

Complexity of industry challenges will drive accelerating adoption of Mortgage BPO services

The challenges of making BPO engagements successful is dwarfed by the challenges of internal delivery
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Much has been made during the past year of the slowdown in new BPO (and ITO) contract signings. Is the market slowing down? Dying? Are customers dissatisfied with service quality and cost? What is an informed customer to do?

NelsonHall's research shows a very different story. Customers are using a disciplined approach to service acquisition, which is not surprising considering that industries such as banking, which has the highest propensity to outsource of all industries, have been outsourcing IT and select processes for close to 40 years. Banks have also been early to off-shoring, as evidenced by Citibank's outsourcing to India in 1986 and setting up its own captive there in 1991. The slowdown in contract signings this past year is the result of customers taking a considered approach to solving very complex business challenges using BPO services. Below I will discuss the direction one key area of BPO, mortgage processing BPO for banks, is moving.

Banking BPO

Globally, the banking industry is facing the greatest change in regulatory oversight since the 1930s. Basel 2, SEPA, Check 21, SAS 70, to name a few of the key regulatory changes mandated, but not yet fully implemented, will necessitate that each bank re-architect its core systems and operational delivery capabilities. These regulations change the underlying processes, such as payment processing, so that re-configuring systems will not be possible, system conversion will be necessary. This is true regardless of whether this is done in-house or not.

Our conversations with banks show that banks understand that this is not a "best of breed" selection process, but rather a set of decisions that "bet the bank" on the future landscape of the industry. **Execution cost take-outs matter less than time to market and flexibility.** Banks face the additional challenge that years of cost competition and outsourcing have hollowed out their ability to internally develop, maintain and operate custom systems

Banking BPO is in fact mature, most banks outsource select processes. In fact, banking BPO represents primarily, an up-sell opportunity, rather than a Greenfield opportunity. Many past outsourcing deals have not delivered the hoped for results. However, past performance failures have often reflected that the bank transferred a platform or workforce that was delivering sub-par performance already. "Same mess for less" is a failed business model. Intractable problems do not become tractable just because they are outsourced.

For better or worse, in a world where regulatory change necessitates operational transformation, "lift and shift" is not an option. Banks need to form a point of view on what the new operational bases of competition will be and partner with service providers to capitalize on the new landscape. Ultimately, in banking it is survival of the most adaptable.

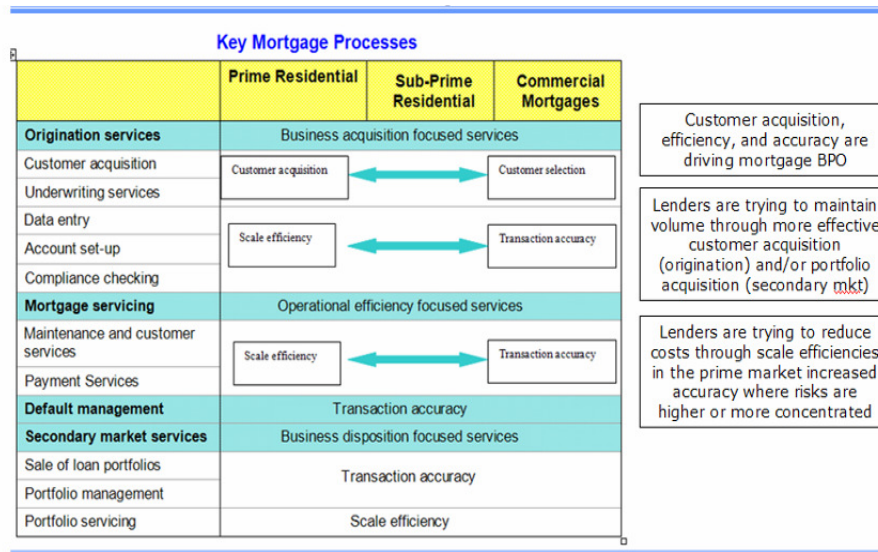
Mortgage BPO

The banking segment with the greatest pressure to transform is mortgage processing. Deteriorating market conditions for mortgages, brought on by increasing interest rates, declining collateral values, and deteriorating borrower credit quality, are forcing mortgage lenders to adapt or exit the market. Banks are looking for 5 key benefits from mortgage processors:

1. **Conversion of fixed cost to variable cost:** through transaction based pricing and rapid scaling of services
2. **Cost reduction:** cost reductions of 20%+, with continuing cost reductions over the next 5 years
3. **Increased speed of execution:** as lenders compete for a shrinking pool of business and conditions deteriorate, executing quickly is a key competitive advantage
4. **Re-engineered processes:** to enhance straight-through-processing and data access
5. **Platform flexibility, compatibility, and improvements:** the ability to integrate to legacy platforms, while adding functionality over time

To achieve these benefits, vendors are breaking apart the entire mortgage process lifecycle and re-architecting processes to deliver relevant benefits. See Exhibit 1 below.

Exhibit 1



Source: NelsonHall 2006

Mortgage BPO has been segmented by borrower type, with vendors specializing on one or a few borrower types. Service is migrating to network enabled, low cost delivery. Key differentiation is moving away from borrower characteristics to process service features.

To meet these market needs, vendors must be able to provide 6 key enablers:

1. **Consistent execution of processes:** strengthening consumer protection regulations (resulting in fines and negative publicity) necessitate consistency of execution
2. **Rapid adaptation to regulatory changes:** incorporation of regulatory changes into operations as a tactical weapon, rather than a response
3. **Access to country specific operational experience:** to support new market entry
4. **Support for secondary market activities:** an increasingly important segment of the marketplace

5. **Portfolio quality enhancement services:** reduce portfolio defaults and manage default activity
6. **Access to data:** customer selection and default management in a deteriorating credit environment requires superior information

These changing market conditions are driving a change in the characteristics and nature of the vendors themselves. Vendors have traditionally provided services to highly localized geographies and specific mortgage types. Today vendors are reaching out across country boundaries to buy regional vendors and product type specialists to incorporate them into a globally delivered, “industrially hardened”, set of service offerings to create the necessary enablers and benefits.

Since the beginning of 2005 M & A activity in by 3rd party mortgage processors has spiked. At the same time, divestitures of mortgage processing operations by firms not committed to this marketplace as strategic to their business, has also spiked upward. These activities will ensure both consolidation and globalization for the industry over the next 5 years.

Finally, everyone is considering offshore delivery of services. The offshore delivery market remains very small, at under 1% of total global mortgage service delivery. As cost pressure forces consideration of alternatives that promise aggressive cost reduction, the offshore market is poised for very strong growth over the next 5 years.

Conclusions

A complex changing business environment makes BPO choices difficult where process transformation is required. However, cost pressures and access to talent have made it imperative that customers increasingly engage with BPO providers to deliver those processes in a flexible manner. The BPO market will continue to grow for the foreseeable future because overall there are no credible alternatives.

Mortgage BPO is a leading area for process transformation due to the confluence of several factors driving consideration and adoption of new service delivery methods. New vendors are entering the marketplace to deliver services adapted to the changing needs of this rapidly evolving industry.