




WHITEPAPER

Back to Basics: What Makes a Strong Credit Analyst?



A strong credit analyst is indispensable to the financial health and strategic direction of a financial institution. This whitepaper explores characteristics to look for that can take your institution's performance to the next level:

- ▶ Pays attention to details & the bigger picture
- ▶ Connects the dots to make sense of datapoints
- ▶ Blends analytical expertise with strong communications skills
- ▶ Structures credits to meet the needs of customers & the institution
- ▶ Keeps a close eye on the portfolio

Credit analysts play a significant role in banks of all sizes and their job performance can help make or break an institution's balance sheet.

While relationship managers drive sales and loan production, credit analysts serve a key control function within the bank. Much like driving a car, relationship managers and client coverage teams help accelerate a bank's growth, and credit analysts function as the necessary safety features designed to prevent the bank from veering out of control.

When credit analysts are empowered to perform at the highest level, the financial institution can protect its balance sheet and boost its bottom line. This whitepaper will outline the key characteristics of a strong credit analyst and present proven strategies that will help them elevate their performance, and their bank's performance, to the next level.

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Characteristics of a Strong Credit Analyst

1 Attentive to Details & the Bigger Picture

Credit analysts directly impact which direction the bank heads in. Good credit analysts will maintain and enforce credit policies that are within the bank's risk tolerance while helping the institution meet its return on equity (ROE) targets. Achieving this requires attention to detail without losing sight of the big picture.

When a large commercial deal is on the line, there is little room for error in the decision-making process. Credit analysts must be accurate, attentive, and thorough when reviewing all the information and financial data associated with a loan request.

At the same time, when poring over the financial records and evaluating the deal, they cannot lose sight of the big picture. Credit analysts must pay attention to client-specific data, such as financial statements and tax returns, as well as data on the client's competitors and overall industry.


Understanding a client's balance sheet beyond what's on the financial statement is what separates a good credit analyst from a great one. A strong analyst gleans deeper knowledge of a client's operations—from their current market share and long-term growth prospects to emerging threats that may affect their business model. These details help the credit analyst see the full picture and accurately determine whether a client's loan request should be approved.



2 Connects the Dots

Credit analysts need to be able to connect the dots and make sense of all the information available to them. Understanding the industry a client operates in, how their business performs against its peers and the strength of its business model are some of the considerations a strong credit analyst evaluates, alongside the typical factors like debt-to-income ratios.

To determine whether a potential client is worth adding to the portfolio, reviewing the client's industry is an important first step. Business doesn't happen in siloes and having a solid grasp of the industry gives a credit analyst the context they need to evaluate the potential client and their loan request. Different industries will often have different indicators of financial health and what is perfectly normal for one business's balance sheet may be a red flag for another.



Credit analysts should be able to connect the dots across three views, including a general overview of the industry, the industry's overall performance, and how the client's performance compares to its peers.

Industry Analysis

Credit analysts must be informed about a client's industry and its competitive landscape to adequately evaluate their business.

Among the factors to consider: How many competitors are in the space? Is it a saturated market? What is the potential for new entrants to disrupt the industry? Are operations seasonal or cyclical in nature? Are there environmental or climate risks to consider? What about labor risks? And how much power do end-users have to drive down costs? Similarly, do suppliers have the power to drive up costs?

Industry Performance

Beyond a high-level overview, a great credit analyst will research how the overall industry is performing.

How has the sector performed in the last five years? How about the last decade? What is forecast for the industry over the next several years: growth or consolidation? How resilient is the industry to macroeconomic factors, such as inflation, unemployment, consumer confidence, and discretionary spend?

Industry Averages

Once an analyst has a general overview of the industry, they can more effectively compare the client's performance to industry averages and competitors. Some metrics to compare may include market share, growth rate, profit margins, revenues, and cash flow.

For instance, a furniture manufacturer with 5% revenue growth and 8% profit margins may look great at first. But, if a peer comparison reveals that its competitors average 8% revenue growth with 10% profit margins, further investigation is needed. An experienced credit analyst will identify this and probe for an explanation. The metrics that warrant comparison will vary depending on the industry as well. A great analyst will identify which data points are most relevant for assessing the business's credit risk. As an example, for some businesses, like those based on subscription models, customer retention rates could be a key indicator. While this is seemingly straightforward, many community banks and credit unions lack usable peer comparison data simply due to the size of their client base. These institutions can instead rely on data, such as the Risk Management Association (RMA) comparison reports to gain knowledge of industry metrics (specific NAICS codes) and ratios. From there, a skilled credit analyst can accurately compare their client's financials against industry averages using the RMA reports.



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Blends Analytical Expertise with Strong Communication Skills

After all the required information is processed and analyzed, a strong credit analyst will understand ways to mitigate or reduce any identified risks. This requires collaboration with the relationship manager and any other supporting team members working with the client.

Understandably, a credit analyst should have strong communication skills, in addition to their analytical background. This role leans on their analytical skills to assess creditworthiness, but will need solid communication skills to accurately present the loan recommendation. Cultivating strong communication skills is vital for effectively conveying the analysis, including any red flags, and articulating the final loan recommendations to stakeholders.

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Structures Credits to Meet the Needs of Customers & the Bank

For both new and existing clients, credit analysts play a major role in ensuring the loan terms, pricing and structure are aligned with the bank's risk tolerance and ROE targets. Economic performance is cyclical and changes like interest rate hikes and higher cost of funds impact how a loan should be structured and priced. After all, different loan structures come with different risks.

For example, a variable-rate loan may be riskier than a fixed-rate loan, as the borrower's payments could increase if interest rates rise. Conversely, longer loan terms may be riskier than shorter loan terms in some scenarios, as there is a higher likelihood of the borrower defaulting over a longer period.

To understand the best way to structure and price a loan, credit analysts should be able to see the full picture of the client's business and how their overall performance stacks up against their peers, as well as what risks their business is exposed to. Much of this information is gleaned during the financial and industry analysis, as mentioned above.

However, when structuring the credit, especially for complex commercial credits, analysts should also consider the purpose of the loan and how it will be repaid. The purpose of the loan is defined as how the loan proceeds will be used and the borrowing cause is the reason for the funds.

For example, a ski resort may need credit to develop a new trail, as well as build a new ski lift. The purpose of the loan is for construction and equipment needs associated with developing the new trail. The borrowing cause could be that annual increases in the volume of skiers warrants a new trail to ease traffic and crowds within the park. The new trail will also support the resort's continued growth by increasing its capacity to comfortably serve more visitors each year.

Consider this borrowing cause versus if the borrowing cause was to replace a broken lift and maintain an existing trail. Each scenario presents very different risks, even if the purpose of the loan is similar. These factors, plus the nature of a ski resort's operating model (i.e. a seasonal business model), should inform how the loan is structured and priced.



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Keeps a Close Eye on the Portfolio— From Collateral & Covenants, to Continuous Monitoring

An experienced credit analyst will also understand the risks, including any risk exposure associated with specific products or credit lines, and how to mitigate those risks. This is where a seasoned analyst will recommend appropriate collateral or credit covenants to minimize the identified risks. For example, based on the commercial loan request, an analyst may deem it's necessary for the borrower to sustain its current profitability levels and maintain moderate leverage. Each request and borrower will present distinct financial needs and have their own unique balance sheet, which makes it crucial that credit analysts can see the full picture to meet the needs of the client and protect the interests of the bank.

Understandably, keeping track of the various credit conditions, as well as the associated covenants and collateral with each credit, can seem overwhelming. Beyond the more in-depth annual reviews, analysts must also continuously monitor for changes to credit conditions that expose the bank to added risk.

For instance, if a commercial client has a decrease in sales that exceeds 5%, this may warrant an immediate review of the credit risk. This is where technology can help. With portfolio monitoring tools, pre-defined rules and triggers can be used to automatically alert analysts when a review is needed. These types of triggers are often early warning signs of weakness in credit health, so analysts are notified weeks or months sooner than if they'd relied on traditional paperwork alone.

Credit analysts are tasked with keeping a pulse on rapidly changing economic conditions, interest rates, market sector trends, and other macroeconomic factors that may impact their portfolio. Tools that make it easier for analysts to access real-time insights into their portfolio performance can go a long way toward helping a bank achieve its ROE targets.



Professional Development Unlocks Potential

Beyond tools and technology, credit analysts also benefit from professional development opportunities. For more junior credit analysts, mentorship is especially important. Consider pairing junior credit analysts with more seasoned analysts, who can share best practices and advice based on their own experiences and scenarios they've encountered during their career.

Another way to empower credit analysts to reach their full potential is by offering training sessions that simulate real-world scenarios. Credit analysis can be complex and practical experience can oftentimes be a more helpful resource than a textbook. Giving analysts an opportunity to practice their problem-solving and decision-making skills and apply them to real-world situations will go a long way toward fostering their full potential.

Credit Analysis: A Role Worth Investing In

While credit analysis is not technically a revenue generator for the bank, credit analysts play a crucial role in generating returns for the bank through any economic cycle. As the guardians of banks' balance sheets, this is clearly a role worth investing in. From technology that helps analysts connect the dots and stay ahead of risk, to ongoing professional development opportunities, there are countless ways to help team members succeed in this role and ultimately, position their financial institution for success.



*Ready to empower your
credit team with industry-
leading technology?*

Let's Talk



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