



**Back-Up Servicing for European Financing Programs:  
How to get the money back for Lenders**

**LOANCOS White Paper Series**



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## Why Back-Up Servicing?

Back-Up Servicing for financings refers to the arrangement where a third-party servicer is appointed to step in and take over the servicing of a loan or other financial asset if the primary servicer becomes unable to fulfill its obligations.

In other words, if the primary servicer experiences financial distress or operational issues that prevent it from properly servicing the loans, the Back-Up Servicer is ready to step in and ensure that the loans continue to be serviced according to the terms of the financing agreement.

The purpose of Back-Up Servicing is to mitigate the risk of disruption in loan servicing, which can have significant consequences for both borrowers and lenders. By having a Back-Up Servicer in place, lenders can be assured that their investments will continue to be properly serviced even in case of unexpected events affecting the primary servicer.

### **Back-Up Servicing is at the heart of getting money back for Lenders**

If the operating platform is no longer able to fulfill its duties, then all new business activity is immediately terminated. It is the role of the Back-Up Service to step in and manage a proper run-down of all existing businesses and to ensure that any financing extended to the platform by lenders is fully repaid.

A fully functioning Back-Up Servicing arrangement in place is effectively working like an insurance policy: It will be looked at favorably by Rating agencies that will reflect the arrangements also in their rating report for the Capital Markets and the investor community.

### **Transactions having an actual Back-Up Servicer in place are considered to be much stronger than simply having only a Back-Up Servicing facilitator**

In general, financing structures that have a Back-Up Servicing arrangement in place, are considered to be stronger and more resilient than arrangements that only have a Back-Up Servicing "facilitator" in place. The role of the Back-Up Servicing "facilitator" is to start to look for a Back-Up Servicer after the operating platform has gone bust, which may be too late to recover outstanding claims if no bankruptcy-remote arrangements were put in place beforehand. Post-insolvency sorting out access to bank accounts will be very difficult in order to establish ongoing direct debits. This is the key requirement for effecting a successful job as Back-Up Servicer. Post-insolvency will require dealing with the insolvency administrator on an ad-hoc basis, which is always a challenge in the middle of a crisis.



While a Back-Up Servicing “facilitator” is generally considered to be a very cheap solution, it may lead to more unfavourable results.

Any delays in finding and setting up an actual Back-Up Servicing will most definitely lead to significant time delays, losses, and shortfalls for the Lenders.

## LOANCOS Back-Up Servicing

**Solution for Financers of Securitisation structures, Embedded financing programs, Contracting structures, Forward Flow managers**

**Contribute to full financeability on the Capital Markets**

The LOANCOS Back-Up Servicing offering caters specifically for the needs of Financers of Securitisation structures, Embedded financing programs, granular Leasing structures Contracting structures and all other platforms that manage forward flows with Third-party financing.

Key services include:

- Cash management for entire pool of outstandings
- Stabilisation of all incoming expected payments
- Ensure controlled, insolvency-proof and managed Run-down

Thus, contributing to the certainty of financing transaction closure and to full financeability on the Capital Markets.

**Time to get activated: Between Hot and Cold Back-Up Servicing**

The easiest way to prepare for an actual crisis scenario, when the operating platform is no longer able to fulfill its duties, would be for the Back-Up Servicer to provide an entire shadow infrastructure with people and processes, allowing it to take over on the spot. However, this would be the most expensive solution.

Given that there may be some leeway before an actual activation is required, a more efficient and economical solution could be deployed, making Back-Up Servicing more efficient to establish and maintain, whilst still addressing the risks and catering for individual business processes.



The guiding rule for putting a Back-Up Servicing concept in place that actually works, ample time needs to be dedicated beforehand so that all necessary steps can be prepared.

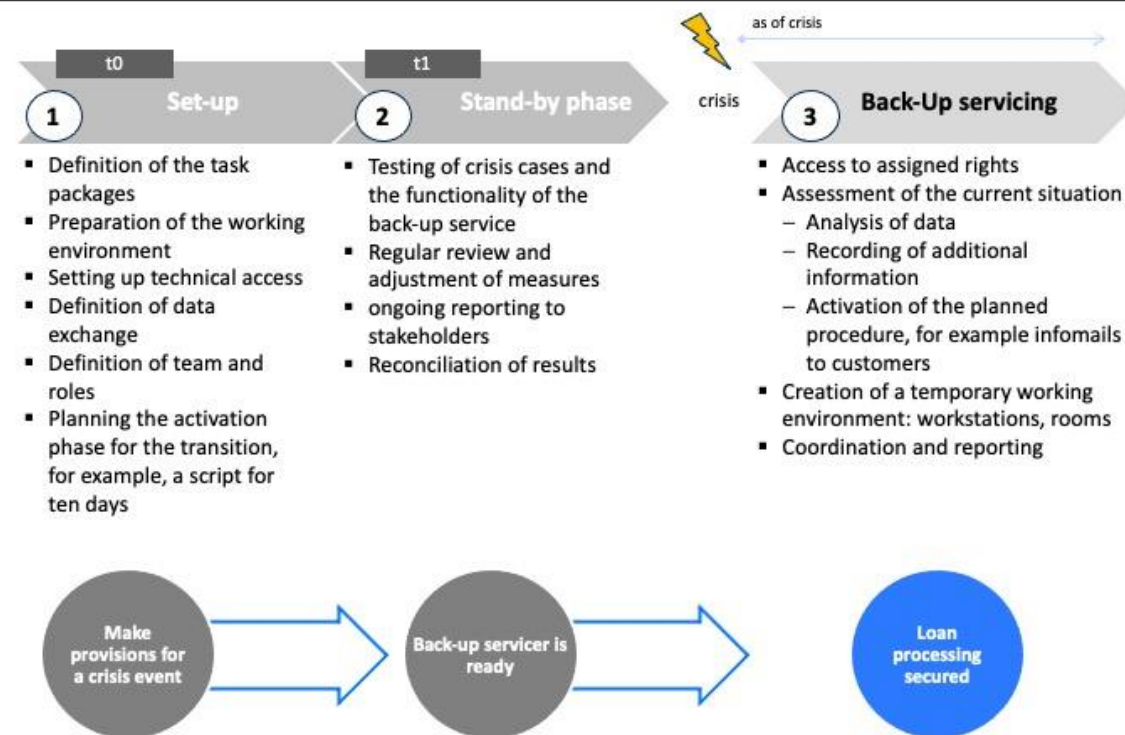
Challenges emanate from time and quality prerequisites. A common requirement is to minimize the time for activating a Back-Up Servicer so that processes can be taken over quasi on the spot. To that extent, detailed clarification is required to establish the availability of all necessary IT systems or printers for sending out statements or client communication, or if lead time would actually be longer than anticipated. Can people capacity be scaled up without delay to process entire loan portfolios?

Obviously, a more or less seamless activation comes at a higher cost, due to the effort required to maintain all necessary prerequisites, than an activation with more time. The scope and extent of Back-Up services requested, is set out and documented as part of the legal contract.

Market practice is to distinguish 3 types of Stand-by: Hot, Warm and Cold. Hot Stand-by entails a very short time for getting activated, which obviously comes at a cost. Warm Stand-by is equal to a medium time for getting activated, while Cold Stand-by allows for a longer time for getting activated. While Hot and Cold Stand-By typically reflect both ends of the spectrum, Warm Stand-by allows taking a more practical and cost-efficient view, given that a medium activation time can be obtained at less cost than a Hot Stand-by, without the need to go for a rather lengthy Cold Stand-by activation time.

**There is always a trade-off: The shorter the time for taking over as Back-Up Servicer, the more effort and capacity is required beforehand, and vice versa.**

## Three steps of Back-Up servicing



### Set-Up: Preparing for the activation event

During the Set-Up phase, a framework for the Back-Up Servicer is set out regarding the scope and extent of services required, such as:

- Should direct debits be effected using the same bank account or is a different bank account required? All necessary authorisation for accessing and managing the bank account will need to be established beforehand.
- What communication is required for retail clients, also with a view to the activation event?
- What lead time is necessary? Should all necessary communication be prepared Up-front? Is a written communication by letter or e-mail required?
- Is there any specific know-how required also going forward?

### Determine processes that are key for succeeding as a Back-Up Servicer

Identify individual staff required to continue to effect processes. Do manuals documenting policies and procedures provide sufficient transparency? Which IT systems need to be accessed? How can access be affected?

Is staff allocated for effecting activity as Back-Up Servicer sufficiently trained in using IT systems that need to be used following the activation event? Are there training concepts? Are specific locations required where processing activity should be affected?

In theory, a Back-Up Servicer could as early as during the Stand-by phase have all systems, processes and staff in place necessary pertaining to an activation event, which would be a high effort and quite expensive.

Therefore, the big challenge in the Set-Up phase is to define a common goal, considering different scenarios for a solution. The key to the solution is to focus on the extent of processes and functions that qualify to be continued by priority.

This is how to identify the rules jointly and systematically for working together in a Back-Up Servicing activation scenario. Among the scenarios, the Back-Up Servicer would take over the existing staff of the operating platform. Another scenario could be that the operating platform and the Back-Up Servicer could put their capacity together in a pool, so that defined functions can have a common Back-Up.

### Stand-by: Maintain, Test, Further develop

In Back-Up Servicing, the Stand-by phase is the most important time, with the Back-Up Servicer being on Stand-by for getting into action following defined activation events and to take over from the operating platform.

The Stand-by phase requires the operating platform and the Back-Up Servicer to work together closely. Among the regular activity is for the Back-Up Servicer to obtain updates e.g., on a quarterly basis regarding ongoing changes within the operating platform, including:

- Changes affecting the IT systems
- Process changes
- IT systems access testing, also taking into account password update procedures
- Number of staff deployed by the operating platform,
- Maintenance of service levels.

The Back-Up Servicer has to assess on an ongoing basis whether the risk of getting activated may materialize. Part of that is to come up with a view whether capacity defined is sufficient for taking over services from the operating platform. To that extent,

the Back-Up Servicer needs to be kept in the loop on any essential changes affecting the way that the portfolio is managed.

Defining a structure for governance is a key element at the beginning of the Set-Up phase, e.g., reporting content, update of key documents and regular meetings. To avoid chaos following an activation event, there have to be detailed procedures setting out how reporting chains and activation steps look like.

It is strongly recommended to effect testing for data transfers, system access and processes on an ongoing basis, so that further development and improvement can be affected.

### Effecting the actual Back-Up-Servicing: Ensure ongoing processing

Only after the actual activation event, it can be demonstrated whether all processes that have been prepared and documented in the process manual are working as envisaged and whether all IT system access can be fully activated, and data be transferred to target systems.

This is the time, when quick decision-making is essential for the Back-Up Servicer to successfully take over the activity as set out in the process manual. Typically, staff that was already involved in the Set-Up phase and in subsequent fire and activation drills should be tasked with coordinating and communicating. That way, the best knowledge transfer and continuity can be achieved, thus minimizing any losses regarding important information or knowledge gaps, also helping to establish capacity and clarity for action.

Taking over the entire portfolio and effecting a controlled run-down will require fully deploying capacity and resources, so that the Back-Up Servicer can do the job and get the money back for Lenders.

### Case Study Vivacon: How LOANCOS managed to get the money back for Lenders

Following the insolvency of S-DAX-listed Vivacon AG in 2014, a 4bn Euro real estate platform with more than 20,000 granular ground leases and over 10,000 granular residential properties on a countrywide level, LOANCOS was the only Back-Up



Servicer in Germany that ever got activated and managed to get the funds back (several hundred million Euros) for investors and creditors.

To stabilise the entire platform as a Back-Up Servicer, LOANCOS was tasked to take over functions as follows:

- Cash management: collect, account, control and effect dunning for all ground lease payments from 20,000 ground lessees on an ongoing basis
- Intensive care: Determine standards on how to deal with missed payments, i.a. collections, settlements based on pre-defined policies incl. continued use of any existing arrangements with DCAs to collect past due items after specific outstanding time or to sell to DCAs any items past due a specific outstanding time
- Manage ground lease transfers: Individual contract review using owner perspective esp. with a view to any necessary approvals, using prior delegated authority
- Ground lease increases: Effect ground lease increases as contractually agreed on a regular basis
- Maintain data at current level on an ongoing basis
- Data storage: Contract availability for effecting ongoing Servicing
- Reporting: Effect ongoing Reporting as per requirements; including for bond securitisation purposes
- Effective ongoing Relationship Management

The key prerequisites included to

1. Have a comprehensive process manual beforehand in place, so that all teams involved in taking over the active role know exactly what needs to be done in an activation scenario
2. Ensure full process automation support through adequate IT and software system deployment as essential enablers
3. Pull together all information for Management, Execution, Control and Reporting in one Data Ware House (DWH)

**LOANCOS was in a position to successfully get the money back for the Lenders**

## Instead of a conclusion

COVID-19 experience has shown that unexpected events can have a serious impact on operational businesses. Therefore, pragmatic and well-thought-through Back-Up Servicing concepts are absolutely essential to establish resilient financing programs that can survive so that Lenders can get their money back, also in case of unexpected negative effects on operating platforms financed.

The key is to have efficient solutions in place, enabling Back-Up for key processes when collecting funds and running down the entire program. However: It will not be sufficient to preserve the status quo. Even existing concepts need to be challenged and reviewed on an ongoing basis so that they can be further developed as and when required. This is the way that Back-Up Servicing can add value, even during the Stand-by phase.

## About LOANCOS

The LOANCOS Group is the largest independent credit platform for building and managing real estate loan portfolios in Germany. It enables credit institutions, insurance companies, and investors to efficiently and scalably manage loan portfolios, particularly in the real estate loan business. LOANCOS combines extensive expertise and technological solutions to provide effective credit management. With its modular outsourcing platform, LOANCOS serves as an enabler for new real estate financing businesses and seamlessly integrates with intermediary platforms within the value chain. This integration facilitates banks and insurance companies in establishing or expanding their construction financing operations with flexibility. The Business Process Outsourcing (BPO) platform offered by LOANCOS provides comprehensive support for all credit processes, ranging from loan origination and disbursement to intensive servicing and work-out (special servicing).

The LOANCOS Group offers all forms of back-up services for companies in various industries in Germany. [www.loancos.de](http://www.loancos.de)

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