

## Servicer Evaluation: GFKL Financial Services AG

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# Servicer Evaluation: GFKL Financial Services AG

## Opinion

Standard & Poor's Ratings Services' ranking on GFKL Financial Services AG (GFKL) is STRONG as a special servicer of consumer finance in Germany.

GFKL has a number of subsidiary collection companies, but our ranking in this report applies to only two of these: Proceed Collection Services GmbH (PCS) and Sirius Inkasso GmbH (SI). Both companies act on behalf of third parties or manage portfolios owned by the GFKL group, but for different asset classes.

The STRONG rankings reflect the following:

- In 2010, GFKL sold ABIT, a software provider subsidiary, to focus the group business on receivable management.
- All of GFKL's subsidiaries have applied a new financial system, designed to improve setting and monitoring of the group's strategy.
- We consider PCS and SI to show appropriate operating structures, tailored to service the different types of assets under management.
- Both companies have each appointed a separate managing director, mainly focused on commercial activity, to strengthen client and investor outreach.
- PCS's portfolio has remained stable and it has counterbalanced the number of closed receivables by acquiring new ones.
- SI's portfolio has continued to grow and it has established a branch in Hamburg, following a new agreement signed with one of its anchor clients.
- PCS and SI have reported results in line with their targets, despite the adverse economic environment.

## Outlook

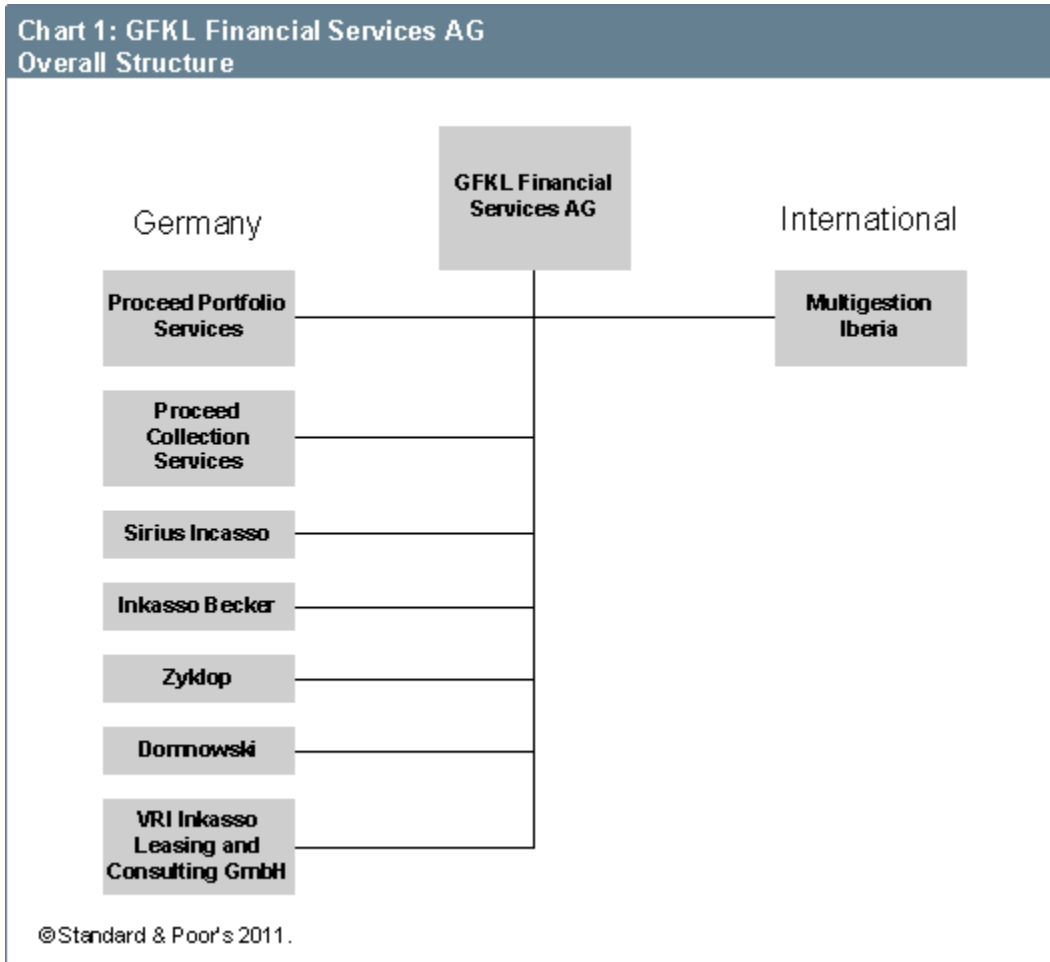
The outlook is stable for GFKL as a special servicer of consumer finance. This outlook reflects our confidence that the structure and operations at group and company levels will help maintain SI and PCS's performance and support future development.

## Company Profile

GFKL is a holding company owning a number of subsidiaries. In 2011, it changed its multi-brand strategy to a one-brand-strategy. Following the relaunch of the brand "GFKL", the corporate design of all subsidiaries has been merged. Four different types of credit products are managed by GFKL's subsidiaries: mortgage loans, consumer credit, small receivables, and commercial receivables.

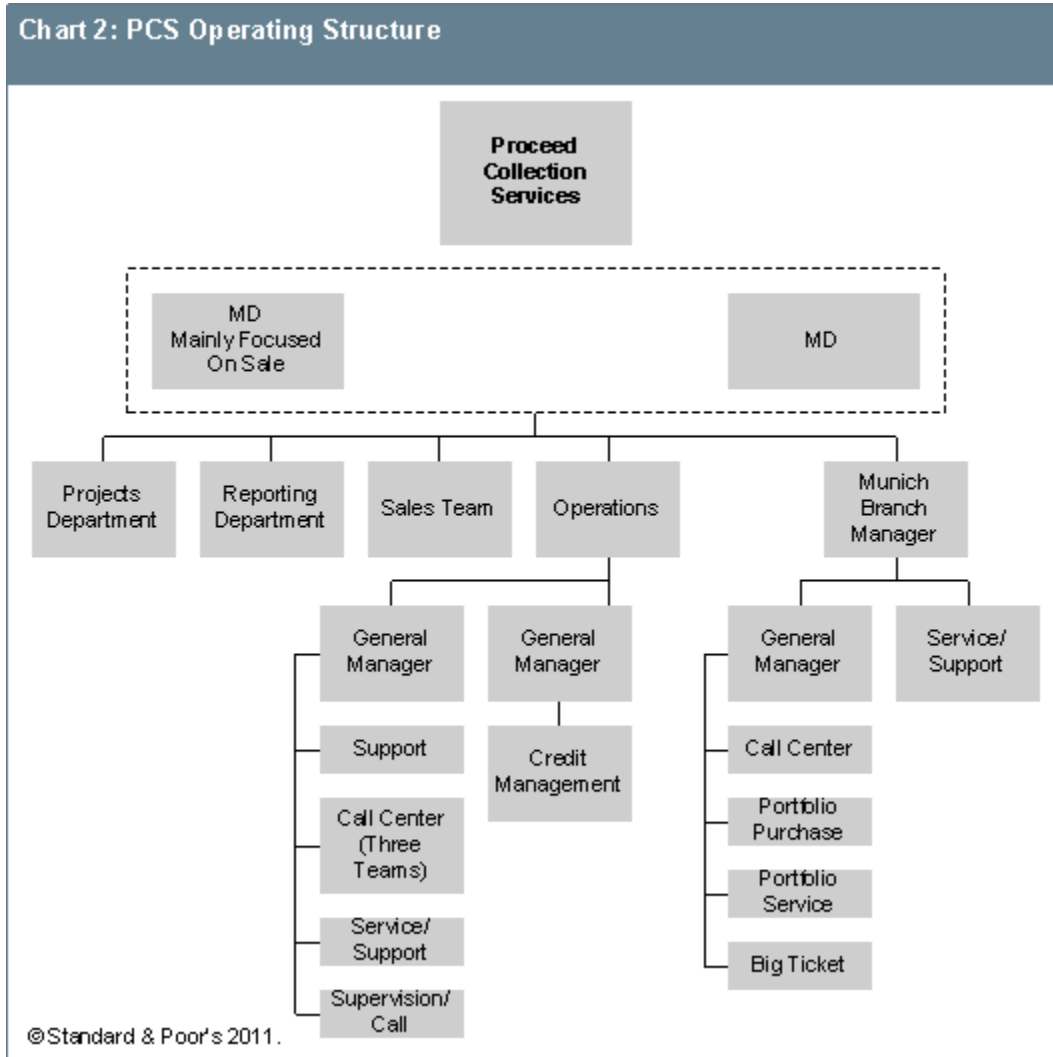
GFKL was originally established in 1992 as a leasing company. In 1998, it expanded into the servicing of nonperforming loans on behalf of third parties, and for its own portfolios. It founded SI in 2003 and acquired PCS in 2006. The group also entered the software business through the acquisition of ABIT, a loan management system

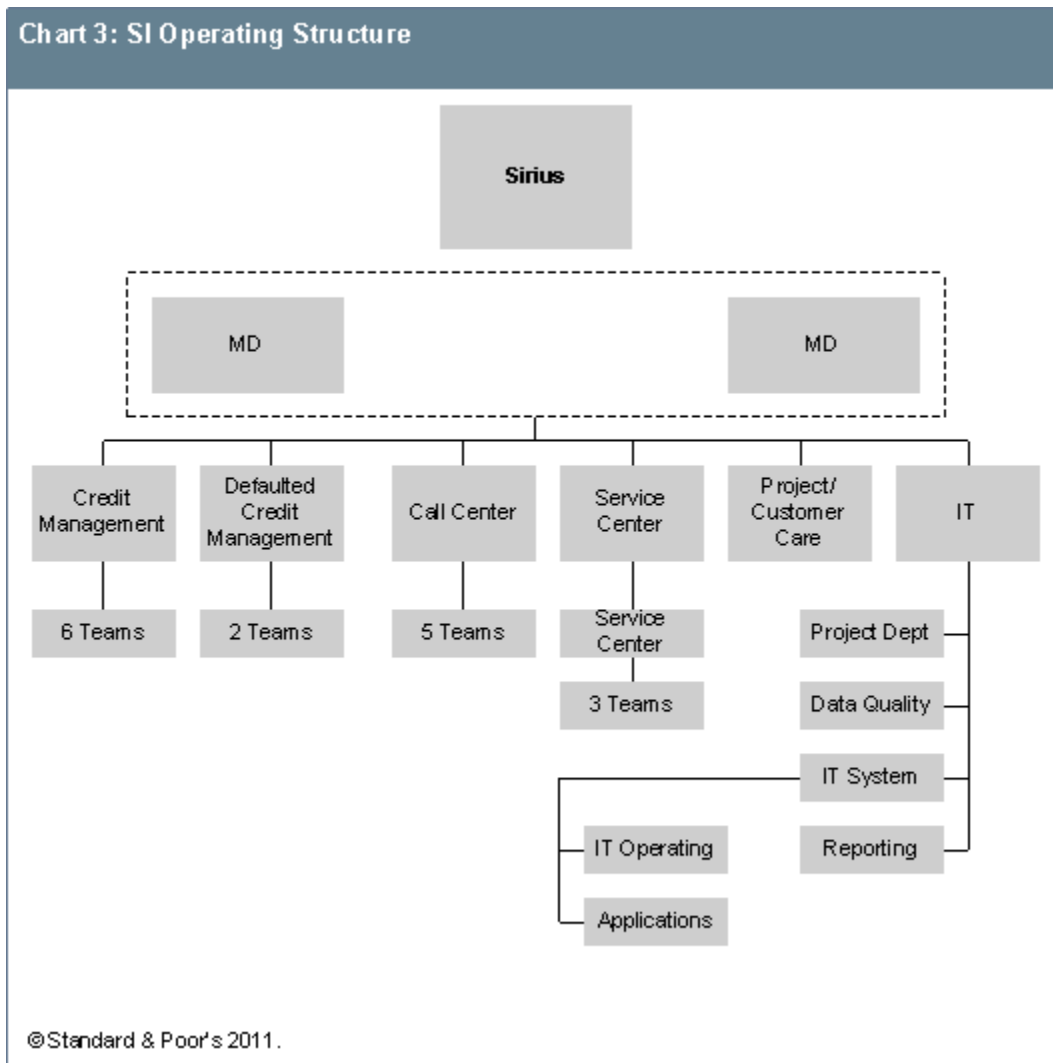
provider. As opportunities opened in collection and debt purchasing business, the group changed strategy, consolidating the main business and dismissing all the others. It wound up the leasing business in 2008 and sold ABIT last year. Chart 1 shows the position of PCS and SI in the overall GFKL structure.



As with all GFKL's subsidiaries, PCS and SI share a common business approach, which was set up by the mother company. They also receive support by group resources for accounting, controlling and risk management, treasury, and HR human resources.

However, the two companies have different operating structures, tailored to service the respective assets under management. Charts 2 and 3 show the PCS and SI operating structures.





PCS services unsecured consumer loans and residential mortgage loans, averaging €17,000 per loan, for the banking sector. SI services receivables with an average size of €300. Together, they work on a portfolio of €8 billion—almost 40% of GFKL's €21.5 billion overall portfolio.

As of June 2011, PCS had 155 full-time-equivalent employees (FTEs), working on approximately 423,000 claims totaling nearly €7.3 billion. Its portfolio includes cases associated with formerly insolvent companies. Consequently, the management services are tailored to single loans, rather than being standardized.

PCS has two offices, located in Essen and Munich. The Essen office works mainly on portfolios comprising loans with low nominal values, while the Munich office focuses on portfolios comprising loans with higher range nominal values.

PCS' call center operators and loan managers are pivotal elements of its business model. Therefore, the company structure, in both offices, incorporates two main departments: one focused on phone collection and administrative support, and the other focused on loan management (see chart 2).

As of June 2011, SI employed 217 full-time-equivalent staff (FTEs) dealing with 1.6 million claims for a total volume of €411 million. It applies a standardized collection strategy over a wider number of credits, so operations are more automated and supported by electronic systems whenever suitable. Consequently, SI has an internal IT department beyond the IT support provided by GFKL at group level. Due to the higher number of files to deal with, SI's phone collection and administrative support functions are separated into two departments, instead of the single one in PCS (see chart 3).

SI services bulk receivables (small tickets, large numbers) for insurance companies, telecoms, utilities, and mail order companies. It operates from four locations in Germany: Dusseldorf (head office), Dresden (additional call center team), Cologne (additional team for receivable management), and Hamburg (working on a portfolio of one of its anchor clients). (See chart 3.)

Table 1 shows assets the evolution of assets under PCS and SI's management.

**Table 1**

<b>Evolution Of Assets Under PCS And SI Management</b>					
<b>(€)</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Insurance receivables	72,278,729	93,307,243	128,047,527	146,351,505	172,284,152
Telecommunication receivables	1,977,233	28,765,446	61,395,939	62,021,118	62,847,219
Commerce receivables	49,159,949	56,897,056	198,813,718	182,219,209	175,795,443
<b>SI total portfolio (OPB)</b>	<b>123,415,911</b>	<b>178,969,745</b>	<b>388,257,184</b>	<b>390,591,832</b>	<b>410,926,814</b>
Consumer loans (unsecured)	6,190,614,046	6,922,498,177	7,522,990,237	7,438,440,007	7,284,516,423
<b>PCS total portfolio (OPB)</b>	<b>6,190,614,046</b>	<b>6,922,498,177</b>	<b>7,522,990,237</b>	<b>7,438,440,007</b>	<b>7,284,516,423</b>
<b>GFKL total portfolio (OPB)</b>	<b>11.9 billion</b>	<b>14.2 billion</b>	<b>14.7 billion</b>	<b>14.3 billion</b>	<b>13.8 billion</b>
<b>GFKL total portfolio (total claim)</b>	<b>16.5 billion</b>	<b>20.8 billion</b>	<b>23 billion</b>	<b>23 billion</b>	<b>21.7 billion</b>

OPB--Outstanding principal balance.

GFKL is ultimately owned by Advent International, a global private-equity firm, which acquired a majority shareholding in GFKL in 2009.

## Management And Organization

Our subranking for GFKL's management and organization is STRONG.

### Strategy and growth objectives

GFKL has consolidated its position over time. It now operates across Europe, with a focus on Germany and Spain, since it sold its Italian subsidiary, Locam SpA, in September 2010.

GFKL informs us that it is constantly working to strengthen the group business culture and has realized several projects since our previous review of the company (see "Servicer Evaluation: GFKL Financial Services AG," published on Sept. 6, 2010). For example:

- An overarching finance system has replaced subsidiaries' former separate ones, aimed at increasing integration and efficiency in business planning.
- A newly-created steer committee now implements projects, aimed at improving the quality of the service to clients; as of today, there are 64 such initiatives.

- A "Best Demonstrated Practice Sharing" scheme now identifies the best processes in a single GFKL subsidiary, and implements it in all the other companies of the group. To this end, all subsidiary operation managers attend a monthly workshop.

PCS has boarded eight new portfolios since our previous review—six in 2010 and two in 2011—either as investment or for pure servicing activity, thus maintaining a stable level of assets under management.

SI is currently working for 23 German insurance companies; during 2010, it added three important new clients to its portfolio, which we consider as a demonstration of its strong capacity to attract new business. Specifically:

- In July 2010, SI added to its portfolio 60,000 new positions from one of its anchor clients, a German insurance market leader. To look after this new portion of the business, it has set up a new office with 12 staff members in Hamburg (five having transferred from the anchor client itself).
- In October 2010, SI boarded 25,000 new positions from another anchor client and established a legal unit in Cologne to deal with collections for this mandate.
- In November 2010, SI boarded 30,000 new claims from another important insurance company.

In our opinion, these two subsidiaries of GFKL have clear strategies and focus on the future. Since our previous review, both have maintained stable portfolios and acquired new business. We consider both to have strong commitment to future development.

### **Staff and training**

In 2010, PCS and SI appointed new managing directors to focus on market outreach strategies. PCS has extended its senior management team by promoting the former sale director to second managing director, who is responsible for commercial activities, and senior management duties shared with the former managing director, who now focuses on operations and staff. SI already had two managing directors when we previously reviewed the company. After one of them left for a new position in GFKL, SI appointed a new external manager and redefined the role to focus on commercial, rather than operational tasks.

At the end of 2010, there were 1,524 FTEs in the GFKL group, the same as in 2009. PCS staff remained stable at 145 FTEs in 2010 compared with 145 in 2009, reporting a turnover rate of 12.97%, which is low by market standards. SI substantially increased its employee headcount, in line with the growth of its portfolio. By end of 2010, SI staff numbers reached 197 FTEs, from 175 in 2009, and it reported a turnover of 5.74% within the past year.

The human resource department is provided at group level. GFKL supports its subsidiaries in hiring, staff appraisal, and training. In our opinion, GFKL has a strong commitment to training and has a professional approach to the continuing education of all its employees. Similarly, there is a clear appraisal procedure in place.

GFKL has 28 internal trainers, 25 of which are PCS employees. Training needs are identified using a top-down approach (when they are planned to inform staff on GFKL strategy, new regulatory requirements, or market updates), or a bottom-up approach (when a subsidiary asks for specific training). In 2010, PCS and SI conducted more 12 hours of training, on average, per employee. This training covered compliance, law, general call center expertise, anti-money-laundering, and GFKL's collection policy. All staff are subject to compliance training when hired, and throughout their tenure.

In our view, all GFKL's subsidiaries apply transparent evaluation processes of the workforce. Each employee sets annual goals with its line manager, following an established procedure. Managers measure these predefined

objectives semiannually, using defined metrics, and assign bonuses according to personal and team achievements. At the end of each year, staff are appraised using a scale with three possible benchmarks: fulfilled, partially fulfilled, or not achieved at all.

**Table 2**

<b>Average Years Of Industry Experience/Company Tenure In 2010</b>		
	<b>Senior managers</b>	<b>Middle managers</b>
<b>PCS</b>		
Experience	19.95	22.89
Tenure	7.20	6.60
<b>SI</b>		
Experience	25.38	17.37
Tenure	6.01	5.63

### Internal/external auditing

PCS and SI are subject to internal audits by GFKL, which has established a corporate auditing department, consisting of three employees that report directly to the executive board at group level.

GFKL has a long-term strategic auditing plan in place, which covers the whole group; each subsidiary is subject to a full audit review at least every three years, while each operational function is reviewed semiannually. Auditors formally document outcomes and report them to the highest level, i.e., the executive board.

GFKL has an audit planning process, which identifies areas to be reviewed, by measuring risks associated to specific operations. This process follows a risk matrix to determine priority and frequency of each audit review. It also provides instructions to identify the appropriate auditor for each review. Once the audit plan has been developed and the allocation of resources has been planned, auditors seek board approval.

The audit then starts with the notification to the selected unit, detailing the focus and strategy of the audit before it is undertaken. Auditors then produce detailed reports on the results and distribute these to the executive board and the risk manager. The board also received an annual report on all internal audits undertaken.

GFKL's auditing department is responsible for all follow-up action, namely the implementation of all necessary and recommended measures. Since early 2009, GFKL has been using software to support the auditing process and trace its activity.

GFKL is also subject to external audits: a year-end examination by Ernst & Young, an asset audit, and audits performed by clients at their discretion. For example, PCS was subject to four clients' audits in 2010—by Unicredit and WestLB, among others. No clients reported any issues.

GFKL has sent us copies of the German version of the 2010 internal audit for PCS and SI and informs us that no significant issues were highlighted.

### Risk and compliance

GFKL oversees risk management and compliance at group level.

Established in 2002, the risk-management team has a solid track record. It now comprises 13 members and reports directly to GFKL's management board. Internally, the group is divided into two areas of responsibility: collection

and software. This reflects a greater emphasis on IT-related risks than we tend to see at other servicers.

The risk management department develops and implement group risk strategies. This process includes: identification, assessment, and mapping of risks, as well as reporting on potential damages that could occur if any risk materializes. Results of the risk management analyses are merged into a risk matrix, risk report and risk management handbook. Senior management review the monthly (including quarterly, and yearly) risk reports, which enable GFKL to monitor and, if necessary, quickly adjust the core processes from initial input to foreclosure measures. The management and supervisory boards share the yearly risk reports with investors.

We understand that, since our previous review, there have been no significant changes to GFKL's risk-management process or to the compliance framework. Its internal control systems involve particularly robust risk management procedures, in our view.

There are standard procedures in place to deal with all complaints, and there is a separate complaints-handling team. Both PCS and SI have not experienced any litigation related to their activities and by industry standards have a low level of complaints, which we consider to be appropriately documented.

### **Policies and procedures**

GFKL's respective departments operate with fully documented policies and procedures, covering all critical functions and processes. Staff can access all procedures electronically through a shared network drive. The personnel department advises to all employees changes to regulatory and internal procedures. Appropriate control mechanisms exist to govern procedural changes, ensuring sufficient controls of decision-making and approval processes.

### **Technology**

GFKL has an established IT department that supports all its subsidiaries. This department is split into two teams, comprising: 21 staff to monitor hardware infrastructure, and 12 for software development, maintenance, security control, transfer of portfolios, and daily user needs. The only exception is SI, which has an internal IT team dedicated solely to its business to deal with the high level of automation included in its processes. We consider the group's technological environment to be well-designed and fully scalable, providing the necessary levels of process automation and internal control.

All GFKL's subsidiaries use technology to minimize the need for manual data entry. PCS and SI, as other companies in the GFKL group, use phinAMV, a receivable management system that was developed and is supported by ABIT, which was owned by GFKL. We understand that it is widely used in the German credit sector and has been customized for GFKL. phinAMV allows for the management of the collection activity and work on the underlying database. Client, receivables, and debtor data can be easily stored into the system and exported from it. phinAMV can track process activities and permits the set-up of reminders. phinAMV integrates a document management system to manage files, scan mail, and perform quality checks.

The IT systems operate with a hardware firewall and antivirus solutions in an air-conditioned, fire-protected data-processing center with access authorization. GFKL performs daily file back-ups, and tapes are stored externally in fire-protected data safes.

### **Disaster recovery/business continuity**

GFKL manages the disaster recovery and business continuity plan at group level. It provides some back-up offices to both PCS and SI. Disaster recovery and business continuity procedures are available for the group-level IT center

supporting SI and PCS' collection activities. Furthermore, the PCS and SI offices replicate each other in terms of systems, processes, and procedures; therefore, they act as back-up sites for each other.

In November 2010, GFKL performed a disaster recovery test, which it reports was successful: IT systems as well as data availability were restored in a reasonable amount of time.

## **Loan Administration**

Our subbanking for GFKL's loan administration is **STRONG**.

### **Boarding**

PCS and SI's portfolios have grown in the past few years, thus continually testing the boarding procedures. Loans are boarded automatically and documents are scanned and attached to receivable management systems by back office staff. All documents are then archived.

Since our previous review, PCS has boarded new loans that counterbalanced the number of closed positions, so its portfolio accounted for 423,489 files by the end of 2011—slightly lower than 429,448 files reported by the end of 2010. SI has boarded 120,000 new receivables from two anchor clients and another important insurance company.

Both companies have informed us that they have solid and busy business pipelines, and new business will guarantee future growth.

### **Arrears management**

As PCS and SI manage different types of asset classes, collection activity can vary in complexity. Both companies adopt a standard process for portfolios managed on behalf of third-party clients and for their own purchased portfolios. They attempt to find an amicable settlement rather than pursue legal recovery. They consider that this saves time and benefits the reputation of GFKL and its clients, which often continue relationships with their debtors.

Besides this, PCS' management strategy is less automated and more case driven, while SI's is more standardized and automated and can handle a much higher number of claims simultaneously. In 2010, the average number of receivable handled by the PCS asset manager was 3925 and the average number of claims handled by SI was about 14,000.

Both companies send a "hello letter" to each debtor once their loan has been boarded. This letter reports the news about the transfer of the loan management to the servicer and includes information on the debt, contact details, and payment options. After a certain period of time, predefined for both companies, respectively, the call center starts calling the debtor, attempting to agree a payment arrangement or a settlement. PCS and SI's call centers operate with effective telephone and collection software, in our view.

On average, 70% of arrangements made with for PCS are honored. Of all claims managed by PCS, 90% are settled without the need for legal proceedings.

PCS and SI's collections strategies are based on the integrated work of three groups: the back office team, the phone collection team, and the receivables management team. Their collection activities are supported by the activity of each internal call center focused on phone collection. The phone system is equipped with a dialer, which is connected to receivable management software. Incoming calls trigger a pop-up window that reports data on the debtor and the claim and the caller immediately inputs a short summary of the call to the system. The call center

team can work on the standard workflow (initial approach, payment agreements, and reminders), or special campaigns. The asset manager monitors the collection process and instructs legal support whenever it is necessary.

## Payments Collection

In 2010, GFKL started implementing a new account system. PCS applied it at the beginning of this year and SI informs us that it has implemented it by Sept. 1, 2011. GFKL intends this new system to provide a unique tool to run different tasks, from reporting to planning and accounting, and integrate these activities across all of its subsidiaries.

### **Investor and third-party reporting**

In 2010, PCS applied a new standardized reporting tool. As a general rule, it now agrees a customized format for the report with larger clients, and applies the standardized template for smaller clients.

## Financial Position

We consider GFKL's financial position SUFFICIENT.

## Related Criteria And Research

- Servicer Evaluation: GFKL Financial Services AG, Sept. 6, 2010
- Structured Finance Sector Report Card: How European Servicers Are Reacting To The Challenges Of The Economic Environment, April 21, 2010
- Standard & Poor's Revises Criteria Methodology For Servicer Risk Assessment, May 28, 2009
- Servicer Evaluation: GFKL Financial Services AG, Feb. 21, 2008
- Servicer Evaluation Ranking Criteria: U.S., Sept. 21, 2004
- Select Servicer List, published monthly

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