Wolters Kluwer's Expert Insights

Riding the third wave of digitization

An executive discussion on compliance technology as a competitive differentiator in the near future with Timothy R. Burniston, Senior Advisor for Regulatory Strategy, and Val Daly, Director, Technology Product Management and Digital Lending, Wolters Kluwer Compliance Solutions

Discover key concepts that are driving the latest transformations in digital lending

Over the last few years, lenders have experienced three waves of digital transformation—with each wave driving fundamental process and technology changes. The first wave was primarily customer experience-driven. Borrowers wanted their lending transactions to mirror their retail transactions over the internet. As broad internet infrastructure became available, the digitization of front-end processes, such as loan applications and underwriting, became achievable.

While digital adoption was slow and incremental in the first wave, the second wave hit like a tsunami. The global pandemic and the need for social distancing turned loan closing on its head. Suddenly, the highly paper-intensive, face-to-face closing process needed to be digitally enabled—and quickly. The pandemic created an urgency for lenders to fast-track their digital transformation to support fully digital loan closings, including remote online notarizations, settlements, and back-office operations.

As the third wave of digitization emerges, technology is now a competitive necessity. Financial services organizations and lenders who proactively embrace digitization will ride the wave to improved compliance and risk mitigation, lower origination costs, and greater consumer engagement.

Now, at a much more sophisticated level, we're seeing that regulators are not only embracing but encouraging organizations to use technology to help identify problems before they become violations

What is driving the third wave of digitization?

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Three key concepts driving the third wave of digitization

Centered around risk management that requires regulatory and best practices processes across the asynchronous, multi-party processes and technologies utilized for each lending transaction.

- Transition from reactive to proactive compliance management
- Compliance-first product development
- System-level compliance

Q: Three key concepts that drive the third wave of digitization—transitioning from reactive to proactive compliance management, compliance-first product development and innovation, and system-level compliance—are all centered around risk management. What do lenders need to know about each of these concepts?

Tim: Compliance should be positioned as a competitive advantage throughout the organization. Regulators want to see a solid, fully functioning framework in place that guards against compliance problems before they happen. Controlling and preventing problems holistically through the three lines of defense and a well-established, integrated compliance risk management framework is foundational to proactive compliance.

Val: The second driver, compliance-first product development and innovation, requires a shift in mindset. Compliance cannot be an afterthought in product development—the risk of having to reengineer, delay, or even abandon a product initiative is high. Regulators expect compliance to be steel threaded and integrated throughout the entire product lifecycle from ideation and design to deployment and post-closing. Starting your digital journey with compliance top of mind is imperative. With true compliance-first product development and innovation, a financial institution gains confidence that its lending products will withstand regulatory scrutiny.

Finally, digital transactions introduce additional compliance requirements unique to the digital process. It's not sufficient to simply apply technology to a traditional process. Developing compliance at the core gives you more robust insight into your lending business and enables digital asset certainty.

Digital asset certainty provides assurance that there is an auditable and tamper-proof digital chain of custody for all loans originated electronically, as well as legal standing proving these digital loans comply with the three enabling laws that govern digital lending: Uniform Electronic Transaction Act (UETA), Electronic Signatures in Global and National Commerce Act (ESIGN), and Uniform Commercial Code Section 9-105 (UCC 9-105).

Q: The third wave of digitization is really about trying to seize an opportunity. What compliance essentials must lenders have not only to catch the third wave, but ride it successfully?

Tim: First and foremost, lenders must have an enterprise-wide compliance focus. This means putting a robust, proactive Compliance Management System in place to ensure the effective management and updating of policies, procedures, controls, testing protocols, training, senior leadership involvement, and complaint program management. Regulators' expectations also extend to third-party providers. Third parties may present elevated risks to lenders and their borrowers. Select third-party providers with a rigorous Compliance Management System that operate in a safe and sound manner, and then monitor your providers closely.

Additionally, lenders must ensure their regulatory change management process properly connects to the rest of their compliance program. When a new law, rule, or regulation is released, the company has to jump on it quickly and assess its potential impact across the enterprise.

That means engaging key stakeholders immediately, assigning roles and responsibilities, and implementing a process to operationalize the change.

Wolters Kluwer conducts an annual Regulatory & Risk Management Indicator Survey to identify regulatory and risk management trends, determine the regulatory impact on financial institutions, and assess the state of risk management efforts. Highlights from the 2021 survey include:

- Keeping current with changing regulations consistently ranks as a top challenge, no matter the lender type or asset size
- The global pandemic sped up digitization in banking. As the demand for digital experiences intensifies, nearly one-half (47 percent) of the respondents indicate they had made some progress with digitizing their lending capabilities. Looking ahead to the next 12 months, the majority (63 percent) anticipate “significant” or “some” acceleration of their organization's digital lending processes
- Organizations remain reliant on manual processes despite tremendous strides toward automation
- The increase in regulatory change drives the necessity for automation in incorporating new or changed regulatory content
- Manual processes and inadequate staffing remain top obstacles to effective compliance management
- Lenders anticipate high investment in strengthening their risk assessment process

For more information, please view the [Regulatory & Risk Management Trends eBook.]

Lastly, product information transparency to facilitate comparison shopping and a better understanding of product features is a fundamental precept of consumer protection law. Make sure you are transparent in your pricing and terms, and most importantly, always act in the best interest of your borrowers. Promoting and selling lending solutions in a way that doesn't fully reveal nuances in pricing and terms gives rise to serious problems.

Q: We've explored the compliance essentials. Now, let's talk about technology essentials. As they move toward a fully digitized loan closing process, what should lenders be aware of?

Val: Financial service organizations and lenders want to replace manual compliance analysis with automated workflows. Digitization allows you to be more proactive and preventative by freeing up resources and empowering compliance teams to find the root cause of noncompliance, rather than just putting out fires.

Lenders also want to deploy analytical tools to review lending patterns. For example, analytical tools help evaluate Community Reinvestment Act (CRA) performance and detect fair lending compliance problems. These tools help lenders identify how well they are serving the needs of low-to-moderate-income borrowers in their assessment area. Tools that can map application and loan data help lenders identify any potential gaps in compliance and pinpoint new areas where organizations might expand services to increase fair lending performance and mitigate risk.

Borrowers have come to expect a mobile and remote experience. Lenders must offer that experience with the same or greater level of compliance and satisfaction than they would on paper, in person, or on a larger screen. Finally, recognize that security and compliance go hand-in-hand. Establishing strong Know Your Customer identity verification and borrower information protection technologies, along with general information security practices, are a must to protect you and your borrowers against fraud and privacy concerns.

Q: Where do regulators stand on the digitization of lending processes?

Tim: Regulators have always welcomed the power of technology for conducting examinations, even going back decades to the use of tools to verify annual percentage rates, for example. Now, at a much more sophisticated level, we're seeing that regulators are not only embracing but encouraging organizations to use technology to help identify problems before they become violations. We've noticed this particularly with anti-money laundering programs and under the Bank Secrecy Act, and even with simpler things like a missing signature on a closing document.

Regulators are also looking at digitization to advance diversity, equality, and inclusion in the delivery of financial services. Lenders can take the pulse of where the regulatory community is by reading the bulletins, supervisory publications, speeches, and congressional testimony that regulators release to ensure top priorities are understood and to effectively manage compliance.

Tim Burniston *is a Senior Advisor, Regulatory Strategy for Wolters Kluwer Compliance Solutions. Prior to joining Wolters Kluwer, Tim spent more than 35 years designing and leading compliance examination and supervision programs at the Federal Reserve Board, Federal Deposit Insurance Corporation (FDIC), and Office of Thrift Supervision (OTS). Tim is the perennial Master of Ceremonies at the CRA & Fair Lending Colloquium*

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Val Daly *is the Director, Technology Product Management and Digital Lending, Wolters Kluwer Compliance Solutions, and the former head of Services for eOriginal. Val has been driving digital lending adoption since 2003 and has enabled lenders to achieve many industry firsts. As a subject matter and technology expert, Val provides industry focus, foundation, and enablement strategies to achieve full digitization of the lending process across the consumer, commercial, and housing finance industries.*

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