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The Importance of Data Quality and Servicing Standards in European Securitisation

A joint thought-leadership piece written in collaboration with the [European DataWarehouse](#) and with [Hypoport](#)

Market participants across the spectrum recognise securitisation in Europe as a critical funding and risk-distribution tool for European companies. Yet despite the recent increased availability of data, many may not have weighed the significance that data quality and servicing standards have, particularly the role they might play in better serving the European securitisation industry.

To explore this, Citi enlisted the expertise of industry leaders **European DataWarehouse** and **Hypoport**, whose generous insights form the basis of this joint thought-leadership piece.

AN INDUSTRY IN CHANGE

We know that as a result of the financial crisis, we have seen an increasing amount of industry and regulatory attention devoted to the transparency of underlying assets and their performance. Specifically, the Simple, Transparent and Standardised (STS) securitisation regulation of the European Commission (EC 2015),¹ the Prime Collateralised Securities initiative (PCS 2017) of the industry itself,² and the eligible collateral requirements of both the European Central Bank (ECB) and the Bank of England³ all require asset originators and issuers to provide loan-level data from the asset pools underlying their securities.

This focus has raised the availability of loan-level data and created the possibility to better aggregate and interrogate the asset performance of securities post-trade, aiding risk and performance analysis in the process. Yet despite these performance and risk insight gains and data availability, we also know public issuance levels continue to be subdued owing to quantitative easing, limited supply and tightened spreads. The ECB commenced asset-backed securities purchasing in 2014 (ECB 2014)⁴ and according to the AFME, too, securitised product issuance for Q1 2017 was 36% lower

than for Q1 2016.⁵ Furthermore, performance risks remain and while the recent European Council announcements have confirmed risk retention at 5% (EC 2017), the debate on underlying technical standards continues.⁶

While we have seen an improvement in transparency, industry and central bank loan-level data repositories can only be as good as the quality of data being provided and their underlying asset servicing standards. So if servicing processes do not assure performance and data quality, then is the transparency reliable?

Servicing performance risks and servicing data are fundamental and inherent to securitisation, including such areas as customer-service methodologies, prime and special servicing processes, collection methods, and data management.

We discuss these risks, data quality challenges and servicing standards, describing some of their underlying factors while considering industry approaches to understanding, assessing and potentially ameliorating these risks in aid of market development and contributing to the development of the technical standards of STS.

THE DATA CHALLENGE

For any practitioner or any stakeholder who has been involved in preparing, executing and running a securitisation, there is always at least one occasion when the availability, type and quality of data is insufficient. This could arise as part of initial pool analysis, rating processes and even post-close investor reporting. Most issues caused by data during securitisation activities are usually resolved with few outward signs. However, these issues aren't unknown to cause grey hairs to those involved.

What can go wrong

A simple yet fundamental issue can be the incorrect flagging of securitised assets, which separates them from originators or servicers' unsecuritised assets. This can lead to incorrect performance data, incorrect cash flows and, at worst, securitising incorrect assets. Remediation in one case involved a significant amount of additional legal work, rating agencies and investor disclosures.

More common issues include reporting delays, an inability to separate periods of data for delinquency and pre-payments, and an inability to produce consolidated data files. These are typically caused by technology, process or staffing constraints. Notably, many servicers rely on a mix of older technology to produce data files and desktop tools to manipulate the data. These approaches are more vulnerable to fraud, human error and model risk, and are difficult to test, debug, audit and scale, especially when historic data grows.

In fact, such approaches also place dependence on key employees who create and run the data files, models and tools, begging the question of what happens if or when such employees leave the servicer during the life of a securitisation. Here, although their explicit knowledge may remain in the form of procedures and processes, these employees are typically in a small group, with considerable specialised or tacit knowledge, which is not always written down or documented.

This situation can be exacerbated, moreover, by a low willingness to invest in technology areas not driven by regulatory requirements or investors, where senior investors, for instance, might be less concerned about some performance changes as a result of data quality or servicing issues but could be concerned if these result in a rating action.

However, performance and data issues can also result in incorrect collection reconciliations, which, in turn, can lead to incorrect attributions of cash collections in priority of payments or waterfalls and ultimately to wrong investor payments. Although adjustments can be made in subsequent payments, wrong payments can cause trustee reviews and, in worst cases, technical default questions, creating a lack of trust and damaging the reputation of the servicer and other deal parties.

How diligence and preparation help

As securitisation spread in the 1980s and 1990s, deal diligence tended to be in depth, reviewing servicers' origination practices, technology, accounting, financial control and ability to produce data in support of securitisations, something referred to as "tape-cracking". Industry participants often deployed specialists to work alongside originator servicers to design deal-specific data files and reports to support their securitisations.

These files and data were often subject to testing prior to deal close, especially if a back-up servicer was used as a deal enhancement. A "warm" or "hot" back-up servicer requires regular production and testing of asset data in a specific format to take over servicing into their own systems and processes.

Historically, the data was also important due to a widespread use of asset-backed commercial paper vehicles, which often required monthly eligibility testing and generally formed the basis of investor reporting.

As deal volumes and the variety of asset classes grew, however, risk tolerance increased and time to market and/or reduced deal expenses became more prominent for participants. This reduced preparation time, diligence and reduced the focus on data and servicing, placing a greater reliance on rating-agency assessments and third-party platforms such as Bloomberg or Intex for reporting.

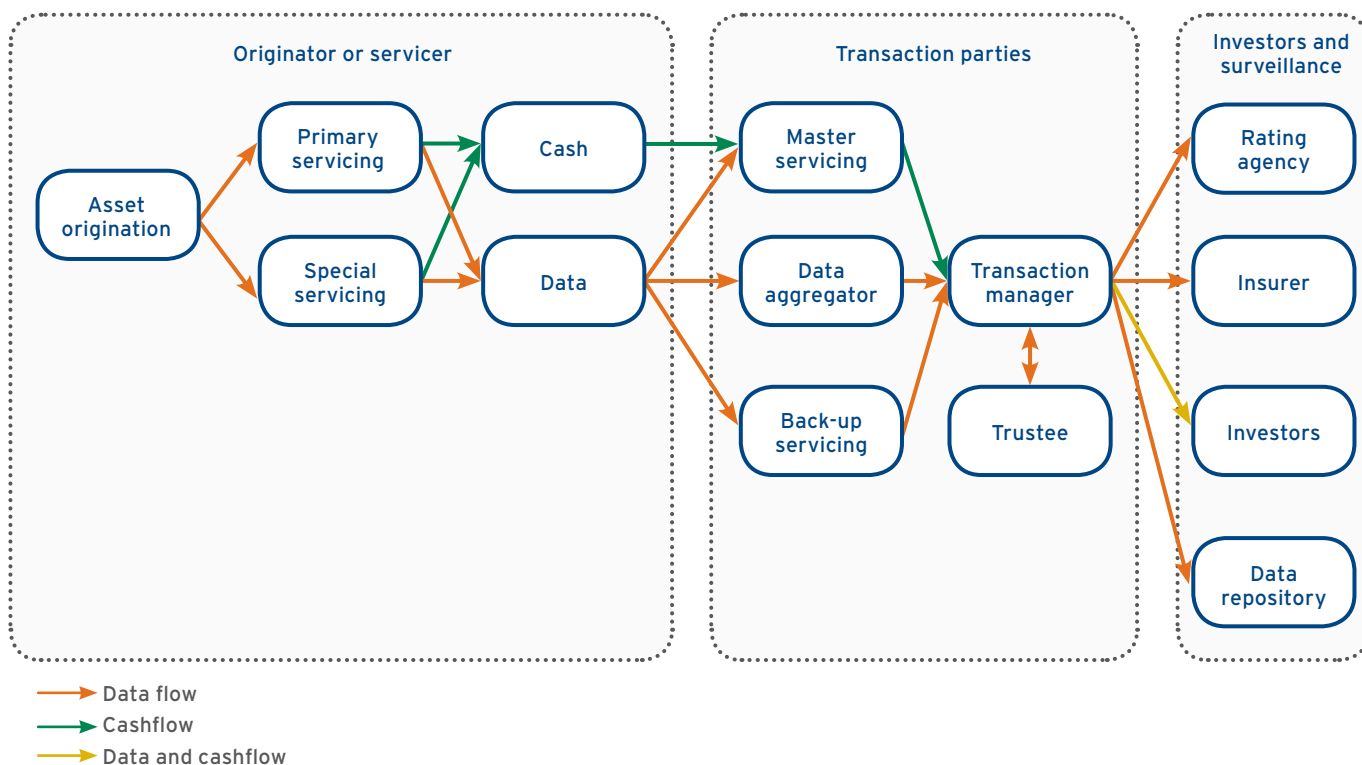
But the assessments of originator-servicer data and processes are critical and should start during the diligence process, when analyses of to-be-securitised asset data are conducted to compile cashflow models and assess historical performance. All parties can focus on the originator-servicer technology and servicing processes ensuring that the processes are adequate and that sufficient data, with appropriate quality, can be produced.

However, this focus can still be short-lived, with priority shifted to deal documentation and time to market, and with reliance placed on post-trade reporting. This is understandable in many respects, for example when securities are to be highly rated or when there is limited buy-side power in a tight-spread low-supply environment.

The impacts of potentially overlapping regulations and disclosures can also reduce the focus on data quality and serving standards, something which the AFME has highlighted (AFME June 2014).⁷

Recently, though, there have been encouraging signs, with greater focus on technology and data diligence, especially in the context of larger-size transactions, which has included all deal participants and service providers. Such focus and engagement with all parties helps the sustainability of data quality and servicing standards throughout the life of transactions, as the diagram

Securitisation Service Value Network: Data and Cashflow Perspective



above shows, although, in the absence of guidelines or standards, these signs remain anecdotal.

Taking all this into consideration, however, we know securitisation activities and diligence alone aren't able to resolve or identify all servicing and data quality issues.

SERVICING FACTORS

Servicing and its underlying methodologies, technology, people and processes play the most critical part in data quality and asset performance yet there has been little change in the approach to servicing and its activities.

As highlighted earlier, two important market perspectives might help explain this: undersupply and tight spreads together with ample credit enhancements and overcollateralisation, which, may result in senior investors being both less concerned and having little or low influence to change practices.

What drives quality and performance

There are a number of key factors that can drive or more accurately influence data quality and performance.

The identification, recording and management of data and cashflow occur throughout the servicing lifecycle. This includes at origination, for instance, where data is first collected and recorded, at primary servicing, the main activity point where obligor payments are received, split

into principal and interest, and tracked at up to 90 days delinquency, and at special servicing, where experienced staff manage 90+ day delinquencies and defaults.

However, customer-servicing methodologies can vary and be exacerbated by country variations, which can both influence performance. For example, servicers that employ methods to identify and control early signs of delinquency, such as first-time collection rates, changes in mortgage rates, requests for letting, and changes in payment methods can enhance performance. Furthermore, timely handoffs to special servicing staff – staff who might be able to identify repayment difficulty root causes, offer forbearance programmes and determine willingness to pay – can also offer performance advantages.

At a national level within Europe, some progress has been made. The Dutch market, for example, has established standardised investor reporting and reconciliations between investor reports and data in the European DataWarehouse. And in the UK, issuers have to follow minimum data reporting standards set by the Bank of England, which are aligned to standards of the European DataWarehouse.

While there are many rules, however, that influence servicing standards – such as the Mortgage Credit Directive, which also sets data and reporting requirements, and the transparency rules of STS's article 5 (EC 2015), which sets additional data and structural disclosure requirements for

structured finance instruments – none address servicing or data-quality standards.

Even in cases where the underlying data quality is in principle high, data consistency and comparability across countries or even within countries at servicer level can be challenging in the absence of pan-European data definitions and standards. Data collected is still primarily driven by national accounting and reporting frameworks and originator-servicer-specific procedures.

As a result, while the published ECB ABS templates and taxonomies are applicable across the eurozone, in practice there can be significant divergences in what is exactly reported in certain data fields. Although some projects will, over time, deliver more convergence towards a harmonised data definition framework, most notably in the form of the upcoming AnaCredit reporting framework for European banks (ECB 2016),⁸ the broad issue of data definition could also constrain progress in servicing and data-quality approaches.

How master servicing might help

In the United States and occasionally in Europe, master servicers support securitisations by providing servicing oversight including data validation and analysis, acting as a key part of a deal's data flow and reporting. They are especially relevant for deals with large data volumes

or specialist requirements such as with commercial mortgages or in a market where there are high volumes of standardised data. Witness the top 10 commercial mortgage master servicers in the US, which had oversight of 166 deals in 2016 (Commercial Mortgage Alert 2017).⁹

A drive to standardise servicing and data could in time help create the right environment for a broad European master-servicing cadre. However, other parties and tools can also assist. Some existing service providers have software tools, approaches and expertise that, for example, can be deployed at preparation, diligence and post-close stages of deals, although, it must be said, prevention remains preferable to curing issues.

All in all, service providers can assist in preparing organisations and staff for securitisation, reviewing servicing practices, identifying required data, designing data files or extracts, and supporting data production and analysis post-deal close.

THE BENEFITS OF SUPPORT

Assisting originator-servicers with servicing standards and data quality could have a number of benefits.

As quantitative easing reduces, for instance, supply and spreads are likely to increase, at which point further

Potential Servicing and Data Standards Framework

Area	Asset Origination	Primary Servicing and Collections	Special Servicing	Data Management and Deal Preparation
Elements	Affordability assessments	Pre-delinquency indicators, i.e. changes in payment methods and pay-day loans	Staff training and competency assessments	Ability to flag assets and data record
	Interest-rate stress tests	Collection productivity incentives, efficacy and quality controls	Customer complaint processes	Identification of key cash, relevant data fields and reconciliation processes
	Use of central credit bureaus	Customer experience indicators	Willingness to pay and forbearance programmes	Production of regular data files and segregation of cashflows
		Common key performance and risk indicators	Collateral analysis	Quality control and validation checks
Supports	Risk monitoring, control indicators, increased application of fair credit and competitiveness	Compliance, competency and performance	Compliance, competency and performance	Accuracy and quality of data, and management of cashflows.

improving investor confidence and trust with clear, reliable servicing standards and data quality could be important points of differentiation. Additionally, such reliability could reduce risk and the need to increase incentives.

The question here seems to be that rather than focus on increasing the volume and repositories of data, should the securitisation industry concentrate on the quality of servicing and data? And could such approaches contribute to the development of technical standards as part of the STS framework?

A FRAMEWORK FOR ASSISTANCE

Would a servicing and data standards framework offer needed assistance for securitisation? Such a framework could provide essential guidance for organisations contemplating securitisation alongside a range of practitioners who can guide the early stages of preparation through to diligence and post-deal close requirements.

Key framework areas could include asset origination, primary servicing and collections, special servicing, data management for securitisation and deal preparation. The table below left highlights the potential elements of these areas and some of the benefits they might provide. There is something else too.

Such a framework and provision of data could be considered for the covered bond market, which differs from securitisation in terms of regulatory, disclosure and post-deal close asset and data reporting, but which could benefit from similar servicing standards and data reliability.

Without industry focus and regulatory dialogue, however, it is likely that any such framework or approach may never be realised. ■

*This piece was jointly written with the generous contribution of European DataWarehouse Senior Adviser **Markus Schaber** and Hypoport Founder **Christiaan Pennkamp** and Senior Associate **Vincent Mahieu**, together with Citi Issuer Services EMEA Business Head **Andrew Mulley** and Product Manager **Michele Bandini**.*

Share your views!

Do you want to help drive ideas on the subject of data quality and servicing standards in European securitisation? We would like to hear from you. Email feedbackIssuer@citi.com to register your interest or send your feedback.

¹ European Commission (EC) (2015), laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012, EUROPEAN COMMISSION, Brussels, 30 September 2015.

² Prime Collateralised Securities (PCS) (2017), The PCS Mission, March 2017, accessible at <http://pcsmarket.org/about-pcs/>, last accessed on 30 May 2017.

³ European Central Bank (2017), Loan-level Initiative, <https://www.ecb.europa.eu/paym/coll/loanlevel/html/index.en.html>, March 2017.

Bank of England (2017), Eligible Collateral, March 2017, accessible at <http://www.bankofengland.co.uk/markets/Pages/money/eligiblecollateral.aspx>, last accessed on 30 May 2017.

⁴ European Central Bank (2014), Decision of the European Central Bank of 19 November 2014 on the implementation of the asset-backed securities purchase programme, (ECB/2014/45), available at <https://www.ecb.europa.eu>, last downloaded on 30 May 2017.

⁵ The Association for Financial Markets in Europe or AFME (2017), Data Snapshot AFME Securitisation: Q1 2017.

⁶ European Council, Council of the European Union (2017), Capital markets union: agreement reached on securitisation, 30 May 2017, accessible at <http://www.consilium.europa.eu/en/press/press-releases/2017/05/30-capital-markets-union-securitisation/>, last accessed on 31 May 2017.

⁷ AFME, High-quality securitisation for Europe, The market at a crossroads, June 2014.

⁸ European Central Bank (ECB) (2016), REGULATION (EU) 2016/867 OF THE EUROPEAN CENTRAL BANK of 18 May 2016 on the collection of granular credit and credit risk data (ECB/2016/13), ECB 1.6.2016.

⁹ Commercial Mortgage Alert (2017), Master Servicers (Ranking), Year End 2016, May 2017.

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