Whitepaper

The future of digital lending: Three pillars for bank success

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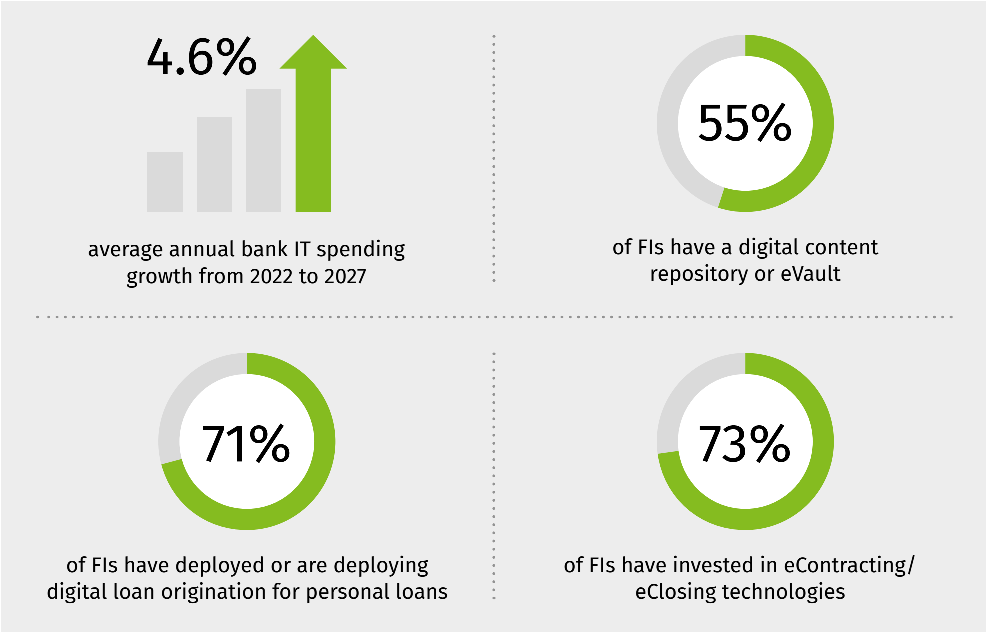
Digital lending overview

Digitization progress. Market setbacks. Right now, it's a complex lending landscape.

For bank lending, is it the best of times or the worst of times?

On the one hand, banks have weathered Covid-19 and made tremendous progress in their journeys to digitization. While IT outlays fell 2.6 percent in 2020 as the pandemic forced financial institutions (FIs) to divert resources, bank technology investments were pegged to rise 5.2 percent in 2023. Going forward, annual increases in IT allocations are expected to average 4.6 percent a year to reach $308 billion by 2027.[1]

What's more, new IT capabilities reflect real digital progress. Nearly three-quarters of FIs now use digital channels to serve both new and existing clients. More than 70 percent of FIs have implemented or are implementing digital loan origination for personal loans. Some 73 percent can electronically prepare loan documents, and another 73 percent have invested in eContracting/eClosing technologies. Finally, 55 percent now have at least one digital content repository or eVault.[2]



[1] "Retail Banking Technology Spending Forecasts 2022-2027," Celent, August 2022
[2] "State of Digital Consumer Lending: Automation Is Accelerating," Celent, April 2023

On the other hand, FIs face some stiff headwinds (See Figure 1). Banks are grappling with:

Higher customer demands

Customer expectations for excellent digital experiences continue to rise. Three-quarters of banks say it's more challenging to win and retain customers than it was a year ago.[3]

Greater competitive pressure

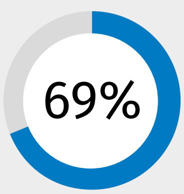
Competitive threats from fintechs are rising, says 69 percent of banks.[3] That's driving a renewed focus on innovation and differentiation.

Increased opportunity risk

Open banking, banking as a service, embedded finance, and other new models are disrupting the status quo. It's no wonder 57 percent of banks say speed and agility are top priorities.[3]

Continuous economic uncertainty

Inflationary trends and rising interest rates have weakened lending demand and squeezed net interest margins.



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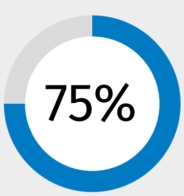

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Bank failures and lending risk

Banks won't soon forget March 2023, when multiple small-to-midsize institutions failed in rapid succession, tipping bank stock prices into steep decline and prompting abrupt action from regulators. Silicon Valley Bank (SVB), Silvergate Bank, Signature Bank, and First Republic Bank all foundered in the face of liquidity pressures that remain in play.

SVB was the biggest U.S. bank failure since the 2008 global financial crisis, and its demise triggered consumers to shift deposits to larger banks. In the weeks following the collapse, small U.S. banks lost $180 billion in deposits as the 25 largest gained $120 billion, according to Federal Reserve data.

Bank lending also dipped sharply in the wake of these failures. As banks grew wary of loan risk, the lending decline trickled down to the broader economy. The impact on businesses continues to jeopardize economic growth while extending the threat of economic recession.

Impact of rising interest rates

Rising interest rates have further depressed lending demand. As inflationary pressures continued, the Fed's repeated rate hikes forced prospective home buyers out of the market. From March 2021 to January 2023, mortgage originations plummeted 83 percent to reach a 28-year low and refinancings plunged 95 percent.[4]

Nearly 20 years of low rates steadily altered banking fundamentals — such as the direct relationship between strong deposits and lending power — as money was essentially free and therefore had less value to banks. In response, banks focused on standalone, fee-generating offerings that encouraged siloed products and processes.

Today, however, banks are racing to integrate silos, innovate new products, and address end-to-end customer financial needs. To achieve those goals, they'll need to fully leverage their technology investments, especially to optimize lending operations.

[3] "Retail Banking IT Spending Forecasts by Technology 2023-2028," Celent, September 2023
[4] "Mortgage Demand From Homebuyers Drops to a 28-Year Low," CNBC, March 2023

Digital challenges and opportunities

Banks have been on the road to digitization for decades now — for lending, at least since the passage of the Electronic Signatures in Global and National Commerce (E-SIGN) Act in 2000. Today, more than three-quarters of banks say they're on track or ahead in meeting goals for digital transformation.[5]

Still, digitization remains a forward-looking priority. Well over one-half of banks say digital transformation remains a core strategic objective for the next three to five years. Yet nearly half also report that functional silos present a significant barrier to such change.[5]

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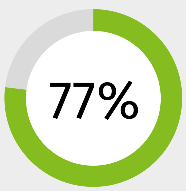

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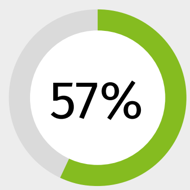

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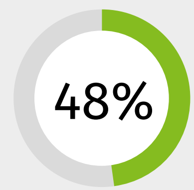

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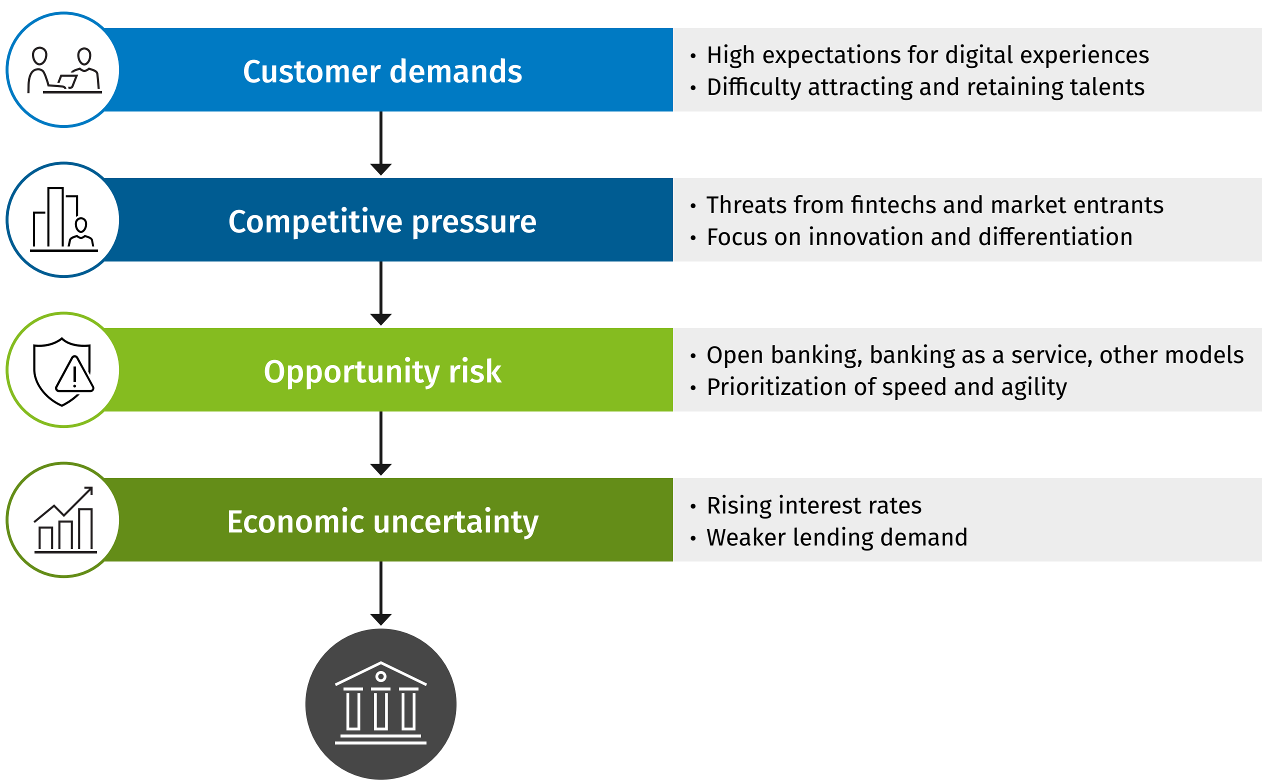

Figure 1: Bank challenges

[5] "Banking in 2035: Global Banking Survey Report," The Economist Group, 2022

Pursuing lending automation

Lending is the primary revenue driver for many retail FIs, and lenders have made important progress in automating many aspects of the loan origination process.

But today's competitive and complex marketplace requires a more aggressive approach to automation. Now more than ever, lenders need digitized capabilities to efficiently manage lending processes, deliver superior borrower experiences, and automate operations end to end — from loan origination, to eContracting/eClosing, to the sale of eNotes into the secondary market.

In fact, digital lending will become the key competitive battleground for banks — and a central differentiator going forward. How banks invest in and leverage technology today will be fundamental to their business success tomorrow.

Banks need to pivot from one-off deployments of point solutions to strategically leveraging technology investments across the enterprise for maximum value. As we've already noted, three-quarters of banks have electronic document prep and eContracting/eClosing solutions. Nearly as many offer digital loan origination. Standalone digital capabilities have become table stakes. What will enable a bank to stand out in the marketplace and outcompete rivals is its ability to tie together automations in innovative and value-adding ways.

Digitized document and data management

Banks invest in four key areas of digital capability to power their core lending operations:

- Loan origination systems (LOS) and loan servicing systems (LSS)
- Customer communications
- Decisioning and analytics
- Document and data management

In each of these areas, functionality is duplicated across lending products: credit cards, auto loans, personal loans, mortgages, and equity loans. In other words, for every lending product they offer, banks typically waste money, time, and effort on redundant capabilities and workflows. This is especially true of document and data management, where FIs have opportunities to realize cost savings and improve operating efficiency by integrating and consolidating technologies and processes (See Figure 2).

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In fact, given current market drivers, document and data management is the single most compelling area of technology investment for banks. Two examples of how this category of lending technology is so critical for operational, financial, and increasingly strategic risk management:

> *"Effective, integrated document and data management accelerates the sale of ABS and MBS into the secondary market."*

Reducing loan repurchase risk

Loan defects persist at a high rate, leading to bank losses when secondary-market investors require loan repurchase. While critical defect rates on mortgage loans can vary with interest rates and lending volume, the overall trend has been a rise in defects, from a low of about 1.2 percent of mortgage loans in 2016 to a high of nearly 2.5 percent in 2022, according to Celent data.

In response, Fannie Mae and Freddie Mac have created a new requirement to increase quality control sampling of loans purchased from 10 percent to 100 percent — a costly process that's likely to uncover more bad loans. For banks, improving document management pre- and post-closing can reduce both default risk and loan repurchase risk.

Accelerating time to monetization

In a highly volatile market — one where banks can experience rapid capital flight from depositors and where capitalization can fluctuate based on equity investor behavior — it's crucial for FIs to pull every lever to achieve financial resilience.

Effective, integrated document and data management accelerates the sale of asset-backed securities (ABS) and mortgage-backed securities (MBS) into the secondary market. The ability to rapidly securitize assets can increase cash flow and provide financial breathing room.

FIs that endeavor to gain competitive advantage and lead in the marketplace should consider the advantages of investing in digitized document and data management — and how they want to achieve those goals.

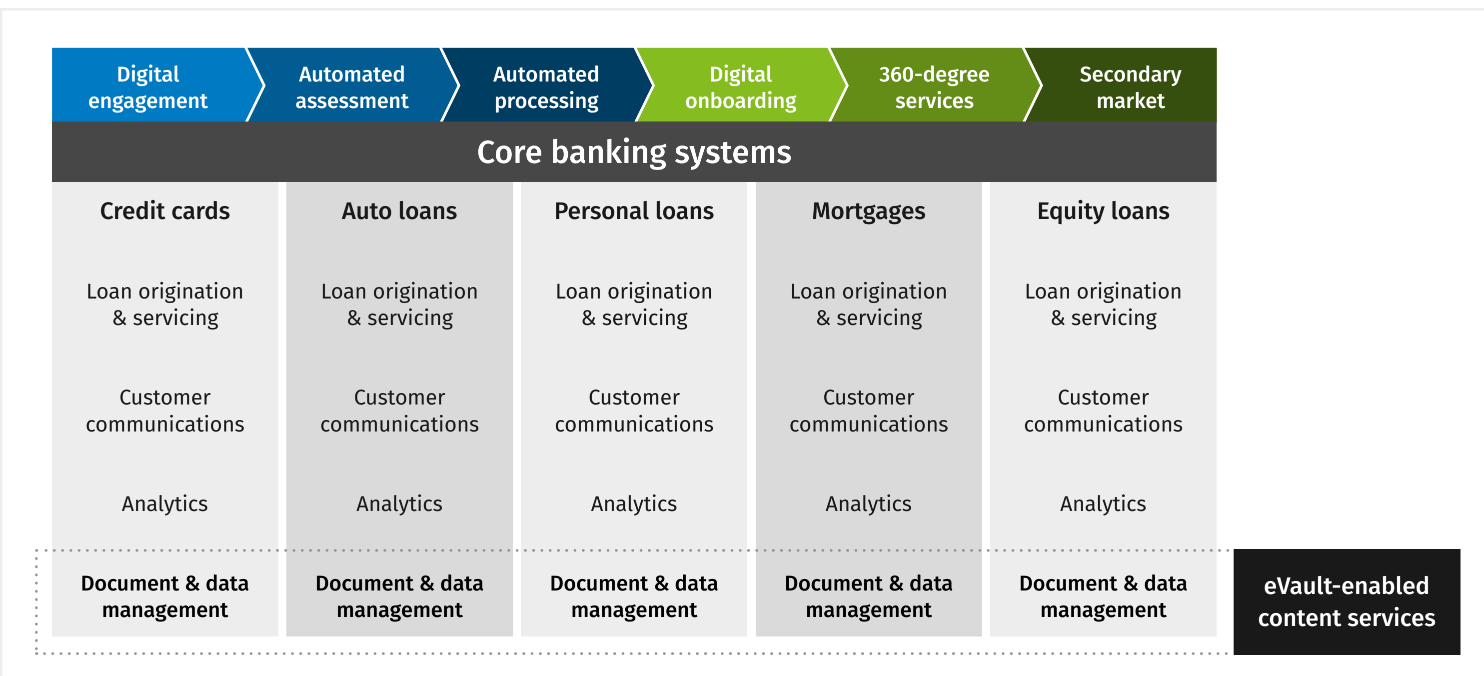

Figure 2: Consolidating document & data management

The power of eVault technology

When banks have ready access to the assets they own or have a stake in, they can:

- Adapt quickly to changing market conditions
- Confidently enter new channels and markets
- Openly accept partnerships with other FIs

That's the value of powering document and data management with an effective digital content repository or eVault. Traditional content management isn't designed for the unique requirements of digital lending. Optimizing document and data management with an eVault provides purpose-built capabilities that enable banks to secure and manage documents and data across loan types and across stakeholders in their partner ecosystem (See Figure 3).

Effective eVault technology enables the secure, trusted creation and management of an authentic, original digital loan contract. It provides irrefutable proof that a digitally signed document such as a personal loan, mortgage, or ABS is the original, unaltered document.

A well-designed eVault will also maintain a tamper-evident digital audit trail to track document access and copying — a crucial functionality for ensuring internal, regulatory, and legal compliance. The owner or secured party can control access rights to the asset and track all asset activity, from signing, maintenance, sale, pledging, collateralization, and securitization through to disposition or destruction.

Crucially, an eVault supports the securitization and sale of digital loan assets into the secondary market. For mortgages, it should power rapid eNote delivery to secondary-market counterparties through the Mortgage Electronic Registration Systems (MERS) registry. Digital eNote management reduces transfer cycle times and increases process efficiencies throughout the post-close mortgage lifecycle.

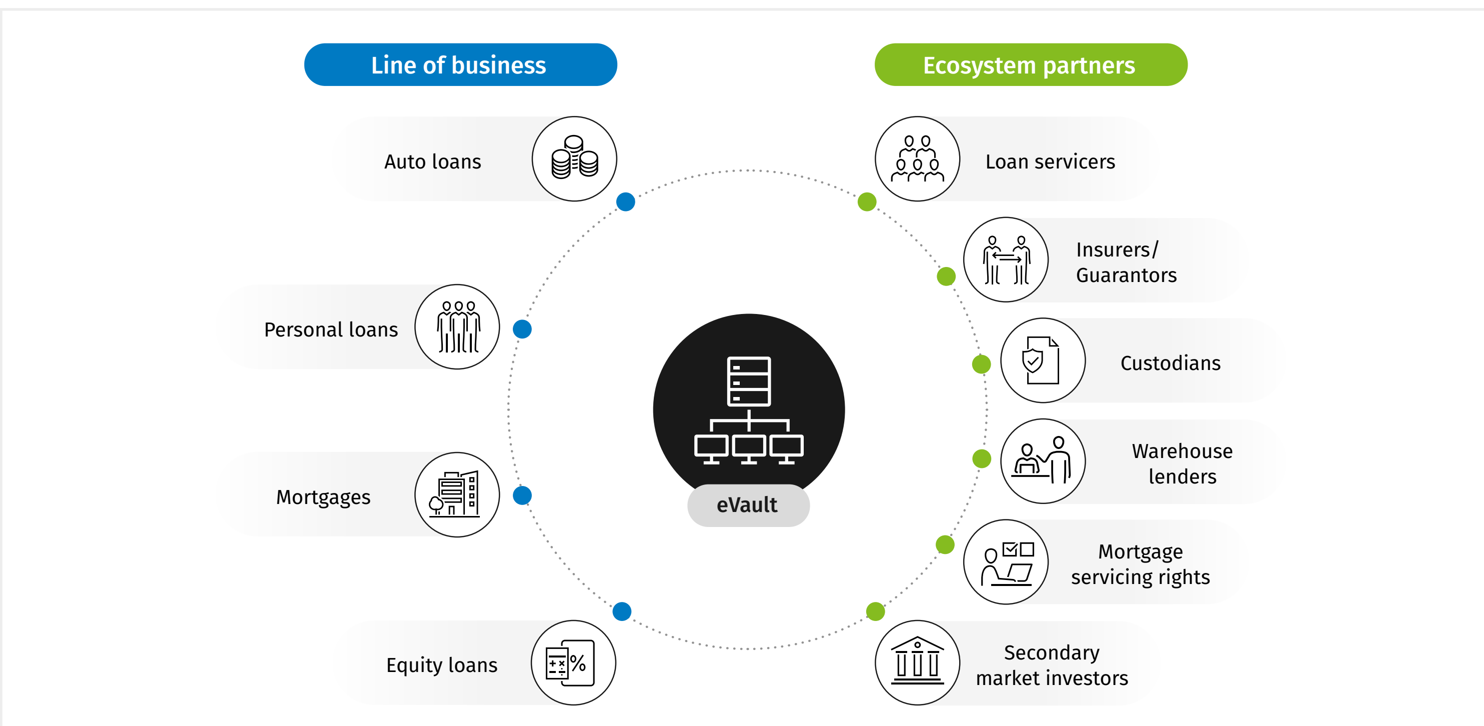

Figure 3: Managing loan type across partners

Three pillars for bank success

A dynamic knowledge platform of loan assets, serving all owners and counterparties, can position banks to take full advantage of their digital capabilities — and optimize their lending operations and outcomes. Such a platform enables three pillars of value that support the end-to-end lending ecosystem and give banks a competitive advantage:

Value Pillar 1:
Support for current and future lending scenarios

An eVault can digitize and accelerate your existing lending operations, providing document management and integration from origination through sale to the secondary market. But it also delivers built-in future-proofing.

Because an eVault provides flexibility to manage multiple types of loans and enables visibility across channels and counterparties, you gain pre-built digitization of new lending products. You can leverage your digitized document management to view data, run reports, integrate workflows, achieve insights, and more to support future lending scenarios. That gives your bank a clear competitive advantage as market conditions change.

Your organization might not currently leverage overnight lending to fund various types of loan origination. But with the right eVault technology, you have the integration and visibility to do so. You might not currently securitize emerging asset types such as vacation rentals. But with an eVault, you can sell eNotes of any asset class into the secondary market. In other words, you gain dynamic object creation and dynamic counterparty support — so you can pivot to respond to market changes and gain new competitive advantage.

Those same capabilities give you clear visibility across existing lending operations. Leadership can analyze individual assets or the entire portfolio without having to gather and assemble reports for each. You can gain a complete picture of your assets, more easily perform audits, and maintain compliance.

Value Pillar 2:
Partner access to documents they need while protecting contract integrity

eVault-enabled enterprise content management can optimize visibility and data sharing across the partner ecosystem. For instance, an indirect loan originator might have an eVault, but the partner bank does not. The parties end up with digital files and paper documents. They can't communicate effectively, and they can't easily transfer assets to the secondary market.

But with an effective eVault solution, rather than sending hard copies of loan documents to the bank, the originator can grant the lender permission access to its eVault. The lender can then examine assets in which it has an interest, even though it doesn't have its own eVault.

As another example, let's say a bank has digital assets in one or more eVaults. Investors and auditors need access to contracts so they know exactly what they're taking on and how to handle payoffs. Ratings agencies and secured parties need to be able to determine asset quality. When pledging assets, the Federal Reserve needs to see assets in one location to meet the requirements of the electronic Borrower-in-Custody (eBIC) collateral program.

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With an effective eVault solution, all these parties can have access without the bank having to manually manage each entity. Discrete permissions allow each stakeholder to access only what they need while original contracts remain untouched.

“Artificial intelligence and machine learning will optimize accuracy, efficiency, and experiences across a broad range of lending scenarios.”

Value Pillar 3:
AI and advanced tools for greater productivity and accuracy

Going forward, artificial intelligence (AI) and machine learning (ML) will identify and reveal crucial data to provide a much faster understanding of asset and portfolio value. These emerging technologies will also ensure data accuracy, regardless of the original document type.

For instance, AI can help process and analyze eVault data. Documents stored in eVaults are unstructured data, such as PDF pages and image files. Third parties that have access to read these files must manually scroll through documents to find the information they need and then read and make note of individual data points. They must then manually enter the data into their own databases, which can introduce errors.

AI can automate the process of extracting information from documents in an eVault (See Figure 4). The technology can automatically determine the right details to extract and convert them to structured data for digitized analysis. This approach can dramatically accelerate reconciliation with an LOS. It can also be used to validate asset pools to support monetization activities such as securitization or asset sales.

These three pillars — enterprise-wise asset analysis, ecosystem partner access, and AI-enabled accuracy and insights — enable banks to differentiate themselves in the marketplace and achieve competitive advantage. And they’re delivered by an eVault that powers enterprise content management.

These capabilities form the foundation of enterprise lending operations going forward. They also provide enterprise-spanning services and insights that position banks to leverage existing digital investments for optimum return on investment.

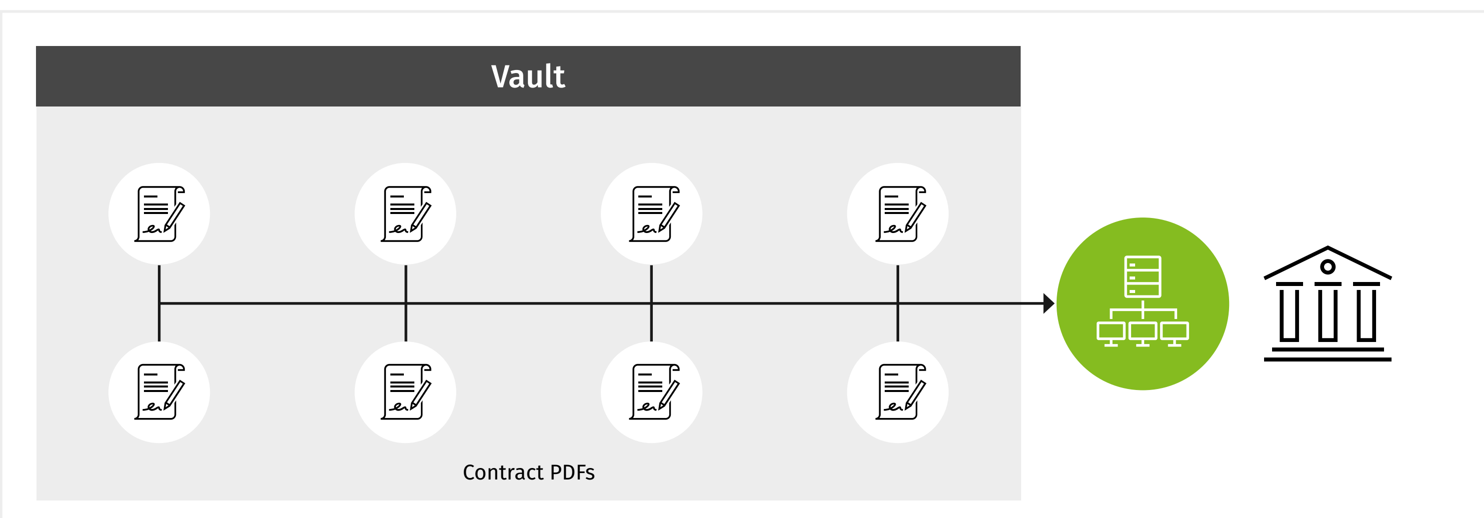

Figure 4: AI-enabled asset visibility

Next steps for banks

From rising competitive pressures to continuing economic uncertainty, the lending landscape is full of challenges. But with the right technologies and strategies, banks have an opportunity to determine for themselves whether it's the best of times or the worst of times. By adopting the three pillars of value and leveraging eVaults to optimize the end-to-end lending value chain, banks can position themselves to:

- Adapt quickly to changing market conditions
- Confidently enter new markets and channels
- Openly accept partnerships with other FIs
- Keep capital flowing freely
- Deliver superior experiences to customers and partners while achieving differentiation and advantage in the marketplace

Ready to learn more about the future of digital lending?

Explore how your bank can leverage innovative strategies to maximize returns on your technology investments and thrive in the marketplace. Watch an on-demand recording of the "Digital Lending Operations in 2024: Building a Future-Proof Technology Strategy" webinar, which was live on December 7, 2023.

Watch Now →

Take advantage of our free Digital Loan Management Risk Assessment tool to evaluate the compliance and operational risk exposure of your digital loan management practices.

Access the Tool →

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Wolters Kluwer reported 2022 annual revenues of €5.5 billion. The group serves customers in over 180 countries, maintains operations in over 40 countries, and employs approximately 20,000 people worldwide. The company is headquartered in Alphen aan den Rijn, the Netherlands.

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