

FINANCIAL SERVICES

Proudfoot helps Doral Financial Corporation save \$38 million



Doral Financial Corporation, a bank holding company, is engaged in a variety of mortgage banking, commercial banking and broker-dealer activities primarily in Puerto Rico, where it operates 58 mortgage banking offices and 43 retail branches. In the face of a declining mortgage market, the bank realized it needed to streamline its operations and reduce costs, and turned to Alexander Proudfoot for assistance. Complicating the task were some past accounting practices which had caused the holding company to restate their financial earnings and accounts for the past five years. This naturally added to the financial, management and regulatory pressures the organization faced.

The Board of Directors asked Proudfoot to conduct a Business Review and develop an implementation program that would augment the

bank's own cost-reduction initiatives. The overall goal was to reduce costs by nearly \$80 million on an annualized basis; at the time of the assignment, Doral had already taken or planned actions on nearly \$50 million in savings. Proudfoot's commitment was to produce at least another \$21.8 million in savings—an expectation that ultimately was surpassed.

Proudfoot's approach included four major initiatives at the outset, with another added several months later. Initial elements included a program to rationalize the holding company's building and real estate inventory and consolidate offices, a move that led to an estimated \$18 million in real estate consolidations as the freed inventory was converted to other use. Two other early achievements included an effort to increase customers' use of electronic statements, which lower the bank's operating costs, and a shift to the Visa debit card, which saved an additional recurring \$3 million. These initiatives were all part of an initial "quick results" program designed to establish momentum.

Once these programs were underway, the deeper, more complex systemic and fundamental process changes were launched,

which accounted for roughly three-quarters of the total financial benefits. These changes included:

- Designing and developing Management Operating Systems (MOS) for the retail branch operations, mortgage operations and administrative areas
- Consolidating four separate mortgage companies and a retail bank into a single business unit
- Re-engineering and simplifying loan processes to speed production and reduce the number of steps
- Defining and implementing appropriate staffing levels, including peak demand flexibility, to match volume requirements throughout the organization

Because of its success in installing and managing these changes, Proudfoot was later asked to take on an additional assignment, helping the company respond to a regulatory audit report on its operations. Altogether, the joint project helped Doral Financial Corporation achieve \$37.9 million in annualized savings, with another \$10.5 million in potential savings identified for implementation in the near future.

Major initiatives

The project approach was structured around five major initiatives:

1. SG&A Savings
2. Real Estate Utilization
3. Management Operating Systems
4. Process Re-engineering
5. The audit response

Of these initiatives, SG&A Savings and Real Estate Utilization were undertaken as part of a “Quick Results” effort designed to establish momentum. The broader initiatives of Management Operating Systems (MOS) and Process Re-engineering provided the bulk of the financial savings. The audit response was added in the middle of Proudfoot’s involvement as a special assignment.

SG&A Savings

After analyzing the bank’s selling, general and administrative expenses, the Quick Results Team identified a number of expense items whose reduction, elimination or modification could produce sizable savings to the bank in a relatively short period of time. One of the most significant single opportunities involved moving the bank from its local debit card supplier to the Visa debit card, mitigating the processing charges previously paid by the bank. This also generates revenue through commissions that are paid when customers use the debit card. The total annualized financial benefit to the bank from this initiative alone is approximately \$3 million. The potential savings were identified immediately, providing a fast start to the overall project. Moreover, the actual effect on the company’s financial statements was seen within the first six months.

Another significant example involved increasing customers’ use of electronic statements rather than costly paper statements. For a variety of reasons, electronic banking statements were not as prevalent in the Puerto Rican financial community as in the mainland United States market. The Quick Results Team helped launch an effort to boost its popularity, achieving an incremental improvement of more than 200% in just three months, and of 290% over the course of the seven-month project.

Real Estate Utilization

Another of the Quick Results Team’s assignments involved maximizing the effective use of buildings, floor space and equipment. The bank owned or operated 94 distinct properties, incorporating some 600,000 square feet of space. The team conducted an extensive survey of space requirements for all of the bank’s operations, redefined the requirements to reflect the anticipated leaner and more efficient bank operations, and then establish the best-suited area allocation plan, based on the interfaces that would be required among various departments and divisions. For example, the corporation’s mortgage operation maintained three separate main buildings housing four mortgage brands within close proximity of each other. By relocating the operations and consolidating all back office functions into one building and under one brand, the parent corporation was able to empty two buildings for subsequent sale or lease. In addition to this direct financial benefit, the new space allocations also improved communication, streamlined operations, and reduced “paper

traveling” in the mortgage application process. Similar reallocations were carried out in other company buildings for call centers, training and audit functions. These benefits were also achieved within a few months of the project’s start.

Management Operating Systems – retail and back office operations

A substantial portion of the assignment involved the design, development and installation of Management Operating Systems for the mortgage, retail banking and administrative support operations, to ensure that both the banking and mortgage operations would be functional with a lower origination cost base. The MOS Team pursued a proven approach to carry out this process, based on Proudfoot’s extensive experience in the design and installation of such systems. The process encompassed seven major steps:

1. Review, define, and develop missing system elements at each company in terms of forecasting, planning, scheduling and reporting the anticipated work volumes
2. Develop Key Process Indicators and summary reports by management level
3. Identify current and future workloads by area/process
4. Determine resource requirements and adjust accordingly
5. Facilitate the use of new information to make short-interval decision-making



- 6. Install daily and weekly review meetings between supervisory and operational levels
- 7. Ensure compliance and understanding of the MOS procedures and policies through one-on-one coaching of managers and supervisors, to ensure that the improvements would be sustainable

Key elements of this system include a Daily/Weekly Operating Report, developed with the IT department in order to consolidate information from different sources into one single page which contains all the relevant information needed to manage a specific operation. At the outset of the project, key branch data was derived from a variety of sources and required extensive time from the branch manager to compile and digest the information. Even more critical, the data varied from branch to branch, depending on the skills of the various branch personnel. As a result of the new MOS, branch managers are

now able to review relevant branch information on a single page, which is ready when they arrive at the branch in the morning. This report can be viewed at the individual branch level, as a consolidation report for a group of branches, and as a report on the entire retail branch operations for the most senior management. Once installed, the report was so well received that it already has gone through various improvement iterations by the client. These changes were prompted by its initial use and a demand from the branch managers to further refine it.

A closely related improvement was the installation of a Branch Profitability Report, which directly measures the cost (and profitability) down to the individual branch level. This provides for greater accountability on the part of the branch and its management to reduce costs, increase profitability and, in effect, establish solvency levels and volume requisites for short- and long-term sustainability in a quantifiable manner.

Process Re-engineering

The mission of the Production Process Re-engineering Team was to revise, rethink, redesign and generate a single consolidated process that works for all of Doral's mortgage, banking and corporate operations. This required simplifying and standardizing the mortgage loan process. The goal was to reduce the number of steps required to process a loan, reduce the unitary cost of processing, and consolidate four distinct mortgage divisions into one processing and closing department with a singular mortgage loan process.

This has resulted in an average 35% reduction in the number of steps required for loan approval and a reduction of approximately 40% in the cost of processing a mortgage loan application. The organizational structure has been streamlined down to three different job categories, from the original level, and the line of supervision has been redefined and streamlined in order to increase control at the point of execution and highlight

Objectives:
<ul style="list-style-type: none"> • Reduce origination costs, with total financial benefits of \$21.8 million or more • Streamline both branch operations and supporting "back office" processes • Rationalize office locations and improve the effective utilization of company-owned buildings • Streamline the processing of mortgage loan applications and lower processing costs

Key methods:
<ul style="list-style-type: none"> • Establish appropriate staffing levels for branches and departments • Develop and install Management Operating Systems (MOS) in retail and mortgage operations • Re-engineer front and back office retail and loan processing • Increase customer use of electronic statements to lower administrative costs • Transition from the existing locally-backed debit card operation to a Visa-backed debit card • Tailor the organization's footprint requirements after the re-engineering into current real estate • Conduct space utilization studies, and develop and implement new utilization plans

Results:
<ul style="list-style-type: none"> • Mortgage processing steps reduced by as much as 48% in some subsidiaries • Mortgage operational structure streamlined from 13 job categories to three • Cost of mortgage processing reduced by 40% • 290% growth in customer use of cost-saving electronic statements • Total annualized financial benefits in excess of \$37.9 million, with an additional \$10.5 million in potential savings identified



the crucial sales management function. Another significant improvement was the implementation of a mortgage “traveler” to accompany each loan throughout the origination process to closing. This process tracks signatures, lead times and rework, and is supported by the implementation of checklists at key steps in the process. The combined effect of these improvements has been to support Doral Financial Corporation’s goal of remaining the mortgage banking leader in Puerto Rico.

Special assignment: audit response

Within a few weeks of the project’s commencement, Doral Financial Corporation was notified that the Federal Reserve Bank and the FDIC had requested an independent audit of both Doral’s mortgage and retail operations. The auditing agency, the Promontory Financial Group, issued a report several months later, which confirmed earlier findings that the bank’s past emphasis on loan volume and market share significantly had contributed to deficiencies that existed in 62% of the closed loans in the mortgage operations.

Because of their success in implementing process changes and management effectiveness, the bank asked that Proudfoot take on the immediate task of helping them plan and manage the response to this “Promontory Report.” The consultants quickly immersed themselves in the various affected divisional areas of the bank and, working with the bank’s senior management, identified the activities required to permanently correct those deficiencies and define

those responsible for carrying out the strategies. Proudfoot was then asked to assist in implementing the strategies, including reverse engineering of the entire loan process, simplifying the loan origination, underwriting and appraisal processes, and revising and simplifying the mortgage lending policy to be used throughout the organization.

As part of this effort, a Quick Reference Underwriting Guide was created to address in a clear and concise manner approximately 95% of the issues that generally arise in the origination and underwriting processes. Proudfoot also assisted Doral’s review and re-engineering of the quality control function, and implemented a tracking system to measure and monitor exceptions throughout the entire loan process. This provides management with a valuable tool for determining the effectiveness of individual employees, and provides the ability to identify and correct the root cause of potential recurring problems. In addition, the property appraisal process was revised along with the loan appraiser evaluation techniques and criteria for being an approved appraiser for the bank.

Measurable results

By the end of Proudfoot’s original

assignment, the recognized and achieved financial benefits had reached \$37.9 million—90% greater than the original commitment of \$21.8 million. Included in this figure is an approximately 37.5% reduction in staff positions from the levels immediately prior to the project. Moreover, additional initiatives based on Proudfoot recommendations offer the potential for an additional \$10.5 million in annualized savings. In the longer term, even greater potential benefits may be achieved, depending on how the bank decides to dispose of unused commercial office space resulting from the real estate utilization and rationalization program. It is estimated the sale of these holdings could free up an additional \$18 million in capital for other uses.

Additional future steps involve assuring the client is prepared to sustain and control the newly installed improvements. In that regard, Proudfoot’s approach helped facilitate an orderly handover of all activities, since Doral personnel were involved in leading all initiatives from the outset. Specific steps have been taken to ensure sustainability, task team support, permanent behavioral change, and continuing management and control of service and quality indicators.

Savings breakdown (in millions)

- Front office efficiency
- Back office efficiency
- SG&A efficiency

Total savings: \$37.9 m

