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# Achieving asset certainty in today's volatile banking environment



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## Overview



While protecting lending asset integrity has always been a critical requisite throughout the banking community, the tenuous conditions of today's financial industry have made that challenge even more formidable. From elevated interest rates and robust regulatory oversight to the anticipated surge of non-performing loans (NPLs), today's banks face an environment fraught with an unprecedented confluence of obstacles.

In order to be successful, banks must rely on resilient technologies that enable them to achieve asset certainty by mitigating risk and maximizing compliance across the volatile lending landscape. In this paper, we will outline the significant threats faced by today's banking community; examine why digitization is necessary to reduce financial risks; and explore how compliance risks are alleviated through robust digital lending capabilities. Finally, we will reveal how digital asset certainty represents the foundation to ensure integrity, enforceability, and authenticity across loans — helping lenders reduce risk in all stages of loan management.

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## Assessing the 2023 lending landscape



Today's banking organizations are operating on fragile footing; as the financial industry continues to take steps to rebound from pandemic losses and the termination of COVID-19 governmental support, banks have been forced to traipse a whole new — highly unstable — terrain. The ripple effects from a plethora of events — including elevated interest rates, aggressive regulatory oversight and the threat of a looming global recession — have compounded a lending landscape already fraught with challenges.

To begin with, the Federal Reserve's series of aggressive interest rate hikes has sparked a number of repercussions. Because rising rates can increase the cost of liabilities and decrease the value of investment securities held as assets, the higher rates have negatively impacted some banking investment portfolios. This, in turn, has led to funding challenges, earnings pressures and issues with capital. In addition, the ongoing acceleration of interest rates has slowed borrowing and forced a growing number of prospective home buyers out of the market; not only did mortgage demand decline to a [28-year low](#) in March 2023, but refinancings plunged 95 percent between March 2021 and January 2023, according to Black Knight.

At the same time, private-sector risk aversion is propelling many banks completely out of the mortgage domain. Unlike the 2008 financial crisis — which resulted in part from lenders assuming too much risk — current market conditions have prompted the private sector to essentially shield itself from undertaking mortgage risk. That, combined with more stringent government rules about how much capital banks must allocate, has resulted in an ongoing exodus from the mortgage landscape.

The current inverse relationship between bond prices and interest rates has also lowered the value of fixed-rate bonds held as investments, which increases a bank's risk profile. And further compounding the interest rate crisis was the March collapse of Silicon Valley Bank (SVB), which took a profound toll on the banking industry. The largest US bank failure since the global financial crisis more than a decade ago, the collapse triggered a broad move by consumers to shift deposits to bigger — presumably safer — banks. In fact, in the week following the collapse, small banks lost \$108 billion in deposits, while deposits to the nation's 25 largest banks grew by \$120 billion, according to [Federal Reserve data](#). On the heels of SVB's disintegration, several other small- to mid-size US banks shuttered — sparking a sharp decline in global bank stock prices and swift response by regulators in an attempt to prevent further damage.



Not surprisingly, bank lending dropped sharply in the wake of the failures, a consequence that threatens a further slowdown in economic growth while heightening the likelihood of recession. Meanwhile, the cascading effects from supply chain issues, the crisis in Ukraine and uncertain geopolitics further enhance risk. And with global economies on shaky ground, investors anticipate that a new surge of non-performing loans will emerge as yet another risk factor for banks.

This barrage of disruptive factors is almost certain to influence regulations in the coming year. Lenders are already feeling angst over new rules on the horizon, including modernized CRA regulations and Dodd-Frank Section 1071 Small Business Reporting regulations. Some experts predict that the Federal Reserve's SVB report, released in April, lays the framework for far-reaching re-regulation and tougher supervision of mid-sized banks. Perhaps foreshadowing this expectation, in March, President Biden called on financial regulators to toughen oversight of medium-size banks with proposals that include requiring banks to protect themselves against potential losses and maintain enough access to cash to carry them through a crisis, as well as subjecting more banks to annual stress tests conducted by regulators. The move seeks to revive some of the requirements included in the 2010 Dodd-Frank law enacted in the wake of the 2008 financial crisis.

As this unprecedented combination of circumstances impacts the banking industry, both financial and compliance risks continue to elevate. With complexity increasing for financial services firms worldwide, evolving regulations will no doubt further complicate the landscape. In order to effectively shield against financial risk, keep pace with everchanging regulatory measures, and maintain and demonstrate compliance amid the uncertainties of a precarious market, protecting lending asset integrity has never been more vital.





## What constitutes “digital asset certainty”?



Digital asset certainty provides the assurance that digital loans are compliant and meet all legal requirements and industry best practices. By providing an auditable and tamper-proof digital chain of custody for digitally originated loans — as well as the legal standing that show loans comply with all applicable laws and rules — digital asset certainty minimizes risk and maximizes compliant-first market liquidity.

Digital assets — which encompass finance agreements such as consumer loans — must contain specific legal and regulatory requirements in order to ensure their enforceability, as well as preserve the ability to sell or transfer the assets while still maintaining holder-in-due-course rights. By protecting a bank's security interest and producing a chain of evidence and custody that is court-admissible, digital loans enable lenders to prove their interest and claim on the secured asset in the case of loan non-performance. It is essential that digital loan documents confer the same level of protection as paper contracts.

Digital asset certainty also enables long-term compliance with established regulations and industry standards for loans that are electronically originated, distributed or transferred — future-proofing these digitized assets from unforeseen threats to their authenticity or integrity. It is important to recognize that electronic signatures alone, including those contained in PDFs or online storage, fail to meet the rigorous requirements for proving the authenticity of digital loan assets. Given the ease with which electronic documents can be altered, it is critical that banks avoid risk throughout the entire lifecycle of the digital loan by securing documents from signature to storage.

Furthermore, electronic authentication of chain of custody adds legal weight and ensures that digital loans, if challenged, will meet legal requirements. In the past, judges have ruled invalid documents signed with electronic signatures but not stored properly, due to the potential for tampering.

In addition, digital asset certainty provides the assurance that there is an auditable and tamper-proof digital chain of custody for loans originated electronically. It is insufficient to simply create and store a loan digitally; the validity of a digital loan must be safeguarded throughout the entire loan lifecycle. Although data protection is essential for any loan, it is not sufficient to ensure digital security. While data protection is about confidentiality or privacy, digital asset protection encompasses two additional aspects: data integrity and an audit trail. Data integrity provides assurance that the asset is immutable, while an audit trail proves that every change made to a digital asset is known.

Digital asset certainty also provides legal standing to prove that the digital loans comply with three enabling laws that govern digital lending: the Uniform Electronic Transactions Act (UETA), the Electronic Signatures in Global and National Commerce Act (ESIGN) and the Uniform Commercial Code Section 9-105 (UCC 9-105). Digital asset certainty also ensures that loans meet the six Safe Harbor criteria that shifts the burden of proof from the lender to the borrower, including: creating an Authoritative Copy, Assignee Identification, Communications and Maintenance, Secured Party Modification, Copy Identification, and Copy Revisions.

## Digital asset certainty: The key to reducing financial risk

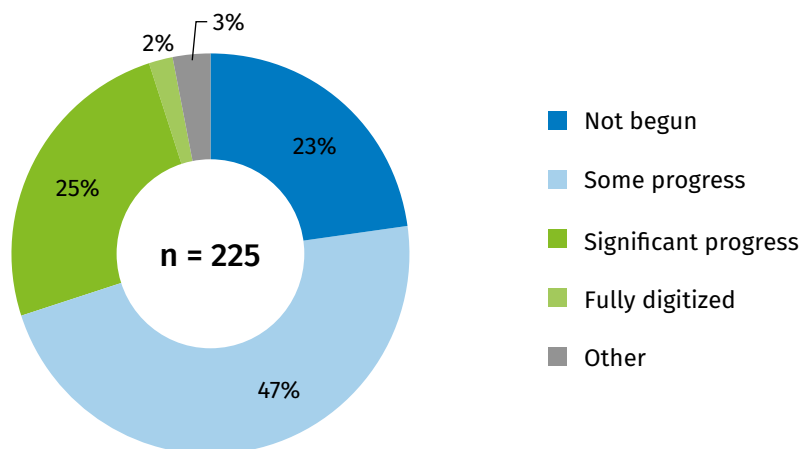


With risk factors continuing to magnify across the lending environment, it is critical for banks to harness resilient technologies that will help them to abate negative financial consequences. Enabling asset certainty is a fundamental cornerstone of these mitigation efforts. Because asset certainty represents the obligation to pay, there must be absolute assurance of judicial admissibility, legal enforceability, and regulatory compliance.

Digitization of loans not only enables banks to manage their portfolios in a more cost-effective manner, but allows them to act on claiming financial interest much faster and more effectively, such as in the event of a foreclosure. The digitization of loans ensures timely document access, supporting the ability to more rapidly resolve outstanding financial obligations, accelerating the process and further reducing downside financial risk.

Although the banking community's need for continued digital transformation is clear, the process has been somewhat sluggish. This reality was underscored in the findings of a [2022 Wolters Kluwer Regulatory & Risk Indicator survey](#), which evaluated the industry's regulatory and risk concerns, realized and anticipated regulatory impacts, and level of current risk management efforts. Although nearly three-quarters of respondents indicated they have made some progress with digitizing their lending capabilities, only 28 percent reported to having made significant progress or being fully digitized — which is a problem when it comes to ensuring asset certainty.

**Digitized lending capabilities**



Technology used to enable digital lending must be able to ensure the existence of a single, legally enforceable loan that has never been altered. Not only must the loan be digitally sealed and tamper proof, it must provide indisputable proof of the secured party. A successful digital lending solution certifies that the first-priority lien is maintained throughout the loan's lifecycle, from initial loan creation through closing, managing and monetizing it in the secondary market. This is especially important to lenders who must provide their interest and claim on the secured asset in the case of loan non-performance.

While loan originators often focus attention on factors such as creditworthiness, agreement terms and loan payment performance, the financial asset is actually the foundation for the obligations of all parties in a loan. The value of the loan or financial asset can be called into question if a lender is unable to ascertain that they hold the authoritative original loan contract. Creating and maintaining digital asset certainty provides a clear set of criteria for what constitutes a legitimate asset. Loans are then securitized according to SEC regulations with all proper rating agency support, and lenders can act with confidence knowing that assets can be sold or transferred as needed. With trust being the greatest currency of the lending ecosystem, digital asset certainty ensures that all participants minimize risk and maximize compliant-first market liquidity.

## Digital assets provide legal validity and enforceability



As non-performing loan volumes continue to increase within today's uniquely perilous market environment, the need for digital contracts with equal enforceability as paper contracts has become absolutely critical. When digital assets are created and managed in full alignment with regulatory bodies, they can be quickly identified, verified, audited, or bundled and sold if needed. This can be a significant advantage during a lending crisis by enabling banks to quickly identify and address potential risks — reducing the likelihood of non-performing loans and more easily mitigating their impact if they do occur.

In order to ensure the effectiveness and enforceability of digital contracts, legal frameworks and regulations have evolved, supporting the enforceability of agreements in court and making digital assets on par with paper assets. With digital contracts now receiving the same legal standing and validity as paper contracts, banks can rely on their digital agreements in legal proceedings related to non-performing loans. This not only enhances asset certainty and reduces legal hurdles, but makes it more likely for banks to recover outstanding debts and minimize losses.

Because digital contracts should include an audit trail that provides a clear and easily accessible history of the digital contract's movement — capturing every step of the contract lifecycle — they help banks to maintain accurate records and strengthen their ability to prove the existence and terms of the contract if any dispute arises.

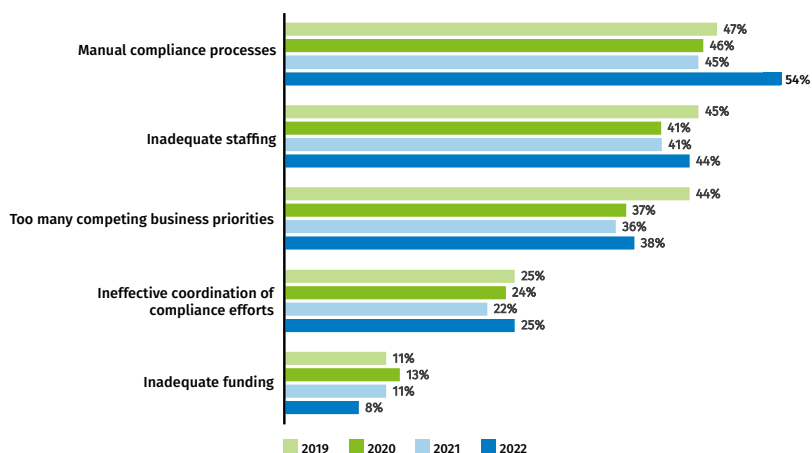
## Robust digital lending minimizes compliance risk



Banks also require proven technology to minimize compliance risk, fulfill ever-changing lending regulations and ensure that loans remain in good standing at all times, making loan digitization an essential instrument.

Managing compliance risk clearly remains an ongoing challenge for banks. When respondents in the [2022 Wolters Kluwer Regulatory & Risk Indicator survey](#) were asked to identify the top obstacles to implementing an effective compliance program, they cited manual processes (54 percent) as the greatest hurdle. Even more, when queried about their ability to track and demonstrate compliance, more than half expressed concern, and nearly 60 percent reported to being unsure about their ability to maintain compliance with changing regulations and manage risk across all lines of business. And, despite tremendous strides toward automation, 87 percent of respondents are still using manual processes or spreadsheets at least some of the time for their compliance management efforts.

### What are your biggest obstacles to maintaining an effective compliance program?



*Manual processes are the biggest obstacle to banks' ability to maintain an effective compliance program.*

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However, today's regulatory environment is far too complex for organizations to effectively manage compliance without the help of technology and automated processes and resources. Continued reliance on manual processes is a primary factor that is tangling compliance administration for the banking industry — notably in tasks such as tracking and maintaining new and changing regulations, as well as collecting, analyzing, and reporting on regulatory required data. In fact, survey respondents revealed that this challenge represents their biggest obstacle to implementing an effective compliance program.

Digital asset certainty minimizes compliance risk in the lending and contracting process by ensuring legal loan ownership. As banks continue to juggle an ever-increasing mass of rules and regulations within the loan process, they need technology to help manage the constantly multiplying barrage of documentation; the average loan mortgage now contains 192 pages of necessary disclosures and documents. Even more, if lenders don't satisfy each and every jurisdictional requirement, they could be liable for examination, regulatory action and fines.

Digital loans are subject to strict regulations that aim to mitigate risk and ensure legal compliance. Because a loan can last for up to 30 years and be in the possession of multiple parties throughout its lifetime, lenders must consider possible issues that can undermine a loan's credibility and provide assurance of a tamper-proof chain of custody.

Finally, because digital assets can be quickly identified, verified, audited, or bundled and sold, banks are able to maximize compliant-first market liquidity.

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## Achieve digital asset certainty with eVault



Whether a bank is just beginning its digital journey or ready for the next phase of digital transformation, eVault technology can help optimize processes, deliver better customer experiences and gain competitive advantage in an increasingly digitized marketplace. Because an eVault ensures that digital loans remain negotiable and transferable, it is the trusted digital vault for the largest buyers and insurers of asset-backed securities in the US.

eVault technology reliably establishes the person or entity to whom the single, authoritative copy of the digital loan is assigned, issued or transferred, while providing a secure environment that ensures digital loans remain negotiable and transferable. With this immutable digital record, financial institutions can pledge, sell and securitize digital assets with full compliance and maximum return of investment. Affording the necessary protection to securely manage the electronically originated documents and assets, eVault solutions meet securitization requirements and are accepted by issuers, legal counsel and rating agencies that support secondary market transactions.

In addition, eVaults provide the foundation needed for digital loans to be considered properly authenticated and stored, as well as creates a tamper-proof digital original that guarantees the asset is the authentic, authoritative copy. As the digital original moves through the lending ecosystem, an immutable, evidentiary trail of ownership is captured with each participant's involvement serving as a record of the loan's history. This effectively creates a tamper-proof chain of custody that ensures the legal enforceability of each digital loan.

eVaults enable fast and seamless transactions; provide banks assurance that they meet all compliance requirements as a lender; and promote market liquidity throughout the lending ecosystem in ensuring that each loan is an authentic, immutable digital copy. Whether a bank creates and holds its loans, or chooses to pledge, transfer, sell or securitize them, eVaults facilitate digital asset certainty, establishing a foundation of trust that is unmatched by other storage solutions.

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# Conclusion

Considering the uncertainty plaguing today's lending environment, it has never been more critical for banks to fully embrace digital transformation and harness the ability to ensure loan asset certainty. While providing financial entities the ability to act with agility and claim financial interest in all secured loans, technology solutions must simultaneously align with the most rigorous compliance standards and withstand the scrutiny of regulators.

To achieve success in today's digital finance industry, banks must have assurance that their digital assets are equivalent to their paper counterparts in terms of integrity, enforceability and authenticity — compliant, transferable financial assets are the cornerstone of liquidity. From providing an auditable, tamper-proof digital chain of custody to demonstrating the legal standing that loans comply with all applicable laws and rules, digital asset certainty minimizes financial risk while maximizing compliant-first market liquidity. Digital asset certainty provides the assurance that all digital loans are compliant and meet all legal requirements and industry best practices, representing the foundation of a trusted transaction.

## See where you stand

We've crafted a short assessment to help bank leaders gauge compliance and operational risk exposure in current digital loan management practices.

Complete this risk assessment to determine your bank's readiness in assuring digital loan management practices.

You'll find questions that every lending and/or compliance leader should ask themselves to stay competitive.

[See your score today](#)

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Wolters Kluwer (EURONEXT: WKL) is a global leader in information, software, and services for professionals in healthcare, tax and accounting, financial and corporate compliance, legal and regulatory, and corporate performance and ESG. We help our customers make critical decisions every day by providing expert solutions that combine deep domain knowledge with specialized technology and services.

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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