Whitepaper

A platform for digital transformation and growth: The next generation of digital lending

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How we got to where we are today—the three generations of digital lending

Until recently, the principal functions of the lending process had not really changed for years. While there were tools to speed things along, financial assets remained as paper-based documents. Involved parties needed to sign these papers and hold them in physical storage for verification and certification. The closing process for loans often required the presence of lawyers or notaries. Ever-growing regulatory compliance added even more complexity and documents to the lending process.

The uptake toward digital was gradual, spurred on by the advent and growth of the internet in financial services. Now, a platform for digital lending was possible. The "Big Bang" event for digital lending came with the global COVID-19 pandemic. Literally in a matter of days, it was no longer feasible to conduct transactions in person. Fortunately, the legal and technical infrastructure was already in place for the broad and quick adoption of remote, contactless transactions, allowing most financial institutions to ramp up with confidence, though not without a great deal of effort. Consumers quickly embraced digital lending and adapted easily, and even as pandemic restrictions lifted, there was no turning back. The customer experience was enhanced, and the digital options for lending became the preferred method of borrowing.

The evolution of digital lending

In the United States, the movement toward scalable digital lending began in the early 2000s. Before then, advocates were confident that digital lending could work from the perspectives of legal enablement and the technology required for execution. The chief obstacles to moving forward were related to managing risk and compliance.

The combination of the growth of the internet and the rise of financial technology (FinTech) solutions brought a growing realization that an end-to-end digital lending platform was feasible. But first, the laws governing the treatment of these financial assets as negotiable instruments or securities had to be revised. The goal was to offer the same processes and protections for digital assets as those in a conventional, paper-based medium. The digital transformation began with revisions and additions to the Uniform Commercial Code (UCC) sections applicable to different types of secured transactions. The Uniform Electronic Transactions Act (UETA) and the Electronic Signatures in Global and National Commerce Act (ESIGN) were adopted soon afterward during a wave of concern about the enforceability of electronic contracts. Many other related statutes and regulations followed, all supporting the basic principle that if you can lend on paper, you can do it digitally.

These laws and statutes defined the standards for creating and signing digital agreements and records and then transferring the rights to third parties. The Safe Harbor provisions were an important addition to ensure that the transfer of the rights of any digital asset meets the following criteria: unique, identifiable, verifiable, unalterable without detection, distinguishable from all other assets, and you must identify the secured party holding the beneficial interests in the digital asset. On the technology and platform side, this required a secure electronic signing process to create the loan agreement. It also called for an immutable record that certifies the creation of the asset and provides similarly unalterable digital chains of custody and evidence—a Digital Original®—and its ongoing management.

Critically, the Safe Harbor provisions do not dictate how you must meet them. Instead, the requirement is focused on compliance, allowing you to develop or use whatever technology you need to be compliant. The clarity and flexibility of these standards have helped fuel the rise of digital lending across multiple financial services sectors, most notably automotive and mortgage lending.

First generation: Loan origination

The first generation of digital lending focused on loan origination. The end point of the first generation was the creation of Digital Original® debt obligations that carry all the authenticity and verifiability of paper promissory notes and agreements. The goal was to automate and accelerate the tedious and time-consuming face-to-face process of manual document production and required background checks to determine creditworthiness. With so much of our data available digitally—financial and otherwise—loan origination can be largely automated by connecting to data sources in real time for authentication and verification purposes. Consumers can do the entire process end-to-end on their computer, or their mobile devices. With this came an increased access to credit and a significantly faster process for credit verification.

Second generation: Execution and the Customer Experience

While loan origination is a critical first step in the mortgage process, the real need was an end-to-end fully digitalized process. The second generation of digital lending focused on execution across the digital lending process to improve the overall customer experience. Specific technologies were developed to support different aspects of the digital lending lifecycle.
This includes digitalized settlement and closing processes, eVaults to store authenticated loan documents and create Digital Asset Certainty, remote online notary (RON) services for verification, and eSignature services for verification and workflow-based automation of lending processes. This entire process is tracked for compliance, all required documentation is digitized and managed remotely and online, and the process allows full access and sharing between a borrower and a lender. Tracking allows following an asset throughout its entire lifecycle from originators and warehouse lenders to custodians, investors, and servicers with full and real-time transparency.

Self-service workflows help tie processes together and significantly enhance the overall customer experience. Consumers can initiate and quickly move the lending process along on their phones and mobile devices, including scheduling and executing related loan activities, such as appraisals and closings. Everything is tracked for compliance, and the documentation is managed remotely and shared between borrower and lender. The improved execution process has made credit more accessible, particularly among the unbanked. By using increasingly available consumer-level technology, such as your computer, tablet or smartphone, more people than ever have been able to access credit markets to borrow the money they need to purchase a house, buy a car, or start a business.

Third generation: Platforms

Second-generation technology made it possible for lenders to string together workflows and deliver a seamless consumer experience. Today, the industry has entered the third generation of digital lending – the effort to link the various aspects of the process together on a single platform for a compliant, seamless process. In traditional consumer lending, the process is sequential, with a handoff from one participant to the next—from origination to asset monetization in the secondary markets, with many steps in between. Third-generation platforms dramatically simplify this process by centralizing tools and resources in the cloud using SaaS-based FinTech solutions for quicker, easier access with end-to-end security.

The maturation of technology supporting end-to-end digitization has created the emergence of platforms that can manage the fundamentals of digital lending, ensuring that both established players and new startups no longer need to reinvent the wheel. This lowers the barriers to entry for the mortgage industry and minimizes the ramp-up time required to achieve profitability.

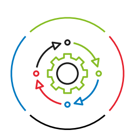
The enhanced digital lending platforms enable financial institutions and lenders to extract more value from their data, which also creates increased value and trusted data across the whole lending process lifecycle. Acting as central hubs for all digital lending activities and transactions, digital lending platforms help manage the flow of data throughout the lending lifecycle. This data—based upon a single source of the truth—can be used as the basis for analytics and reporting. Leveraging newer solutions including artificial intelligence (AI) and machine learning yields improved insights, improved process efficiency, better customer experiences, and accelerates the monetization of securities in the secondary market.

Today, with digital lending platforms that have a greater awareness of and transparency to the end-to-end process, you can move out of sequence with the understanding that compliance is correctly monitored throughout, and the appropriate data and documents are all kept and managed in one place. The result is a smoother, faster process with fewer bottlenecks. For example, Wolters Kluwer currently has finance companies on the eOriginal® platform which manage a "flow securitization" process on an accelerated timeline. This involves preparing securities offerings, engaging with all required participants, getting rated by a recognized agency, and finalizing the close—all done in weeks rather than months. Other financial institutions can execute the secondary market collateralization funding processes on a next-day basis, which has dramatically improved their capital efficiencies.

The generations of digital lending

First generation:
- Focus on loan origination
- Use of available data online to determine creditworthiness
- Improved access to credit for consumers

Second generation:
- Focus on execution and customer experience
- Technologies for RON and eSignature
- Self-service workflows with tracking for full compliance



Third generation:
- Focus on platforms that support compliant, seamless end-to-end loan processes
- Ability to move out of sequence with centralized data
- Smoother, faster processes with no need to reinvent the wheel

The benefit of Digital Asset Certainty

One of the most significant benefits of digital lending is Digital Asset Certainty. With traditional loans, up to twenty percent of documents are returned through the mail or courier because of incomplete data or missing signatures. Digital lending eliminates errors because the process will not advance if it's incomplete, giving consumers and lenders confidence they are always dealing with accurate, trusted data and documents. Ultimately, lending is about risk management. The more trusted, verifiable, and usable information and data that you have, the less risk you will incur. By enabling organizations to access and analyze relevant data only, digital lending and its capital markets will move toward true Digital Asset Certainty.

Right now, most digital processes are replicating the paper world. Instead of paper, there are PDFs or other digital replicas. What happens when lenders fully transform, when it's all about data and not documents? This is when the true value of analytics will create the fourth generation of real-time digital lending without maintaining formal document structures.

Digital lending platforms: Finding a best-in-class solution

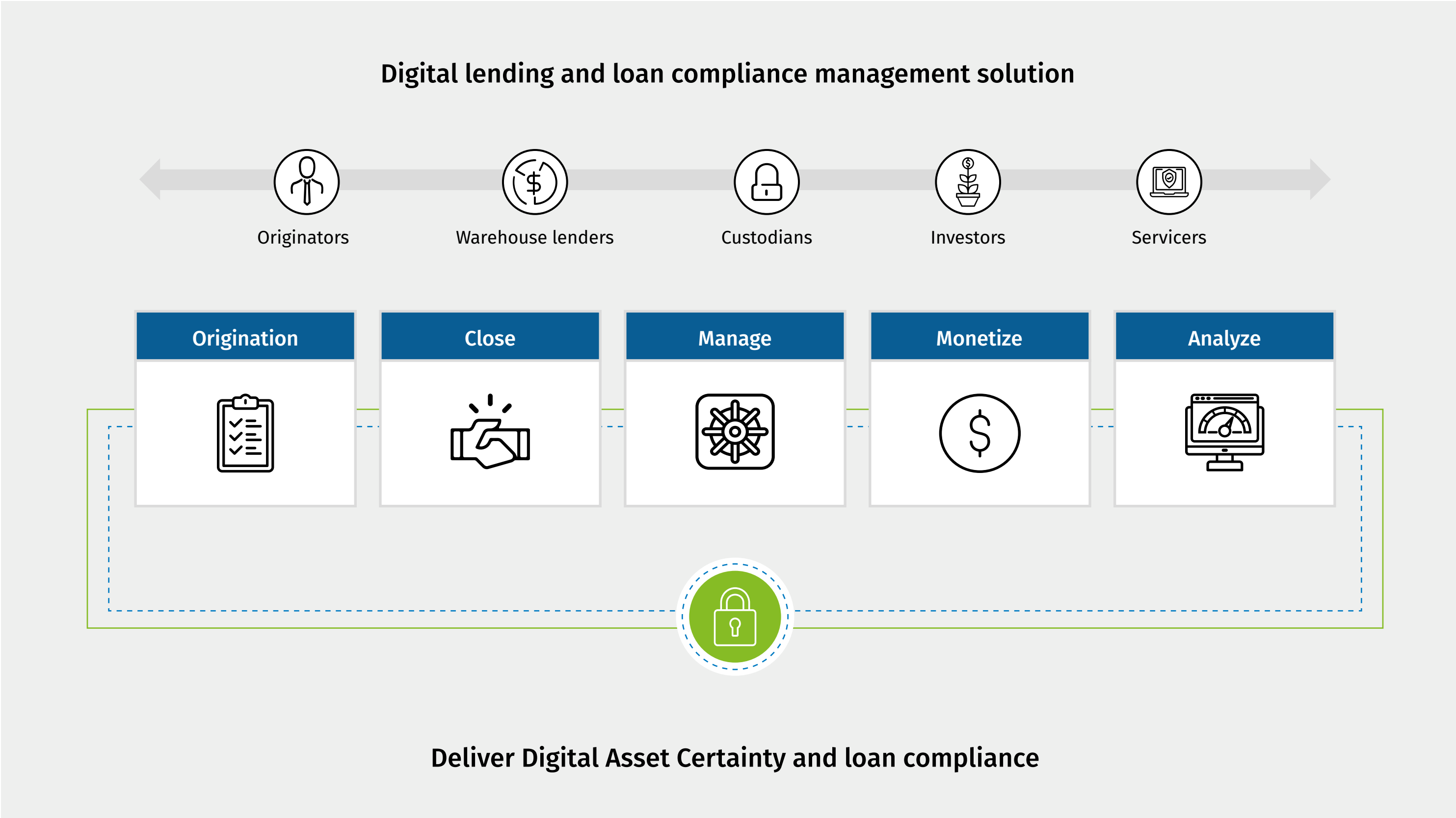
For lenders and other players in the lending industry, a digital platform should have the ability to support the phases of the end-to-end digital lending process with relevant tools and robust functionality. These include:

- **Document engine:** A document engine provides the core inputs for initiating a digital loan transaction and produce Digital Original® agreements in a fully automated fashion with warranted loan agreements and contracts. Turnkey integration with document preparation and instant access to compliant lender documents is also critical.

  Support of multiple languages is increasingly important as well, ensuring the same certainty and confidence we have in traditional loan processes, and ensuring accuracy in what may be a multi-lingual process.
- **eClosing capabilities:** eClosing tools accelerate and simplify complex loan agreements with workflow management. Look for intuitive settlement agent software, support for collaborative loan-closing operations, eSignature capabilities, and built-in RON connections to streamline closing. Together, such capabilities help ensure a better overall closing experience for lenders, borrowers, and settlement agents.
- **eVault:** An eVault holds an authoritative digital copy of the loan in compliance with the Safe Harbor provisions of UCC 9-105, ESIGN or the UETA. It consolidates digital loans in one system and ensures Digital Asset Certainty along with the full ownership and control of assets.
- **Digital Original®:** A digital lending platform needs to support the maintenance of an immutable history of the digital chain of custody for all Digital Original® agreements throughout the full asset lifecycle. This implies some sort of digital certificate or public key infrastructure (PKI) to support digital certainty. While blockchain is sometimes mentioned as a potential solution, it is currently considered too opaque and distributed to fit the needs of the lending industry, where security, verification, and legal certainty regarding ownership are paramount—particularly as assets are transferred into the secondary market.
- **MERS® eRegistry:** Mortgage Electronic Registration Systems (MERS®) eRegistry is the legal system of record for identifying the holder, custodian, and servicer of every eNote. An eNote is a MISMO standards compliant digital mortgage promissory note. For mortgages, Fannie Mae and Freddie Mac require MERS registration for eNote transfers. For this reason, look for a platform that integrates with MERS and allows you to update the servicer and custodian or transfer control to an investor, as needed. The platform should also allow you to log life-of-loan events, such as when the loan is modified, assumed, or paid off.
- **Analytics and reporting:** Increasingly, lenders need tools to analyze risk and ensure compliance through information sharing and accurate reporting. Look for a platform that supports advanced analytics to deliver data-driven reporting and insights and improve decision-making.

The task for a digital lending platform is to bring these components together to make the complexity "under the hood" invisible to consumers but fully transparent to lenders. The automobile provides a helpful analogy. Years ago, many car owners had a fundamental understanding of how their cars operated. They could do basic maintenance and repairs. Today, car owners may never even look under the hood. They simply want to know how to start, stop, and drive—with many also preferring advanced features, such as automated parallel parking and emergency braking.

Success for auto manufacturers is now functional simplicity, intuitive usability, and trusted performance. The same is true in other sectors, including digital lending. Arguably, these criteria are even more important in digital lending than in other sectors because lenders operating digitally never want to give potential customers a reason to abandon the process mid-way. The technological enablement of a complete end-to-end digital lending process that is fully compliant while delivering a positive experience for the consumer is needed now more than ever.



Digitize and gain far superior lending processes and customer experiences

More certainty for lenders, more power for consumers

Digitization has dramatically changed the lending process, and the trajectory of digital lending platforms continues to rise. According to a [report by Grand View Research, Inc.](), the global digital lending platform market size is expected to reach USD 44.50 billion by 2030, registering a CAGR of 25.9 percent from 2022 to 2030. With access to the tools and technology required to generate fully compliant loans faster, lenders can focus more of their efforts on issuing more loans, even reaching previously underserved and new markets with greater regularity.

While digital lending platforms ensure certainty for financial services players on the industry side of the equation, they also deliver tremendous benefits to consumers. The process is faster and easier with far fewer hassles and interactions. The consumer is in the driver's seat. They determine who they want to do business with, when, and where. Although the global pandemic was the catalyst for this next generation of digital lending, it's safe to say that both lenders and consumers were more than ready for it.

Ultimately, lending is about risk management. The more trusted, verifiable, usable and real time information and data you have, the less risk you will incur.

Final Thoughts

The path to scalable, modern digital lending began in the early 2000's, but was accomplished in significant, sequential phases of adoption, as is true of all great business transformations. Once the enabling legal foundation and guidance were in place for the creation and management of digital financial transactions, the lenders and financial services organizations began to experience three separate generations of digital transformation.

The first generation focused on loan origination which eliminated the need for an in-person process, improved credit access to underserved borrowers, and allowed lenders to use available online data to make decisions quickly and accurately.

The second generation was driven by the execution of the overall customer experience, including utilizing technology in support of eSignature and RON, creating self-service workflows with event tracking to enable full compliance.

The third generation, where we are today, focuses on platforms that support compliant seamless end-to-end loan processes. Those platforms must be purpose-built with functional simplicity, intuitive usability, and trusted performance. These three factors are the keys for adoption of technology, especially in consumer digital lending. The third wave of digital transformation is still ongoing, but the future of digital lending is approaching. The challenge is to make the complexity of lending completely equitable and invisible. Data will play a critical role in helping organizations meet these criteria.

Today, most digital processes replace paper counterparts, but a next generation of digital transformation will eliminate the need to maintain formal document structures. What happens when we fully transform, when it is all about data and not documents? This is when the true value of analytics will create the fourth generation of real-time digital lending.

Ultimately, lending is about risk management. The more trusted, verifiable, usable and real time information and data you have, the less risk you will incur. By enabling organizations to access, analyze and rely on trusted relevant data, digital lending and its capital markets will move towards ubiquity and true Digital Asset Certainty.

Steve Bisbee *is the Senior Advisor of Applied Technologies for Wolters Kluwer. Steve is the founder of eOriginal, Inc., a leading digital lending platform acquired by Wolters Kluwer in 2020. A pioneer in both the technology and regulatory considerations in digital lending, he is widely regarded as one of the most authoritative voices in the field.*

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