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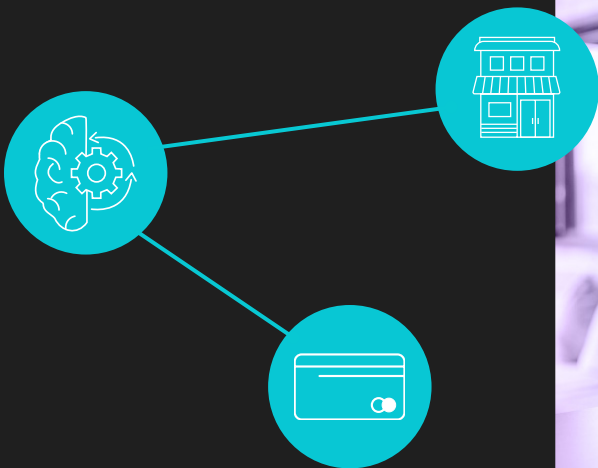
The Beginner's Guide to AI Loan Approval

HOW SMALL BANKS AND CREDIT UNIONS CAN USE AI LOAN TECHNOLOGY TO REVOLUTIONIZE CONSUMER LENDING

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CHAPTER 1

Market Challenges Driving AI Adoption

Generative AI Shakes Up Banking

No industry has been immune to the buzz around generative artificial intelligence (AI), financial services included. While generative AI has turned a lot of heads over the past year, its applications in the banking world remain limited. At present, generative AI operates as a black box model, meaning that it doesn't provide any reasoning behind its decisions. That's a problem for financial services.

Because they have to follow fair lending laws and regulations, financial institutions need to operate with a high degree of explainability when making credit-related decisions. They can't simply take the output of a generative AI tool and run with it. Whether they're approving a credit card or granting a mortgage, banks have to be capable of justifying their decisions, both to consumers and regulators alike. Black box generative AI models aren't up to those kinds of tasks.

But all the excitement around generative AI does have a tangible impact on the financial services space. It's shifted the spotlight to more conventional (and explainable) machine learning (ML) methods, like logistic regression, XGBoost algorithms, and linear regression. Banks have used these ML techniques for some time, especially for fraud prevention.

Now, feeling both newfound attention around generative AI and the heat from fintech competitors, banks are doubling down on their ML investments.
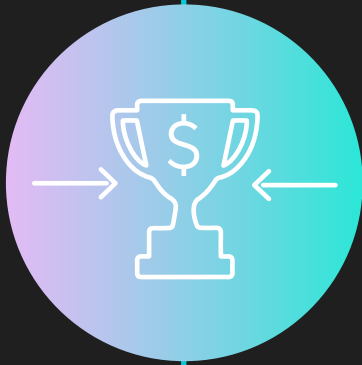
Fintech Competition

Fintechs have undeniably disrupted the industry, leaving traditional banks with no choice but to embrace more sophisticated risk segmentation techniques. The days of relying on FICO scores for pricing strategies are over. Even smaller national banks and credit unions are waking up to the imperative of using ML for smarter, faster loan origination.

To keep their consumer lending practices nimble alongside incumbents like Chime, SoFi, Cash App, and Venmo, traditional banks have to make substantial investments in their digital offerings. These prolific fintechs have raised the bar for seamless digital experiences, and consumers have adjusted their expectations accordingly.

Evolving Consumer Relationships

Fintech influence isn't the only reason traditional banks are under pressure to evolve their consumer lending experiences. In the past, consumers were likely to buy multiple products — such as debit cards, credit cards, mortgages, and personal loans — from a single primary financial institution. Now, as most consumers maintain relationships with three banks on average, everyone's fighting for a smaller piece of the pie. This presents a challenge for smaller banks as they risk losing business to competitors who can cross-sell more products to more customers.

Smaller banks and credit unions need to increase the number of products customers hold with them to enhance loyalty. But they've struggled to get new customer experience solutions to market quickly. On top of the IT resources required to build the products, they often face bureaucracy, IT backlogs, and budgeting conflicts.

The challenge for community banks, credit unions, and smaller national banks is clear. The answer is also clear: use AI to uplevel the way customers spend, save, and borrow money.

3 CRITICAL APPLICATIONS

Credit Decisioning

Fraud Detection

Risk Segmentation

Introducing AI to the Lending Process

What do AI and ML actually do to modernize digital lending practices? In short, these technologies enable faster loan origination, smarter credit decisions, and better loan application experiences. They provide banks with the tools to say "yes" to more of the right customers, streamlining manual decision-making processes, and enhancing user journeys.

Many banks already have a preferred decision engine, risk model, or fraud verification system. They don't necessarily need to rip up and replace them with totally new AI systems, but they might choose certain applications to enhance with AI. For instance, introducing ML to the credit decisioning process can help banks approve the right near-prime or subprime applicants, expanding lending opportunities without increasing risk.

Banks wanting to ramp up their AI profiles should look to three critical (and incrementally valuable) applications in the consumer lending space: credit decisioning, fraud detection, and risk segmentation.

Credit Decisioning

Smaller banks and credit unions have tended to perform credit decisioning via manual methods, whether using a simple rules-based engine or a physical scorecard. These might work fine when you're processing one application a day. It doesn't work when you're aiming to expand your customer base efficiently and profitably. Manual credit decisioning simply doesn't scale. When loan volumes increase, banks revert to hiring more staff, which increases overhead.

Beyond the scalability issues in the more traditional credit decisioning processes, consumer expectations have changed. If a bank can't provide an instant response about an applicant's eligibility for a financial product, they'll likely turn to a competitor who can. This creates an adverse selection problem. The best loan applicants will opt for banks with the smoothest customer experiences. The applicants willing to endure a lengthy application process tend to have limited options because of their risk profiles.

Lending to customers with exceptionally high credit scores or extremely low scores is pretty straightforward. Lending to anyone in between… not so much. Distinguishing between creditworthy and non-creditworthy applicants in the near-prime or subprime range is notoriously difficult, but that's where AI and ML shine.

Let's consider a scenario where a bank's FICO cut-off is set at 600. By using ML, they may choose to lower that threshold to 570, since the algorithms can help them distinguish between credit-worthy and -unworthy applicants within the 570 to 600 range. This way, banks can expand their credit box, backed by an enhanced ability to assess creditworthiness. Expanding their lending opportunities also positions banks to cater to a wider range of customers.

AI and ML algorithms make this credit decisioning much more efficient, allowing underwriters to focus their attention on more nuanced applications and edge cases.
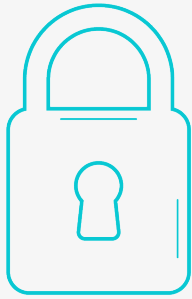
Fraud Detection

Fraudsters are constantly refining their tactics. **The key challenge in digital lending is minimizing fraud risk while ensuring a seamless customer journey.** Striking the right balance is essential. Aiming for a zero-fraud rate is unrealistic — banks either end up lending to no one or imposing excessively high standards that make it impossible for customers to complete the application.

ML models excel at identifying which attributes tend to correlate with varying levels of risk. Working with an ML partner allows banks to tap into an array of third-party vendors and data sources, and this enriched dataset can help them better identify applicants likely to pose fraud risks. An ML technology provider will also train models across multiple partners and asset classes to ensure models perform optimally.

By using ML to highlight relevant risk attributes and thresholds, banks can stop fraud before it happens while lending more profitably and confidently. They can also improve the end user journey by minimizing the need for low-risk customers to physically visit a branch or endure other types of high verification barriers.

Risk Segmentation

Risk segmentation is a cornerstone of both credit decisioning and fraud detection. It involves categorizing customers into risk buckets to price them appropriately. Risk segmentation also allows banks to match the customer journey to an applicant's perceived risk level. For example, low risk applicants will be served a seamless lending application experience. If the ML model deems an applicant to be high-risk, they may be prompted to complete additional steps to help prevent fraud, such as taking a selfie with their driver's license.

Digital mitigation is critical for smaller banks and credit unions. It ensures that even higher-risk applicants can navigate the process efficiently without having to visit a physical branch or complete pages and pages of digital paperwork. The right technology empowers institutions to achieve both secure lending experiences and frictionless customer experiences, ultimately enhancing their competitive edge in the lending market.

Benefits of AI in Lending

Embracing AI and ML in consumer lending delivers a range of advantages, starting with time and cost efficiency and spanning across risk management, fraud detection, and credit decisioning intelligence.

1. Reducing Operational Costs

One of the standout advantages of using ML, particularly in risk segmentation, is the reduction in vendor costs and operational expenses. By accurately categorizing customers into risk segments, banks can curb the need to buy unnecessary data sources to support the decisioning process. For instance, they can funnel low-risk customers through a smooth application process without incurring additional data retrieval expenses. Additionally, ML empowers underwriters to focus on assessing applicants where risk is less clear-cut, maximizing the value of their talent. This saves operational costs but also ensures that valuable human resources are channeled towards more decisive lending decisions.

2. Time Efficiency

Some aspects of the lending process, like application review, can require human discernment and domain knowledge. These should remain the focus of an underwriter. Other aspects like data entry demand undue time and concentration, and these operational tasks deserve to be automated. AI and ML will make an especially significant productivity impact for credit unions and community banks accustomed to manual underwriting. This well-deserved efficiency enables teams to tackle a broader range of projects and value-add initiatives, rather than getting bogged down by menial tasks.

3. Risk Mitigation

As discussed in the section on risk segmentation, AI empowers banks to make more precise lending decisions, helping them better identify applicants who pose credit risks and price loans accurately. Aligning appetite for risk with sales expectations is a key step towards establishing a more balanced and profitable lending portfolio.
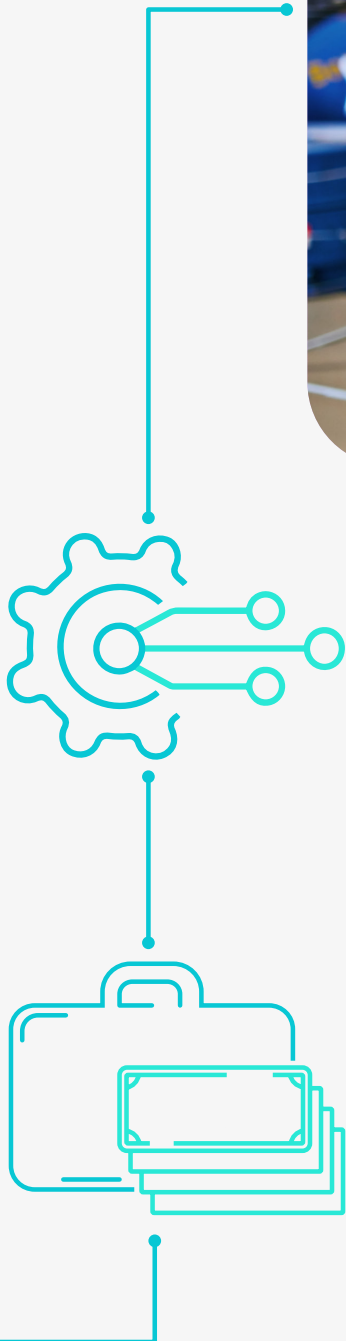
4. Automated Decisioning

In most areas of their relationships with businesses, consumers expect instant or near-instant results or responses. Smaller banks that rely on manual decisioning may struggle to keep up with this pace. By incorporating AI into the lending process, banks can introduce auto decisioning, where applicants receive instant decisions on their loan applications. Auto decisioning gives smaller banks and credit unions a huge opportunity to meet modern consumer expectations and compete effectively.

5. Smarter Lending Decisions

Beyond automation, AI brings an element of intelligence to lending. Lending money is much easier than getting it back. AI-powered loan origination helps banks make informed decisions that lead to successful repayments. AI solutions can aid financial institutions in evaluating creditworthiness, assessing risk, and verifying fraud. All of these insights assist banks in establishing profitable lending relationships — which is especially important for smaller banks launching new lending products.

Incorporating AI and ML into consumer lending isn't just about speed. It's a long-term strategic move that enhances employee efficiency, reduces vendor costs, and positions smaller banks and credit unions to make faster and more informed lending decisions in a highly competitive market.

CONCLUSION

Moving Forward with AI

Some banks are still hesitant to use AI to make credit decisions — even as ML models become indispensable and more ubiquitous. They may simply not feel comfortable relying solely on a model to generate final decisions. However, even the AI-wary will find value in using ML applications to enhance their rule-based policies.

For instance, instead of feeding a model with transaction data, you can input a set of anonymized customer attributes. The model can then identify which attributes tend to correlate with varying levels of risk. Credit and risk teams can subsequently review these attributes and construct policies based on these insights.

Speaking of how ML models can guide employees to make more informed decisions, it's important to point out that the presence of AI doesn't necessarily threaten financial services jobs. In the context of credit unions and community banks, where manual processes abound, AI can greatly empower current employees. It can liberate them from mundane tasks such as manually entering information from one system to another, or approving shoo-in credit card applicants with an 800 FICO score. Their time becomes free to review more difficult applications or undertake more strategic projects. When introduced correctly, AI serves as a means of upskilling and enhancing your team's abilities, rather than replacing their human expertise.

For some banks, motivation to implement ML might be the case of: "come for the automation, stay for the augmentation." The ability to process loan approvals in minutes instead of weeks is an incredible advantage, but it only starts there.

When banks implement ML across the lending journey, they see its full power to augment human decision-making, improve efficiency, and provide insights that sharpen their lending strategy. As AI enables banks to serve consumers with the efficiency and usability they've come to expect from other financial service providers, perhaps the greatest AI beneficiaries are the customers themselves.

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About Amount

Amount is a digital origination and decisioning platform that spans the entire lending journey, from the digital customer experience to credit decisioning, fraud detection, and seamless third-party vendor integration, all the way to the final loan closing, across various asset classes.

Given the urgency to launch new digital banking services and the learning curve (and IT resources) required, most banks need a technology partner to do the heavy lifting. Whether you're rolling out Buy Now, Pay Later, simplified personal loan originations, or streamlined credit card applications, the Amount platform gets products to market quickly and securely.

Be it for fraud prevention, credit assessment, or KYC compliance, Amount takes on the heavy lifting. We work with over 60 top-tier third-party data vendors to enrich our platform with comprehensive customer credit information. We integrate and manage these data sources, handling the complexities of parsing and normalizing data and training the ML models. Combining all this data is how the platform makes credit decisions and handles fraud and verification tasks with precision — and is able to provide end-users with different digital journeys based on their risk profile.

Consolidating loan origination and data orchestration into a single platform eliminates the need for different teams (such as underwriters, credit analysts, and fraud investigators) to juggle multiple systems, reducing training time, operational expenses, and vendor costs. It also provides banks with a unified view of customers across various loan products. With Amount, banks can cross-sell and upsell more effectively, ultimately scaling their lending portfolios.

Whether serving consumers, small businesses, or dealing with multiple asset classes, the Amount platform equips financial institutions with the technology they need to revolutionize their digital offerings.

60+
We work with over 60 top-tier third-party data vendors

Let's talk about how you can use Amount to power your performance advantage. →

AMOUNT