

MBA'S NATIONAL MORTGAGE SERVICING

**BUILDING
TOGETHER**
for **TOMORROW**

CONFERENCE & EXPO 2008

Offshoring Strategies, Benefits and Obstacles

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Business Process Offshoring in the Mortgage Industry

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Recap of FSI Global Offshoring Research

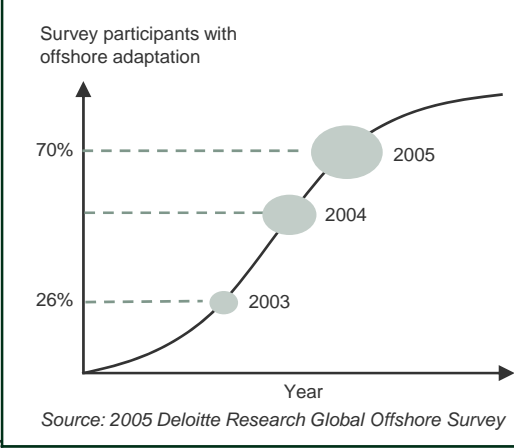
Rapid Growth and Building Momentum

India as the Leading Offshoring Center

Emergence of Distinct Operating Models

Economies of Scale and Substantial Cost Savings

Offshoring Adoption



- Rapid increase in the number of institutions that offshore (70% of surveyed FSIs either offshore or are in the planning stages of offshoring)
- Best performers offshore 4-5 functions
- Increased scale and complexity of offshored operations (from simple applications development to complex business processes)
- Strong growth in the BPO services and substantial expansion of offshore service delivery centers

Leading Offshoring Centers



- India remains dominant with over 70% of offshore headcount share among participants
- The key offshoring players are establishing additional service centers across major offshoring markets e.g., China, Philippines, Eastern Europe and integrating them into a seamless network of delivery centers
- There has been a recent trend toward customer inquiry contact center activity in Latin American locations such as Costa Rica

Business needs coupled with a rapidly developing marketplace are driving the significant offshore growth

Business Issues

- Recent market turmoil putting increasing pressure on margins
- Industry is increasingly focused on reducing / streamlining costs
- Lenders are challenged with driving value through streamlined delivery models
- Strong need exists to better balance the peaks and valleys of production
- Lenders continue to seek ways to transition fixed costs to variable costs to dynamically align capacity with demand
- Loan quality and portfolio scrutiny are forcing organizations to review and improve business processes

Potential Benefits

Cost Savings

Productivity Gains

Improved Time to Market

Risk Transference

Core Competency Focus

Flexibility

Product Expansion Opportunity

Offshore Market Characteristics

- Deep pool of highly skilled resources
- Rapidly developing technology & process integration expertise
- Extended hours of operations (e.g. extra 'shifts')
- Maturing offshore management experience and capabilities
- Increasing number of BPO organizations in marketplace
- Access to highly educated English speaking workforce
- Significantly lower labor costs than in US (e.g. India: ~12% of US costs)

Other Enablers

- Improved scanning and document handling
- Lower cost of communications
- Web-centric analytic tools
- Enhanced security

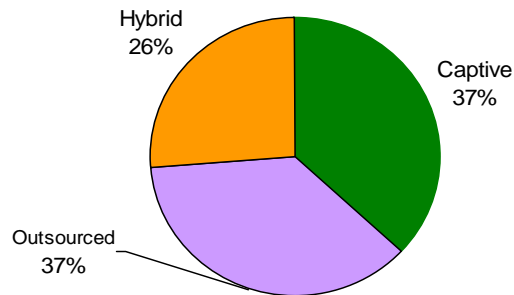
Mortgage Offshorers are relatively evenly split between three offshore operating models

Figure 3: Considerations for choosing an offshoring model

Options	Criteria						
	Upfront Investment	Center of Excellence / Pool for new ideas (IP)	Time to Start Operations	Offshoring / Outsourcing Expertise needed	Cost Savings	Quality Gains	Information Security
Captive							
Third Party							
Hybrid							

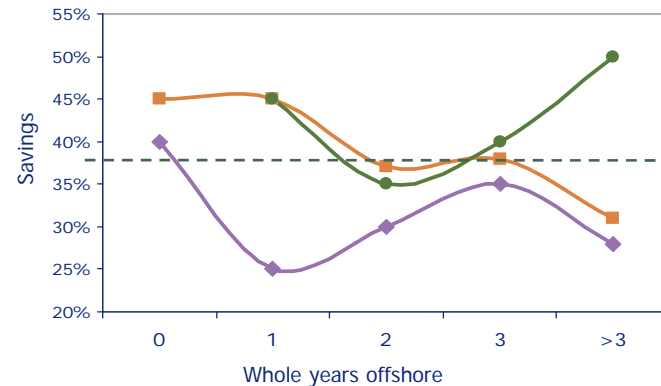
Most Attractive Least Attractive

Offshore Models: Leading US Mortgage Lenders



Based on the study of top 40 mortgage lenders

Typical Savings by Offshore Model



Financial Services industry case examples illustrate a wide variety of execution options

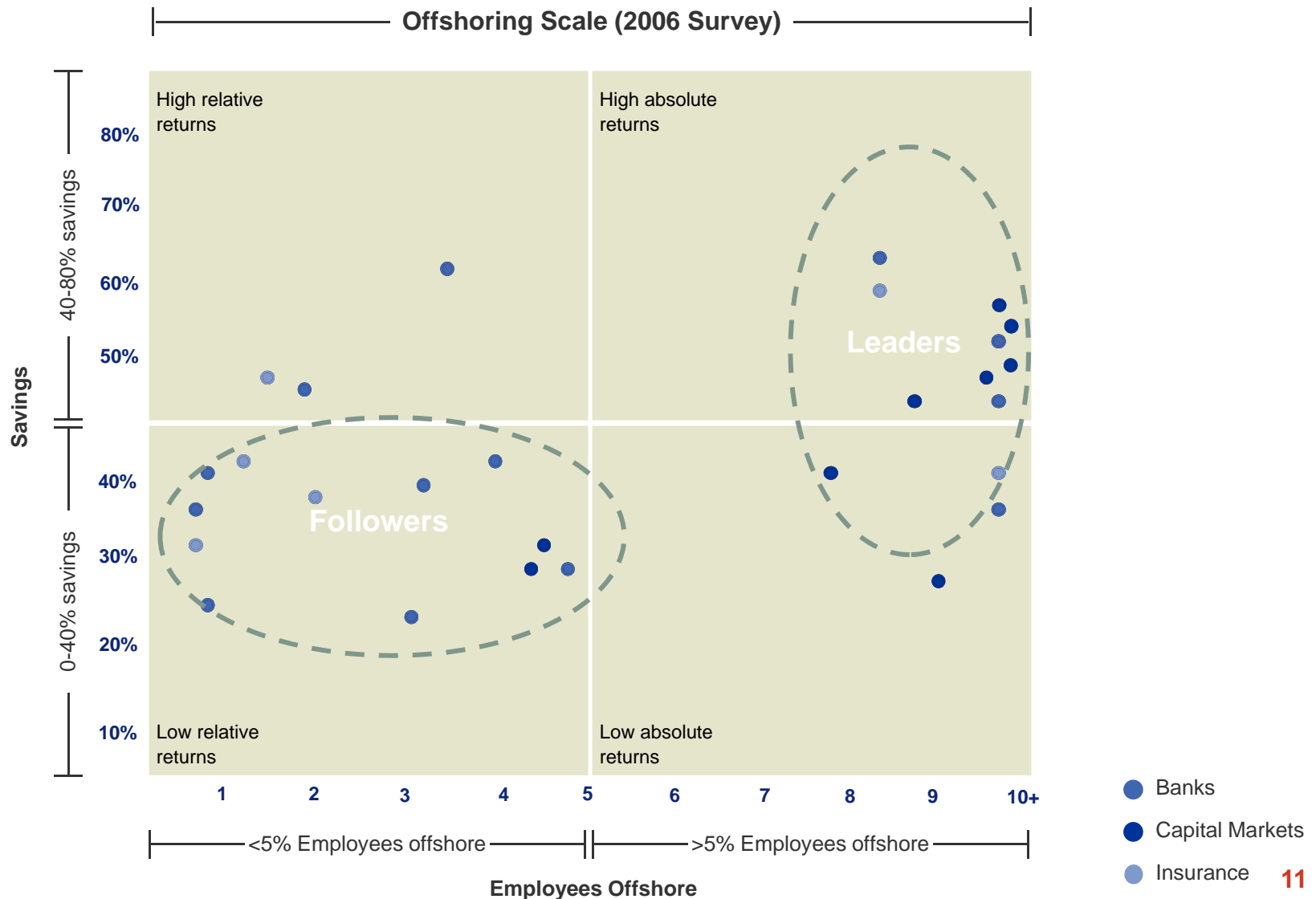
Lender	Functions Offshored	Business Model	Comments
Leading US based mortgage and real estate lender	<input checked="" type="checkbox"/> Mortgage <input type="checkbox"/> Cards <input type="checkbox"/> Deposits	Captive	<ul style="list-style-type: none"> Opened a wholly-owned processing center in Mumbai in 2004; 250 people in India by end of 2005 Utilize IT offshoring to allow for less downtime due to time difference Initially used to provide services for data entry, pipeline management in-bound customer calls; Center in the final stages of becoming a full processing and customer service provider, mirroring processes including IT Programming, appraisal quality control and call center
Leading global financial services firm	<input checked="" type="checkbox"/> Mortgage <input type="checkbox"/> Cards <input type="checkbox"/> Deposits	BPO	<ul style="list-style-type: none"> Reached an agreement in 2004 with a vendor to provide private label mortgage processing services Customer service officers take client applications using a customized web tool built by the vendor, which supports the institution's pricing and credit policy Applications flow to vendor, which provide all borrower contact, processing and fulfillment services through loan closing
US based top 10 savings and loan originator	<input checked="" type="checkbox"/> Mortgage <input type="checkbox"/> Cards <input type="checkbox"/> Deposits	BPO	<ul style="list-style-type: none"> 300 FTEs in India in less "customer-oriented" roles; plan to have 1,500 workers in India by 2008 Currently performing welcome calls to new borrowers, new customer verification, loan collections and call center activities offshore Cost savings in the double digits in the double digits in the second year Chose vendor for loan origination and underwriting, about 60% of vendor's work is done offshore Considering near shoring to Mexico to serve Spanish speaking population
US based, diversified financial services company	<input checked="" type="checkbox"/> Mortgage <input checked="" type="checkbox"/> Cards <input checked="" type="checkbox"/> Deposits	BPO	<ul style="list-style-type: none"> Renewed deal with vendor for consumer credit and small business card processing services (November 2006). Vendor acquired client's entire unit of ATM and Debit card processing (March 2007) Client to locate its IT and Business Process Outsourcing Centre in Hyderabad Another vendor partners with client to deliver its digital Loan Management solution

Financial Services industry case examples illustrate a wide variety of execution options (Cont'd)

Lender	Functions Offshored	Business Model	Comments
Leading US based consumer and small business bank	<input checked="" type="checkbox"/> Mortgage <input type="checkbox"/> Cards <input checked="" type="checkbox"/> Deposits	BPO/Hybrid	<ul style="list-style-type: none"> ■ Internal technical help desk outsourced to vendor in India in 2004 ■ Philippines based vendor provides a variety of customer management services in English from the Philippines and Spanish from Costa Rica for retail banking clients. ■ Has an on-going seven-year business process outsourcing (BPO) agreement with another vendor, to host and manage check processing operations using leading-edge image-based technology
Leading global financial services firm	<input checked="" type="checkbox"/> Mortgage <input checked="" type="checkbox"/> Cards <input checked="" type="checkbox"/> Deposits	Captive/BPO/ Hybrid	<ul style="list-style-type: none"> ■ Relationship established in 1992, client pioneered the use of India's potential for providing cost-effective services to their global operations ■ Recently sold its captive operations with 10000 FTE's to third party for \$700M ■ Another vendor runs client's mortgage back office operations through its call centers in Delhi and Mumbai and dedicated a 100 member team to handle the BPO job. ■ Contract includes global mortgage customer queries (pre-sale and post-sale), mortgage processing, refinance, logistics management and related tech-support ■ Has nearly 2000 FTE's located in India (handling everything from call center support to number crunching for investment research) ■ The Global Services offered were: loan processing, appraisal first-level review, global customer service queries (pre- and post-sale), refinance, tech-support, Trade Services, Cash Management, Retail Banking, Insurance, Capital Markets, Credit Cards Operations, Mortgages, Benefit Administration & Retirement Services and Financial Middle Office

Executing an Offshore Model

Recent research shows a growing divide between leaders and followers in the offshoring evolution



Source: 2005 and 2006 Annual Deloitte Research Financial Services Offshoring Surveys

Note: The savings ranges denote the highest reported savings per process and the institutions have been plotted as per average savings reported across for all functions

What differentiates the leaders?

Vision

Leaders see offshoring as a core part of their overall group strategy

Strategy

There is clarity on the role of offshoring in group operational strategy

Execution

Different execution approaches can lead to offshoring success

Leaders focus constantly on operational excellence to prevent savings leakage and to justify scaling the operation

Compliance

- Building global ethics: A key way to improve morale and ethics is a formalized, longer-term programme of compliance activities.
- Onshore and Offshore should be seamlessly integrated from a compliance perspective

Culture

- Tour of Duty: A truly global operating model requires more top managers setting up and operating offshore units to embed ethics and establish the management framework
- Retained organizations should be optimized around the offshore model



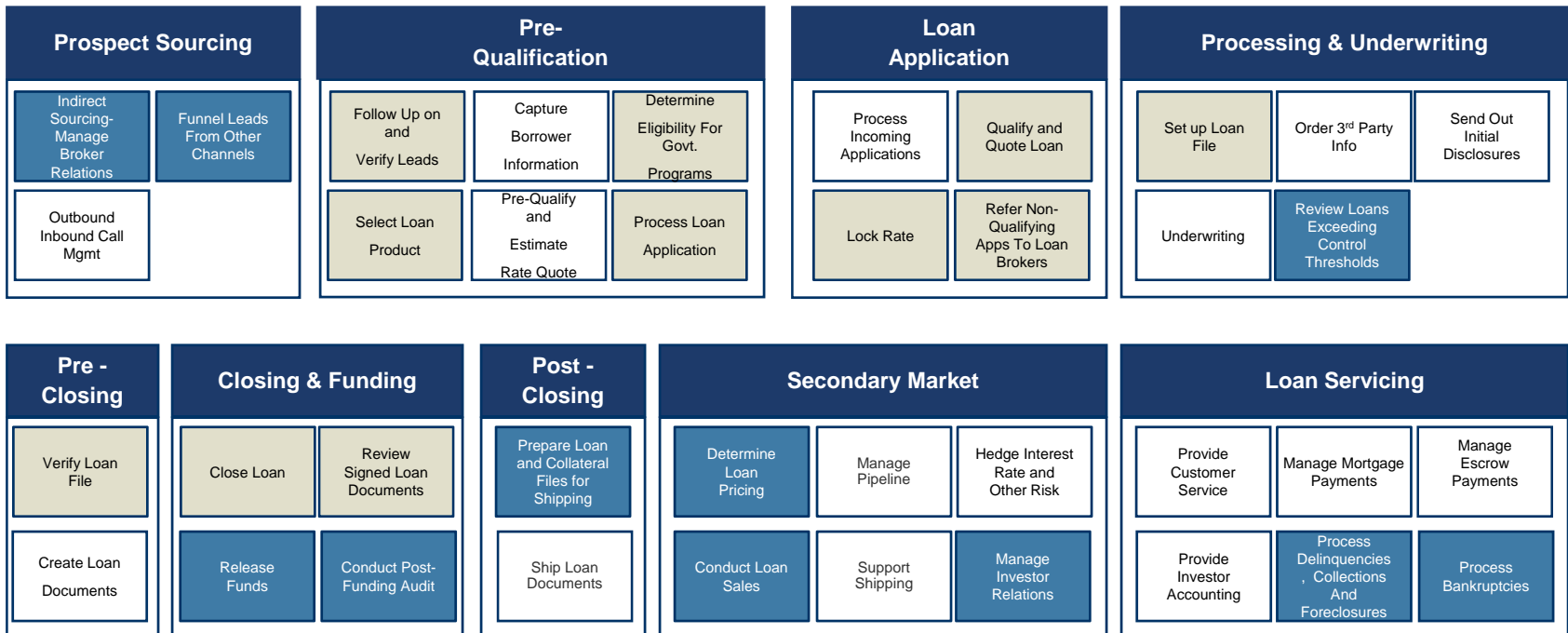
Cost

- The bottom line impact can only be sustained if savings are recycled back into operations
- Finding a balance between short-term investor demands & long-term strategic development is imperative

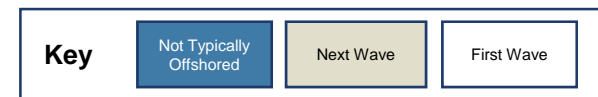
Complexity

- Building a business model and strategy with offshore as a key component is essential
- Our survey shows that its not possible to stand still – the big challenge ahead will be to scale ⁴³ focus or fail?

Leaders methodically analyze the value chain to find and sequence offshore candidates



Note: Deloitte's best interpretation of activities, subject to clarification/discussion



Sample Metrics

Accuracy:

- Audit Scores: Quality Audits
- Frequency of Transaction Monitoring
- Knowledge Shop Percentage
- Mystery Shop Percentage
- Monitoring Shop Percentage
- Regulation Shop Percentage

Speed:

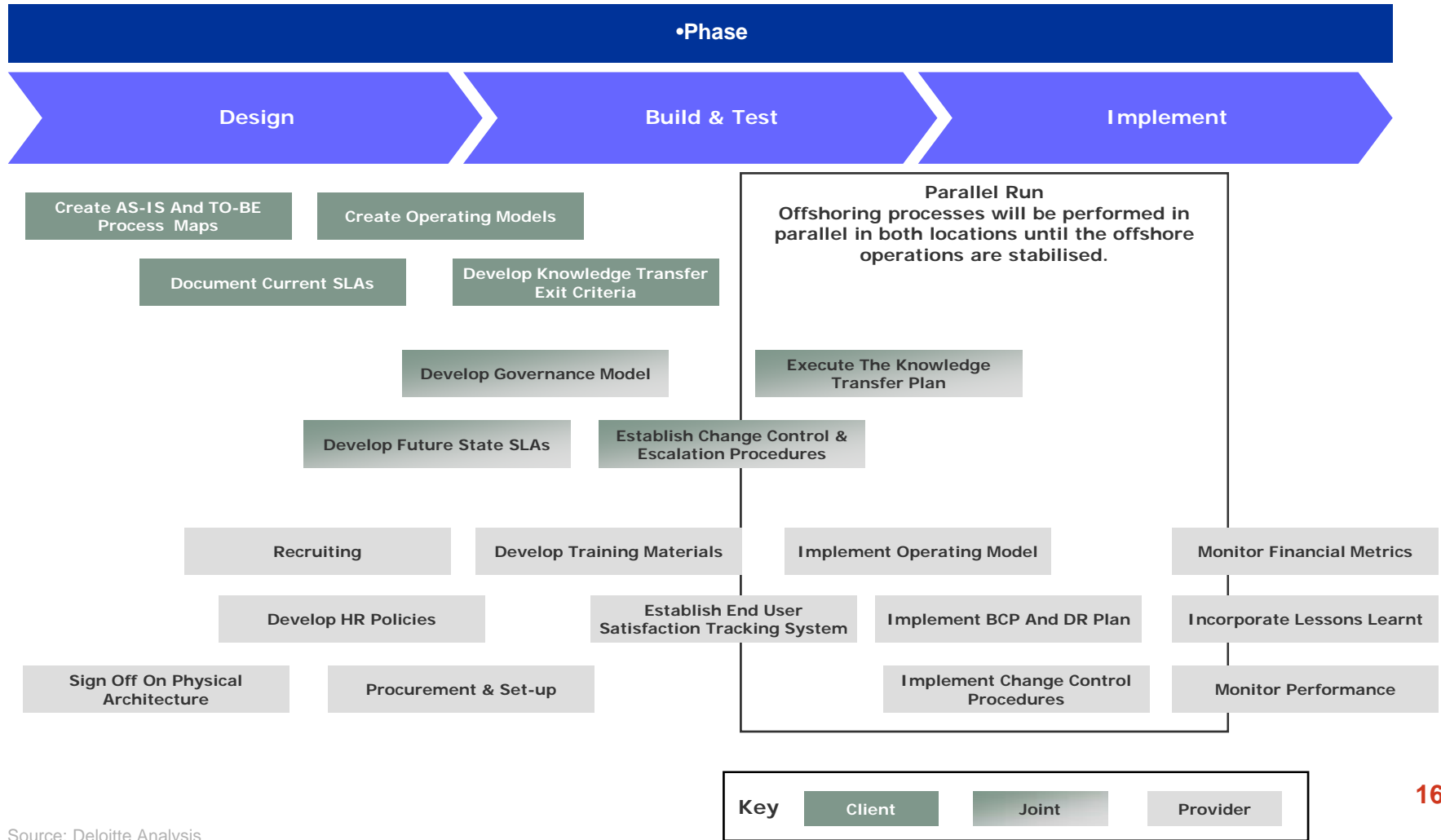
- Contact Rate - Right Party Contacts per Hour
- Average Handle Time
- Calls per Hour
- Cycle Time/ Turnaround Time

Productivity:

- Cure Percentage
- Payments vs. RPC
- Inbound and Outbound Conversion Rates
- Title-Policy and Title-Endorsement Pull-Through Rates
- Pull-Through Rate – Completion of Tasks on Ti
- Documents Retrieved (>3 Months)
- Percentage Aging
- Loan Sub-Tasks Verified per Agent per Day
- Capacity Percentage
- Volume Assigned per Day
- Total Faxes and Total Emails Processed per Full Time
- Employee (FTE) per Day
- Speed
- Total Number of Applications on Due Diligence
- Report Run/FTE/Day
- Funded Dollars Percentage
- Closing Rate

Leaders view transition as a key potential failure point and plan accordingly

Transition Management



Moving Forward

- Recent slowdown in originations with some clients has impacted the offshore mortgage BPO business
 - Buyers will find a ready market of talented resources and vendors ready for new business
 - This is a positive development for mortgage companies new to offshoring
 - Entering into transaction based agreements may be more difficult without volume guarantees
- Wage inflation and attrition continues to be a challenge for the Indian vendors
 - Vendor peak staffing support should be evaluated in light of attrition challenges
- Currency movements (i.e. dollar vs. rupee) continue to be a factor and should be considered appropriately when contracting

Offshoring Strategies

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VP

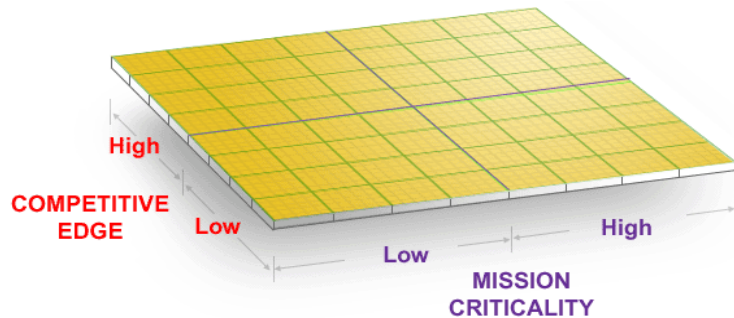


- **What to offshore?**

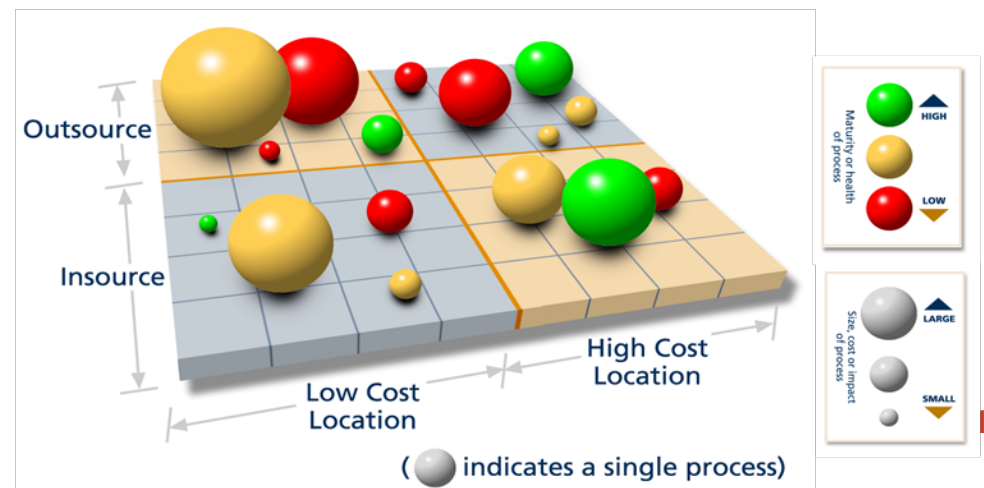
- What processes?
- What functions?

- **How to offshore?**

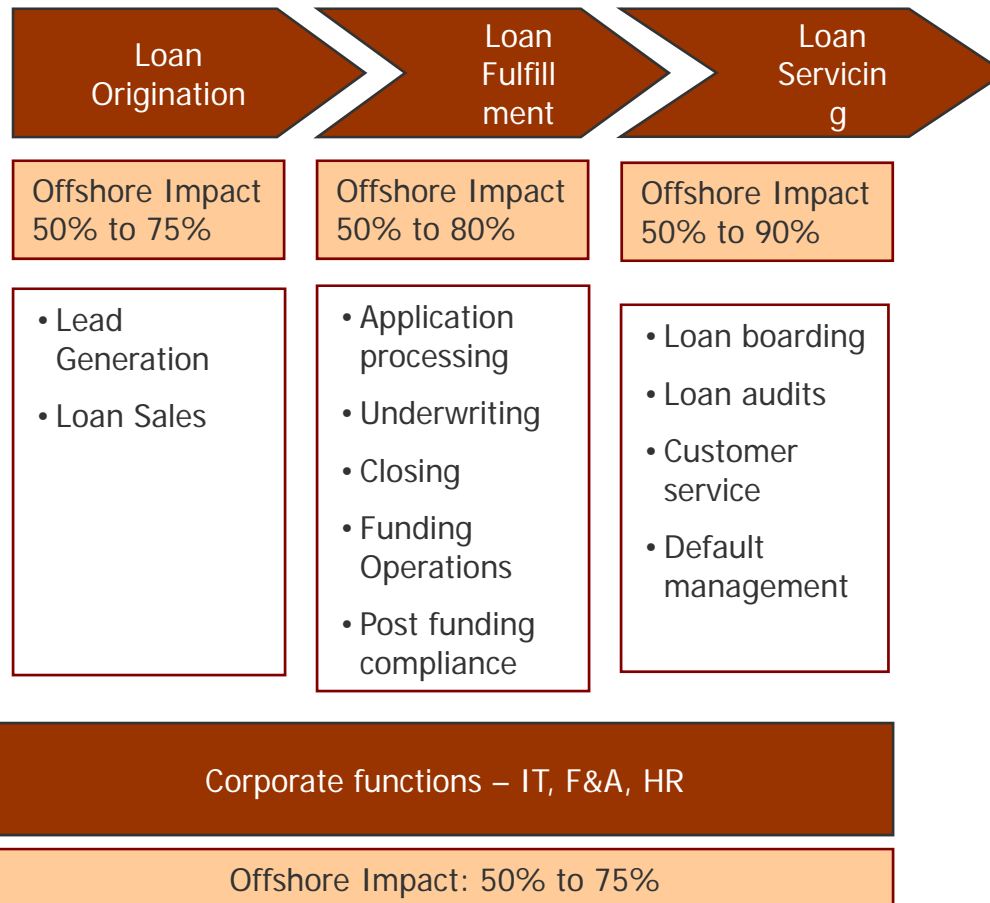
- Operating models
- Key success factors



- Evaluation of mission criticality and competitive edge
- Impact of the process
- Process maturity
- Assessment of readiness for remote delivery of services
- Cultural, Regulatory, Technological constraints



More than 50% of the processes can be offshored
Offshore cost savings of at least 30%



What is the scope of Offshoring

- Traditional Business Process Outsourcing in the Offshoring context involves the use of Client's Processes and Technology while replacing Client personnel in high cost centers with Service Provider's personnel typically located at a lower cost center
- Evolving model where Service Provider provisions the Business Service using its own People, Process, Technology and Infrastructure. Benefits of the model:
 - Best practices: In most cases, Service Providers can bring in superior processes and technology based on experiences with other Clients within and outside the Industry
 - Variable cost model: Services provided with a Transaction based Pricing model, rather than an FTE based pricing model
 - Service Provider has every incentive to improve processes and automation. Creative contracts should look at how both Client and Service Provider can share in the benefits of continuous improvement

Comparison of the two models

	BPO	iTOPS
Process	Client	Service Provider
Technology	Client	Service Provider
People	Service Provider	Service Provider
Infrastructure	Service Provider	Service Provider
Variable Pricing	Not really	Yes
Process improvements	Marginal at best	Yes
Technology improvements	Marginal at best	Yes
Cost benefit	Significant	More significant
Client control	Greater control	Lesser control

- Stateside companies have traditionally offered “iTOPS” solutions for decades:
 - Loan sub-servicing
 - Even end to end Loan Fulfillment
 - Collections
 - Now, Default management

- “Offshore” companies are beginning to offer iTOPS or Platform based solutions:
 - Loan Fulfillment
 - Default management

- Captive Model
 - Company invests in a fully owned subsidiary in the Offshore location
 - Company owns its infrastructure, processes, technology and people
 - Centralized processing model extended beyond the borders
 - Helps retain operational control
 - Great for competition sensitive, customer confidential or regulated processes
 - Significant cost benefits, but not as competitive as Service Provider model
 - Several successful examples: Amex, Bank of America, BONY, Aviva, Prudential, Countrywide, JP Morgan, Morgan Stanley, etc.
 - The Captive model can be built through a Build-Operate-Transfer approach
 - Emerging variants: Vendor Assisted Models
- Service Provider model
 - Service Provider follows Client's processes and methodologies
 - Service Provider uses Client's technology platform through a remote log-in mechanism
 - Service Provider hires and trains people to work on the processes from its facilities
 - Most of the times, Service Providers sign up to SLAs
 - Model delivers significant cost benefits because of the labor cost arbitrage
 - Model is still a semi-fixed cost as it is not in the interest of the Service Provider to reduce head-count. As a result, continuous improvement is at best incremental and marginal

- Select the right process candidates
- Choose the business model, and service provider that works best for you. Flexibility, Culture and People are more important than Cost
- Contract that defines Service Level Agreements
- Process improvements before Process transition
- Collaborative Transition Management involving strong program management discipline
- Steady state governance
- Relationship management
- Offshoring as a process not an event

Benefits of Offshoring

Steve Arnold
Vice President



Reduced Operational Cost

A company that is considering an outsourcing solution must analyze all costs associated with a specific process to properly compare current costs to projected outsourcing costs.

» LOWER LABOR COSTS

- Despite a weak trending dollar, there are still significant labor arbitrage opportunities
 - › 20% 30% -- or even more for complex or value judgment services like loss mitigation and collections.

» VARIABLE COST

- Variable cost structures –cost structures that are more transactional in nature.

Some key indirect costs to consider that are in addition to the regular wages offered to in house employees:

» Insurance and Benefits

- Insurance and benefits can add as much as 25% additional to the total cost of employment.

» Facilities Overhead

- Office space, electricity, lighting, water, etc.

» Services Allocated

- This would include any HR support function for this group, as well as IT support time and resources.

» Attrition and Turnover Training

- This expense is estimated to add 11% – 14% to labor costs.

Benefits of Offshoring (cont.)

Quality Improvements

- » Guaranteed quality through enforceable Service Level Agreements.
- » Expertise through working with multiple servicers – what may be ancillary or rote to your firm can be a core competency for a BPO provider.
- » Certain offshore models allow for second and even third reviews that are economically infeasible in the US.
- » Maturity of BPO platforms / concepts – Vertically inclined BPO/KPO providers now have the scale to sustain quality through market and customer cycles. Your choices are no longer Wal Mart BPO or Mom-Pop BPO –there are firms with both vertical expertise AND scale.

Balance Sheet Management

- » Many services can be outsourced with little or no capital expense – your vendor partner can roll start up expenses into the per unit price for the service and/or into their normal cost of doing business.
- » Outsourcing can reduce the need to invest capital funds in non-core business functions. Instead of acquiring the resources through capital expenditures, they are contracted for on an "as used" operational expense basis. Outsourcing can also improve certain financial measurements of the firm by eliminating the need to show return on equity from capital investments in non core areas.

Risk management

- » In some arrangements -- new markets, channels, products, processes can be established without disrupting core operations – risk and return can be allocated between the servicer and the service provider.
- » BPO can be a hedge against volatility in your staffing, volume, IT, and regulatory environments

Corporate viability and shareholder accountability

- » BPO frees your management to focus more on customer and shareholder value.
 - The stigma of Outsourcing/Offshoring is waning. People want better, faster, and cheaper goods and services and the next generation of home buyers could care less where the work gets done.
- » BPO relationships evolve through distinct phases of value – you cannot short circuit the process of building a BPO platform and/or vendor partnership. However – once you have the mechanics (Relationship mgt, reporting, technology/connectivity, migration methodology) you will find outsourcing to an option for most everything you do.

Overcoming Obstacles to Offshoring

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EVP



First American
Global Offshore Services

Overcoming Obstacles to Offshoring

- **Business Culture – Unwillingness to Transform**

- Many companies struggle with the implementation of offshore (outsourcing) solutions due to a lack of buy-in from the management team and/or departmental staff.
 - How to avoid/overcome:
 - Make sure that the messaging is clear and that the Corporate Vision is communicated to the ENTIRE organization.
 - Provide reassurances that the business plans to re-deploy strong/talented employees to new areas of the business
 - Be firm relative to performance expectations
 - Align compensation methodologies accordingly

- **Technology Constraints**

- The success of any Outsourcing/Offshoring initiative is contingent upon the availability of enabling technology.
 - If the applications that support the functions to be outsourced are not web-enabled, then consider:
 - Develop web interface/application
 - Citrix connectivity
 - Process in batch transmissions (if necessary)

Overcoming Obstacles to Offshoring (cont)

- **Limited knowledge/expertise with executing offshore strategies**
 - To some businesses, offshoring is a relatively new solution strategy. As such, these businesses typically do not have the necessary management expertise on their teams.
 - Most Offshore/Outsourcing service providers will provide support in the areas of:
 - Strategy design
 - Project plan creation
 - Transition and training
 - As offshoring is typically a long-term commitment, consider the addition of an internal Global Operations manager to handle outsourcing and offshoring initiatives/oversight.
- **Wage Inflation Concerns – Will I realize long term economic value?**
 - The answer is YES!
 - Keep in mind that your labor related costs in the US also increase year over year.
 - What is your providers strategy to combat wage inflation within their core business model?
 - Make sure that you protect yourself contractually.
 - Have you crafted contracts that insulate you from exchange rate risk? Etc.

Overcoming Obstacles to Offshoring (cont)

- **Customer Perception**
- At the end of the day, what our clients (or customers) think of us is key to our long term stability and success.
 - Maintain appropriate levels of visibility to your internal operational strategies.
 - The “Need to Know” approach
 - Avoid deploying high-risk, customer facing processes
 - Inbound voice
- **Information Security and Compliance Concerns**
 - Require your vendors to have robust Security and Compliance plans.
 - SAS 70, True Secure etc.
 - Require your vendors to have appropriate levels of security at the offshore facility
 - Security guards, Biometric technology
 - Arrange a tour of the vendors facilities, if at all possible.

Overcoming Obstacles to Offshoring (cont)

- **Fears related to Loss of Control**

- Strategies to address loss of control
 - Define communication protocols Day 1.
 - Matrix reporting structure with your internal management team having direct access to offshore teams.
 - Establish detailed Service Level Agreements and review production reports daily/weekly/monthly for compliance
 - Make sure the vendor has a robust quality plan with visible CQI's (Critical Quality Indicators)
 - Establish Pay-for-Performance models that provide incentives to vendors

Q&A