The Current State and Future Implications of Increased Regulatory Oversight of Business Process Outsourcing (BPO) in the Re-Regulated Mortgage Origination Industry
The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (DFA) is the Federal government's attempt to promote stability in the U.S. financial system. Underpinning the DFA are four (4) relevant goals: 1) Improve accountability and transparency in the financial system; 2) End the perception that certain financial institutions are “too big to fail”; 3) Protect American taxpayers by ending bailouts; and 4) Protect consumers from abusive financial services practices. The DFA creates two new regulatory bureaucracies to lead government’s pursuit of these goals: The Financial Stability Oversight Council and the Consumer Financial Protection Bureau.

The Financial Stability Oversight Council (FSOC) is responsible to:
- Identify risks to the financial stability of the United States;
- Promote market discipline by eliminating expectations that the Government will offer a shield from losses in the event of failure; and,
- Respond to emerging threats to the stability of the United States financial system.

The Consumer Financial Protection Bureau (CFPB), is responsible to:
- Implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services; and,
- Ensure that markets for consumer financial products and services are fair, transparent, and competitive.

As these new bureaus have just begun their work, mortgage banking executives are uncertain about what their organizations should do now in anticipation of evolving rulemaking. As these uncertainties tie in with the topic of this paper—Business Process Outsourcing and oversight of third party service providers—mortgage-banking executives need to assess where their organization is right now when it comes to the evolution of their entire operations platform, including their BPO infrastructure and partnerships.

### Dodd-Frank Act: Means and Ends Goals

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<td>Identify risks to financial stability</td>
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<td>Promote market discipline</td>
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<td>Eliminate the perception of a government shield against market losses</td>
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<td>Implement and enforce Federal consumer financial laws</td>
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<td>Ensure access to markets for consumer financial products and services by all consumers</td>
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1. The contentiousness surrounding DFA is not easily traceable to a single or even a few specific sources. It has all the intrigue, political infighting, macro-economic ideology, and social engineering subplots that one could imagine emanating from the mind of a great American novelist. We opted to make a broad-brush stroke statement rather than embark on a discourse that itself would consume the word count target of this paper.
In this paper, we lay the contextual groundwork for probable future implications of increased regulatory oversight of business process outsourcing in the re-regulated mortgage origination industry. We do this by presenting an overview of the current state of mortgage industry regulation. Specifically, we examine three (3) prescient questions:

1. Where is the mortgage origination industry in the Evolution of the BPO Market?

2. What core products and services are mortgage originators and servicers currently outsourcing to BPO vendors?

3. What should mortgage bankers do now to ensure compliance of their BPO vendors to the new and fluid Consumer Financial Protection Bureau mandates?

1. Mortgage Settlement Service Business Process Outsourcing

Procurement of third-party real estate settlement services has evolved neatly with the continuously evolving mortgage lending industry, at least in the early years. In the post-World War II years, the booming population and resulting run-up in residential homebuilding to support the emerging baby boom generation, Savings and Loan Associations (S&Ls) dominated the dispensing of mortgage funds through a network of individual or multi-community branch offices. Laws prohibiting multi-state banking served to advance the notion that “all lending is local.” In those days, facsimile machines and credit reporting terminals with dial-up couplers represented “high technology” essentially. Outsourcing mortgage services to third-party vendors, the responsibility of the credit loan officer, was limited to ordering title searches, appraisals, credit reports, and sometimes flood zone certificates. Some institutions took it a step further, by writing credit life, property, and fire insurance policies at the local branch, underwritten by selected insurance providers.

The end of the S&L dominance in mortgage lending corresponds to the mid-1980’s S&L crisis that destroyed a wide swath of the industry, along with many tens of thousands of investors. From January 1, 1986, through year-end 1995, the number of federally insured thrift institutions in the United States declined from 3,234 to 1,645, or by approximately 50 percent, according to a Federal Deposit Insurance Corporation (FDIC) post-mortem report.

Beginning in the mid-1980s non-bank mortgage companies including Lomas and Nettleton, Miles Homes, Prudential Home Mortgage, and Sears Mortgage, among others stepped in to become a dominant distribution channel. The demise of the S&L model hastened the process. Many of these firms eschewed the traditional model of managing third party vendors in-house.

Unfortunately, these regional and national nonbank lenders had neither the financial resources, physical plant and production workers, expertise, nor interest to retain this role. Many mortgage companies began outsourcing settlement services acquisition to companies known as Vendor Management Companies (VMCs). Widely used by consumer finance companies for appraisals, property reports, and title insurance, VMCs welcomed these new players to their client lists.

As VMC moved beyond offering products, like title policies and appraisal reports, and began to expand into BPO, the industry suddenly found itself evolving in a less elegant manner. VMCs added new services to their offering list and developed transaction management systems technology (TMS) to meet new client needs, developing closer than arms-length relationships in some cases. They were standing by to meet the needs of the mortgage channel that followed: Bank owned mortgage-lending operations.

Deregulation of the banking industry, legalization of interstate banking, and precipitous advancements in transaction management technology to monitor outside suppliers, automate outside vendor management, order placement, tracking, pre-delivery quality control, report transmission (first via fax or EDI; later PDF), accounting and post-delivery quality control made outsourcing the norm rather than the exception for modern mortgage bankers, but made consistency of service a challenge.

Within the last 5 years, unprecedented change in the mortgage lending industry—several previously dominant players exiting the business or going out of business altogether, a glut of new specialized service providers—specifically in loss mitigation and default servicing—and radical new federal programs (Home Affordable Modification Program, Home Affordable Foreclosure Alternatives, Home Affordable Refinance Program) have turned the BPO market upside down.

These same factors contributed to the marked increase in the past few decades of consolidation in the mortgage banking industry. Even before the 2008 housing bubble burst, the top 5 mortgage lenders originated over 35 percent of all residential purchase and refinance mortgages in 2007, through direct, wholesale, and mortgage broker channels. Contrast that to the top 5 originators today—Wells Fargo & Co., Chase, CitMortgage, Inc., Bank of America, and U.S. Bank Home Mortgage—which together originated 53 percent of the residential purchase and refinance mortgages, in 4Q2011. Not only is mortgage lending consolidating, most of these (5) originators own or control vendor management companies.

II. What Mortgage Lenders Outsource

Previous Accenture research has shown the most frequent business drivers for pursuing an outsourcing model are: Greater levels of cost savings and value; access to cross-company business intelligence; the opportunity to avoid future capital expenditures by leveraging existing technology platforms; the ability to leverage a pre-existing global delivery model; the ability to focus on mission-critical initiatives; increased access to supply market expertise; speed to value; improved user experience; and certainty of outcomes. Mortgage originators have become increasingly willing to outsource non-core functions and even core functions to third party vendors to achieve lower cost, higher productivity, and more effective operations. Not only do lenders outsource traditional Finance and Accounting, Human Resources, and related administrative functions, many engage title insurance companies and other BPO providers with offshore operations involved in keying data, reviewing files, and performing web-based property information searches.

Moreover, it is now common for mortgage originators to outsource key loan production processes: Flood determination, appraisal, credit reporting, and title insurance (referred to as FACT). It has been a long-held tenet in the industry to outsource non-core operations, but never core competencies. Mortgage lenders, within reason are now challenging this tenet. Lenders often outsource core loan fulfillment, including loan processing underwriting, closing, and post-closing functions. Late adopters embraced this model mostly for capacity-management purposes. More mature lenders are taking advantage of strategic BPO relationships to add analytical insight, allowing them to tie the value of their outsourcing contracts to measurable business outcomes in the form of higher quality, faster processing times, and shared technology investments. Entire industries have emerged to handle vendor management and reporting functions once handled by loan officers and in-house vendor managers. Lenders now also outsource quality control functions, including post-closing review and analysis of individual files as well as pre- and post-purchase audits of pools of residential loans.

Through all of this, BPO vendors have evolved, making great strides in creating innovative automated solutions for analyzing, assessing and rating the various risks involved in mortgage lending. The leading firms now realize that the business of BPO is no longer about cycle time on a given sub-function. Today, BPO outsources promise and deliver increased loan performance and quality over time, lower total cost to fulfill, and strategic enhancements. They’re doing this through non-political, external, data-driven analysis, as opposed to internal/isolated tactical reactions.

III. Ensuring Compliance of BPO Vendors to Consumer Financial Protection Bureau Mandates

The CFPB has authority to supervise insured depository institutions and credit unions with total assets of more than $10 billion, and their affiliates, for compliance with Federal consumer financial law and other related purposes. Arguably, the most significant of the Bureau’s powers deals with the level of oversight applied to these so-called affiliates, which include third party service providers. The Bank Service Company Act, 12 USC 1867(c), authorizes Federal Financial Institutions Examination Council (FFIEC) members to examine and regulate the functions or operations performed or provided by third-party servicers to the same extent as if they were performed by the bank itself on its own premises. Even so, the Agencies did not invoke this power with consistency, staging their audits with great regularity, but with little warning in advance as to how detailed or involved the audits would be.

In the recently issued CFPB Bulletin 2012-03, the Bureau makes clear that it expects supervised banks and nonbanks to oversee their business relationships with service providers in a manner that ensures compliance with Federal consumer financial law. The CFPB warns that, “(T)he exercise of its supervisory and enforcement authority will closely reflect this orientation and emphasis.” A warning to every supervised institution and business process outsourcing (BPO) vendor that CFPB intends to reach-through the lender to ensure compliance of BPO providers to consumer protection laws.
Next-Generation BPO: Are You Ready?

If you hesitated for even a moment before answering this opening question, then your answer must be a resounding "No!" Assessing your current organization to find out where it is generationally in the BPO arena is a vital first-step in executives’ preparedness for the re-regulation of the mortgage lending industry.

Accenture research has shown that growth and development of BPO over the last quarter century follows what we describe elsewhere as "BPO Generations." Our research found that the BPO business is advancing through what we identify as six (6) levels of generational maturations.

**Generation 1.** Pioneers of the late 1990s lift work out of the enterprise and shift it to onshore BPO providers.

**Generation 2.** In the early 2000s work is lifted and shifted to low-cost offshore outsources, taking advantage of savings through labor arbitrage.

**Generation 3.** By the mid 2000s, the business had shifted again, this time to "middle offices" that offered up full-time employees who worked on the clients own technology platforms to complete the work. Many ACS clients are in this stage of development.

**Generation 4.** Today, we are in the fourth generation of BPO, where every outsourcer is simply another “office” of the primary enterprise. Analytical tools and global capabilities allow outsourcers to focus on business outcomes, giving back to the enterprise cost savings, industry depth, analytical insight and innovation. Some ACS clients have reached this stage.

**Generation 5.** In the near future, we will see on-demand services applied across multiple clients through flexible software platforms and commercial contract structures paired with standardized processes. Some of the nation’s larger originators and servicers are planning and beginning to implement plans in this stage.

In the sixth generation, we envision using social networking as an extension to the fifth generation platforms, which will build social learning communities centered on BPO-provided processes.

Knowing where your organization and your relationship with its BPO provider(s) fall within this scheme is a vital first step in assessing your institution’s ability to deal effectively with this new level of regulatory oversight.

In the mortgage lending industry, for both originators and servicers, generation 4 and 5 are the targets for the leading players. As a firm moves from generation 4 to 5, the emphasis shift toward standard or shared platforms, joint analytics and BPO service performance as both a driver and an implementation tool for overall business strategy.

As regulation brings more stringent requirements for process adherence, operational functions that may once have been viewed as a competitive differentiator are becoming commoditized into pass/fail type tests where outsourcing to a national, industry leading BPO (where best practices and a common interpretation of compliance/performance are the norm) becomes a more reliable outlet for both process compliance and efficiency.

**CFPB BPO-Preparedness Action Steps**

**Action Step 1.** Continue to monitor developments surrounding the Dodd-Frank Act, FSOC, CFPB, in Washington, media, and various trade publications. Also monitor the judicial system for court rulings that will inevitably play out in the coming months regarding oversteps in the authority vested in the (2) new regulatory agencies.

**Action Step 2.** Mortgage banking leaders and their BPO service provider partners alike should invest time necessary to read the Accenture publications referenced in this paper.

**Action Step 3.** Conduct an internal audit (or hire a qualified firm to conduct the audit) to identify where the organization—and its BPO partners—are situated on the BPO Generations Table. Mortgage banks and/or BPO vendors residing in Generation(s) 1, 2 or 3 should consider this a red flag that must be addressed immediately by seeking an understanding of why you are at this stage and then developing a road map for progressing beyond it. If there, move on to the next action step.

**Action Step 4.** Now that management has read the material and understands the framework of the BPO evolution, and conducted an audit to gauge where the organization is along the (6) generational sextiles, it is prepared to hone what we call “Outsourcing and procurement mastery.”

**Action Step 5.** Return to Action Step 1. Repeat.

Next Steps

In our next white paper, the final in this series, we’ll discuss specific ideas for IT organizations operating within supervised institutions.

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