

How credit market conditions expose challenges of securitization technology systems*

by Dave Hoffman, John Gibson, Christopher Scarpati
and Keith McConchie



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Due to the ongoing liquidity crunch and a lack of a secondary market activity for many types of securitized instruments, organizations must now rely more heavily on financial models to support valuation prices. These valuation models are driven by assumptions around the performance of the underlying asset level collateral. Inaccurate or incomplete collateral data can have a significant impact on the valuation results and attendant reporting and compliance. Going forward, investors and ratings agencies will expect issuers to provide more detailed underlying collateral data than has been provided in the past that can be analyzed objectively. Those issuers whose systems can provide granular data which can be analyzed objectively will garner the confidence of investors and rating agencies.

Issuers also face the pressures of SFAS (Statement of Financial Accounting Standards) 157, the new standard in effect since reporting periods after November 15, 2007. This standard defined requirements for establishing the fair value of financial instruments including detailed disclosures around valuation sources, methodologies and assumptions.

If issuers fail to respond to the expectations of investors and rating agencies and the requirements of SFAS 157, they will continue to risk their credit ratings, their reputations and their ability to issue securities efficiently.

Issuer challenges

The processes and technology supporting issuers' securitization activities are often less mature or robust than other data collection or reporting functions within the institution. Many companies rely on an inconsistent set of tools and solutions that may have been developed organically within organizational silos and are frequently not well integrated or flexible. This situation frequently results in:

- **Inefficient and inadequate processes and technology.** In many cases, activities are relegated to the back office or reliant on the IT organization to provision the data. In others, data may be maintained on simple spreadsheets without adequate controls. In either situation, data needs to be managed significantly as information is updated or revised throughout the lifecycle of a securitization transaction. In both situations, data is significantly altered as information is updated or revised throughout the lifecycle of a securitization transaction. Currently this data cannot be made easily available to others, such as investors and rating agencies, so they can independently analyze it.
- **Weak control environment around data collection, manipulation and reporting.** Data stored on individual computers and spreadsheets increases the risk of unintended data manipulation or quality problems.

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- **High-risk exposures around the inaccurate production of information.** Data quality is a significant concern, and companies often rely on only one individual for critical tasks.

These inefficient processes, siloed systems, and lack of controls drive up costs and inhibit the ability to execute effectively in the marketplace. Ultimately, they will result in significant limitations on the ability of an issuer to bring deals to market, negatively affecting balance sheet management and profitability.

Going forward, we believe issuers are going to have to present data in a way that allows investors to perform their own analytics. For mortgage-backed securities, that means exposing underlying credit scores and other indicators of borrowers' creditworthiness, loan-to-value ratios, differences in default definitions and an array of other information.

A changing market environment

In addition to the higher level of scrutiny and the demand for more granular asset-level information and historic performance data, there are likely to be a number of additional impacts, including:

- **Reg AB-like reporting will become the new market standard.** Whether or not actual new regulations are imposed, the marketplace is going to hold issuers to that type of standard. Investors will expect more

detailed reporting and greater standardization across asset types consistent with Reg AB and other industry requirements.

- **Issuers will become more focused on their ability to be agile when taking deals to market.** With the increased likelihood of future market volatility, issuers will want to be able to move more quickly and take advantage of periods when spreads are more favorable. This will make it essential that issuers can present data in a transparent and credible fashion, enabling decisions to be made quickly.
- **There will be a heightened risk of data disclosure errors.** Because of the impact of subprime-related defaults, these issues are at the forefront of awareness for perhaps the widest audience ever. This means that data inaccuracies will have a ripple effect, not only on the issuer's pricing but on investors' perception of the issuer itself.

How to respond

Participants in the securitization market have a range of opportunities and alternatives to improve their securitization systems. They will need to employ a multi-faceted solution that deals in a coordinated way with business processes, controls and technology—building an operating architecture whose central function includes analysis of valuations and ensuring that the valuation process is tightly controlled and prevents inconsistent

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and ad-hoc decisions. Robust technology solutions are available that will give issuers the ability to maintain these controls, flag exceptions, and provide investors with the data and the confidence they require.

Financial institutions should evaluate and implement some combination of the following responses, including:

- Standardizing data to improve efficiency and consistency of reporting, both within a particular asset platform as well as across multiple platforms.
- Streamlining processes and enhancing controls to reduce manual data manipulation and focus on producing high-quality and error-free information.
- Realigning organizational responsibilities for greater efficiency and accountability around data collection and reporting.
- Integrating or remediating spreadsheets and local databases through automated means such as XML integration technology and implementing standard data dictionaries to improve the automation and flow of information.
- Implementing new, more commonly available technology solutions to enhance efficiency, data standardization and controls.

- Enabling the consistency and security of data moving between market participants to facilitate transparency and increase efficiency.

The solution for each institution will be unique based upon its strategy, operations, size and other factors. Enhancing the securitization infrastructure will provide meaningful advantages including faster, more effective management of the balance sheet, efficient transaction processing, reduced risk of error and more timely execution.

How to take advantage of the opportunities

The benefits that will accrue to leaders in this market are significant. We believe an efficient infrastructure and transparency around securitization operations will become a commonly accepted norm for taking a deal to market. Issuers now have the opportunity to enhance their brands and distinguish themselves in the marketplace through more robust disclosure and timeliness of information. Issuers are also likely to achieve better pricing through increased transparency as investors better understand what they are buying. A robust securitization infrastructure can provide the operational agility to shorten deal timelines, take advantage of spread movement and reduce the operational risk to an organization. Even just a few basis points savings on a multibillion dollar transaction can have a real impact on the bottom line.

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The advantages to moving quickly—enhanced reputation and confidence among investors and rating agencies, competitive advantage against late adopters, potentially better pricing and greater speed to market—are clear and compelling. Forward thinking issuers are already moving in this direction, and the marketplace is going to demand a continuation and an acceleration of these improvements in the months ahead.

About the authors

Dave Hoffman and John Gibson are Partners with PricewaterhouseCoopers LLP, the leading advisory, assurance, and tax services provider to financial services organizations. Dave Hoffman co-leads the firm's Southeast Region Financial Services Advisory practice. John Gibson is based in the Washington, DC office of PwC's Structured Finance Group. Christopher Scarpati is a Director in the Metro New York Financial Services Advisory practice. Keith McConchie is a Director in the Structured Finance Group and leads Securitization Technology Services.

For more information about securitization technology systems, please contact:

Dave Hoffman
(703) 918-3856
j.david.hoffman@us.pwc.com

John Gibson
(202) 414-4691
john.l.gibson@us.pwc.com

Christopher Scarpati
(646) 471-7099
christopher.v.scarpati@us.pwc.com

Keith McConchie
(202) 414-1471
keith.mcconchie@us.pwc.com

www.pwc.com

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