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Delivering Value to US Mortgage Banking Industry

A brief look at the Technology & Outsourcing trends within the Industry

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Date	Version	Author	Description
March 20 th , 2006	V1.0	Zia Bhutta	Initial Creation of Document
Document Owner: Zia Bhutta			

1 Introduction

The Mortgage Lending Industry has been traditionally a paper intensive industry. There has been tremendous influence of technology in industry however the adoption of technology and outsourcing in the Mortgage industry has been relatively slow. There are many factors that contribute to this:

- Industry is accustomed to many of the manual processes that currently exist within the business.
- Not enough disciplined Technology spending by traditionally smaller to medium sized Brokers and Lenders (or the “Channel”) partly because of lack of understanding of what efficiencies/competitive advantages Technology can bring to the business.
- The fragmented nature of the services industry that serves the Mortgage Banking Industry. The industry is dominated by many small players with their own niche services. There are some larger players with a wide menu of services however they generally serve the medium to larger sized lenders.
- Industry participants have been too overwhelmed by the record levels of financing prompted by low rates over the last 8-9 years. Most industry members are simply busy keeping up with business to consider implementing new technologies. A Corollary to this is that most experienced senior management realized that the ‘boom’ would never continue, and the bubble would burst, leading to industry consolidation, discouraging infrastructure investment. It was simpler to simply throw bodies at a problem as a band-aid, and wait for the industry shake out, before committing to large projects.
- Record profits for the entire industry reduced the needs for Executive Management to improve margins, so the need for efficiencies was not as pressing.

The Changing Industry landscape and the cyclical nature of the Industry also effect the strategic Technology and Outsourcing decisions. The market boom of the last few years created many new Players, provided huge opportunities for existing players and as the high growth levels off and the Industry heads towards another round of consolidation, focus is again towards Operational Efficiencies, Process Automation and Cost Reduction. As interest rates rise, margins tighten and Lenders look towards streamlining their operations.

Another thing to consider is that as the Regulatory and Compliance environments get tougher, it is becoming more important for Lenders to rely on their Outsourcing and Technology providers to help them cope with ever changing Compliance requirements.

This Paper analyzes some of the Technology and Outsourcing Challenges/Issues currently seen in the Industry.

2 Market Segmentation

Before analyzing some of the challenges, issues and opportunities that exist within the industry, it is important to define the various market segments within the Industry at a higher level. It is also important to note that many of the Industry Players are serving multiple market segments. For e.g. Washing Mutual Corporation has a strong Retail division as well as lends through Brokers, Correspondents and does Conduit lending. The bank also services the loans, securitizes them for sale in Secondary Markets, as well as providing warehousing, and custodial services to the Industry.

2.1 Retail Mortgage Lenders, Brokers & Correspondents

The Retail Mortgage Brokerage firms sources the loans from individual Borrowers, processes and brokers them to various Lenders., Retail Lenders vary from small to large sized companies with targeted market reach to the Largest Aggregators (Lenders/Banks/Securitizers) which may also originate through their own Retail Banking outlets. At the very front end of this space are the Loan Officers who directly deal with the borrowers and guide them through all the phases of the Loan Application. The Loan officers may be working for any entity in this trail, Mortgage Brokers, Banks, Direct Lenders, Net Branches, Captive arrangements, REITS, Services etc. Essentially this “channel” is organized in any possible way that can make business sense for the parties involved and is within guidelines of current laws and regulations.

The Retail Mortgage companies typically have following operational groups (These vary from one bank to another). It is also important to note that although many banks centralize the Processing and Underwriting functions for greater efficiencies and control, many others leave the Processing and Underwriting at a Branch level for faster processing speeds(Loan Officers typically like to keep the loan file as close to them as possible). The tradeoff here is that of speed vs. efficiency and a firm achieves its optimal balance based on its business realities.

- Sourcing or Lead Origination
- Loan Production/Processing/Origination
 - Boarding of loan into a Loan Origination System (LOS)
 - Processing Loan (Processing Lender Conditions, Credit, Appraisal, Title Review etc, other third party services)
- Underwriting
- Closing & Funding
- Post Close QC & Audit
- Warehousing & Shipping
- Secondary Marketing & Rate Lock Management
- Interim Servicing

2.2 Wholesale Lenders

Wholesale Lenders source loans through a variety of channels including Retail Brokers, Independent “Net” Branches or Correspondents. Many of the Wholesale Lenders are either Independent or are wholly or partially owned subsidiaries of large Banks (or Investment Banks), REITS (Real Estate Investment Trusts) are increasingly playing an active role in the mortgage space, and recently Hedge funds have also begun to take notice of the potential return from certain types of residential lending. Many of these Lenders are also in the Servicing (Loan Administration) business as well.

Wholesale Lenders typically provide various high end Technology Solutions to their “Clients” i.e. the Brokers. The mortgage market is extremely competitive and having a Technology edge is an

extremely important criterion for success. They typically provide their Brokers and/or Correspondents with web based “Portals” which provide Self Registration and Approval mechanisms for Brokers to enroll. In addition, the Portals also allow the Brokers to create and maintain their “Pipelines” by uploading single or multiple 1003 application extracts (Typically in Fannie DU format). Many also have developed sophisticated Automated Underwriting systems which can provide instant Product Eligibility, Pricing and Rate Lock facilities.

Brokers originate their Loans for either one or multiple Investors (or Lenders). Brokers are looking for the three “P’s”; Pricing, Product and Performance. Here again, the role of Technology is critical for each of the three P’s. Pricing is dependent on efficiency, the greater the efficiency, the better the pricing that can be offered. Products are critical, the more products a lender has the less need a broker has for multiple lenders, but the more products a lender has the more important a “Product Finder” and “Automated Underwriting” is to provide support to the Brokers and the Back Office. Performance is the most important P, no matter how great the pricing and product are, if the loan does not close, no one makes money. Technology such as Work Flow, Interactive Web Portals and process automation are critical to any lenders performance. A typical large Lender may source business through thousands of brokers and smaller lenders.

3 Technology Challenges

3.1 Sourcing or Lead Origination

There are several mechanisms by which Lenders generate leads and source loans. This includes (but are not limited to)

- Local Loan Officers at Local Branches (Local Newspaper advertising, Lead Referrals etc)
- Partnerships with Residential/Commercial Builders, Real Estate Agents/Companies
- Online Leads (Either Lenders own sites or sourced through LendingTree.com etc)
- Direct Marketing (Outbound Telemarketing, Direct Mail)
- Affinity Marketing, including retention efforts

Loan Officers use all types of tools for tracking leads. Some may use standard desktop tools such as Goldmine and ACT etc and others may use sophisticated CRM systems such as Salesforce.com, Siebel etc. Many Loan Origination Systems also have built in Sourcing modules which can work well as they can directly feed a “Loan Pipeline”, should the lead go further into preliminary processing mode. There are others who may simply use mundane tools such as Outlook or Excel (We have seen those), and there are those who still have the paper files.

Although the ideal solution is the one where a lead is tracked through the LOS itself and can be converted into a full blown application within the LOS system, once it reaches the stage of Processing, the Loan Officers may prefer to maintain the lead to themselves and track it using their own Desktop systems until it become a true loan. To Retail Lenders, keeping good Loan Officers happy requires them to be flexible however a balance must be reached between the two to attain maximum efficiency, productivity, compliance and control.

There are several things that can be done to streamline the sourcing process. Again, the approach will vary from one Retail Lender to another depending on Business Realities:

- Evaluate existing lead sources by segmenting by Regions/Branches, Products, Sources etc. Determine various Regional and Product trends based on the existing lead flow. This will help in formulating an optimal lead sourcing strategies using existing as well as newer channels. If most of the business comes from the existing Loan Officers, then offer them various tools to help them become more efficient and productive. Here again a common corporate strategy will help. For e.g. if most of the Loan Officers are accustomed to using ACT for tracking leads then either offer them a Web Alternative such as Salesforce.com or Internet version of ACT. Whatever tools are being used, they should be used by “All” Loan Officers of the company. This will make the process of converting Leads into Loan Applications much smoother. For e.g. all ACT data can be exported in certain formatted CSV or TXT templates and can be imported into an LOS system. In reality, Many Loan Officers will usually resist centralizing data. A Top performer may be given more latitude than a lower performer.
- Evaluate existing lead sourcing process and identify/remedy areas of improvement. For e.g. implement a company wide Lead Tracking system and standardize it. Whether it be a module within the LOS, a stand alone system or any other system, the standardization of the lead sourcing process will improve not only the quality of the lead but will also provide better tracking and much more efficient conversion of leads into “Loan Applications”.

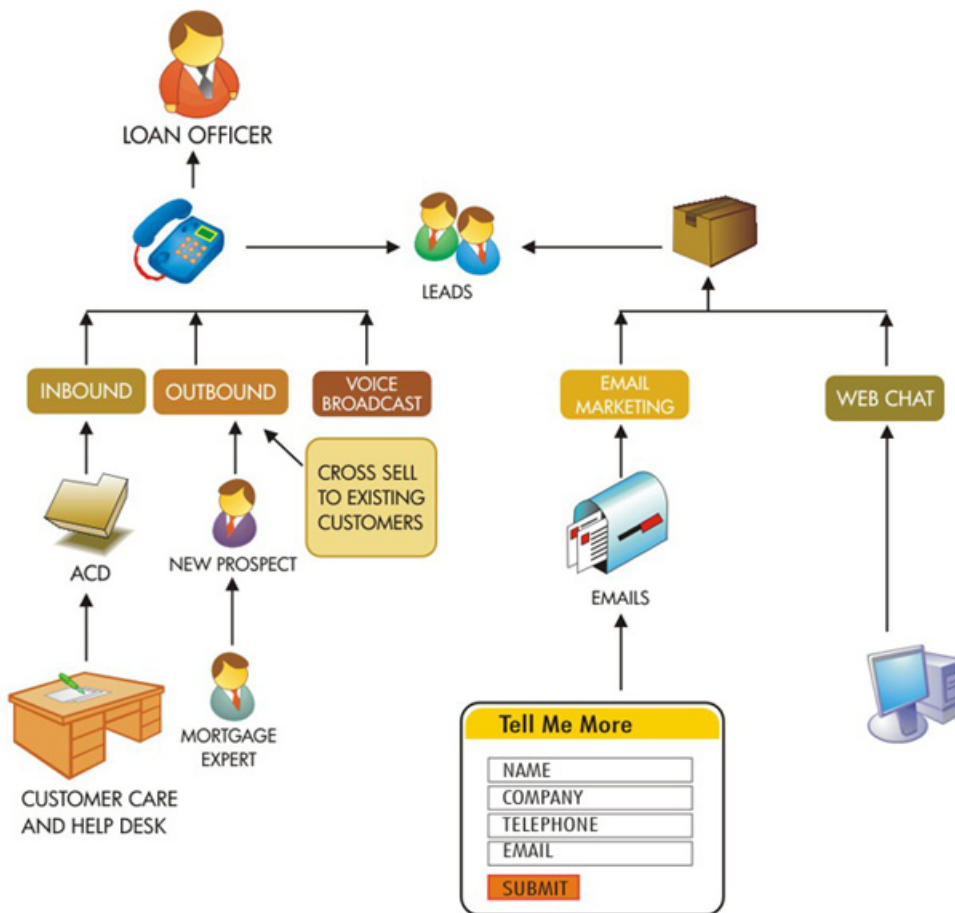
Most of the Lead Sourcing companies either obtain leads through extensive targeted Telemarketing campaigns or by advertising and marketing (Both Online and Traditional). Some of the examples of National Lead Sourcing companies include LendingTree.com, GoApplyLeads.com etc. There are many other localized Lead Sourcing companies that serve certain states or niche community markets as well.

It's interesting to note that competition has driven some of the Telemarketing firms to Offshore the lead origination process. Targeted lists are obtained through market research and are handed over to Offshore Call Centers (India, Singapore, Philippines etc) for perusal. Call Centers are generally paid on per lead basis or in some case resource basis as well. For larger operations, the Call Centers are paid per resource basis but tracking mechanisms are put in place to measure productivity.

Typically an offshore Mortgage call center deals with all mortgage-related end-customer queries and requests for information. They offer guidance and solutions to customers who are misled and unable to understand the mortgage offerings provided via the Net. These call centers make inbound or outbound inquiries, offering back-end processing services for data entry in the loan form, property evaluation, checks on property insurance, legal clearances, credit evaluation, appraisal valuations, early and overdue collection calls, asset management, overdue payments processing; and accounting and reconciliation. Quality leads are a key ingredient in a successful marketing campaign for Mortgage lenders.

Some of the systems that are traditionally used by Loan Officers to track Leads include ACT, Goldmine, Salesforce.com etc. Some of the providers offer enhanced solutions specific to Mortgage Industry. It is important to evaluate these systems based on the existing business frameworks, future goals, and End User Input. Most Lenders would prefer a lead which has been through the bare minimum Pre-Qualification process.

Some of the more popular LOS systems also offer the integrated lead sourcing modules. The Diagram below depicts the typical Lead Sourcing Processes.



3.2 Loan Processing & Origination

Broadly defined, a Loan Origination System is Software that automates many front office to back office processes involved in originating a loan. From Point of Sale (POS) to Post Closing to Secondary Marketing, the software automates every step of the Mortgage Application process workflow as well as providing Data Storage, Validation and Reporting.

Most LOS systems offer a wide variety of features however in most cases, at a cost of added complexity. The complexity may result in deployments which don't use the LOS systems to their full potential as well as result in staff training issues. It is our experience that almost 80-90% of all new LOS deployments have been faced with longer than expected timelines and/or are over budget.

Many Retail Lenders are now able to provide remote access to the LOS for their Loan Officers in the field (via Virtual Private Networks VPN) thereby empowering the branches and the Loan Officers to use the Corporate systems and follow the corporate processes and compliance mandates. However, most of the LOS systems implemented today are not fully utilized to their potential and many processes are still conducted manually.

There are several causes for this

- Many LOS Software companies have Product as well as Professional Services divisions. In many cases, the line between Product and Professional Services divisions are not clearly drawn which may have an impact on the Product design. Complex Product User Interfaces and Designs may intimidate Users and the Users may decide to do some tasks manually instead of using the System. Many companies separate the Professional Services Divisions from the Product Development to keep Product Development independent and stay innovative and User focused.
- The Professional Services arm for many of the LOS companies, have limited resources hence bulk of the implementation work is done by the Client. Smaller to Medium sized Lenders generally lack the Resources, Skills and Planning that is required to implement such a complex piece of software across all aspects of a mortgage operation. Adequate User Training sessions are not conducted either.
- The data migration from legacy systems and integrating with Client's existing Systems is a monumental task (Accounting, Risk/Secondary, Credit/Automated Underwriting, Servicing). This aspect of the implementation is usually underestimated. Again, success requires extensive planning at various implementation stages.

3.2.1 Loan Origination Systems

A Loan origination system is a comprehensive automation tool designed to bring commercial efficiencies and facilitate workflows to streamline the loan origination process while maintaining required controls. Such a system is primarily equipped with in-built features and functionalities for online execution of the entire loan processing cycle. The system enables management, administration, tracking and reporting features for the loan process beginning with the origination of a loan from the initial request through to the initial funding.

LOS systems enable quick qualification of loan requests, full underwriting, multi-level credit sign-offs, along with pre-closing and post-closing due diligence. Through integrated document generation, document tracking, task lists, reporting/analytics and email functions they provide a collaborative workspace for a consistent view of the status of a deal across all involved parties. LOS's also enable clients to set production goals, measure production volumes against these goals and analyze the quality of loan requests being submitted by third parties.

A typical LOS system maximizes the automation of steps required to process a loan application. Specifically an LOS system can automatically:

- Populate the 1003 with information from a prior loan.
- Check credit and merge credit information.
- Pull underwriter findings/conditions and merge information.
- Communicate electronically with other 3rd party vendors.
- Generate all required documents.
- Access any business or person (and their contact information) involved in the load via our Rolodex feature.
- Perform all calculations for any particular loan, including fees.
- Generate loan numbers, if desired.
- Insert notes or comments or questions related to a loan.
- Add an unlimited number of borrowers, assets, liabilities or income sources to a loan.
- Input all data required for the 1003 in a quick, simple, logical manner.
- Manage Loan Pipeline/Workflow.
- Manage loan documents or can optionally provide interfaces to 3rd Party Document Management or Imaging Systems.
- Maintain and Monitor Lock data.
- Provide basic eligibility and pricing rules.
- Maintain security of customer's personal data.

The LOS systems include a support for variety of Loan Products as the processing needs and requirements may be different from one loan product to another.

The next section takes up the topic of the challenges related to an implementation of an LOS system.

3.2.1.1 Selecting an LOS System

Knowing what Business Problem a company is trying to solve as well as what stage of the process a company is at is important. If a Lender/Broker determine that their current LOS System is out of date (because of functionality, scalability etc type of reasons), then before they approach the LOS Software companies, they might want to go through an RFI/RFP (Request for Information/Proposal) process first to analyze their needs and then decide on a System to implement.

There are several Management Consulting companies which assist in the RFI/RFP process by engaging for weeks (or months) to understand the Lender/Broker's current business processes. Although, many of these companies do have Alliances with LOS companies and may want to recommend solutions based on that. In any case, the RFI/RFP process will help to create a manageable path towards making the right decision.

3.2.1.2 LOS Implementation

There are two things that need to be present at the onset of a successful implementation: a working relationship between the customer and the vendor, and careful planning. Beyond this, there are several steps that should be followed to ensure success, all working towards the goal of transforming your antiquated, outdated loan origination software into a state-of-the-art profit center.

Every implementation should start with pre-installation planning. This should include identification of the current operational environment through completion of a pre-installation checklist. Because this will be a partnership, this is also when you will choose the appropriate liaisons between LOS vendor and customer, including a designated system administrator. Additionally Communication protocols should be established (such as weekly updates and project meetings) with all parties (LOS Vendor, Technology Partners, 3rd Party Vendors, Department heads, etc).

Once these initial steps are taken, there are several more pre-installation tasks that must be fulfilled. These include verifying the network, server and workstation configurations through proper analysis. Time lines for both training and service activities must be set, and the vendor and customer must decide on clear-cut objectives for your operating system.

Another important step is the Initial training for the designated system administrator on daily, system and administrative functions. Some of these functions are set-up, user-defined macro reports, insurance tables, company files and user-defined custom forms. This will provide the system administrator with a working knowledge of how to operate, enhance and maintain the new system.

The next step is installation of a test system. During this step, the new system is configured by setting up passwords, default files, mortgage programs and insurance tables. In addition, any other customization that may be required is done during this stage. The customization process can vary from weeks to months depending on the complexity of the existing business processes. In some cases, existing process have to be mapped according to the way things are implemented in the new LOS system.

Other considerations that may arise are the integration effort required to integrate the LOS system with the existing Applications (Accounting G/L, AU, Secondary and/or other Applications) as well as the data migration strategies from the existing LOS system. In many cases, the old LOS is gradually phased out by conducting parallel tests of the new system and creating data archives from the old system until it's completely phased out.

3.2.2 Automated Underwriting Systems

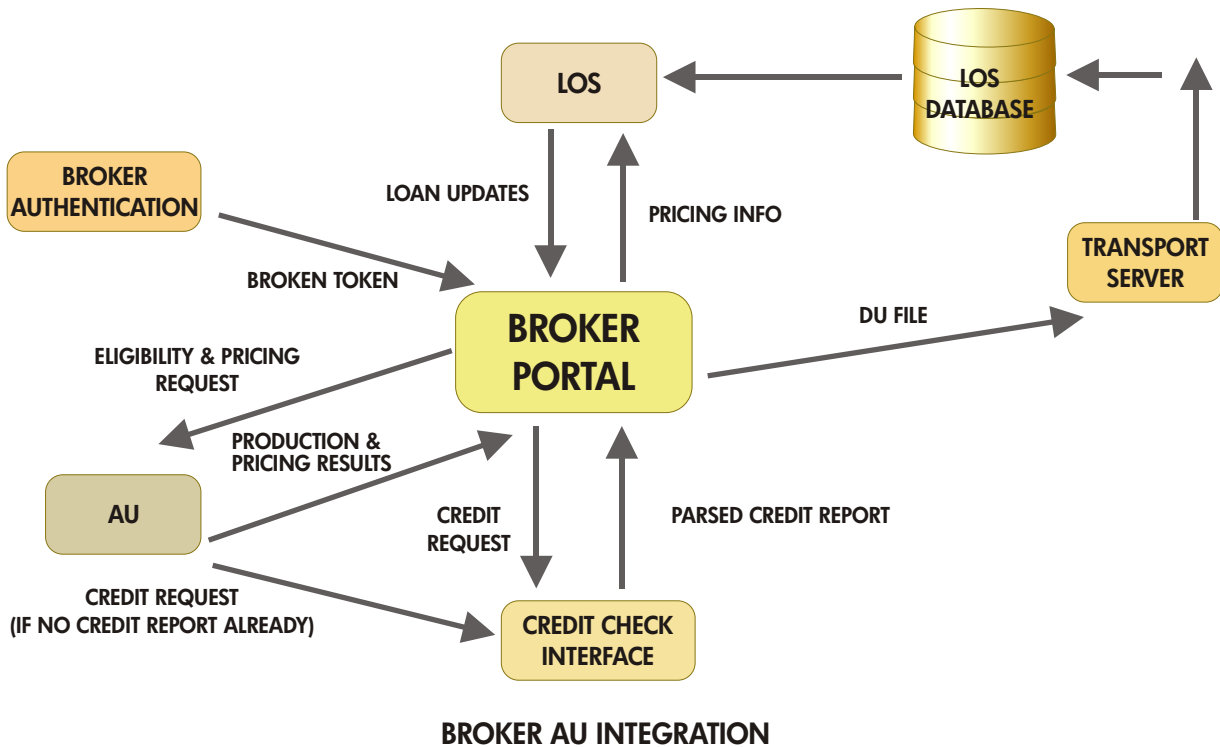
Many of the Large Lenders are investing mega Dollars in sophisticated Automated Underwriting systems to provide Brokers and Retail Customers faster service, streamlined pricing and reduced error rates. Simply stated Automated Underwriting systems are BREs (Business Rules Engines) where Lenders can program in Business Rules and those rules are applied to the Loan data provided by the brokers. The AU Systems processes the rules on the loan data and provides Product Eligibility, Deal Structures (Best Product Fits etc) and Pricing information to the Brokers. Without the AU systems, the process is mostly manual and can take anywhere from 4 – 24 hours which is a competitive disadvantage.- The larger AU Systems (DU and LO) are actually “rules+models” based on the huge agency portfolios. This means the rules engine updates itself based on changes in the Servicing portfolio.

The process starts by Brokers entering in or faxing in 1003 information to the Lenders. Many Lenders also provide the facility to import single or multiple 1003 Applications in Fannie DU 3.2 format or MISMO 2.3.1. Brokers may also do a pre-qualification and a “Credit Pull” and the liabilities data is populated in the 1003. The Brokers then submit application via Lender web site and the Lender provides the Product Eligibility and Pricing information based on the data provided. Most of the Lenders may re-pull the Credit and reconcile before processing the Application. Also, the AU system provides the “Decision Path” as well as the Conditions that apply to the Decision.

The AUS system deployment is a complex process with considerable Technological as well as Business Process challenges. In many cases, a Lender may have to modify their existing business processes to fit the solution they are planning to deploy.

For Conforming products, Fannie Mae provides a Desktop Underwriting system “DU”. This system is used by most of the Lenders for products that fulfill Fannie Mae guidelines or “Conforming Products”. There are also many third party providers who specialize in underwriting solutions for certain product types. For e.g. ET Systems based in Seattle, WA is a leading provider of AUS for HELOCs, GHR and ARC Systems specialize in other types of Underwriting and processing solutions. Hence in reality many large Lenders end up in deploying systems with many different integration points.

Some of the noticeable Vendors of AUS systems include iLog JRules Engine, Mindbox, GHR, ET Systems, ARC Systems, Ellie Mae, Fannie Mae (Desktop Underwriting Only) (Fannie now offers custom DU. The Diagram below depicts a typical Process flow of an AU system Deployment.



3.2.3 Imaging & Document Management Systems

Document Imaging systems are nothing new to Mortgage Industry. As the drive towards Operational efficiencies continue, the deployment of imaging systems is also becoming a critical operational and competitive advantage. The idea behind the Imaging and Document Management systems is to eliminate the “hardcopy” loan documents and move towards the holy grail of an “e-mortgage”. Other benefits include quick search and retrieval (Imaged documents are Indexed and tagged with Meta data information) and remote access to the imaged copies of the documents. In addition, Imaged files can be linked to a POS/LOS system for quick access to the entire File.

Companies can utilize the Imaging Technologies either by

- Deploying an In house Imaging Solution (Usually an expensive solution to implement but Cheaper in the long run as well as other added benefits) OR
- Outsource the Imaging function to an Outsourcing provider (The physical files are picked up by the Outsourcing provider and scanned at their site and is available for review Online (Usually overnight), many of these companies also provide for the physical storage of the files).
- A recent entry is where the documents are imaged by the end user (Via Fax or scanner) and aggregated in a “Shared Drawer” available to the broker, Lender, etc – A leader in this is BlitzDocs

It makes sense to out source the Imaging function in the short run as it may be as simple as setting up the frequency of Physical file pickups. However, Mortgage companies typically are

uncomfortable in not having access to the Physical file during Processing and Closing. The other drawbacks to using an Outsourced solution may be difficulties in integrating the POS/LOS functionality with the Imaging system for seamless access. There may be service providers out there that may offer creative solutions to this issue but main fact remains i.e. the two Systems are deployed on different Network infrastructures and there are some inherent issues in trying to tie the two systems together.

There are several Imaging systems in the market including OnBase, Mobius etc. Today's Imaging and Document Management systems not only provide the Scanning and Web based Retrieval mechanisms but also ability for companies to create interfaces to these systems. Workflow modules within these systems can automate the flow of the document from one phase of the Loan Application processing to another.

Some of these Systems also allow Interfaces for OCR Software (or may have built in OCR capabilities) where data elements from the Scanned TIFF or PDF images may be read directly from the Scanned copy. This can be powerful feature especially considering that many of the documents within a Loan Application are standard documents (Such as W-2s, 1099, K1 etc) Data Extracted directly from these documents can be used to feed the LOS or other systems for Processing tasks such as Income Verification etc.

Some of the common Imaging Systems using in the Mortgage Industry include Mobius, OnBase, aLaMode, Archive Systems etc.

3.2.4 Regulatory Compliance Systems

Mortgage Industry is a highly regulated Industry. Brokers and Lenders have to meet strict compliance guidelines provided by different Government Agencies and Compliance codes (RESPA, HUD, HMDA, GLBA etc). In addition, Public Companies also have to comply with Sarbanes Oxley guidelines. To complicate matters even more there is a plethora of State and local regulations. The final complication is different lenders may be subject to or exempt from various agency and jurisdictional regulation based on their corporate structure (REITs vs. Federal Saving banks, LLC's vs, HUD approved, Agency Approved, etc).

There are many companies which market their compliance solutions. In addition, certain Compliance solutions are built into the common LOS systems as well. The systems analyze Loan data for Regulatory, Compliance, Fraud, High Cost (Section 32) and OFAC related guidelines and presents the findings to the Lender. The processes can be automated where loan data can be processed online to a 3rd party provider (such as Clayton, ComplianceEase, Brooks, Interthinx etc). The findings are returned and will be interpreted and processed depending on the business processes of the Organization.

3.2.5 Enterprise Reporting Systems (Decision Support Systems)

Enterprise Reporting needs in the Mortgage Industry are driven by the volumes of data that is captured during the Origination and other processes. In many cases, companies create Reporting "Data Warehouses" where the information is compiled in from various systems including LOS, Accounting, Servicing etc. The information is modeled in such a way that it optimizes quick data retrieval. Several "canned" or routine reports are created which may run as batch processes with scheduled report delivery to recipients. In addition, sophisticated OLAP systems are used to create multi-dimensional views of the data. For e.g. Originations by Region based on Product Types and other Attributes can be viewed in multiple-dimensions. Several Business Intelligence products such as COGNOS, Hyperion, Business Objects etc provide these capabilities and are commonly used in the Industry. Most of these companies have also created packaged solutions around the common needs of the Mortgage Industry.

3.2.6 Secondary Marketing Support Systems

Secondary Marketing departments play one of the most critical roles in the Industry. For a Mortgage Broker/Originator Secondary Marketing performs the function of providing the accurate Loan Pricing information to the Loan Officer and locking the rate. At the same time Secondary Marketing also locks the sale of the loan to an Investor. The accuracy, speed and the timing of the Rate Lock process is critical to the success/profitability of the Originator's operation.

For many large Lenders, the Secondary Marketing process involves the processes related to the procurement of closed and funded loans from correspondent lenders. Investors can buy individual loans and pools of loans that have already been closed and funded under the originating Lender's name. Loans are committed via "Forward Commitments", with an investor for a pool of loans that meet certain criteria.

Many LOS systems provide the functionality for the Rate Lock process however, for many Brokers the Pricing calculations are mostly a manual process based on the daily rate sheets provided by the Investors. The pricing adjustments are calculated mostly using Excel based tools. Most of the Brokers lack the budgets/resources for deploying automated pricing systems.

Secondary Marketing also provides the function of Risk Management (Interest Rate and Portfolio Risks) and Hedging (Loan Pipeline Risk). Several Analytical Software packages are commonly used to create Analytical models to optimize Mortgage pools and provide "Best Execution" scenarios given the current Interest rates, Pool characteristics and various other parameters. QRM (Quantities Risk Management) is one of the most commonly used software used by most of the large lenders.

Another commonly used software is PowerSeller (by Associates Software Consultants). PowerSeller is also Secondary Marketing Pipeline Risk Management and Hedging software which is commonly used by many Lenders.

3.2.7 Commission Calculators

The compensation model in the Mortgage Industry is heavily driven by commissions. Commissions paid to Loan Officers, Brokers, Account Executives, Regional and Divisional Managers etc are usually calculated by Finance departments manually using standard Commission Structures and overrides etc. The information feeds the HR and Finance systems and ultimately hits the payroll.

Once again, some of the LOS systems provide the Commission calculation features however there is simply no "One size fits all" model for Commission calculations. The commission models are revised frequently amid general market conditions. So the level of flexibility that is required is simply not accommodated by the 3rd party systems and there is some sort of customization usually done to fit the system to the Company's business model.

3.2.8 Servicing Systems (Master Servicing, Special Servicing, Servicing)

Mortgage Servicing at a high level relates to Accounting for Collections of Principal & Interest, Disbursements to Investors and Default Management. Because of the economies of scale required to make money in the Servicing business, the Servicing Industry is dominated by few large players. They include Countrywide, Wells Fargo, Washington Mutual etc.

The Servicing Software is complex software which feeds into Accounting (G/L) systems, Enterprise Reporting Systems and other related downstream Systems. Most of the servicing software is custom developed by larger Institutions and is highly customized. Some of the Commercial Servicing systems include Fidelity(CPI), Loanware, SBO 2000 (Servicing by Others/Master Servicing), MSTD (Special Servicing & Default Management).

4 Outsourcing Trends & Challenges

4.1 Technology Outsourcing

The outsourcing landscape in the Mortgage Industry is very interesting. Outsourcing is nothing new to Mortgage Industry. Companies have been outsourcing Technology work for many years and it will continue to grow. Many Lenders simply don't have the resources and the capabilities to build out systems to automate various business processes and create operational efficiencies. Most of the Companies understand the competitive advantage that technology provides. According to Mortgage Technology magazine, the cost per loan spent on technology rose from \$99 in 2004 to \$119 in 2005. Although the dynamics of the Market has changed recently as the market is cooling down, smart Companies will continue to invest in Technology and Outsourcing to stay Competitive.

Most Lenders have in house Staff for maintenance and installation of IT Infrastructure but very limited (or none) Development staff to build out and/or deploy various solutions. Larger companies do have formal Business Solutions group and formalized IT Development groups which service the Business Units of the organization. Even, larger companies frequently outsource bulk of technology work. The work that usually kept in house usually involves mission critical applications as well as applications where IP (Intellectual Property) is involved (For e.g. ongoing maintenance and development of AUS systems as they contain Proprietary Business Rules).

Another Big challenge for many lenders is managing in house development resources. These resources are often pulled in many directions, and Executive Management knows how to manage mortgage professionals, not Development professionals.

Before partnering with an Outsourcing Provider, it is important to consider the Provider's domain understanding as well as Technical expertise. It is also important to understand Vendor's grasp of Compliance and Regulatory issues.

Many Technology Consulting companies with Mortgage Domain expertise have Technology products and frameworks they have built based on their experiences. It is important to understand the difference between a framework and a product. For e.g. a company may claim that it has an Document Management and Workflow based product, however the product may not be flexible enough to meet the Company's existing processes and may require existing process re-engineering. Technology frameworks on the other hand are loosely coupled building blocks (or components) which can be put together based on a Company's unique needs and requirements.

The other thing to consider before engaging with a Technology Outsourcing provider is domain experience of its Personnel. The Consultants are not expected to be Mortgage Bankers but they are expected to understand the "language" of the Mortgage Industry. This is critical as many crucial projects may end up in the hands of Consultants who may not understand how to communicate with the Business folks.

4.2 Business Process Outsourcing/Knowledge Process Outsourcing

Business Process Outsourcing terminology itself is pretty self explanatory. Lenders have routinely used outside service providers to perform some of their Business functions. For e.g. many companies outsource the Post Close Audit and QC Operations of their Loan Portfolio to an outsourced service provider. There is a good reason for this. Mortgage Industry is generally cyclical and many Lenders don't have the flexibility to keep hiring new staff and balance their existing personnel during down turns. Outsourcing helps where the Outsourcer uses its staff to handle work load of various Clients. Outsourcing provides the flexibility to ramp up and down and get things done quicker and more efficiently rather than doing every thing in house.

With the adaptation of Offshore Outsourcing of Technology work, the scope of off shoring BPO work has also been expanding the past few years. The concept is similar where the work is performed by an Outsourcing partners although outside of United States (Typically in India, Philippines, and China etc).

There is one subtle difference between off shoring BPO work onshore vs. Offshore. Typically a company would outsource Onshore because of the speed and flexibility required. Costs are not a major concern (Most Outsourcers charge on Per Transaction/File basis). Although the same is true for offshore companies, there is also a Cost benefit of off shoring work to low wage Countries. It is because of this Cost benefit that the scope of BPO is much wider for Offshore since Companies can utilize this model to offload many of their mundane processes (such as Call Centers, Data Entry, Lead Generation, Loan Data Entry etc).

Many household name companies such as Countrywide, GMAC, Greenpoint Bank, OptionOne Mortgage etc have either their own operations in Offshore locations or they have engaged with Offshore Vendors who provide them those services.

As the Vendors providing these companies have matured so have their services, some of the Niche Vendors have started to offer higher end services (much more than just mundane/repetitive tasks). Some of these services include (but not limited to)

- Loan Processing, Conditions, Credit Checks, Income Verification etc
- Title Review Services
- Document Mapping Services
- Quality Control, and Post-Close Audit Services
- Rate Locks

These are some of the front end processes where timing and execution are critical. Hence, the companies venturing into these types of engagements have to be absolutely sure about who they partner with. It is also important to understand that there is a gradual learning curve associated with such engagements. Although many of the processes at a higher level are similar, the actual business process differs from one Lender to another. Pilot projects must be planned and executed to ensure the success of the Offshore Outsourcing initiative. However, if successful the Cost savings are significant.

The Outsourcing of higher end **Business Process Outsourcing is also referred to as Knowledge Process Outsourcing or KPO**. For e.g. an Outsourced Call Center operation is not quite as complex as an Outsourced Loan Processing/Production operation.

4.2.1 4.2.1 BPO VS. KPO-A perspective

KPO is not just about 'Cost Arbitrage'

BPO is driven primarily by Cost arbitrage. But KPO is driven not by Cost, but by the ability to deliver high value, mission critical processes. In fact, KPO players solely based on cost differentials will hardly be sustainable in the long run. The central theme of KPO is to create value for the client by providing the highest-quality business expertise and superior productivity/effectiveness rather than cost savings based only on geographic cost arbitrage. KPO services help improve the time-to-market, access to special skills, absorb peak load and enhance organizational effectiveness. Moreover, it simplifies the process and makes it more flexible. Consistent quality is the key word and primarily drives the buying decisions. For example, an error made in a corporate finance valuation model can have a huge financial downside, which is likely to be in factors of 1000+, possibly larger than the savings made by having the spreadsheet produced in India. Similarly, a patent with badly written claims can damage the protection of multi-million dollar products in global markets. Finally, the outsourcing solutions for high-end processes are usually highly customized, which is an important element of value creation for the client, but also requires the vendors to run multiple customized processes in parallel.

BPO's cater to the large company, large volume market while KPO's are ideal for the vast majority of Lenders.

BPO is largely a volume game and therefore used by large players to outsource extremely low end "cyber coolie" functions while KPO is a highly specialized knowledge driven function that is aptly suited for the specific requirements of vast majority of Lenders.

3. BPO's serve existing markets. However KPO companies have the unique opportunity to create new markets, since their price points allow them to offer new types of services simply not available in high-wage countries for cost reasons.

4. BPO breeds low end generalists while KPO demands high end specialists.

"Jack of all Trades" approach does not work in KPO. The work at KPO requires dramatically higher levels of domain expertise and therefore the culture and customer requirement of KPOs and BPOs vary significantly.

5 Conclusion

As described, the outsourcing arena has undergone a sea change, with requirements demanding greater understanding of both business and technology.

The ability to integrate specific Process requirements with an understanding the larger Business scenario is a prerequisite. Technology needs to meld seamlessly with Operational workflow and both must be aligned to strategic Business goals.

Therefore, while selecting an outsourcing partner it must be kept in mind that the most successful outsourcing partners do not treat Business & Technology as separate fields. Rather they believe in, and possess the ability to bring about the synergistic confluence of both & enable clients & partners to realize benefits from the same.

5.1 Synechron's Approach to Mortgage KPO & Technology Outsourcing

In keeping with this principle, in the Mortgage Domain, Synechron's Mortgage KPO Business Domain experts work very closely with our Mortgage Technology specialists & both symbiotically leverage their complementary business & technical expertise sets. This enables Synechron to dynamically create innovative, cost effective, streamlined solutions & structured process that addresses the clients needs & issues from a holistic business perspective.

With established strategic partnerships and alliances with many of the 3rd party Lender Services and Technology providers, Synechron's unique approach enables both Mortgage KPO & Mortgage Technology teams to actively collaborate on projects leveraging a synergy of Business & Technology insights & expertise. This enables Synechron to not just develop reams of "application code" or provide "outsourced processes", but deliver holistic, value adding Business –Technology Solutions to our clients.