The Shift to a Platform-based Operating Model in Lending

Enabling Stakeholder-first and Digital-ready Lending Experiences

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Contents

Introduction

The lending industry has been at an inflection point in the past couple of years due to technology advances within lending and the changing macroeconomic scenario. Changing customer preferences and the rise of non-bank lenders are further impacting lenders' profitability and market share. While the demand for digital was already rising before COVID-19, the pandemic only served to highlight the need for the industry to go digital.

Following the 2008 financial crisis, lenders pulled back on extending credit as they wanted to minimize credit risk and their exposures. However, non-bank digital lenders made credit accessible to more borrowers and operated on digital platforms that offered better lending experiences. As a result, borrowers flocked to these new market entrants. Post the pandemic, there is an increasing demand for lending products. However, given the economic uncertainty, lenders 'credit risk appetite has shrunk. Although it is important for lenders to exercise caution, they must also take care of their shrinking book size by targeting the right set of customers with the right products. Furthermore, customer behavior has changed significantly in terms of how customers consume lending products and the experiences they demand. Today, not only the end borrowers, but all participants in the lending ecosystem, such as underwriters, administrators, and servicers, demand better experiences. Lenders are gradually realizing that streamlining internal stakeholder experiences can help improve employee productivity and drive operational efficiencies.

We are seeing a shift to a digital lending culture, with the need for new products, channels, and experiences to meet stakeholder demands. At the same time, lenders must have the agility to respond to continuous changes in demand. Different hyper-segments within lending are demanding digital experiences, as they have different touchpoints in their digital journeys. Similarly, stakeholders such as underwriters, administrators, and loan officers have their unique nuances. Additionally, lending organizations are characterized by multiple disparate systems that are siloed by products or business units. At its core, thus, lending grapples with a massive data problem – how to effectively analyze borrower data, understand borrowers' journeys, and identify better cross-sell/upsell opportunities. A platform-based operating model, which is flexible enough to accommodate these hyper-segments, different products, and their underlying data will be essential to address these evolving demands with speed and scale.

This report describes the benefits of a platform-based approach for lenders and concludes with the way forward for the global lending platforms market.

The current state of lending and the changing business model

Traditionally, lending firms have grown via inorganic investments, resulting in multiple disparate systems siloed by products or business units. However, profitability pressures, along with the need to enhance operational efficiencies and experience, require lending firms to modernize and simplify their systems.

It is thus difficult for lenders to offer personalized customer experiences as they lack the clarity to make customer journeys more meaningful and contextual, impeded by scalability issues due to existing legacy platforms, hampered by increasing operating costs, and plagued by difficulties in partnering with right-fit ecosystem partners, as exhibited below.

EXHIBIT 1

Key challenges for lenders

Source: Everest Group (2022)

- Scaling talent with digital skills
- Modernizing the data and decisioning infrastructure
- Managing security and compliance
- Optimizing costs
- Selecting right-fit ecosystem partners

In the backdrop of these challenges, customer demand themes are changing. New hyper-segments are emerging within lending that need contextualized interactions and experiences as they navigate different lending products with the same lender. The traditional platform model is not geared to provide this kind of flexibility. Such platforms need to be built each time there is a need to serve a new hyper-segment. Lenders not only sell loans but help connect many ecosystem partners and, in some cases, their own offerings such as home insurance, life insurance, and house maintenance services. There is limited opportunity to cross-sell and leverage insights from the massive datasets available. Additionally, significant time and effort is wasted in thinking about the customizations needed for each segment.

Customers are increasingly demanding access to new and value-add functionalities, by platforms facilitated by an Application Programming Interface (API). The adoption of these new and value-add functionalities requires real-time insights from data ingestion to assist lenders in identifying customer journeys better. Thus, the use of Artificial Intelligence (AI) / Machine Learning (ML) models across customer journeys can enable data-driven intelligent lending processes across automated document classification, AI-led pre-qualification, eligibility, underwriting, and loan disbursement. There is an increasing need to incorporate platform-driven thinking as lenders set out to serve different hyper-segments with varied lending products and provide contextualized experiences with the help of AI and ML.

The exhibit below depicts the changes that accompany the shift from a traditional model to a platform-first operating model.

EXHIBIT 2

Key challenges for lenders

Source: Everest Group (2022)

Traditional model	Platform-first operating model
Targets a single lending product or hyper-segment at a time	Targets multiple lending products and hyper-segments at a time
Build once, deploy once for each lending product or hyper-segment	Build once, deploy multiple times for each lending product and hyper-segment
Not scalable and costly	Scalable and cost-effective
Customize current system for each lending product or hyper-segment	Configure platform for different lending products and hyper-segments
Non-adaptable business processes	Customized business processes for different lending products and segments
No/limited ecosystem collaboration	Can tap into the ecosystem via microservices / an API-enabled platform
Infrastructure usage cannot be optimized	Optimized infrastructure use per peak volume and use across segments
Limited ability to cross-sell and provide contextual customer experiences	Cross-selling and up-selling across multiple products and hyper-segments
Slow to change features vis-a-vis a changing macro-environment leading to loss in revenues	Faster feature delivery with customer-centric innovation leading to growth in revenues

A platform-first operating model is scalable, configurable, and cost-effective, and it enables a hyper-segmentation approach

Platform-led thinking: moving to a stakeholder-first vision and orchestrating a best-in-class platform

Shifting to a platform-based operating model can help lenders take a phased approach to modernization. In the near-term, the focus should be on introducing point solutions to bridge gaps in operations and experience and connect disparate systems. In the long-term, the vision should be to stitch composable elements that deliver end-to-end operations across hyper-segments and lending products by creating configurable front-ends to drive more personalization. This principle of build once and deploy multiple times is the target state for lenders.

A platform-based IT operating model brings elements of composable architecture, data-driven operations, and as-a-service consumption models and creates impact across experience, agility, and efficiency for a lender. This impact needs to be designed and measured across the lending value chain for different lending products, as we describe below.

Mortgage origination and refinancing

Home purchasing and refinancing is at a decade-high due to record-low interest rates. Lenders want to quickly adapt to changing customer needs and prioritize digital experiences to enable a simple and quick end-to-end mortgage experience. Applying for a mortgage online has become the bare minimum requirement for customers, while internal stakeholders such as administrators and underwriters look for digital tools to reduce manual work. This digital push is accelerating digitalization efforts, and mortgage lenders are looking to partner with third-party platform providers to capitalize on changing customer preferences.

For example, as home purchasing hit a record high in December 2020, Fifth Third Bank partnered with digital lending technology provider Blend to digitize its mortgage processes. The bank also made loan originators their process champions to help consumers in their home purchase journeys. Additionally, it used data such as bank and payroll credentials to complete applications and save time in furnishing documents. The new digital platform enabled loan officers and processors to collaborate in real-time, even as it automated many of the manual processes that were proving to be burdensome for employees and consumers alike. As a result, customer satisfaction increased, while average time to fund a loan reduced.

To cater to the needs of different borrower segments, lenders are launching targeted products. For example, for second-time home buyers, Scotiabank has launched a Secondary Home Financing Program to finance the purchase of a second home, cottage, or investment property. Nationwide has launched a Later Life Lending product suite that offers comprehensive mortgage options and digitally convenient advice for individuals aged above 55.

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Small and Midsized Enterprise (SME) loan origination

SME lending is a highly dynamic sector as SMEs operate in a risky environment and are sensitive to economic changes. During the pandemic, these firms faced a severe cash crunch due to the loss of business. Traditionally, the biggest challenge for SMEs has been to get approved and verified for a loan, typically due to the lack of a modern technology infrastructure in banks that is receptive to SMEs' demands such as dynamic cash flow management, calculation of loan requirements, and faster approvals. Several lending platform providers are plugging these gaps by providing a digital offering that solves for these challenges.

A case in point is the SaaS banking platform Mambu, which has signed a deal with Ranqx, a New Zealand-based credit technology firm, to provide lending, origination, and decisioning for its SME bank customers. It also signed a deal with the UK business banking challenger Tide for revolving credit facilities and the overdrafts functionality for its SME customers.

Buy Now, Pay Later (BNPL)

With a rise in digital payments and increase in online shopping, retailers are partnering with banks and FinTechs to offer the BNPL facility to customers at checkout, thereby enhancing banks' lending business. There is growing interest in this area among banks and FinTechs alike. Goldman recently announced its intent to buy the BNPL provider GreenSky for US$2.2 billion, with plans to integrate it in its Marcus app. Apple partnered with Affirm Holdings to launch BNPL services for Apple device purchases in Canada. Scotiabank and CIBC also partnered with Visa to bring this offering to their Canadian customers. Lenders are realizing the need to offer this service to their customers before non-banks usurp their market share.

Loan servicing

Once a loan has been originated and disbursed, the original lender either retains the loan to service itself or sells the right to service to another entity. Servicers already operate in a low margin, highly fragmentated market, in which the cost to service a non-performing loan is significantly higher than a performing loan. Traditionally, the profits from performing loans have helped servicers cover non-performing loan costs. However, the pandemic has tipped the scales, with the share of non-performing loans having increased steadily. Additionally, the volume of loans in forbearance are at an industry-high, which translates into thousands of hours of effort as servicers help borrowers analyze their options. Servicers are thus looking for a platform-based model to minimize their servicing efforts, improve operational efficiencies, and enhance stakeholder experience.

For example, the US-based Fintech Sagent, which focuses on mortgage and consumer loan servicing, has partnered with digital lender Figure to reinvent the mortgage servicing experience. The partnership will enable borrowers to manage their entire home and loan life cycles from their phones and enable servicers to manage every performing and nonperforming loan detail for consumers, regulators, investors, and partners.

Within servicing, there is increasing need to not just automate back-office processes but also digitize the front-end. For instance, Constant, a provider of self-service technologies for banks and credit unions, has partnered with Alkami, a digital banking solutions provider, to offer hardship and financial wellness solutions to cPort Credit Union. A digital front-end will bring down wait-times as customers call their banks for payment assistance and, in turn, help the credit union prepare for tackling delinquency trends as payment assistance, foreclosures, and forbearances come to an end.

FinTechs' disruption of the lending value chain

While traditional lenders are grappling with legacy issues and working toward a platform-based operating model, next-generation FinTechs are already disrupting the ways of working. They are leveraging a modular architecture by employing AI, big data, and even blockchain to solve longstanding issues within lending. These FinTechs are unencumbered by legacy infrastructure and can, hence, bring product and experience innovation to serve different hyper-segments' needs and provide a single platform to cater to different lending products effectively.

For instance, FinTechs such as AvantCredit are focusing on middle-income customers. Another FinTech, Affirm, offers BNPL services for point-of-sale purchases, and it gained traction as online buying picked up during the pandemic. Business lending is not far behind, with BlueVine and Kabbage offering credit to businesses with lower credit scores. Another lending platform, SoFi, offers consumer and business loans via its digital platform. Thus, FinTechs are eliminating the industry's longstanding issues to improve loan approval time, credit decisioning, customer onboarding time, and collections management, among other things. Additionally, they are investing in themes such as API integration, AI/ML, cloud, and video Know Your Customer (KYC) solutions, as exhibited below.

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EXHIBIT 3

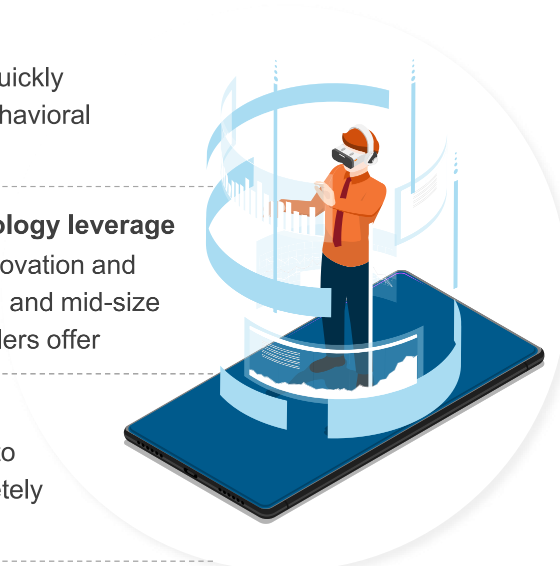
FinTechs' key areas of technology investment

Source: Everest Group (2022)

API integration for data collection and validation
APIs are enabling access to internal or external data sources to quickly gather and validate information as well as expand the range of behavioral insights for faster and better decision-making

AI & ML technology to enable quicker processing
APIs are enabling access to internal or external data sources to quickly gather and validate information as well as expand the range of behavioral insights for faster and better decision-making.

Cloud hyperscalers partnership for co-innovation and technology leverage
Large product vendors are partnering with hyperscalers for co-innovation and co-development of solutions in the financial services space. Small and mid-size vendors are trying to leverage the tools and IPs that the hyperscalers offer



Alternative data sources for credit underwriting
Alternative credit scoring has become crucial for lenders to cater to the rising Gen Z borrowers as well as consumers who are completely new to the credit system

Video KYC solutions for contactless onboarding
COVID-19 pandemic has forced lenders to reevaluate their KYC verification process, and video KYC is becoming an integral part of end-to-end digital lending

Traditional lenders understand they need new growth avenues to compete with emerging FinTechs. There is a shift in their mindset as they realize that a lack of borrowers' credit history does not necessarily translate into higher risk. Rather, there is a need to analyze alternate data sources to determine the creditworthiness of this segment. Lenders must balance traditional scoring methods with AI/ML models or forego the chance to penetrate this underserved and unbanked market. The use of AI/ML can not only help expand customer base, but also reduce human intervention, improve accuracy, and provide faster approvals. BNPL has been a disruptor in the post-pandemic scenario and has highlighted the demand for faster and easier access to credit. AI and ML technologies can facilitate real-time data ingestion for faster insights, better decision-making, and curated and personalized experiences for different hyper-segments.

The push to a sustainable ecosystem

As sustainability becomes a board-level agenda, banks face a dual mandate of becoming responsible and sustainable institutions themselves while enabling sustainability for their clients, ecosystem partners, and the communities they serve. To advance in their sustainability journeys, lenders are becoming increasingly agile and responsive to adapt to these changes. For example, ABN Amro has announced a sustainability discount on mortgage interest rates for energy-efficient homes. Climate First Bank, a US-based community bank, was launched in February this year, with a focus on lending for "green" initiatives and sustainable projects. DBS has launched green credit cards that reward customers for supporting green and sustainable businesses. These are but a few instances, and green lending products are expected to become mainstream in the next few years. To support this growing demand, lenders need to have a platform-first operating model that can help create customized processes for such hyper-segmented products.

Conclusion: how lenders can adopt a platform-led mindset

The platform-driven mindset is redefining the lending value chain as lenders rethink the ways through which they identify prospects, onboard customers, provide offers, design stakeholder experiences – both authenticated and unauthenticated, manage underwriting, ingest documents, and optimize infrastructure use. To embark on this journey, lenders need to modularize their front-to-back systems to provide a seamless experience for different segments and lending products.

As different customers and stakeholders demand personalization, a platform-first thinking will help serve these hyper-segments effectively. The cloud is the infrastructural element that will enable the platform's agility, flexibility, and scalability. Correspondingly, enterprises will be required to make investments to redefine their target operating models to serve various hyper-segments via different products and contextualized experiences.

Alongside, lenders must reimagine their traditional data value chains with future-ready data exchanges, enabling real-time data analytics and decision support to provide deeper customer and channel insights. The cloud allows lenders to utilize data and AI technology to make the best use of internal and external data. Notably, platform-led thinking is not just about technology; it is a business model shift that encompasses the creation and delivery of value to each stakeholder in the ecosystem by bringing together business and technology teams to drive the mindset shift. To achieve their objectives, enterprises should invest in a robust platform that can support and scale this vision in the long term.

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