Executive Summary

The U.S. subprime mortgage crisis ended a prolonged period of growth and prosperity within the housing industry. Rapidly increasing home prices and residential mortgage backed securities (RMBS) increased home lending. The housing bubble burst, and with it, many private investors and originators exited the housing finance market. Government-sponsored enterprises (GSEs), operating as government conservatorships, increased their position within the housing finance market in an effort to stabilize the housing industry.

The GSEs have become the dominant players in the mortgage market in the absence of private investment. Investors have been waiting for direction from the U.S. Department of the Treasury regarding the future of the GSEs. In February 2011, a report to Congress from the Treasury Department was released, which discussed a plan to "responsibly reduce the role of the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") in the mortgage market and, ultimately, wind down both institutions."

Industry players speculate that the gradual and measured reduction of the GSEs’ market dominance will provide opportunities for private investors to re-enter the housing finance market. Although the Treasury's plan lacks the specific details that would draw a clear incentive for private investors to re-enter the market during ongoing challenging economic times, the plan to wind down the GSEs and support the private sector’s efforts to become the dominant provider of mortgage credit is a positive sign.

In addition to the government's proposed role, it is clear that private investment will rely heavily upon improved risk management and clearer visibility and understanding of the risks within an investment pool prior to ramping up private investment efforts.

The shift to a primarily private investor-driven market with clearer management and understanding of risk is one of three primary factors affecting the revitalization of the housing finance market. The role of government regulation in the housing market is the second factor affecting the revitalization of the housing finance market. The February Treasury report provided insights into the gradual change within the GSEs. Moreover, The Dodd-Frank Wall Street Reform and Consumer Protection Act has given broad directives regarding what constitutes a qualified residential mortgage, reasonable lending practices and risk retention requirements for loan originators and mortgage securitizers. A lender’s and/or investor’s ability to effectively and efficiently address and manage regulatory change is a critical component to successful growth within the new RMBS space.

The stabilization of the housing market is the final factor. There are emerging signs that the housing market is beginning to stabilize, including
a decline in foreclosures, increasing household formations, increasing corporate profits, increasing consumer confidence and home affordability. These factors point to a gradual positive turn in the mortgage industry. Mortgage banks will need to gear up proactively in order to capitalize on market opportunities as they begin to emerge.

The emerging suite of services referred to as “mortgage process as a service” (MPaaS) offers several solutions to revitalize the housing finance market. Ensuring loan quality and providing data transparency will help reduce risk and increase private investment. Loan origination data will be collected, verified and presented in a standardized manner, which will improve credit underwriting decisions for the originator and deliver improved due diligence services to private investors. Enhanced loan information quality will result in fewer mortgage repurchases and potentially reduce early loan default rates by providing deeper, more accurate and more meaningful information during the loan origination process.

By removing the cost of ownership of technology infrastructure, applications, platforms and people, as well as adopting a pay-per-use model, MPaaS enables banks to save money. They can then focus on increasing market share, while relying on their MPaaS partners to streamline processes, manage and extend systems capabilities and provide meaningful loan information to help them make better business decisions that comply with government regulations.

How We Got Here
There are many opinions as to whom and what is responsible for the exit of private investors from the secondary mortgage and housing finance markets. Key contributors include the easing of lending standards (such as Fair Isaac Corporation (FICO) scores, loan-to-value (LTV) ratios, debt-to-income (DTI) ratios, etc.); exotic mortgages (such as adjustable rate mortgages, interest-only loans, stated income loans, etc.); the government’s desire to increase home ownership; shareholder pressure on companies to stay competitive and increase revenue; heightened speculation in the housing market; appraisal fraud; broker fraud; and borrower fraud.

As delinquencies spiked due to borrower defaults, demands for mortgage repurchases from investors (mortgage securitizers) to originators increased. In most cases, subprime originators provided a guarantee to investors (private-label mortgage securitizers) to repurchase a loan if it went into early default or if there was a misrepresentation in the terms of the loan when it was purchased.

Subprime mortgage originators became insolvent due to improper forecasting of defaults and were unable to repurchase their mortgage loans. Many of the subprime lenders went bankrupt or closed lending operations. Heavily leveraged private-label mortgage securitizing companies suffered large losses and exited the secondary mortgage market, defaulted on RMBS payments to their investors or filed for bankruptcy. This led to a dramatic decline of private investment in the housing finance market.

The decline of the housing finance market caused many to question existing regulatory oversight. Banking regulators reassessed the secondary mortgage market and housing finance to determine what oversight and rules could be implemented to avoid the mistakes of the past. Congress and other regulators (Federal Housing Finance Agency, Office of the Comptroller of the Currency, etc.) have provided guidance and regulatory requirements to banks and private investors.

A major directive came from the Dodd-Frank Act, whose extensive consumer banking provisions added stringency to existing lending requirements (e.g., defining a qualified residential mortgage), detailed acceptable lending practices and mandated 5% credit risk retention requirements for originators and mortgage securitizers. The intent of the legislation is to promote a safer housing finance market by spreading the share of risk in securities for originators and mortgage securitizers and improving lending standards and practices.

As banks and private investors work to implement and comply with these new regulations, change is occurring within another department of the U.S. government. The exit of many private investors in the RMBS issuance business resulted in the GSEs emerging as dominant players in the secondary mortgage market. The U.S. Treasury directed the GSEs to stabilize the housing market by providing liquidity. Private investment has remained on the sidelines, waiting for business conditions to improve.
The February Treasury report to Congress provides the Treasury’s plans to significantly reduce the GSE’s presence in the mortgage market. It is evident that the reduction in the GSEs’ market share will be gradual and measured. The report states, “Our plan presents several proposals for structuring the government’s long-term role in a housing finance system in which the private sector is the dominant provider of mortgage credit.”

Private investors anticipating a return to the secondary mortgage market are interpreting this release as a positive signal for developing plans to re-enter the market. As the conditions of the housing market begin to improve, private investment will increase (see Figure 1).

### Forces Driving the U.S. Mortgage Industry

<table>
<thead>
<tr>
<th>Area</th>
<th>Drivers</th>
<th>Impact</th>
<th>Implication</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic Environment</td>
<td>Unemployment rate estimated to stabilize at 5% after 2013</td>
<td>Increased demand for housing</td>
<td>Early signs of gradual revival for housing and mortgage borrowing</td>
</tr>
<tr>
<td></td>
<td>Household formation to average 1.2 million/year over the next decade</td>
<td>Increased demand for housing</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Improving credit scores, deleveraging, declining delinquencies</td>
<td>Improving credit quality of borrowers</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Declining price-to-income ratio</td>
<td>Increased affordability</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Low mortgage interest rate scenario</td>
<td>Increased affordability</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Rising rental incomes</td>
<td>Improved attractiveness of ownership</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Slow rise in consumer confidence</td>
<td>Improved willingness to borrow</td>
<td></td>
</tr>
<tr>
<td>Industry Drivers</td>
<td>Lower net interest margins scenario</td>
<td>Lower profitability levels</td>
<td>Revival of lending and RMBS business</td>
</tr>
<tr>
<td></td>
<td>Declining foreclosure filings</td>
<td>Demand and prices for homes will stabilize</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Increase in all-cash deals</td>
<td>Traction in housing market</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Jumbo deals activity in RMBS market</td>
<td>Revival of investor risk appetite</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Uptick in ABX index</td>
<td>Improving prospects of secondary RMBS market</td>
<td></td>
</tr>
<tr>
<td>Regulations</td>
<td>Prospect of significant reduction of the role of GSEs</td>
<td>Revival of private players' interest</td>
<td>Increase in cost of compliance</td>
</tr>
<tr>
<td></td>
<td>Heightened regulatory oversight</td>
<td>Increased compliance and reporting</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Risk retention norm</td>
<td>Capital adequacy implications and enhanced safety for RMBS investors</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Enhanced consumer protection measures</td>
<td>Creation of a safer market</td>
<td></td>
</tr>
<tr>
<td>Technology</td>
<td>Siloed structure of banking IT systems</td>
<td>Challenges on the compliance front</td>
<td>IT challenges and opportunities</td>
</tr>
<tr>
<td></td>
<td>Regulation-induced need to reinvent IT systems and processes</td>
<td>Increase in IT spending</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Competition-induced need to build new competencies</td>
<td>Opportunity to marry competitiveness goals with compliance-driven investments into systems</td>
<td></td>
</tr>
</tbody>
</table>

Source: Cognizant Research Center

Figure 1
Market Conditions
The U.S. mortgage market is navigating its way out of the subprime crisis. Home sales fell from 7.53 million units in 2006 to 5.23 million units in 2010 (see Figure 2). Loan originations peaked at $3.8 trillion in originations in 2003. This year, the U.S. mortgage industry forecasts approximately $1 trillion in originations (see Figure 3).

Home Sales in Units

<table>
<thead>
<tr>
<th>Year</th>
<th>Home Sales (Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>7.26</td>
</tr>
<tr>
<td>2004</td>
<td>7.98</td>
</tr>
<tr>
<td>2005</td>
<td>8.36</td>
</tr>
<tr>
<td>2006</td>
<td>7.53</td>
</tr>
<tr>
<td>2007</td>
<td>6.43</td>
</tr>
<tr>
<td>2008</td>
<td>5.40</td>
</tr>
<tr>
<td>2009</td>
<td>5.33</td>
</tr>
<tr>
<td>2010</td>
<td>5.23</td>
</tr>
<tr>
<td>2011*</td>
<td>5.10</td>
</tr>
<tr>
<td>2012*</td>
<td>5.36</td>
</tr>
</tbody>
</table>

Sources: Fannie Mae Annual Reports, Federal Reserve Board, Bureau of Census, HUD, National Association of Realtors, Mortgage Bankers Association and FHFA
* Forecasts for 2011 and 2012 are from National Association of Realtors, July 2011

Mortgage Origination Estimates
One- to four-family homes

<table>
<thead>
<tr>
<th>Year</th>
<th>Purchase ($ Billions)</th>
<th>Refinance ($ Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>234</td>
<td>905</td>
</tr>
<tr>
<td>2001</td>
<td>1,283</td>
<td>960</td>
</tr>
<tr>
<td>2002</td>
<td>1,757</td>
<td>1,097</td>
</tr>
<tr>
<td>2003</td>
<td>1,463</td>
<td>1,280</td>
</tr>
<tr>
<td>2004</td>
<td>1,514</td>
<td>1,309</td>
</tr>
<tr>
<td>2005</td>
<td>1,326</td>
<td>1,399</td>
</tr>
<tr>
<td>2006</td>
<td>1,140</td>
<td>1,312</td>
</tr>
<tr>
<td>2007</td>
<td>777</td>
<td>731</td>
</tr>
<tr>
<td>2008</td>
<td>664</td>
<td>643</td>
</tr>
<tr>
<td>2009</td>
<td>473</td>
<td>412</td>
</tr>
<tr>
<td>2010</td>
<td>697</td>
<td>531</td>
</tr>
<tr>
<td>2011*</td>
<td>400</td>
<td></td>
</tr>
<tr>
<td>2012*</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Mortgage Bankers Association
* Estimates

RMBS issuance, which rose to around $724 billion in 2005-2006, has dropped to $39 million in 2010 (see Figure 4, next page). The steep fall in home prices and rising job losses pushed foreclosures higher. Foreclosures went from less than 1 million in 2005, to their peak in 2010 of over 3.82 million (see Figure 5, next page). As a result of the downturn in the economy, studies indicate that consumers became more averse to debt and began saving more (see Figure 6, next page).
RMBS Issuance

Source: Federal Reserve

Figure 4

Foreclosure Trends

Source: Realty Trac

* Foreclosure filings for 2011 are for the first six months only.

Figure 5

Post Crisis: Higher Savings, Lower Debt

Source: Federal Reserve Bank of San Francisco

Figure 6
There are emerging signs of a market revival. Mortgage servicers are working through their defaulting loan portfolios, and housing prices are nearing a bottom. Low interest rates, reduced home prices, increasing credit availability, improving job prospects, rising consumer confidence and the opportunity for buyers to rent out properties at profitable rates are among the key factors that could stimulate the demand for mortgage loans and, in turn, increase the supply of loans to RMBS investors. The historical data representing these factors and their estimated trends point to a slow and steady revival.

Corporate profits, a key determinant of business growth prospects, point to the likelihood of job creation. The St. Louis Federal Reserve’s research indicates that corporate profits as a percentage of GDP hit a low of 5% in 2008 and rose to 8% in 2010 (see Figure 7). The industry considers this favorable employment scenario as a strong influencer that increases borrower confidence in buying homes. The Wall Street Journal reports that household formations, which declined to 578,000 in 2008, rose to 950,000 in 2010. This figure is expected to rise gradually, which is expected to increase housing demand.

The unemployment rate, presently around 9%, is expected to gradually decline and settle at around 5% after 2013 (see Figure 8). A slow but steady drop in the unemployment rate should improve upon already increasing consumer confidence numbers. Additionally,
Delinquencies and foreclosures that surged in the aftermath of the subprime crisis peaked in Q2 2010 at 11.59% and are now on a declining path (see Figure 10). Estimates of foreclosure filings for 2011 are one-fourth of the filings of 2010. All these factors signal a positive turn for the mortgage industry. The Wall Street Journal article provides some insight into what the next five years might look like: “Once the foreclosure mess begins to clear up, say housing economists, the traditional drivers of the housing market — demographics, affordability, loan availability, employment and psychology — should take over.”

The Economist concurs that “the best news of all may be the ongoing improvement in credit conditions. Delinquencies have trended downward since late 2009. Consumer-debt payments relative to incomes are at a 17-year low, and household credit scores are rising. Banks are still being stingy with credit, but households are better positioned than they were to take advantage of cheaper homes.” There has also been a marked shift in originations, from a low LTV scenario, to rapidly rising LTV since 2007 (see Figure 11, next page).
The present conditions in the U.S. housing market have significantly improved home affordability. The price-to-income ratio (an indicator of affordability) fell from 2.7 in 2007 to 1.8 in 2010 (see Figure 12). The Freddie Mac 30-year fixed-rate mortgage at 4.27% in August 2011 is the lowest in the last 50 years. Additionally, the oversupply of homes and rising rental incomes (see Figure 13, next page) should increase the attractiveness of buying property. The scenario has already led to considerable growth in all-cash deals, with bargain-seeking investors attempting to cash in on low property values. The Mortgage Bankers Association (MBA) estimates that purchase originations for one- to four-family homes may decrease by 12.71% in 2011, to $412 billion, and rise by 29% in 2012, to $531 billion.

Homes are More Affordable Now
Price-to-income ratio, national average

Source: Fiserve Inc.; Federal Housing Finance Agency; Moody's Analytics
Figure 12
The market for RMBS, which nearly evaporated, is beginning to show signs of a likely revival. There have been two private-label RMBSs offered in the last two years: Redwood Trust 2010 and Redwood Trust 2011 ($290 million issue). The securities comprise loans with high unpaid principal balances (average under $1 million), high credit scores (average 775) and low LTVs (average 63%). Private market players are taking proactive steps to set up conduits in anticipation of the reduction in GSE loan-buying limits in October 2011.

The Wall Street Journal reports that “subprime and other residential mortgage bonds are back in vogue with long-term investors, in the latest sign that American credit markets are healing after the worst downturn in a generation.” This is reflected in the substantial improvement in the ABX index from 30 in 2009, to around 60 in 2011 (see Figure 14).

**Growing Attraction**

The ABX index, which tracks prices of subprime mortgage bonds, has recovered since the crisis.

![Rent Changes in Realtors' Local Area, Year-Over-Year](source: National Association of Realtors)

![ABX index recovery](source: The Wall Street Journal)

*Note: ABX.HE.AAA.06-2 sub-index*
Gearing up for a New Mortgage Industry
The prospect of increasing regulatory oversight makes compliance key to the survival of mortgage banks and securitizers. There are many signs pointing to the emergence of a different mortgage industry, including the increased focus on customer protection, the creation of credit risk retention requirements for mortgage originators and securitizers, the curbing of predatory lending practices, the rise of the spend-thrift and debt-averse customer, and the increased capital adequacy demands.

Given the present state of the banking landscape and the prospect of a gradual recovery for the mortgage banking industry, originators would be wise to take proactive steps to position their businesses for success in the new mortgage industry.

The banking industry’s business processes and IT systems need to undergo considerable change in order to meet the unfolding regulatory requirements, as well as build new competencies to be successful. These investment decisions pose significant challenges to banks that are presently operating in a business environment of weakening demand, declining spreads (see Figure 15) and intensifying competition.

U.S. Banks: Falling Net Interest Margins

![Graph showing falling net interest margins](image)

Source: Federal Reserve Bank of St. Louis

Figure 15

Increasing regulatory focus on banking is driving up the cost of compliance (see Figure 16), while spreads are falling. The net interest margin of U.S. banks began falling at the end of the first quarter of 2010. MBA research indicates the cost of originating a loan rose approximately 375% in 2011 from 2003, 53% in 2011 from 2008, and going forward it is likely to increase significantly (see Figure 17, next page).

Rising Cost of Compliance

IT spending by financial services firms on governance, operational risk and compliance

![Graph showing rising cost of compliance](image)

Source: Celent

* Estimate

Figure 16
The profitability of the industry is driven by volumes, spread and efficiency of operations. Industry origination volumes and interest margins are generally driven by the market. Mortgage banks will need to leverage their operational efficiencies to increase profits and differentiate themselves from the competition.

Many banks are challenged by the existence of silos within their organizational structure. Traditionally, compliance and business needs are separately addressed, a gulf that has widened over time as systems have evolved. Legacy systems are traditionally inflexible and incapable of adjusting to rapid changes within the banking industry. These older, hard-coded systems rely on manual intervention to provide workarounds and overcome process limitations.

**Enter Mortgage Process as a Service**

The emerging business processes as a service (BPaaS) delivery model offers a viable option to mortgage banks in need of a technology refresh and process makeover. This approach enables banks to rely on service providers with expertise in mortgage processing services to shoulder the cost of ownership of technologies, infrastructure and people. One flavor of BPaaS — mortgage process as a service (MPaaS) — provides banks with the talent and systems wherewithal to handle essential lending services, enabling them to solely focus on rebuilding their businesses to the needs of the changing industry and capture market share.

The conditions and challenges that lenders face require a significant end-to-end process overhaul. With unfolding regulatory changes, investor scrutiny and a heightened focus on loan quality, lenders will be required to move quickly and deploy more flexible business and technology solutions. MPaaS providers can be a critical ally during significant times of change. Their pointed emphasis on mortgage services and ability to readily adapt to changing business needs can help banks get more bang from limited IT budgets — by shifting Cap-Ex to Op-Ex, through pay-per-use or outcomes-based models — while accessing new and more automated service capabilities. Coupled with a lender’s ability to manage business processes via MPaaS, banks have a tremendous opportunity to manage the challenges in the new landscape more effectively.

Traditional mortgage business process outsourcing (BPO) services providers already provide skilled domain resources and a scalable organization with appropriate infrastructure to manage critical mortgage functions, such as loan processing. In this existing model, lenders essentially leverage a service provider’s resources and infrastructure capabilities, while retaining their own technology and defined processes. The perceived value of this arrangement is cost, timeliness and quality.

Today’s mortgage market requires significant change in this value proposition. As such, BPO services companies must transform into MPaaS providers. Beyond cost, timeliness and quality,
the MPaaS provider will need to offer pointed solutions to the lender’s and investor’s business objectives, risks and processes. The expectation can no longer be focused on executing a lender’s internal process while leveraging the lender’s tools. The value proposition and expectations need to be extended to align the service output with the goals and objectives of the lender and investor.

Consider loan processing, for example. The administrative aspects of loan processing have been outsourced to third-party specialists for many years. In many cases, the BPO process is a reflection of the process requirements of the lender rather than the business and risk objectives of the lender and investor. While some may contend that there should be no difference between the two (lender processes should address business and risk objectives), the flood of repurchase requests should point to the likelihood that a majority of loan origination processes do not provide the process output that meets or exceeds the risks or objectives of the business.

In short, many lenders’ processes lack the needed depth of analysis, trust, accuracy and credibility with respect to investor requirements. Thus, the traditional mortgage BPO provider is measured on how well it executes a lender’s process rather than more strategic aspects, such as accuracy, loss severity, repurchase risk, compliance, downstream efficiencies and customer experience, to name a few.

To evolve, the mortgage BPO provider must offer solutions rather than capable bodies. The solutions must address the critical aspects of the business. Loan processing solutions, for instance, need to provide outputs that provide clear visibility into loan data at a document and field level, in addition to deeper analysis that will enable effective and compliant decisions. Critical loan origination values such as “Total Monthly Income” need to be encapsulated with the specific documents, document areas, document meta data (values extracted from the document) and calculations utilized to arrive at the critical value. The information collected should be compared with other available information and analytics to provide a more trusted understanding of the accuracy of the information.

In the loan processing example, the provider must move beyond the checklist-prepared file to the risk-and-objective-prepared file that clearly and methodically provides trust and transparency, in addition to analysis that allows downstream consumers of the service to extract more value (see Figure 18).

**Future Dimensions of Mortgage BPO: Driving The Solution Needs**

**Traditional Dimensions of Mortgage BPO**
- Focused on labor cost savings and staff augmentation for scale and capacity.

**Market Drivers**
- Increased focus on portfolio and repurchase risk.
- Need for greater process transparency, improved data integrity and increased loan due diligence.

**Mortgage Market Needs**
- Need for great scrutiny and due diligence during loan origination.
- Provide increased visibility into potential loan risk.
- Reduce overall origination, processing and servicing costs while increasing process quality.
- Increased process control and consistency to increase loan quality and reduce repurchase risk.

**Traditional Dimensions of Mortgage BPO**
- Labor Cost
- Capacity/Timeliness
- Domain
- Quality

**Market Drivers**
- Rising origination costs
- Increased regulatory and investor requirements
- Significant repurchase risk
- Significant default risk

**Future Dimensions of Mortgage BPO**

**Mortgage Process as a Service** (Sourced as utilities on pay-per-use basis)
- Risk Mitigation (Data accuracy & Intelligence)
- Process Consistency and Control (Process accuracy & Intelligence)
- Process/Solution Benefit (Cost benefit of solution vs. pure labor cost)
- Traditional Dimensions (Capacity, domain and quality)

**Source:** Cognizant

**Figure 18**
A New Strategic Services Era
The time for more strategic services has arrived. Mortgage processes need to be retooled to address the need for enhanced regulatory scrutiny, process transparency and risk mitigation.

The absence of transparency and data integrity was one of several root causes of the industry’s problems that led to increases in repurchase claims (see Figure 19).

Residential Mortgage Loans

<table>
<thead>
<tr>
<th>Year</th>
<th>BoA</th>
<th>JP Morgan Chase</th>
<th>Wells Fargo</th>
<th>Citigroup</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>2,271</td>
<td>1,093</td>
<td>620</td>
<td>75</td>
<td>4,059</td>
</tr>
<tr>
<td>2009</td>
<td>3,507</td>
<td>1,705</td>
<td>1,033</td>
<td>482</td>
<td>6,727</td>
</tr>
<tr>
<td>2010</td>
<td>5,438</td>
<td>3,285</td>
<td>1,289</td>
<td>969</td>
<td>10,981</td>
</tr>
<tr>
<td>2011 Q1</td>
<td>6,220</td>
<td>3,474</td>
<td>1,207</td>
<td>944</td>
<td>11,845</td>
</tr>
<tr>
<td>2011 Q2</td>
<td>17,780</td>
<td>3,631</td>
<td>1,188</td>
<td>1,001</td>
<td>23,600</td>
</tr>
<tr>
<td>Total</td>
<td>35,216</td>
<td>13,188</td>
<td>5,337</td>
<td>3,471</td>
<td>57,212</td>
</tr>
</tbody>
</table>

Source: Company Annual Reports and Natoma Partners

Several factors undermined the quality of mortgage loans, including the origination of exotic mortgage types, predatory lending practices, easing of underwriting guidelines, increasing property prices and the ability of financial intermediaries to lever their relationships to bypass underwriting guidelines. Ensuring data quality during the loan application and credit underwriting process would have removed some of the risk associated with purchasing mortgages.

The importance of data quality is also evident in Fannie Mae and Freddie Mac’s joint effort in the Uniform Mortgage Data Program (UMDP) as part of their Loan Quality Initiative (LQI). The UMDP establishes uniform requirements and file formats for appraisal and loan delivery data. Improved data quality throughout the loan application and underwriting process will help revive the housing finance market. Increased loan transparency provided by MPaaS solutions will enhance the quality of loan originations and reduce repurchase risk. Higher quality loan information and originations will result in increased mortgage performance. This will gradually produce a stronger mortgage market and increase borrower and investor confidence in the housing finance market.

The rise of software as a service (SaaS), platform as a service (PaaS), virtualization and cloud-based sourcing of servers, storage, desktops and data centers have created an environment that is conducive for innovations such as MPaaS that optimize efficiencies by reorganizing the industry services chain. Under MPaaS, vendors provide all four key elements: people (BPO/KPO), applications, platforms and cloud-sourced infrastructure, which can be used like utilities on a pay-per-use basis, obviating the need for banks to lock in their capital in these four areas.

By variabilizing fixed costs, MPaaS offers a compelling case for significantly enhancing capabilities at a time when banks are facing significant transformational challenges. Banks and financial services industry players are already ahead of other industries in embracing cloud computing (see Figure 20, next page). This places them in an advantageous position to embrace MPaaS.
Originators’ systems need to handle high volumes of originations and defaults. Even during the prolonged period of prosperity that preceded the U.S. financial downturn, banks did not prioritize the need to invest in rebuilding their systems and processes to reap sustainable efficiencies.

The case for sustainable efficiencies is now stronger, coupled with the need to invest in systems to gear banks for greater levels of regulatory scrutiny. An MPaaS partner can lend consulting services that will provide guidance and solutions to regulatory challenges and opportunities. A partner with the resources and capacity to assist in navigating regulatory hurdles can make perceived barriers to market re-entry less challenging.

Moving Forward
The mortgage BPO industry, which is projected to reach $3.56 billion in 2013, is embracing MPaaS because it enables mortgage bankers to access applications and processes built to serve the demands of the emerging industry order. By leveraging an MPaaS partner, mortgage banks will be better positioned with critical information to make better loan decisions.

MPaaS providers can act as infomediaries to provide independent and unbiased information about the mortgage transaction to enable originators to make sound lending decisions and underwrite quality loans. In addition, such information will also help originators present quality information about their loans to mortgage purchasers.

The MPaaS partner will be able to offer and package information that is specific to the vintage of the loans, the demographics, the overall credit quality, etc. The infomediaries will ensure transparency in loan sales by offering flexible platforms that will maintain compliance with underwriting criteria, as requested by the user. The information available to the user will foster trust and build sustainable business foundations. The mortgage purchasers will have greater knowledge regarding the pools of loans that they are buying, which will remove the mortgage purchase risk that was prevalent in the past. Better loan information will lead to better loan originations, informed loan purchases, increased loan performance, reduced risk, reduced repurchases and a stronger housing finance market.

The reformed mortgage market places huge demands on employee and IT resources that are tied up in attempting to comply with current rules and regulations. Lenders are hard-pressed to focus on product innovation and future business planning. The MPaaS partner can help banks be more flexible and respond to regulatory change. Banks and other lenders can leverage the strength of partnerships with MPaaS providers that double as infomediaries. In addition, working with MPaaS solutions providers (see sidebar) can help them gain market share and reduce risk in origination and purchase decisions.
What to Look for in Your MPaaS Partner

The emergence of MPaaS is accompanied by the rise of potential partners that can enable loan originators of all types to better navigate the unfolding industry transformation. We believe they should seek the following in a partner to ensure they are on the right course:

• Capable of rolling out utilities in the MPaaS model, providing variabilization of fixed costs.

• Offers consulting services and possesses strong domain expertise rather than acting as a pure-play provider that lacks the ability to offer business advice or consulting in the transition to global sourcing.

• Provides best-of-breed workflows, data products, analytics and process controls that are aligned to the needs of a changing mortgage business.

• Delivers a solution that can process mortgage application documentation and critical underwriting data that empowers the originator and loan purchaser to make better investment decisions.

Footnotes


References


About Cognizant

Cognizant (NASDAQ: CTSH) is a leading provider of information technology, consulting, and business process outsourcing services, dedicated to helping the world’s leading companies build stronger businesses. Headquartered in Teaneck, New Jersey (U.S.), Cognizant combines a passion for client satisfaction, technology innovation, deep industry and business process expertise, and a global, collaborative workforce that embodies the future of work. With over 50 delivery centers worldwide and over 118,000 employees as of June 30, 2011, Cognizant is a member of the NASDAQ-100, the S&P 500, the Forbes Global 2000, and the Fortune 500 and is ranked among the top-performing and fastest growing companies in the world.

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