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Outsourcing banking processes:

The question is no longer *if,* but *how* to effectively manage extended enterprises

In today's business environment, banks are continuously facing challenges to reduce their overhead costs, enhance operational efficiencies, and improve their services. As a result, outsourcing of business functions has become an integral part of banking operations. In this context, the term outsourcing can be defined as use of a service provider by the bank to contract out part of its day-to-day banking activities to reduce its cost of operation, enhance customer satisfaction, utilize specialized skills, and reap other strategic/operational benefits.

The term *service provider* in the above definition refers to a third party that forms part of the bank's extended enterprise and provides material services related to the bank's offering of financial products and services.

Banks can leverage outsourcing in some of the following key areas:

- Loan application management
- Know your client (KYC) support
- Customer support
- Mortgage and other loan servicing management
- Deposits services management
- Default management
- Complaints management
- Information technology (IT) infrastructure and technology help desk support

Outsourcing challenges and risks

While extended enterprise has become a standard business practice, it has also created newer risks for banks related to its quality of service, continuity of operations, oversight over the outsourced process, and compliance with regulatory requirements. These risks can be broadly grouped into the following categories.

Outsourcing risk categories

Strategic risk: Banks primarily use outsourcing as a tool to reduce their costs of operation and/or enhance their quality of service. However, successful outsourcing of a business process requires clear articulation of outsourcing objectives, defined parameters to evaluate quality of service, and selection of tools to monitor the performance on an ongoing basis. If a bank does not have methods and tools to effectively evaluate the critical success factors, it not only can limit the benefits from outsourcing, but can also prevent the bank from achieving its overall strategic objectives

Operational risk: Successful outsourcing can help a bank in enhancing the efficiency and effectiveness of its operation. While operational risks are intrinsic to any banking process, the probability of materializing the risks can significantly increase if such processes are outsourced without adequate due diligence. Successful outsourcing requires anticipation and identification of all critical operational risks and establishment of risk indicators, and monitoring them on an ongoing basis.

Regulatory & Compliance risk: As per Consumer Financial Protection Bureau's bulletin issued in October 2016, the bureau recognized that use of service providers is often an appropriate business decision for banks. If a service provider is unfamiliar with the legal requirements applicable to the products or services being offered, or does not make efforts to implement those requirements carefully and effectively, or exhibits weak internal controls, it can harm consumers and create potential liabilities for itself and the bank.

Reputational risk: If not done right, the benefit of outsourcing can quickly translate into reputational loss to the bank. For example, lack of adequate quality checks over the outsourced process can adversely affect customer satisfaction and adversely affect the bank's reputation. A successful outsourcing strategy should have adequate oversight over and establishment of appropriate protocols and metrics (goals) to effectively manage the outsourced process

Extended Enterprise Risks: Governance through Tools and Metrics

While use of an extended enterprise has its own set of risks and challenges, an effectively managed outsourced process can provide numerous advantages to a bank such as reduced cost of operation, improved quality of service, greater compliance with regulatory requirements and increased customer satisfaction. Therefore, the question is no longer if a bank should outsource processes, but how to effectively manage the risks arising due to use third arties.

Deloitte's Third-party risk management framework consists of the following operating model components that can be leveraged by banks to effectively manage extended enterprise risk.

- Governance and Oversight
- Policies and Standards
- Management Processes
- Tools and Technologies
- Risk Metrics and Reporting
- Risk Culture

While each of the above components plays an important role in effectively managing the third-party risks, the discussion in this article focuses on how "Tools and Technologies" and "Risk Metrics and Reporting" can be leveraged to effectively manage the risks related to extended enterprise.

Outsourced process lifecycle

Defining objectives: The foremost virtue of a successful outsourced process is to have clearly articulated business objectives. These objectives drive all the subsequent decisions for the remainder of outsourcing life cycle. Therefore, it is important that outsourcing objectives are unequivocal, specific, and measurable.

Identifying outsourcing risks: It is important that all the risk associated with the outsourced process are identified and analyzed. This will include both the process as well as other risks that may be introduced due to outsourcing. Participation of all the key stakeholders in the risk assessment process will be critical to the success of risk assessment process.

Establishing key metrics: Once the outsourcing objectives and related risks are defined, it is important that key metrics are established to manage risk levels and achieve performance targets. Well-defined metrics should:

- Align with defined objectives
- Track and measure all identified risks
- Measure performance objectively
- Incorporate realistic performance targets
- Measure performance both quantitatively and qualitatively
- Be flexible to changing environment
- Provide results and trends proactively

Selecting tools to measure performance metrics: After the key metrics are established, the next step is to select a tool that can effectively measure the performance of the outsourced process. Consider the following when selecting the right tool:

- Cost effectiveness
- Ease of implementation and operation
- Ease of disseminating information to key stakeholders
- Scalability and flexibility to meet future demands
- Reliability and relevance of information provided

Scorecard strategy for continuous enhancements: An effectively managed outsourced process strives for continuous improvements. Its performance goals are dynamic and improve with time and maturity of the process. Establishing a scorecard process helps the banks to enhance the efficiency and effectiveness of an outsourced process on a continuous basis.

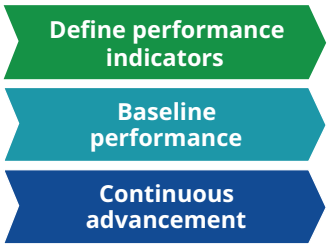
Performance dashboards - one tool for effective managements

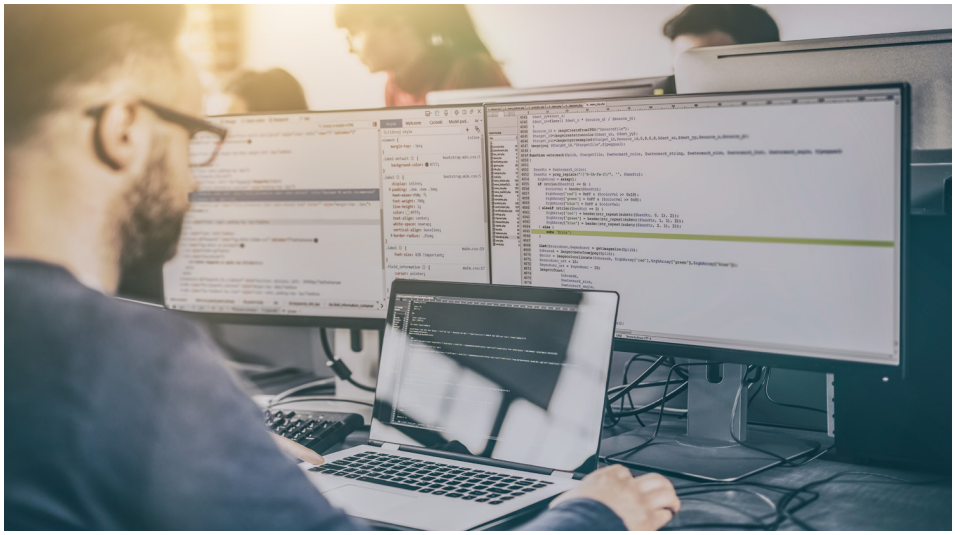
To fully achieve the benefits of outsourcing, a bank should establish a forward-looking performance measurement system to confirm that the service provider is operating within a performance zone and providing expected business value to the bank. This performance measurement system should provide the key stakeholders with indicators to assess the current performance relative to the proposed goals and objectives. A performance dashboard acts as a system that incorporates all critical metrics to monitor process risks, performance goals, and other contractual obligations. Performance dashboards should be versatile and showcase the rates of change over the period (e.g., the metrics goals should be based on maturity of outsourced process).

Essentially, an effective performance dashboard is one that:

- Uses a scoring mechanism that focuses on continuous performance improvement across all measurable dimensions.
- At a minimum, mimics the same performance standards maintained by the bank prior to outsourcing the process.
- Incorporates an internal performance target adjustment that is aligned with the evolutionary life cycle of the outsourced process.

The following steps should be performed to create effective metrics for performance management.





- **Defining measurable performance indicators**
  Identifying and selecting quantifiable parameters of outsourced services not only includes the metrics collected by the bank as part of its regular work processes prior to outsourcing, but also incorporates newer metrics to monitor those risks introduced by outsourcing (e.g., business process risk and outsourcing related risks). Having comprehensive metrics can enable the bank to actively monitor, manage, and rationalize their goals and performance targets.
- **Baselining existing performance**
  Baselining current performance, prior to an outsourcing action, requires reviewing the process's defined goals. These goals are then required to be calibrated with defined objectives and industry standards. Further, for each performance target, a data source, metrics acquisition mechanism, and data refresh rate should be clearly established.
- **Continuous advancement**
  Metrics defined for an outsourced process should be dynamic and forward looking. The bank should establish different maturity stages of the outsourcing process and define goals for each stage. Benchmarking the goals for different maturity states can help the bank in reviewing its performance realistically and making timely course correction to obtain maximum output from the outsourced process.

An ideal performance dashboard should track the following critical components of the outsourced process. Each of these components is equally important for effective management of the outsourced process:

- **Cost:** Tracking and management of delivery cost for services outsourced
- **Time and schedule:** Measurement of schedule and time frame
- **Performance:** Quantification of the amount of service provided in a given period
- **Quality of service:** Objectively measuring the quality of services rendered for the process outsourced
- **Customer satisfaction:** Measurement of satisfaction quotient of internal and external customers
- **Capacity utilization:** Monitoring of capacity utilization and critical levels of services outsourced
- **Talent development/skill enhancement:** Quantification of progress in skill inventory and internal job satisfaction
- **Trend:** Monitoring the efficiency in service over the period of time

Scorecard strategy

The overall objective of a scorecard strategy is to compare the actual results with established performance metrics. Since the performance goals are specified at the time of outsourcing a process, it is likely that a scorecard and its associated scoring method would allow targets to be met in one area but missed on other areas. Therefore, banks should perform scorecards on a periodical basis to revisit the performance goals as needed. A successful scorecard strategy not only focuses on multi-dimensional performance improvement, it also assesses the performance measurement on a proactive basis.

It is imperative to note that scorecard strategy must be performed in context of the outsourcing life cycle, and scorecard goals must be tailored for different stages of the outsourcing process. Following are the different stages of the outsourcing life cycle for which specific scorecard goals should be established.

Initiation and transition	During this stage, personnel and knowledge transition take place. At this stage: • While there is a potential for performance degradation, there is also an intense learning. • Service Level Agreements (SLAs) are defined and aligned with business strategies. • From a scorecard perspective, the goal should be that the initial SLAs are achieved.
Stabilization	During this stage, assimilation of personnel and infrastructure is complete. At this stage: • The requisite processes and practices are in effect. • The outsourced arrangement is beyond the learning curve and the bank is ready to enact the performance improvement targets. • SLAs are revised based on mutually agreed upon efficiency and customer service levels. • From a scorecard perspective, the goal is to assess positive movement toward performance metrics in alignment with the medium-term goals and objectives.
Steady state	During this stage, the bank's outsourced processes mature and the initial performance targets are no longer valid. From a scorecard perspective, the goal is to assess the rate of performance change needed to sustain the desired business performance in the long term.

Conclusion

Outsourcing can be a critical decision for a bank. Various factors play an important role in this decision, such as quality, cost, and customer satisfaction. Performance dashboards can help effectively manage the outsourcing process and enable key stakeholders to measure, monitor, and manage the process by assessing the progress toward stated objectives. Performance dashboards can be tailored for different user groups to incorporate scorecards, reports, and analytical tools that run off a common set of data and metrics. Collectively, they can enable key stakeholders to identify problems on a timely basis, take appropriate remedial actions, collaborate with others, and revisit plans and goals as needed. However, performance dashboards are merely tools for communication, coordination, and continuous assessment. In order to realize success from outsourcing processes, banks need an effective enterprise monitoring program to navigate the various risks that can come with outsourcing.

How Deloitte Risk and Financial Advisory can help

A true challenge in managing outsourced processes is in clear articulation of business goals, charting a course towards the goals, and demonstrating flexibility in making mid-course corrections as needed. While utilization of dashboards for communication, coordination, and organizational navigation is an efficient way to enable outsourcing success, designing and developing an effective monitoring program requires an in-depth knowledge of the outsourcing life cycle. Deloitte Risk and Financial Advisory's team consists of practitioners with in-depth experience in risk-based, third-party management practices. Our practitioners can assist banks by providing the following tailored services:

- Assessment of bank's vendor management process
- Design and development of target state operating model
- Identification of business requirements for risk sensing and performance dashboards
- Benchmarking
- Third-party screening and assessments
- Design and development of performance dashboards
- Design and development of scorecard strategy
- Design and development of cross-risk, third-party reporting
- Contract compliance assessments and optimization
- Ongoing consultation and support throughout the outsourcing life cycle
- Analytics and visualization
- Regulatory compliance

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