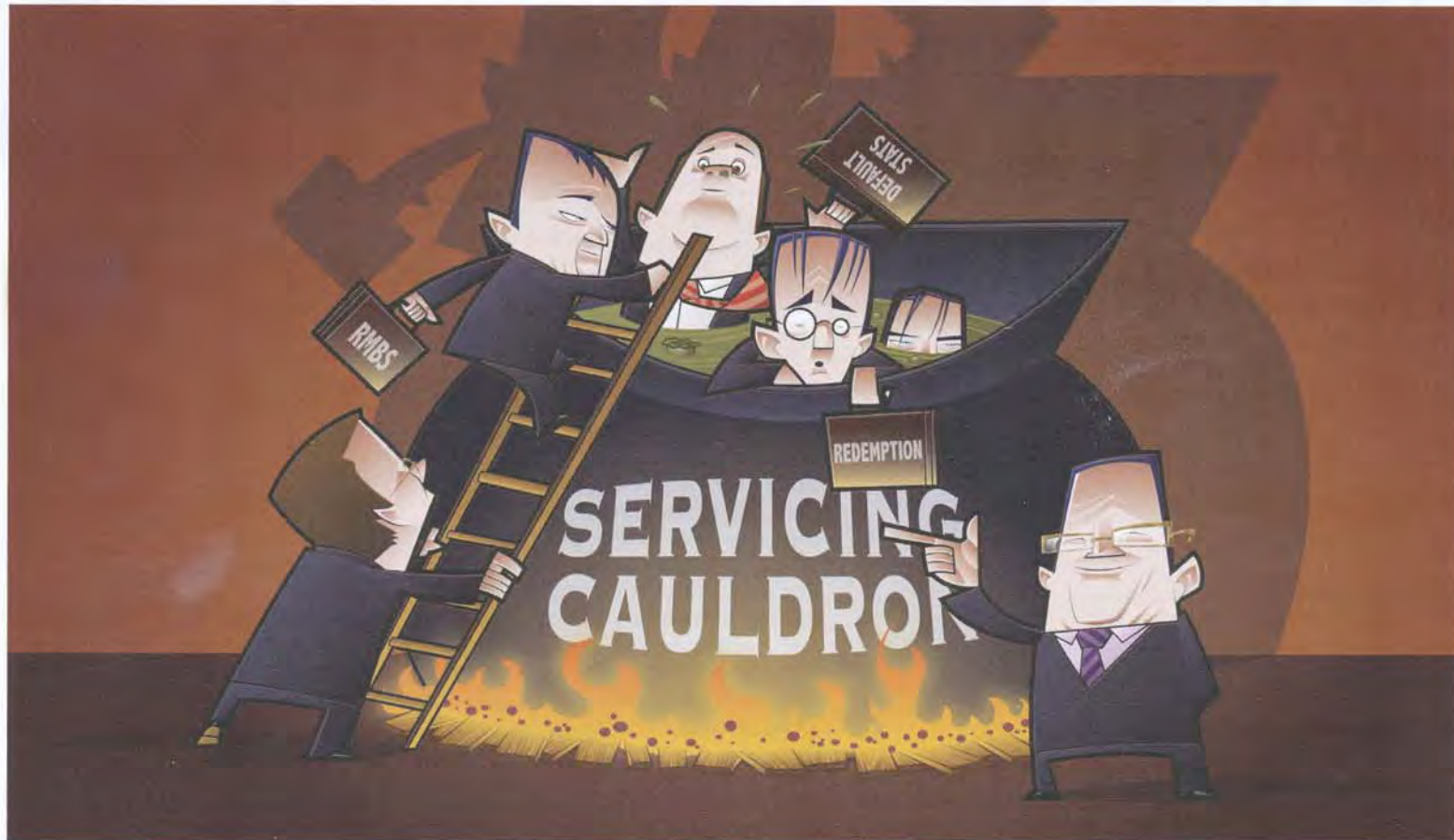


The EuropeServicing conference on 28-29 April at the British Film Institute is themed around *Vertigo* – Hitchcock's classic film that exploits our fear of falling from on high. Toni Moss, driving force behind the event, considers it the perfect metaphor for the state of European mortgage lending industry

Servicing – recipe for recovery



When the going gets tough there's a temptation to sweat the business that little bit harder – an idea that we pick up in our cartoon – but when it comes to mortgage servicing, whether captive or outsourced, is that the best way forward, or is it a recipe for further trouble?

Toni Moss, co-founder of EuroCatalyst and the driving force behind the EuropeServicing event, is under no illusions about the challenges facing lenders and their servicing operations. She maintains that she launched the event back in 2005 to prepare the industry for the downturn playing out today.

We catch up with Moss on how the lending landscape has changed since the last EuropeServicing event in 2006, and how servicing is finally at the forefront of industry concern and attention.

In 2006 growth in securitisation was raging, driven by investor appetite for residential mortgage-backed securities. Investment banks were acquiring spe-

cialist lenders, packagers and portfolios at record pace, as well as competing with clients by launching their own specialist lenders to increase volumes for their RMBS conduits. Building societies were acquiring buy-to-let and non-conforming portfolios in record volumes to build balance sheets and boost their entry into specialist lending sectors.

The size and capabilities of third-party servicing provider HML facilitated and enabled much of the increased business, while SMS seized on the opportunity to build its own third-party servicing volumes through whole loan sales in which servicing was retained.

Meanwhile, Vertex hit the radar with a much-publicised outsourcing deal with Deutsche Bank's db mortgages. It appeared as though UK third-party servicing volumes would reach the scale to support several new players in a market dominated by HML for 20 years. How have times changed and how is Moss planning to pick up from two years on?

'Throw in a little more data, cut back a little on fees, apply a little more heat and bring to the boil'

"As always, we'll pick up from exactly where we left off," says Moss. The final session of EuropeServicing 2006 was called 'Crash: When High Street meets Wall Street in the City which way do you turn?' Moss says: "I would like to think that it was very prophetic but frankly we were shooting goldfish in a barrel. The title shows that we were questioning the wisdom of launching so many new sub-prime and non-conforming lenders quite late in the game. The session itself discussed what might be the fallout in case of a crash. Now we see the aftermath, and very few were wearing seatbelts.

"Global liquidity froze in August 2007 when losses of \$20bn were disclosed. At the recent G7 summit participants estimated the immediate fallout to be around \$400bn in losses, while residual and related losses will likely reach as high as \$3trn.

"When I said back in 2002 that mortgage markets were the epicentre of the global economic fault line, I wasn't kid-

ding. Globalisation is the context for understanding mortgage markets and unfortunately it took this crisis for everyone to realise how inextricably wed everything has become."

As a result, she says, the forthcoming EuropeServicing event will emphasise the most successful global strategies in portfolio defence, loss mitigation, collections and recovery and, in particular, will be asking how well servicers are performing in loss mitigation and how much room there is for improvement.

One of the opportunities arising from the sub-prime crisis is 'playing the dark side' – buying distressed portfolios and working them out based on superior servicing. "We'll be very focused on those opportunities", says Moss. "The entire reverse cycle of lending is one of the most profitable endeavours of all. But to succeed you have to have world-class special servicing skills on board."

As part of EuroCatalyst's advisory work, Moss's firm does work for numerous banks across Europe – particularly those issuing covered bonds – as well as European servicers and distressed asset funds. The banks, in particular, "need deep experience in loss mitigation and workouts to set up triage servicing units and enhance recovery on a large scale". And many newer servicers that have not been tried and tested in distressed market conditions are looking for best practices and personnel to better serve their clients.

EuropeServicing 2008 opens with a session on the psychology and mindset of special servicing. "This is not a workflow process that banks or service providers can simply tweak," Moss says. "In addition to continuous surveillance for changes in borrower behaviour and asset value, special servicing is psychologically difficult for those driving collections efforts. It takes a unique skill and disciplined mindset to be effective."

Her greatest concern is restoring investor confidence. EuropeServicing will address this by bringing investors directly into the servicing dialogue for the first time. "Not only will the audience be full of analysts, the most outspoken investors are joining each session onstage," she says.

Although Moss agrees that UK mortgages are underwritten with stricter criteria than in the US, she emphasises the emotional aspect of investor behaviour. "Investor confidence is shot right now across almost all Western national markets. Someone in Kansas opened the curtain and found a cheeky little old man pretending to be the Wizard of Oz. Not only has sub-prime become a dirty word, it has taken virtually all mortgage-related investments with it, including commercial real estate, and now most asset-backed classes including consumer loans, auto loans and student loans are weakening. The only way to restore



Toni Moss

investor confidence is to take investors behind the scenes to show them how the industry works."

In another first, EuroCatalyst is giving equal billing to the Chartered Financial Analysts of the UK (formerly UK Society of Investment Professionals – editor). "For years, investors have complained about a lack of representation at many levels but were not well organised. In strengthening their own organisations they are now taking a hands-on approach to issues like servicing. This partnership was a significant achievement and I'm very grateful to Giovanni Pini and Joe Biernat of European Credit Management who were the catalysts to make it happen."

Moss says: "The industry, and servicers in particular need the inspiration to view themselves as the investor's front office – and not the originator's back office. The 'back office' concept is outdated, diminishes the value of servicing and demotivates the entire sector.

"Servicing has been so discounted in this industry that it was a very lengthy dialogue and challenge to convince investors that this is where their interests really lie."

Will this lead to a change in the way RMBs are reported and perhaps bring them more in line with commercial mortgage backed securities which feature much more robust reporting?

"The ESF has been addressing that issue rigorously due to the fact that investors have been begging for better reporting for years," says Moss. "In this crisis, investors have essentially gone on strike. The power is truly in their hands. This will be an expensive process for many in-house and third-party servicers, but the demands for greater transparency and informational delivery provides a chance to rise to a whole new level in meeting them. And this is when we will see servicers truly become the bank within the bank."

Moss offers additional insight on how lenders and third-party servicers can drive profits via a different approach to market positioning. "Much of my work in investor relations is helping strong issuers differentiate their bonds by emphasising superior servicing capabilities. Similarly, if I were a third-party servicer I would be focused on building my brand directly to investors, who can influence where the servicing goes. For marketing to be powerful, it needs to go toward those who influence the decision-makers, and not necessarily the decision-makers themselves."

When further pressed on the tendency for banks to drive down costs by squeezing the margins in servicing and administration, Moss declares: "That's vertigo. That's proof of just how imbalanced this industry is. The focus has been monopolised by origination and distribution. Shouldn't we be dedicating more atten-

tion and funds to the guys collecting the payments on these loans and managing the collateral behind them?"

Moss, however, does not believe the origination and distribution model will change as a result of the current crisis. "I do see repricing occurring across all parties in the value chain and can only hope that servicers will not get hit hard by it. Servicing costs are already thin and it would be suicide to substitute cost for quality in today's market."

With regard to repricing in other sectors, Moss is working with some intermediary organisations across Europe which have seen their fees fall between 50-100bp or split with a deferral of 50% paid at origination and 50% in 10 years. "Like everyone else, intermediaries are trying to replace lost revenues with new business opportunities and I have always believed that the servicing process begins at packaging. At the same time, title insurers are moving further into expanded information services so I see servicing as the new point of convergence for the industry."

What else is on the agenda for EuropeServicing? "We're going to question the basics – the creditworthiness of the borrower, how perceptions have changed due to performance and how risk managers are calibrating their models. We'll also address property values. How do we really know what a property is worth? Are the techniques used really objective and empirical, and how do valuations stand up in a crisis when the target is constantly moving?"

EuropeServicing will also provide an open forum for servicers to compare their performance against global benchmarks.

Moss is intrigued by the evolution of social banking platforms. "I am fascinated by the social banking platforms like Zopa, Prosper and CircleLending (now VirginMoney) which are expanding the peer-to-peer lending concept to a much more granular and viral level," she says. EuropeServicing will feature some of these new business models in a session dedicated to expanding the servicing sector with new business models.

Finally, following up Moss's habit of bringing the conference to a close on an issue that will provide a curtain raiser to the following year's event, it's disappointing to learn she hasn't made up her mind on this year's closing session. "If I could draw a direct link between sovereign wealth funds and servicing, I would, because our future will be dominated by their actions and investments," she says.

So far EuropeServicing is on track to be a provocative event for which EuroCatalyst is renowned. This time, Moss warns, "we're taking the gloves off, leaving our egos at the door and bringing our best ideas and efforts to make the industry stronger." Lending Strategy will be there with full coverage. **LS**