diversification strategies for portfolio safety and loan growth

The combination of government stimulus programs for consumers, businesses, and community and regional financial institutions has swollen deposits to record levels.

According to a 2021 FDIC Risk Review, "The banking industry saw unprecedented deposit growth in 2020 as increased economic and market uncertainty shifted consumer and business spending and saving behavior. Expanded monetary policy coupled with government assistance and support programs, including stimulus and unemployment payments and the PPP, bolstered cash for consumers and businesses, which further supported deposit growth and personal savings. Total deposits increased **$3.3 trillion**, or **22.6%**, in 2020, the largest annual growth since 1984."

While many banks and credit unions have been looking to purchase quality assets to put their cash to work (with interest rates on the rise and portfolio assessments beginning in the 2022 Safety and Soundness Exam cycle), they will find concentrations that need to be diminished or loans that need to go.

Financial institutions with elevated levels of credit exposure to affected sectors are potentially more vulnerable to market disruptions and risk management challenges as payment delinquencies increase and credit deteriorates.

Take commercial real estate (CRE) for example. CRE is the most severely impacted loan segment by the pandemic. Until strategies are implemented to repurpose vacant commercial real estate, the industry will be in a lurch, as delinquencies that were masked by government programs and deferrals will cause huge issues for some banks and credit unions. And that's just one example.

Those with high concentrations in certain areas should be looking to offload these troubled loans to reduce loss, as the pressure to satisfy regulatory requirements by reconciling loan portfolios (while continuing to put cash to work) will only grow in the coming months. As asset/liability structures continue to shift, how can your institution meet your goals for revenue generation, portfolio growth, and credit quality in the years ahead?

loan participations

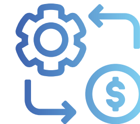
Incorporating loan participations into your long-term growth strategy presents the opportunity to supplement organic growth while more effectively managing your balance sheet. Cloud-based platforms can make selling and trading easier, allowing you to manage your loan portfolio more strategically – now and into the future.

These systems allow you to:

- Diversify your portfolio by geography, industry, and loan type.
- Reduce inherent risk by identifying deterioration early and removing the asset from the balance sheet.
- Expand your peer network beyond current regional and economic limitations.
- Better serve the needs of your community by fielding requests that may lie outside the scope of your current business model.

expand efforts into other industries

Now that stimulus programs have run their course, small business owners are once again seeking financing to fund new growth. This presents an opportunity for banks and credit unions to step in and help fund their expansion. It also presents an opportunity for lenders to diversify their portfolios – which was tough for many during the pandemic.



As businesses seek financing to fund new growth, banks and credit unions have an opportunity to step in and help fund their expansion.

When considering which industries are likely to drive loan demand, a careful eye should be given to those that carry accounts receivable and inventory. Why? Consider the asset structure of different types of small businesses. For example:

- A temporary staffing firm houses many receivables with few other assets to offer as collateral. On average, a staffing company's accounts receivable makes up more than 45% of total assets – a substantial ratio. If a company with that structure has the potential to expand, it's very likely they will need a source of short-term working capital to make that opportunity a reality. These types of companies are also challenged to meet weekly or bi-weekly payroll expenditures, despite their customers often paying them on Net 30 terms.
- A small trucking company's accounts receivable averages 32% of total their assets. They rely heavily on receivables to supplement weekly cash demand for payroll, hefty fuel costs, and short-term expenses. They also face a high growth potential in the coming months and years.

It's likely that businesses in similar positions to staffing and small trucking companies have outstripped their cash cycles. As a result, the market for short-term working capital is robust. Banks and credit unions that have the appetite and relevant technology to manage an uptick in business are well-positioned to strengthen accountholder relationships and drive revenue.

digital loan management

It's essential to invest in modern technology that allows you to manage increased demand with speed and accuracy while reducing risk and delivering a seamless accountholder experience. A comprehensive system can make all the difference, as it can automate administrative functions and help manage critical aspects of working capital and financing such as invoice entry and verification, risk analysis, invoice delivery, trend analysis, and credit checking.

"In 2020, (credit) risks intensified as the economic contraction unfolded. Banks remained relatively resilient – partly because of government support extended to businesses and consumers ... However, banks and credit unions with elevated levels of credit exposure to affected sectors are potentially more vulnerable to market disruptions and could present risk management challenges."

2021 FDIC Risk Review

create limitless possibilities

Learn more about our digital lending technology.

For more information about Jack Henry, visit jackhenry.com.

© 2022 Jack Henry & Associates, Inc.®