

# Playing Scrabble without the vowels

**Europe's mortgage markets are being shaped by the forces of globalisation. But the integration that must result is being hampered because players from different countries and market segments do not talk to each other — let alone understand each other.**

**So argues Toni Moss, an American who moved to the Netherlands five years ago. After three years helping to develop Stater, one of Europe's first third party mortgage servicers, she left to found EuroCatalyst, a company which aims to bring the whole European mortgage industry together through events and other activities.**

The last time I had the privilege of addressing the structured finance market in public was in Barcelona in 2000. In retrospect, I may have come across a bit too strong, but the music — 'I Saved the World Today' by the Eurythmics — was great!

As I chided the banking industry for its difficulty in managing data, I exalted mortgage data as a literal currency itself, because of its value in cross-selling and to MBS investors.

I was attempting to reposition the role of mortgage administration in European financial services.

Today, I'm taking my evangelism to a broader audience, within a more relevant context. That context is globalisation.

If you really think about it, community precedes commerce. So the logical progression here is to try to facilitate a pan-European mortgage lending and housing finance *community* that can accelerate the development of a true, commercial, pan-European *industry*.

The goal is not to exacerbate the problems of the European lending environment nor expect homogeneity of views or purpose. The markets are far too large and unique, and some of its markets actually function quite well today.

Rather, to the extent that we can identify common ground, we can accelerate the many issues on which everyone agrees.

## Why globalisation?

I refer to the unabridged, George Soros def-

inition of globalisation as "the unrestricted movement of capital and the increasing domination of national economies by global financial markets and multinational corporations."

In a nutshell, national structures can't keep up with the pace of change in the financial markets. While economies are globalising (Basle II is a perfect example of this), politics are localising (Basle II is a perfect example of this). Is there an echo in the room?

In the context of globalisation, both "mortgage lending" and "housing finance" become oxymorons.

Why? Because housing and mortgage fulfilment are inherently local activities, while finance is now a global activity. When applied to the national European mortgage markets, this disconnect is even more dramatic, for many reasons which we really do need to start talking about.

But who are "we"? How did I get to this point? And what are those reasons?

## Previously on Toni Moss ...

Nearly five years ago I arrived at the scene of a new job in a small office in a small village in a small country working with what was, at that time, a small company with some local momentum and a darned good business model.

STATER was the first true residential sub-servicer in Continental Europe — a nascent industry segment in 1997, to say the least.

My goal was to export the business model featured in our Dutch "factory showroom" to other European markets, leveraging our independent status, proprietary process and technology platform into outsourcing joint ventures with the largest lenders in other countries.

I quickly discovered that positioning the company for new opportunities required the positioning of third-party servicing itself.

With no precedent to follow and no preconceptions to overcome, third party administration in Europe soon took on a more hip role as the digital bridge to connect the primary (origination) and secondary (funding) markets.

At that time, the impending introduction of the euro gave added encouragement to lenders wanting to cross borders, and third party administration was poised to help them.

The truth is that the future of European lending lies in third party administration, as that business model is the very centre of convergence for every direction in which the industry is heading.

The problems I encountered weren't in tapping into the investment banking crowd, who were just as anxious to promote securitisation as I was to promote third party administration — our activities were complementary.

The rating agencies were also helpful; they were racking their brains to devise relevant rating criteria for European mortgage markets and were genuinely interested in moving things forward.

## The Tower of Babel

The real struggle was in finding the markets themselves. This isn't just because I am incapable of reading a map. The current status of the European mortgage lending industry reminds me of Duke Ellington's description of jazz: "playing Scrabble without the vowels".

It wasn't until my first ABS conference experience in Cannes in 1997 that I realised this is actually the norm — everyone speaks in consonants. It is very difficult to communicate about things like transparency when we aren't even using the same terminology from market or even within the same industry segment.

Most originators traditionally fund their loans from retail deposits and as such, ser-

vice their portfolios internally. It's no surprise that practices are widely subjective and divergent both within and among each EU country.

Overall, lending practices are highly fragmented and labour intensive, lack contemporary risk management and capital market efficiencies and follow at the trailing edge of the technology curve to the point of falling off altogether.

It is also hard to find the market when a huge part of the industry speaks only in terms of assets and liabilities. Investment banks and rating agencies have set up entire organisational structures based on a balance sheet formula, and although numbers talk metaphorically, I have yet to communicate with a number.

Every time I speak to an analyst or an investment banker they ask, "hang on a sec, are you talking about the credit side or bank capital side here?" Well, both — because it's not always so black and white.

Within rating agencies, for example, there are naturally methodological differences between how structured finance and bank analysts view certain risks, and how they should be guarded against or provisioned for. Some say these differences offer potential for ratings arbitrage.

## Transparency and communication

To complicate matters further, European lending institutions are characterised by a culture of secrecy both within and outside of the organisation.

Maybe this cultural reluctance to share information is a classic "no carrot, no stick" situation that could be resolved with different pay and incentives.

Or maybe it's the rigidly hierarchical and bureaucratic structures that isolate departments from each other.

But the practice has actually withheld the development of performance reporting for European residential MBS, which every investor routinely flags as a serious issue.

In the US, pooled mortgage performance reports are routinely delivered on tape without a second thought. In Europe, even the most benign data is excessively difficult to acquire.

Whether it is full performance figures on securitised portfolios or historical performance on their overall book, European lenders fear that the most minute detail will give away some competitive advantage.

## Community

Among the lobbyists and trade organisations, the European Securitisation Forum might say that covered bonds are looking more and more like mortgage backed securities.

The European Mortgage Federation, whose membership is dominated by covered bond funders, might say that MBS appear to be small covered bonds in a pinstriped suit living off the coast of the UK!

But both products are about how originators fund loans and manage the risk.

So why don't they collaborate? Recently the EMF asked the ESF to help draft its position paper on securitisation for Basle.

However, as Alexander Batchvarov, head of international structured credit research at Merrill Lynch, explained, given how the BIS document is structured, covered bonds fall into one category and securitisation falls under another.

It's that balance sheet thing again, complicated by too few resources to go around.

The specialised commission on securitisation within BIS is different from the specialised commission on banks and finance companies, and the two lobbying groups address their respective regulators.

Considering that more than 50% of European ABS is MBS, cooperation between the ESF, with its access to risk management rocket scientists, and the EMF, with its broad membership base, long-standing tenure in Brussels and excellent lobbying skills, could provide both with maximum leverage with the European Commission, as well as the foundation for a new European mortgage lending community.

## Convergence

Today, discussions within the industry are fragmented or occur bilaterally within specific industry segments, without always addressing the big picture.

At the same time, many organisations which do see the big picture face political complications as their member base seeks to cross borders.

A collective approach might allow them to achieve the goal of serving their membership while extending their unique perspectives to other markets.

What is needed is a larger framework and paradigm to find the elements of common ground throughout the industry and at the very least standardise the concepts and terms, if not best practices.



**Toni Moss: covered bond and MBS communities should collaborate**

Not only should the dialogue be collective from the perspective of national markets, but from that of industry segments too. After all, globalisation demands integration, not isolation.

Despite the fact that many Europeans do not really want a single market, the ultimate question is, how long will their national markets survive globalisation?

My intent here is to provoke thought by raising more questions than I can answer. Of course, no single person can, and that's my point.

So here's the plan. It's so simple, it's radical. It's called communication. If investors will seek to impose harmonisation on financial products through natural selection, perhaps we can achieve the same effect through a collective understanding of the European mortgage industry in the context of globalisation.

If European mortgage lenders were to fully understand the market efficiencies and economies of scale that the global capital markets actually provide, their mortgage products might take on more streamlined characteristics that could generate higher returns when pooled and sold in the secondary market.

At the same time, why not introduce at least the idea of conceiving mortgages as a pan-European asset class, spanning covered bonds and MBS?

Survival strategies are not always first choices for anyone, but it helps to consider every contingency.

We all have a voice in shaping the way that globalisation unfolds. A new dialogue should preserve the cultural identities of Europe yet strive to give Europe a collective voice.

**SFI**