The Awakening of Securitisation in South Africa

Neil van Vuuren, 1 December 2004

Until fairly recently, securitisation was an uncommon concept in South Africa, and as the South African capital markets emerged into the new millennium, the last 3 years have shown some significant development in the securitisation industry.
Investors' need for alternative and innovating investment products are expanding and the new securitisation regulations under the Banks Act 1990 that was published in 2001, have brought certainty to the industry, opening the doors for a variety of players. Whilst investors learn and become more familiar with securitised assets as alternative investment products, the still relatively small sector is developing a similar sophistication to some of the world's largest markets, and is poised for further growth…

What is securitisation?

Securitisation is the conversion of a pool of assets with a regular and predictable cash income, such as mortgage repayments or credit card receivables into a security or marketable instrument. In very basic terms, securitisation enables a company (in most cases a bank) to "sell" a large number of its assets (e.g. mortgage loans), which would otherwise not be attractive as individual purchases, to a specially formed company - the Special Purpose Vehicle ("SPV"). The SPV funds the purchase by issuing debt securities in the capital markets, and the cash flows derived from the asset (such as the mortgage or credit card repayments) will serve as principal and interest payment obligations under the marketable securities. Hence the issued securities are called Asset-Backed Securities ("ABS").

Securitisation is the generic term for any kind of Asset- or Receivable-Securitisation. It is derived from the word security, because usually illiquid and sometimes even intangible assets that generate a constant cash flow are formed into a tradable security and are floated on the debt market.

A success story

In just three years a thriving, sophisticated securitisation market has emerged in South Africa from virtually nothing. Apart from the first securitisations of: 1) a R250 million mortgage-backed issue by the former United Building Society in November 1989, and 2) a R60 million issue backed by instalment rental loans by Sasfin in 1991, the development of securitisation in South Africa has been limited due to the regulatory constraints. Then, in 2001 a change to the banking regulations triggered and accelerated growth, and from a virtual standing start some R40bn of securities have been issued. SA Home Loans led the way by launching the first domestic securitisation initiative in November 2001 through the Thekwini Fund, apparently even before the changes to the regulations were officially enacted. Incorporated in February 1999 and spearheaded by Simon Stockley, SA Home Loans was the first non-bank to challenge the big four banks' monopoly in the mortgage market and the core of its business strategy was to use securitisation to raise capital. The R1.25bn deal was the first of many to follow for SA Home Loans and pioneered the issue of residential mortgage-backed securities in South Africa. The deal was very popular and the bonds, which were twice oversubscribed, were sold to around 20 investors in South Africa, predominantly fund managers and with certain banks also participating. Other market participants were quick to realise the benefits of securitisation potential locked up in the South African market and soon started to copy the trend as a popular means of raising finance.

Changes to the Securitisation Regulations

The trigger for the accelerated development of the securitisation market in South Africa was mainly due to a change to the law in December 2001 by the South African Reserve Bank. Prior to the introduction of the new regulations, securitisation was regulated by two separate Government Notices: 1) Government Notice No. 153 published in the Government Gazette No. 13723 on 3 January 1992; and 2) Government Notice No. 2172 published in the Government Gazette No. 16167 on 14 December 1994 (the "existing regulations"). The previous regulations created uncertainty amongst originators and especially amongst banking originators. It is a contravention of the Banks Act to operate the business of a bank without registration as a bank or as a branch of a foreign bank. However, in terms of the new securitisation regulations published in Government. Notice 1375 on December 13, 2001, the operation of a securitisation scheme is not regarded as "the business of a bank", (provided that the conditions set

out in that Government Notice (commonly referred to as the "securitisation exemption" or the "securitisation regulations") are complied with).
Another main aspects of the legal change were to allow banks to fulfil multiple roles in a securitisation transaction. In other words, the new regulations allows for corporates as well as banks to use securitisation, and by widening the definition of a securitisation transaction, the still relatively small sector is developing fast to accommodate a variety of players to a level that took the US and countries in Europe many years to obtain.
The new regulations are aimed at facilitating the growth of the securitisation industry in South Africa in accordance with market demand, existing international securitisation principles and the draft Bank for International Settlement ("BIS") capital adequacy proposals.

The following list of transactions illustrates the prominent development of securitisation in South Africa. Upon looking at the below illustration, an especially striking feature is the pace of development together with the level of sophistication to which the market has grown between 2000 and 2003.

ISSUER	ASSETS	VALUE (R)	ORIGINATOR	ARRANGER	YEAR
United	RMBS	250 million	United BS	United BS	1989
Sasfin Asset Securitisation	Lease receivables	60 million	Sasfin Bank	Sasfin Bank	1991
Siltek	Trade Receivables	250	Siltek	Mettle	2000
FirstRand 2000-A	Credit Card - Future Flows	1,8 bn	RMB / CSFB	FirstRand Bank	2000
RMB CDO 1 Limited	CDO	3,9 bn	RMB / Morgan Stanley	RMB	2000
Kiwane	CDO	500 million	Gensec / JP Morgan	Gensec / Real Africa Durolink	2000
Thekwini I	RMBS	1,2 bn	JP Morgan / SCMB	SA Home Loans	2001
RMB CDO 2 Limited	CDO	2,9 bn	RMB / Goldman Sachs	RMB	2001
Clover	Trade Receivables	300 million	Clover Danone	Mettle	2001
Mustek	Trade Receivables	250 million	Mustek Computers	Mettle	2001
FRESCO	CDO	1,1 bn	RMB	FirstRand Bank	2002
Procul	Autoloans	1,3 bn	RMB	FirstRand Bank	2002
OntheCards	StoreCard	1,93 bn	RMB	Edgars	2002
Thekwini II	RMBS	1,1 bn	SCMB	SA Home Loans	2002
Fintech	Lease receivables	630 million	Gensec / JP Morgan	Fintech	2002
Private Mortgages	RMBS	1 bn	Investec	Investec Private Bank	2002
Eagle Bonds One	Aircraft - ECA Guaranteed	1 bn	SCMB / Gensec / Imperial Bank	Safair Lease Finance	2003
Autoloan Investments	Autoloans	1 bn	RMB	BMW	2003
CARS 1	Autoloans	2,955 bn	ABSA Corporate & Merchant	ABSA Asset & Vehicle Finance	2003
Thekwini III	RMBS	1,5 bn	SCMB	SA Home Loans	2003
Private Mortgages II	RMBS	1 bn	Investec	Investec Private Bank	2003
Autoloan Investments II	Autoloans	1 bn	RMB	BMW Financial Services	2003
Equipment Rentals Securitisation	Lease receivables	670 million	Sasfin Bank	Sasfin Bank	2003
Workforce	Trade Receivables	50 million		Mettle	2003
Clover II	Trade Receivables	100 million	Clover Danone	Mettle	2003

Source: Rand Merchant Bank, SFI News

Up to now there have only been some three international securitisation transactions by South African issuers. In 2000, FirstRand launched a R1.8bn securitisation of future flow receivables from credit cards, which was arranged by RMB and CSFB, and also in 2000 a R3.9bn CDO arranged by RMB and Morgan Stanley which was repeated in 2001 for R2.9bn and arranged by RMB and Goldman Sachs.

Newcomers to the fore

At the beginning of 2004, Sanlam, one of South Africa's largest insurers, together with Absa, the largest mortgage lender, announced the establishment of a joint venture company that will offer home loans to Sanlam clients. Sanlam Home Loans, currently originating mortgages among its existing clients in association with Absa's servicing abilities, expects to securitise its first pool of residential mortgages and is planning to issue the first securities for around R1bn-R1.5bn in the summer of 2005. More issues will follow annually as soon as the process gets going. Traditionally, banks provide home loans by getting funds from their own investors, depositors and he money market. To service these investors and depositors means banks must have an expensive branch network. They also add interest on to the cost of these funds to cover overheads and still provide a profit margin for themselves. Through securitisation, individual borrowers are linked directly to the wholesale investors, therefore resulting in lower interest rates given to the public and thus saving borrowers millions in mortgage payments. SA Home Loans with its lower interest rates is the perfect example of the above scenario and Sanlam and other lenders will soon follow in their steps.

Conclusion

Securitisation does not only mean alternative ways of funding, but it also results in cheaper and more flexible financial resources. South Africa has a good regulatory system governing the securitisation market and the banking industry. The 2004 South African Securitisation conference in Cape Town attracted more than 200 attendees, compared to the 20 odd attendees of the previous year. Surely, this is a sign that the new legislative framework that governs securitisation, accompanied with the expanding number of eager participants in the market, including lawyers, bankers, accountants, trustees, rating agencies and the Bond Exchange of South Africa, caters for an opportunity whereby we can add value to the rapid development of securitisation in South Africa.