for AFs. It requires careful planning, patience, and persistence. The vendor review processes enforced by bank regulators have made the partnership process more stringent and more difficult. Furthermore, partnering with a bank means that the policies, processes, and procedures of the AF should resemble those of the bank. It's not good enough to simple abide by the reduced regulatory regime that non-bank lenders operate under.

Factors for success with banks. What does a vendor, particularly an AF, need to do to succeed with banks?

Understand the framework that bankers operate under. Bankers fear risks related to privacy, vendor quality and integrity, reputational risk, and similar issues. Today, every business decision is reviewed closely by a bank's internal compliance group and must meet external regulatory demands. Beyond addressing compliance issues and conducting a detailed vendor review, banks will only sign up if working with an AF "moves the needle," meaning banks need to view the revenue opportunity as substantial enough to justify the work required to put an agreement in place. To the extent possible, AFs need to quantify the economic upside for a bank and show that it can be a meaningful number. Alternative Finance personnel differ in many ways from the typical banker, but they need to understand how bankers think and the often-arduous internal bank decision-making process.

Provide a solution that is as turnkey as possible. Large banks have difficulty in changing entrenched systems and processes. Small banks generally lack the resources necessary to innovate. Therefore, AFs need to do most of the work and provide a turnkey solution.

Obtaining the initial approval of the bank to work together is only step one. For example, to generate the volumes that AFs want they need to establish a loan referral process for the bank that is centralized and simple. Feedback to the bank needs to be quick and transparent. The AF needs to take the lead and shoulder the majority of the work related to setting screening criteria for referrals, establishing process flows, and closing a deal. AFs need to play a key role in leading execution of their bank relationships.

Be prepared for the regulatory and compliance issues. AFs must anticipate and address a myriad of regulatory and compliance questions. Some AFs may find that the effort and investment required in doing so is greater than the likely payoff of working with banks. The AFs most likely to succeed with banks will operate with a management team that has experience in these areas and can respond to the bank's concerns with detail and credibility. There is no room for making it up as you go along. This will include the need for an internal compliance function within the AF that manages an active program of creating many of the policies and recordkeeping that banks expect within their own organizations.

Be patient and persistent. The bank approval process will often involve line officers, compliance, legal, IT, and others. Banks are simply not going to be rushed to make decisions. Last year, in working with one vendor we came up against the annual planning cycle, resulting in bankers shutting off consideration of any new business opportunities for three to six months.

In many cases, the internal educational process within banks will also take time. Recently, a bank put off working with a top-tier AF player, primarily due to bank concerns over the reputational risk related to the AF. However, both this company's and the industry's reputational risk has been declining as the media and borrowers see AFs offering a needed lifeline to small businesses. Rather than an outright rejection, this AF needs to view the delay as part of the long-term bank mating dance and continue to market to the bank. It would be understandable, but a mistake for this vendor to give up too soon.

One critical positive change that has been occurring in recent months involves the greater receptivity that more banks show toward alternative finance players. Many banks realize that these players are here to stay and that they provide capabilities that banks need to embrace. While AFs face multiple challenges, the access to millions of small business customers that banks provide seems worth the effort for those with the fortitude and know-how to do so.

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