BANCA D'ITALIA
EUROSISTEMA

DIRECTORATE GENERAL FOR FINANCIAL SUPERVISION AND REGULATION FINANCIAL SUPERVISION DIRECTORATE
REGULATION AND MACROPRUDENTIAL ANALYSIS DIRECTORATE

Servicers in securitization transactions
Risk profiles and supervisory guidelines

The growth in non-performing loans on banks' balance sheets and the asset de-risking initiatives taken by financial intermediaries', also supported by the Bank of Italy, have increased business opportunities for companies operating in the market for the management and recovery of NPLs in recent years.

This has led to an increase in the number and total amount of securitization transactions, also in relation to non-bank assets (commercial receivables/loans, healthcare receivables/loans, etc.) contributing to the development of a diversified market with multiple players subject to different regulatory regimes (originators, investors and operators involved, in some way, in credit recovery activities).

In this context, the Bank of Italy stepped up its action vis-à-vis servicers (supervised entities that are active in servicing loan securitization transactions), with the aim of obtaining a comparative overview of the operators, assessing the functioning and adequacy of their organizational arrangements, and analysing the current regulatory framework.

Servicing activities in securitization transactions are governed at national level in Italy by Law 130/1999, which only allows banks and financial institutions in the Bank of Italy's Single Register (pursuant to Article 106 of the 'TUB' – the Consolidated Law on Banking) to collect transferred loans/receivables; to provide cash and payment services (Article 2, para. 3), and to check the compliance of such transactions with the law and with the information contained in the prospectuses (Article 2, para. 6-*bis*). By means of its Supervisory Provisions for Financial Intermediaries (Circ. 288/2015, Title III, Ch. 1, Section VII, para. 5), the Bank of Italy has provided a more detailed description of the prerogatives and risks associated with these activities.

It was decided to hand back servicing tasks for loan securitization transactions to banks and financial intermediaries as a result of the need to ensure effective compliance oversight of such transactions through the direct involvement of supervised entities specializing in the management of credit and payment flows. However, the checks carried out in recent years have highlighted the dissemination of market practices that are not fully consistent with the regulatory framework described above, which could hamper the achievement of the aforementioned aims.

For example, while the regulatory framework is based on the centrality of the servicer as the entity that is subject to prudential supervision, practices have emerged that are characterized by a clear distinction between the 'master servicer', i.e. the supervised entity responsible only for ensuring compliance which cannot be delegated,

as provided for by Law 130/1999, and the 'special servicer', an operator in charge of recovery activities, holder of a licence pursuant to Article 115 of the Consolidated Law on Public Security (TULPS), but not supervised by the Bank of Italy.

Recovery tasks are often entrusted to the special servicer under complex contractual arrangements, which are centred on the figure of the investor (and also on the choice of the special servicer), relegating the master servicer ('servicer') to a purely formal role, causing uncertainty about the scope of responsibilities in the area of portfolio management, especially in cases of underperformance in credit recoveries. This has led to an opaque identification of the entities actually involved in credit recovery activities and has limited the powers of the supervisory body, against the background of a regulatory framework that, by overseeing the outsourcing of important operational functions, aims instead to ensure that servicers are able to monitor and manage the risks associated with the activities entrusted to third parties, while remaining responsible for them.

From an organizational standpoint, how servicers are structured is not always well suited to the greater operational complexity, thereby exposing them to operational and reputational risk. Deficiencies are often found in their internal control and operational risk management systems, as are weaknesses in how they manage relationships with special servicers, during both the initial assessment of the special servicers they engage and the ongoing monitoring of their recovery rates. This latter activity, especially among small intermediaries, sometimes lacks sufficient analysis of the extent and significance of deviations from the business plans and, therefore, does not provide critical insights to be shared with the management bodies in the periodic reports on the status of transactions handled.

As in the securitizations of non-performing loans backed by State guarantees (GACS), these risk profiles also relate to segments of activities for which, in addition to the protections set out in Law 130/1999 cited above, it is necessary to safeguard the public interest.

Therefore, bearing in mind the market dynamics that have encouraged the spread of the practices described, any solution adopted can neither marginalize the servicer's role nor take a minimalist approach in defining structures and internal procedures. Servicers are thus invited to carefully assess the impact of such operating procedure templates on their liability and risk profiles and, more generally, on the transparency and integrity of the securitization market.

Beyond the content of the agreements between the parties to the transactions, left as such to their contractual autonomy, given the existing regulatory framework, the servicer remains, in fact, the entity that is expected to provide the Bank with an overall view of the transactions handled. It should therefore be stressed that servicers must immediately take measures to ensure that their organizational and control structures are consistent with the role entrusted to them by lawmakers, following a business model that guarantees informed and ongoing participation in all aspects of securitized loan management, for example by reacting promptly to anomalous situations and to recovery flow trends that are below their business plan projections when special servicers are involved.

The servicer's governance bodies must actively promote a renewed and reinforced perception of the company's role and responsibilities, ensuring that there is an adequate degree of enforcement at all organizational levels involved in monitoring securitization transactions and protecting against the underlying risks.

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The growth, current and future, of the securitization market also means that servicers should provide the Bank with updated and comparable data on the performance of individual transactions by including them in their periodic reports on securitization transactions handled.

Two special templates have therefore been prepared, one for securitization transactions backed by a public guarantee (GACS) and one for other types of transactions. They will be available on the INFOSTAT platform by the end of this month, along with instructions on how to complete them.

The templates must be submitted by banking and financial servicers every six months by the 20th day following the reference date. The first report must refer to the situation at 31 December 2021.

The templates, containing general information on individual transactions and detailed data on revenue and recovery trends supplement, but do not replace, the information already submitted through ordinary supervisory reporting.