

# The Point

An Outlook Financial Services Publication

## Prime Opportunities

Finding high performance  
and cost savings in the  
credit crunch

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After years of strong profits, many lending institutions are struggling to deal with the fallout from the subprime mortgage meltdown and ensuing credit crunch. For U.S. banks, in particular, the cycle of borrower defaults followed by mortgage write-downs will continue to play out. With few new revenue-producing products in the pipeline and an uncertain economy looming, the growth outlook is cloudy.

Banks are now at a crossroad. They must continue to grow revenues and decrease costs while keeping a tight rein on portfolio risk. For the first time in a decade, banks find themselves in a credit-driven market, which demands a return to traditional credit practices such as stricter underwriting. Shaving costs through tactical efficiencies may be a short-term strategy, but beating



the competition long term requires more significant change. Eventual winners will be those that seize the chance to stabilize and build for the future by adopting flexible operating models that enhance profitability. As the industry transitions away from easy credit, banks need agility to thrive in a more disciplined credit environment and under greater regulatory scrutiny.

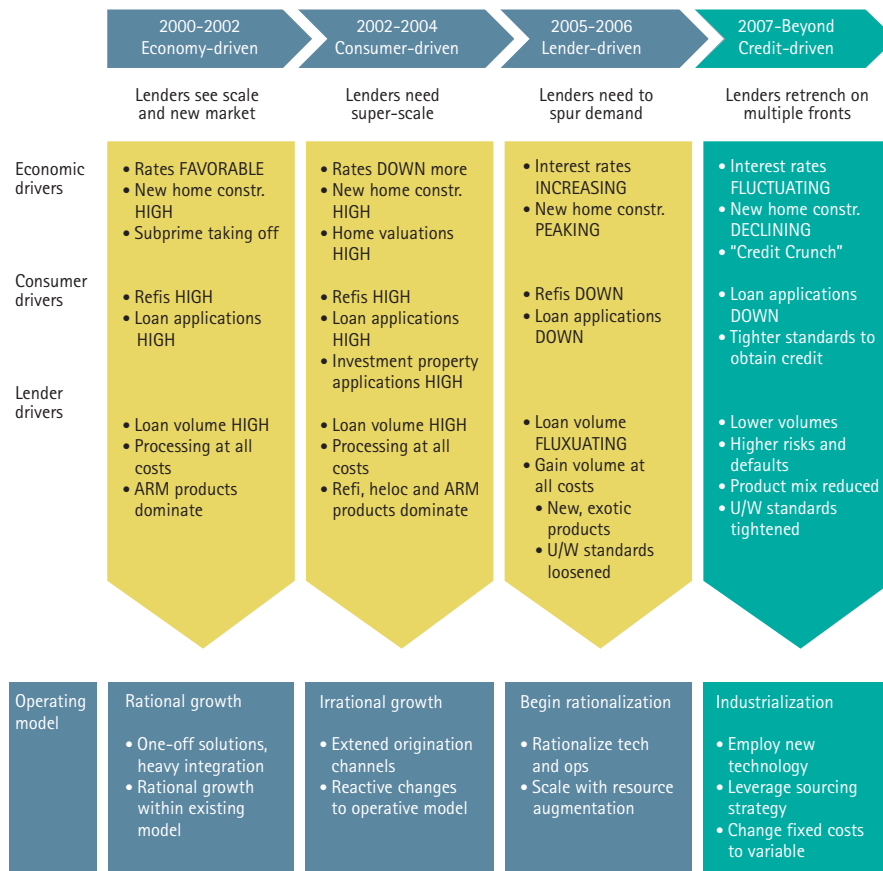
In short, lenders need to industrialize their credit services operations to achieve competitive advantage in the next growth phase. That industrialization can take many forms: combining multiple lending systems across lines of business, standardizing and automating processes across credit products and creating a co-sourced model that utilizes outsourced services for non-core processes. Whatever form the credit services industrialization might take, the opportunity to gain

competitive cost and performance advantages has never been greater.

Lending institutions, especially in the United States, are feeling the strain. In the wake of the weak housing market, subprime mortgage crisis and ensuing credit crunch, they are struggling with how to increase revenue in a market, if not an economy, that is retrenching. Net interest margins are at their lowest levels since 1991.

Mortgage banking profits fell to negative \$50 per loan in 2006 from a plus \$258 per loan in 2005, according to the Mortgage Bankers Association's annual cost study. While production revenues rose on a per-loan basis, the increase did not keep pace with the rise in production operating expenses, which grew by 17 percent to \$3,416 per loan in 2006. Indeed, lenders' high fixed-cost

The evolving credit market: How providers are adjusting to market changes



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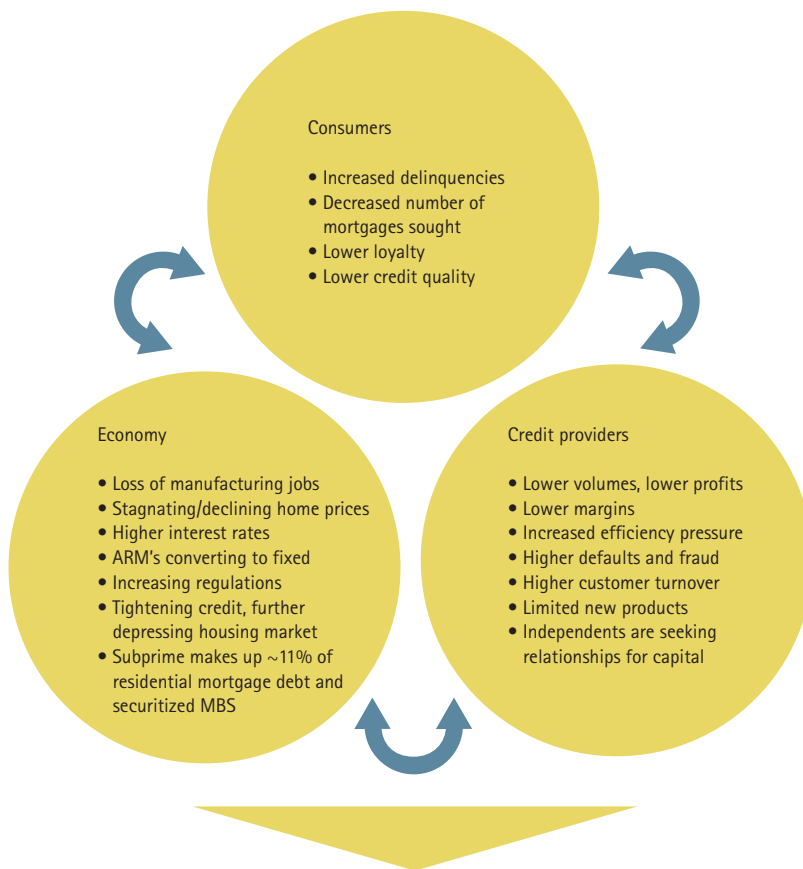
operating models hinder them from rapidly adjusting to changing market conditions. Looking ahead, higher delinquencies in consumer lending—credit cards and auto loans—may further depress revenues.

While it is unclear if the worst of the credit quagmire is behind us, its impact will be felt for some time. With few new products in the pipeline and the big revenue producers of recent years largely jettisoned as lending standards tighten, near-term mortgage lending

prospects appear dim. With growth uncertain, banks must become more efficient. Indeed, traditional lending operating models will not survive in tomorrow's credit-driven market if large volumes of loans continue to slip into default.

The industry is at a turning point. In 2007, banks were largely reactive—forced to confront a plethora of challenges, including excess capacity, exotic products and channel inefficiencies, resulting in portfolio risk

Simplification is the key to high performance, competitiveness and cost reduction



2007-Beyond  
Credit-driven

WINNING credit organizations will successfully:

- Pursue rigorous efficiency in a shared operating model
  - Break silos to eliminate redundancy, and consolidate onto shared multi-credit solutions
  - Drive variable costs in operating model
  - Leverage multi-disciplinary workforces to specialize and simplify
- Capture an increasing share of complex consumer/credit-driven market
  - Apply disciplined analytics for smart acquisition & cross-sell strategies
  - Minimize fraud/risk with active and decisive management

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and secondary market concerns. While these issues will undoubtedly persist in 2008, winning lenders must be bold and proactive—making course corrections in their operating models to build for the future. With increased regulation at every turn, banks must prepare for a new world of rigor and discipline in extending credit for all borrowers, regardless of their creditworthiness. In this environment, an operating model that manages costs and enables flexibility can provide competitive advantage and improve profitability.

### Retooling and re-emerging

As the market shakes out, remaining lenders have a window of opportunity to retool and re-emerge. While tactical efficiencies will continue in 2008, winning longer term requires more significant change.

Beyond workforce reductions and improved underwriting practices, banks need to seamlessly integrate loan

origination with the back office through more closely aligned credit processes for accepting and fulfilling loans. In the back office, lenders should look at how to consolidate across consumer and commercial lines of business. For those with multiple lending systems, this is the time to streamline: assess all back-office functions to determine core competencies and which functions can be managed more cost effectively through co-sourcing.

Banks must also adopt flexible delivery models. While it's too early to determine how the wholesale broker market will recover, banks with strong retail channels will have a significant advantage. A renewed focus on retail sales and a strategy for capturing a much different wholesale market are key to edging out competitors.

In turn, simplification—consolidating multi-credit platforms, sharing back-office operations, re-engineering

Industrialization enablers: Advances in technology, process and workforce sophistication are driving change

Enablers	Advances / Trends
1. Workforce	<p><b>Evolution of the shared opportunity model</b></p> <ul style="list-style-type: none"> <li>• Outsourcing provides a flexible organization at variable costs</li> <li>• Vendors are committing to SLAs, sharing risk</li> </ul> <p><b>Workforce diversification (e.g. viable onshore/offshore model)</b></p> <ul style="list-style-type: none"> <li>• Global footprint provides off-hour processing capability</li> <li>• Diversification provides a reduced cost structure</li> </ul>
2. Process	<p><b>Driving need for consistency</b></p> <ul style="list-style-type: none"> <li>• Improved ability to manage and tune complex processes through workflow</li> <li>• Business process management and modeling sophistication</li> <li>• Improved performance management capability</li> </ul>
3. Technology	<p><b>Advances in automation and standards</b></p> <ul style="list-style-type: none"> <li>• Web-based "plug and play" technologies are more readily available</li> <li>• More stable industry standards promote internal and external platform orchestration</li> <li>• Straight-through processing minimizes processing errors and improves efficiency</li> </ul> <p><b>Wrapper technologies</b></p> <ul style="list-style-type: none"> <li>• Improved wrapper technologies around core platforms increase efficiency, differentiation and quality of the process (e.g. imaging solution, a workflow tool).</li> </ul> <p><b>Service-oriented architecture</b></p> <ul style="list-style-type: none"> <li>• Improves reusability across components, reducing total cost of ownership</li> </ul>
4. Politics /Profit	<p><b>Increased focus on efficiency and cost reduction</b></p> <ul style="list-style-type: none"> <li>• The pressure to grow revenue in a contracting market has increased the appetite for integration across lines of business</li> </ul> <p><b>Higher quality standards</b></p> <ul style="list-style-type: none"> <li>• Minimize loan defaults and underwriting errors</li> <li>• Minimize predatory lending penalties</li> </ul>

Source: Accenture



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processes and co-sourcing—can deliver up to 30 percent reductions in overall operating costs across credit lending processes: loan origination, fulfilment, servicing and collections.

### Back to the future

In recent years, credit providers have endured a mortgage market cycle that spurred both rational and irrational growth. To better understand the current environment, it helps to take a look back at that cycle. It began as the 1990s closed, with the saturation of the consumer market (and expansion of subprime lending), as banks tried to tap into a broader range of credit-worthy consumers up and down the credit scale.

Since then, lenders have traversed three waves of the cycle:

#### Economy-driven (early 2000s):

Favorable economic conditions—low interest rates and an increase in new home construction—caused lenders to scale up operations to meet high consumer demand for loans (including subprime loans).

**Consumer-driven (2002–2004):** As interest rates dropped even lower and home valuations increased, strong

consumer demand for refinancing, as well as new residential mortgages, home equity and investment property loans, forced lenders to increase capacity by building ever-larger and more complex operating models.

**Lender-driven (2005–2007):** As interest rates climbed and home construction peaked, applications for loans and refinancing dropped. Lenders were forced to compete for a smaller pie to fill their expanded capacity, so they loosened underwriting standards and introduced exotic products to entice a wider range of customers. The subprime market went from approximately \$50 billion originated in 1995 to roughly \$600 billion in 2006. Lenders had succeeded in creating artificial consumer demand but with built-in potential for time-delayed problems once teaser rates expired.

Stung by the fallout from the subprime crisis, financial institutions are entering the next stage: a **credit-driven** market requiring tighter underwriting and a smarter, more efficient lending operation. By getting back to basics and returning to more traditional, sounder credit practices, they are, in essence, going back to the



Credit lending vision: Accenture sees an evolving maturity in credit influencing the way solutions and services are delivered



Source: Accenture

future. Unlike in previous markets, banks today can leverage extensive consumer data using advanced analytics, which, in light of current market difficulties, can help define additional parameters for approving credit in the future.

### Positioning for next growth phase

To improve operations, lenders need to industrialize—that is, simplify technology platforms and internal processes to reduce costs, increase efficiency and position themselves for greater scalability in the next growth phase.

Consider that roughly 80 percent of credit processes are common across such credit categories as auto finance, home mortgages and consumer loans. For example, the basic processes of closing an auto finance loan and a mortgage application are, for the most part, the same.

Credit processing offers attractive opportunities to cut costs and improve competitiveness through industrialization. Just as automakers rationalized their operations by standardizing chassis and engines across multiple car brands, banks can reap both short-term cost savings and long-term strategic benefits by standardizing processing, roles and technologies across various credit products.

Although differences exist among mortgage loans, car loans and secured business loans, managing data pertaining to collateral for each loan type is largely the same. Similarly, lenders are already reaping cost efficiencies and scale economies through outsourcing and white-label lending arrangements that effectively allow them to share a common technology platform. But industrialized banking may also make it possible to deploy technologies—such as imaging—that are uneconomical for one product line or unit but can deliver powerful advantages when deployed across several areas.

In one particular instance, a major North American bank recently took

a hard look at the complex network of lending operations centers and technologies it had acquired in the course of its various mergers and acquisitions over the years and found scores of people duplicating each other's capabilities and work. For example, in a lending operation that included 20 different processes, the bank had nine separate servicing systems. Headcount and labor costs were high, needless to say. But worse, the complexity of the lender's operations made it impossible to deploy technologies or standardize processes that might streamline business servicing and support.

Given the process similarities, sharing technology across credit categories is a natural step. The bottom-line benefits of such sharing depend, of course, on the size of the lender and the number of credit categories or products it offers, but might well be measured in the tens or even hundreds of millions of dollars, euros or yen annually.

### Keeping the factory humming

How can industrialized lending transform a siloed lending operation into one that is simplified and scalable? The first step is to eliminate redundancy and consolidate onto a shared multi-credit platform known as a lending factory. Lending factories, by eliminating silos and process duplication, can help reduce overall credit lending operating costs by 30 percent or more.

By consolidating origination and fulfillment activities, these savings can be realized by:

- Standardizing credit assessment across all channels and utilizing automated scoring and standard referral rules and processes.
- Creating common repositories of credit policies and rating rules for mortgage and non-mortgage products.
- Using technology to automate and increase straight-through processing.
- Leveraging workflow and business process management tools to automate and streamline operations from loan approval to fulfillment.

The Accenture logo features a stylized greater-than sign (>) above the word "accenture" in a lowercase, sans-serif font.

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- Integrating imaging and document management to remove paper from the process.

In turn, grouping operations by similar products and processes can cut costs and help manage complexities. Creating scaled shared services and physical consolidation of operations and support can minimize the problem of multiple handoffs between processes, front and back offices and products. Using technology such as imaging and workflow solutions to automate manual and paper-based functions such as exceptions processing can improve efficiencies.

Most banks, understandably, prefer to handle customer-facing or other functions they consider competitive differentiators themselves. But creating a co-sourced model that utilizes outsourced services for non-core processes is gaining traction on a number of key levels, including:

- Loan processing, document management and pre-closing functions
- Post-closing, routine servicing and bill payment
- Bankruptcy, foreclosure and asset disposal

Datamonitor released survey research last year which asked bankers how likely they were to engage in mortgage business process outsourcing (BPO).

Interest in mortgage BPO was above 50 percent, although only 12 percent said they were doing any at the time. Datamonitor projected, however, that mortgage BPO will soar from \$1.5 billion to \$6 billion by 2010.

Considering just the post-close phase of the lending life cycle, using co-sourced labor, leading-edge technology and BPO services, medium-sized lenders can achieve annual savings of \$3 million to \$5 million in processing costs. One mid-sized North American bank achieved the following results in a matter of months:

- 300 percent improvement in loan boarding process to servicing
- 100 percent improvement in loan availability for sale
- 30 percent reduction in data integrity errors in loan file
- 30 percent reduction in time from closed loan to receipt of paper file
- 80 percent reduction in time from receipt of paper files to audit completion

Budgetary pressures, spending cuts and workforce reductions will continue for the foreseeable future. But going forward, the question remains: how can banks get back to market profitability and high performance? An industrialized lending operation that relies on streamlined processes, shared platforms, automation and strategic co-sourcing can pave the way.



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