PERCEPTIONS ON THE OUTLOOK FOR THE SECURITISATION MARKET IN SOUTH AFRICA

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ABSTRACT

The sophisticated financing technique, securitisation, was blamed for the global financial crisis of 2007 -2008. After the crisis, the securitisation industry suffered globally as the number of issuances dwindled. Today, the USA and Europe securitisation markets have recovered as a result of support from the Central Banks, but the securitisation market in South Africa has not experienced a similar trend. The purpose of this research was to gather the views and opinions of key market participants on the development of securitisations in South Africa.

This research, qualitative in nature, was conducted through semi-structured interviews with market participants who included: originators, both bank and non-bank lenders, arrangers, credit rating agencies, trustees and investors. The results revealed that securitisation is an important financing technique and is still very useful in the South African economy. The downward trend in securitisation activity that began during the global financial crisis has somewhat continued because the market faces a few constraints. The market participants identified the constraints to growth as being the lack of education by investors on asset-backed securities, the conservative approach by credit rating agencies, the outdated securitisation regulations and the absence of a secondary market for securitisation paper. As long as these issues are not addressed, the market participants do not expect growth in securitisation activity.

DECLARATION

I declare that this research report is my own unaided work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in any other university.

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March 2016

DEDICATION

This research is dedicated to My Family: my husband, my children, and my mother who stood by me throughout the two years of my MBA. Thank you for all your love, support and patience with me during this journey. I love you all very much.

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- My family for all the love and support you gave me throughout this journey.

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CHAPTER 1. INTRODUCTION

1.1 Purpose of the study

The purpose of this research is to analyse the development of the South African securitisation market and to gain a perspective of the likely future trend, as viewed by market participants.

1.2 Context of the study

There are several definitions of securitisation in literature. Moyo and Firer (2008) describe securitisation as the financing process whereby a corporate entity will move assets to a bankruptcy remote special purpose vehicle for the purpose of selling these assets to investors. Gambacorta et al. (2007, p. 2) offer a simpler definition of securitisation as:

“A process whereby individual bank loans and other financial assets are bundled together into tradable securities that are sold to the secondary market.”

According to White (2011), securitisation is the process of isolating a pool of assets or the right to receive a cash flow and restructuring it to be traded in the capital market.

There are several parties involved in this process. The bank or non-bank credit provider is known as the originator (Scott, 2006). The originator sells the pool of debt to a legal entity known as a special purpose vehicle (SPV) to be traded on the secondary market (Peicuti, 2013). According to White (2011), the SPV has no managers or employees and a trustee performs all its administrative functions. Credit rating agencies (CRAs) are responsible for rating the loan portfolios before they are sold off to investors. The lender usually performs the role of servicer of the payments.

Securitisation originated in the USA in the 1970s, as an alternate funding vehicle for mortgage lending (Hess & Smith Jr, 1988). Because Federal government agencies (such as Fannie Mae and Freddie Mae) participated by guaranteeing the mortgage backed securities, the industry grew rapidly (Gambacorta et al., 2007). Banks were now able to supply more loans to borrowers. Not only was the lending capacity of banks improved, their risk was also lowered. Banks have to manage the interest rate risk associated with using short-term deposits to fund the long-term mortgages (Hess & Smith Jr, 1988).

Choudhry and Landuyt (2009) discuss how securitisation offers significant benefits to the whole economy. For financial institutes, benefits are improved liquidity and diversification of risk while consumers and businesses enjoy access to more credit and lower transaction costs.

The cash flow securities created by securitisation can be classified into different types, namely, residential mortgage backed securities (RMBS), commercial mortgage-backed securities (CMBS), credit card backed securities (CCBS), motor vehicle loan backed securities (MVBS), collateralised debt obligations (CDO) and other asset backed securities (ABS) (Moyo & Firer, 2008). The other asset backed securities (ABS) category includes the less common cash flow securities, such as equipment leasing, trade receivables, royalties and small business loans (Cetorelli & Peristiani, 2012). All these securities have complex structures and investors rely on credit rating agencies to value the credit risk associated with each SPV. Some of the methods used to value the securitisation products have been found to be flawed (Blommestein et al., 2011).

A. Saayman and Styger (2003) researched the history of securitisation in South Africa. The first securitisation issue in South Africa was completed in 1989 and then the market experienced a period of no activity between 1991 and 1999. The slow growth was attributed to:

(1) Strict regulations set by the South African Reserve Bank (SARB) and (2) there was insufficient demand and supply. There was an exponential growth of securitisation activity in the bond market from 2000 to 2007 (Moyo & Firer, 2008). This may have been triggered by the new SARB regulations issued in 2001 and also the decrease in interest rates at the same time (A. Saayman & Styger, 2003).

A study done by White (2011) revealed that there was a decline in South African securitisation issuances in 2008 and 2009 in response to the global financial crisis. This is the same trend that was seen in the United States.

According to many academics, securitisation played a major role in the devastating global financial crisis of 2008 (Esterhuysen et al., 2012; Peicuti, 2013; Steen, 2011; White, 2011), the main contributor to the global financial crisis being the outbreak of the US sub-prime mortgage crisis (Steen, 2011; White, 2011). Sub-prime mortgage products were designed for people who did not have enough money for a down payment or lacked the required income documentation or had spotty credit history (G. Gorton & Metrick, 2012b). A rise in interest rates led to borrower defaults, bank defaults and a subsequent collapse of the housing and stock markets in the USA (Karanikolos et al., 2013). The crisis in the USA quickly spread to European banks that were heavily invested in the US mortgage-backed securities (Karanikolos et al., 2013). As the RMBS and CDO markets crumbled, there was a run on global financial firms who were also securitising (Kamin & DeMarco, 2012). Countries all over the world were affected severely and this resulted in a global economic recession.

While the US securitisation market collapsed during the GFC, the securitisation issues in Europe and the UK continued to climb (Steen, 2011). In the research done by Erber (2011), it was found that countries such as Ireland, Portugal and Greece whose credit rating had been downgraded, were securitising more. This implies that the trends in securitisation within the European markets differ among individual countries.

This research attempts to examine the trends in the South African securitisation market and look at the future prospects.

1.3 Problem statement

The aim of this research is to analyse the securitisation market in South Africa, in order to identify factors influencing the market and implications for the future of the industry.

1.4 Significance of the study

Although similar research has been done on the effects of the global financial crisis on securitisation in South Africa, this study provides insights into the current state of the market. While the US market seems to have recovered from the effects of the global financial crisis and the UK is still facing challenges (Neuhauser & Michayluk, 2015), both markets have introduced new regulatory reforms aimed at preventing future crises (Steen, 2011). In this report, the securitisation activity in South Africa is compared to the United States and European markets. The aim is to understand the similarities and differences in the challenges each market faces.

The findings of this study will provide information on what changes have occurred in the South African securitisation market and whether or not the market is recovering from the 2008-2009 decline. This information may be of value to investors interested in accessing this market, and also to banks and other financial institutions. In the USA, banks have started lending again with stricter credit standards and the investors over there are now seeking quality debt (Steen, 2011).

As mentioned previously, securitisation provides additional sources of funding for banks and other lenders and this benefits consumers and investors. The whole economy is impacted positively by securitisation. According to Steen (2011):

“The financial sector depends upon a well-functioning securitisation market, one that is built on simple structures and a high level of transparency and disclosure”.

This type of study could provide value by adding to the literature available on the history of South African securitisation market (Moyo & Firer, 2008; A. Saayman &

Styger, 2003). The research done by Saayman and Styger (2003) covered the period from 1989 to 2002, whilst Moyo and Firer (2008) focused on the period between 2000 and 2007. This study covers the period between 2008 and 2015. The findings can provide an understanding of what factors can help restore confidence in the South African securitisation market.

Finally, the findings in this study may provide guidance to regulators in South Africa on the impact of recent regulatory reforms. In the USA, the federal government has created regulatory reforms that are aimed at ensuring the sustainability of the securitisation market in the long term (Blommestein et al., 2011). The consequences of any new regulatory reforms are also considered.

1.5 Delimitations of the study

The future of any securitisation market is influenced by both the supply (originators) and demand (investors) sides (Saayman & Styger, 2003). In-depth interviews were carried out in order to get views from different market participants on the factors impacting the South African securitisation market. The key participants interviewed in this study were originators, arrangers, trustees, rating agencies and investors.

The report only considered regulatory reforms that have a direct effect on the securitisation market.

1.6 Definition of terms

- **Global Financial Crisis:** "A worldwide period of economic difficulty experienced by markets and consumers. A global financial crisis is a difficult business environment to succeed in since potential consumers tend to reduce their purchases of goods and services until the economic situation improves" (BusinessDictionary.com, 2014).

- **Subprime mortgages:** This is a type of housing loan granted to borrowers with low credit ratings, who would not qualify for a conventional loan.
- **Economic recession:** A period of decline in economic activity. It is characterised by a decline in country's real Gross Domestic Product (GDP) in two consecutive quarters

1.7 Assumptions

- The interviewees all gave honest and subjective answers.

CHAPTER 2. LITERATURE REVIEW

2.1 Introduction

This literature review covers the major issues affecting the securitisation industry and the trends observed in South Africa and overseas. Most of the available literature focuses on the U.S and European securitisation markets and a few cases on other nations. The literature on the South African securitisation market specifically, is limited. Although there is not much published in South Africa on the securitisation industry, South African databases show that many university students have done research on this topic.

The first part of this literature review gives a detailed description of the process of securitisation and its benefits. In the next section, an overview of the development of the South African securitisation market covers the trends observed and the factors affecting the industry. This is then followed by a discussion of the literature on the current global trends in the securitisation industry. And finally, section 2.4 concludes the literature review with a key research question for this study.

2.2 The process of Securitisation

There are several parties involved in the securitisation process; originators, arrangers, SPVs, trustee, rating agencies and investors as shown in Figure 1.

Fender and Mitchell (2009) summarised the three important steps in a securitisation transaction as:

Step one: The pooling together of assets that have a cash flow from the balance sheet. *Originators* are the owners of the cash generating assets. These assets can be mortgage loans, auto loans, credit card receivables, lease payments or any other instalments of debtors (Juhas, 2013). Therefore, originators can be banks or non-banks such as business enterprises, municipalities, governments and other financial institutions. In some cases, the originator has bought the assets from a third party and may be referred to as a Sponsor (Gorton & Souleles, 2007)

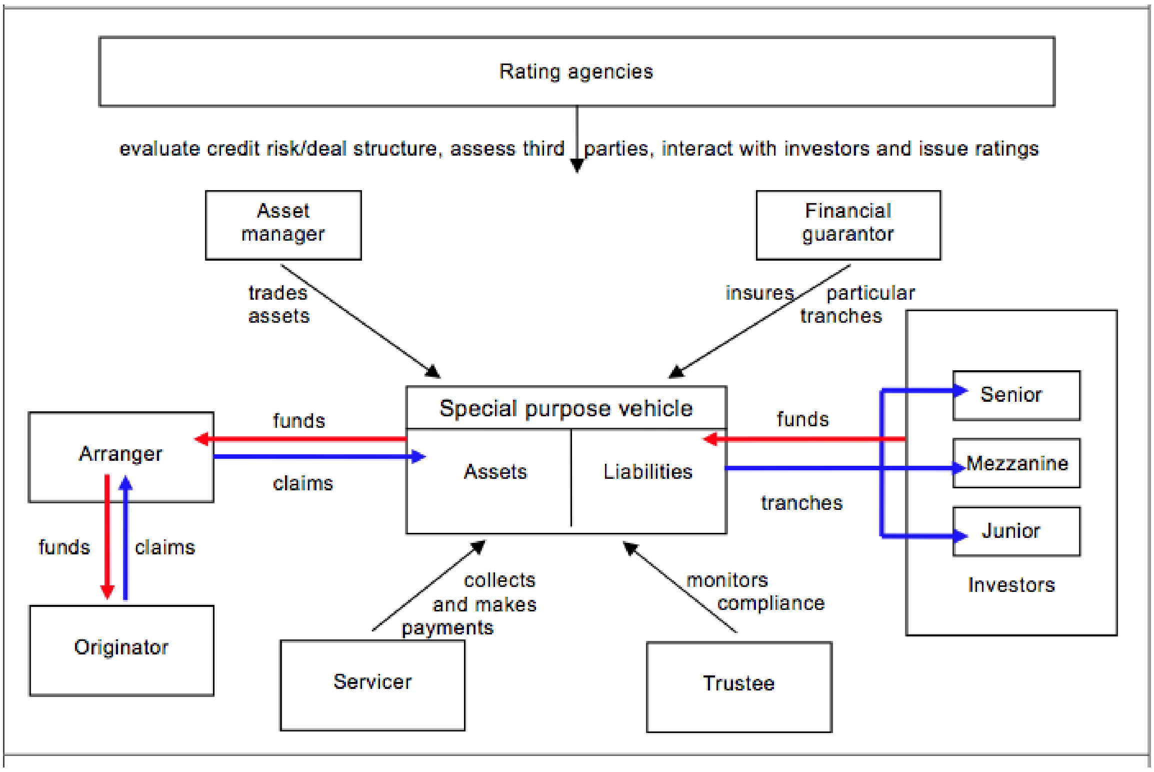

Figure 1: A graphical representation of the securitisation process (Fender & Mitchell, 2009)

Step two: The pool of assets is sold to a standalone *special purpose vehicle (SPV)* created for the purpose of the securitisation deal (Van Vuuren, 2004). The SPV is a "bankruptcy-remote" entity, which has no economic impact on the originator or other parties in the transaction. The SPV has no physical location, no employees or managers and a trustee performs its day-to-day administrative duties (SPVs) (Ratings, 2006)

Step three: The SPV, also known as the *"issuer"*, issues securities (asset-backed securitisation paper) with different levels of seniority to sell to investors in the capital markets. The term, securitisation, comes from the word “security” because the pool of assets are converted into marketable securities (Van Vuuren, 2004). The cash flows generated from the asset pool are allocated to the different classes of securities also known as “tranches” according to their risk profiles. This creates a “waterfall of payments” with the priority given to the senior tranche, which carries the lowest risk and is AAA rated (Cetorelli & Peristiani, 2012). Some of the tranches have ratings higher than the average rating of the unrated asset pool, while other tranches will have a lower rating or remain unrated. Figure 2 below is an illustration of the waterfall of payments (Fender & Mitchell, 2009).

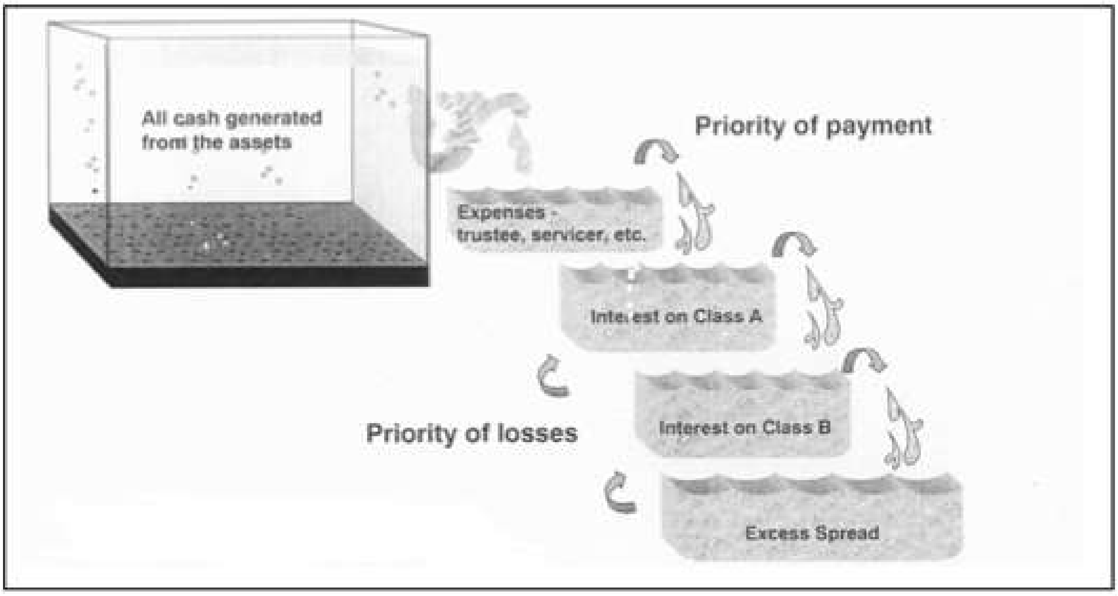

Figure 2 – Waterfall of payment (A. Saayman & Styger, 2003)

There are other parties in the transaction who also play important roles during the securitisation:

An *arranger* will source assets from the originator and also plays the role of structuring the securitisation issue by planning, organising and supervising the overall transaction (Gumata & Mokoena, 2005). Paligorova (2009) describes the arrangers as the key players in the securitisation deal since they are responsible for the design of the security. The arranger is usually an investment bank and receives compensation through fees paid by the investor.

A *servicer,* who is usually the originator, is responsible for the collection and distribution of the cash from the assets. Their compensation is usually a fixed fee and a percentage of the outstanding balance of the loans (Paligorova, 2009). The *borrowers* continue to make payments on the loans (assets) to the originator.

Fender and Mitchell (2009) state that the *trustee* controls, and monitors the SPV, which is usually set up as a trust. A trustee is an independent firm responsible for monitoring the servicer and overseeing the security on behalf of the investor (Cetorelli & Peristiani, 2012).

The *investor* purchases the asset-backed securities issued by the SPV in the form of bonds and they receive interest and capital payments (Paligorova, 2009).

The *credit rating agencies* play a very important part in the securitisation process. They are responsible for assessing credit risk of the securitisation deals and issuing ratings to be provided to investors (Fender & Mitchell, 2009). The information from the rating agencies on the loan performance of the assets helps with transparency and enables investors to develop their own credit risk models. Due to the highly complex nature of some of the securitisation products, credit ratings failed in their measurement of risk and this may have contributed to the defaults seen during the financial crisis of 2008/9 (Fender & Mitchell, 2009).

There are three types of credit enhancements used to improve the credit ratings of securitisation transactions:

Excess credit spreads – this is the monthly revenue left over after all expenses have been paid, such as payments to investors and to the servicer. The excess spread account is a reserve account and is used as the first line to protect the investors against default (Mandel et al., 2012).

Subordination – the cash flow waterfall allows for priority of payments to different tranches with the senior tranche getting first claim. The originator will hold a subordinated or junior claim, which will absorb losses first and provide protection to senior tranches (Mandel et al., 2012)

Overcollaterisation – this is when the value of the asset pool is much larger than the securities it backs. The excess cash flows can be used in the case of late payments or defaults from the securitised assets (Sandback, 2003)

2.2.1 *Benefits of Securitisation*

Securitisation broadens the range of assets that asset managers are able to access for their investors. Because of *tranching* (claims issued with different levels of seniority), securitisation instruments will cater for varying investor risk appetites (Mpundu et al., 2013). Investors with a low risk appetite can pick the most senior AAA rated instruments while investors with a high-risk appetite pick the low rated B or even unrated instruments. Investors that purchase securitisation paper are usually investment firms, pension funds and insurance companies (Sandback, 2003).

Originators of securitisation deals are usually large financial institutions such as banks and other finance companies, but other commercial enterprises, small, medium or large in size can also securitise their assets (Sandback, 2003). This is because any cash flow generating assets can be securitised. Figure 3 gives examples of assets that have been securitised.

Examples of Securitized Assets	
Aircraft Leases	Manufactured Housing Contracts
Auto Loans (Prime and Sub-prime)	Mortgages (Residential and Commercial)
Auto Leases	Railcar Leases
Boat Loans	Real Estate
Credit Card Receivables	Recreational Vehicle Loans
Dealer Floorplan Loans	Royalty Streams
Equipment Leases	Stranded Utility Costs
Home Equity Loans	Trade Receivables
Marine Shipping Containers and Chassis Leases	Truck Loans

Figure 3: Examples of securitised assets (Sandback, 2003)

From both the local and international literature, several authors stated that originators were driven to securitise their assets for the following reasons:

Ready access to cash. According to Van den Berg (1998b), securitisation generated "new cash" which could be used to fund more loans. This is a similar reason to the reason given by Sandback (2003) that originators receive cash upfront from investors purchasing the asset-backed securities instead of waiting for monthly cash flows.

Diversification of funding. Securitisation offers an alternative source of funding to a corporate (Tensfeldt et al., 1993; Van den Berg, 1998b).

Cheaper funding. In their research on banker's views on securitisation in South Africa, Tensfeldt et al. (1993) found that the bankers did not perceive the potential to lower bank funding costs as a benefit of securitisation. It is interesting to note that a few years later, Van den Berg (1998b) in a study in which he consulted professionals in the industry, reduced funding costs were found to be one of the advantages of securitisation. The author also mentions that at that time only two public issues had been done: the United Building Society securitisation deal for ZAR 250 million and the Sasfin deal for ZAR 60 million. Even a special report by Fitch Ratings (2005) did not mention cheaper funding when discussing the benefits banks get from securitisation.

From the international literature, the authors discuss securitisation as a means to access lower-cost funding because the underlying asset pool is separated from the credit profile of the originator (Paligorova, 2009; Sandback, 2003).

Matching funding of assets and liabilities. Securitisation funding can be used to match long-term loans and thereby mitigate against interest rate risk and liquidity risk caused by mismatches. In the case of banks, securitisation funding can be used to fund mortgage loans instead of using short-term deposits (Ratings, 2006; Van den Berg, 1998b).

Regulatory arbitrage for banks and financial institutions. Several authors agree that under certain conditions, originators were able to remove the securitised pool of loans from the balance sheet and reduce their regulatory capital requirement (Martín-Oliver & Saurina, 2007; Sandback, 2003; Tensfeldt et al., 1993; Van den Berg, 1998b).

Risk transference. By securitising their assets, the originators may be able to transfer the assets and the risk of loss of those assets to investors. This improves the originator’s risk profile and they can now access cheaper funding (Agostino & Mazzuca, 2011; Martín-Oliver & Saurina, 2007).

The fee income generated by arrangers from securitisation was generally not discussed in literature as a benefit of securitisation. However, one author, Paligorova (2009), mentioned it when he was describing the role of an arranger in securitisation.

2.3 Development of the South African securitisation market

Asset securitisation dates back to the 1970s when the US government agencies securitised the first mortgage loans (Saayman & Styger, 2003). In South Africa, the first securitisation transaction was issued almost 20 years later, in 1989 by the United Building Society, which is now part of ABSA (Saayman, 2003). The development of securitisation in South Africa can be divided into three stages.

2.3.1 *Securitisation trends in South Africa*

The first stage covering the period before the year 2000 was characterised by initial slow growth. Besides the Sasfin (Pty) Ltd securitisation completed in 1991, there were no other issues of asset-backed securities between 1991 and 1999 (Van den Berg, 1998a). Both Van Vuuren (2004) and Saayman and Styger (2003) attribute the slow growth in the securitisation market before 1999 to a regulatory framework that did not favour securitisation. The South African Reserve Bank later issued new regulations in December 2001, which signalled confidence in mortgage-backed securities (Saayman & Styger, 2003). Another reason for the lack of supply and demand for the asset and mortgage-backed securities was the public misperceptions that organisations only securitised when they were facing problems (Saayman & Styger, 2003).

During the second stage beginning in the year 2000 until 2007, there was an accelerated growth of the securitisation market with the issuance volume reaching a peak of over ZAR 40 billion (JSE). The market was more mature with a variety of asset classes being securitised, including receivables from auto and consumer loans (Moyo & Firer, 2008). One unusual transaction in 2003 was an aircraft deal issued by Eagle Bonds for ZAR 1 billion (Van Vuuren, 2004). This was a flourishing period for the overall global securitisation industry. According to Fender and Mitchell (2009), the combined issuance volumes for USA and Europe totalled \$3.8 trillion during the 2005-2007 period. Scatigna and Tovar (2007), in their paper on securitisation in Latin America, described the period from 2003 – 2007 as a period of vibrant market recovery followed by rapid growth.

The third stage began in 2008 with market instability caused by the global financial crisis. The market for asset-backed securities in South Africa literally collapsed with issuance volumes falling to a low of ZAR 5,28 billion compared to the ZAR 40.4 billion issuance in 2007 (JSE). This was followed by a further decline in issuance in 2009 to just ZAR 4,10 billion (JSE). Market participants were reacting to the crisis in the US, which resulted in the failure of large banks and firms in the financial sector. Securitisation was blamed as the cause of the financial crisis (Blommestein et al., 2011; Peicuti, 2013; Steen, 2011; White, 2011).

According to the data from the JSE (2014), issuance volumes dropped from over ZAR 40 billion in 2007 to ZAR 4 billion in 2009. Volumes peaked again in 2011 to ZAR 20 billion before starting to fall again, as shown in Table 1 below.

Table 1: South African Securitisation issuance data (JSE, 2014)

Sum of Issued Amount	Issuer Type	Notes				
	Securitisations					**Grand Total**
Year Issued	**ABS - Auto**	**ABS - Other**	**CDO**	**CMBS**	**RMBS**	
2003	3,360	1,397	-	1,400	2,000	8,157
2004	1,100	1,252	-	800	2,500	5,652
2005	4,058	4,670	-	3,875	8,499	21,103
2006	13,085	695	-	4,035	13,543	31,358
2007	13,575	1,047	2,060	3,501	20,225	40,408
2008	1,000	1,640	-	442	2,205	5,287
2009	800	1,793	-	750	760	4,103
2010	-	3,526	-	812	8,315	12,653
2011	5,595	4,006	-	-	12,210	21,811
2012	2,391	1,930	-	-	12,747	17,068
2013	-	3,034	-	2,225	6,169	11,428
2014	-	615	-	-	3,049	3,664
Grand Total	44,964	25,606	2,060	17,840	92,221	182,691

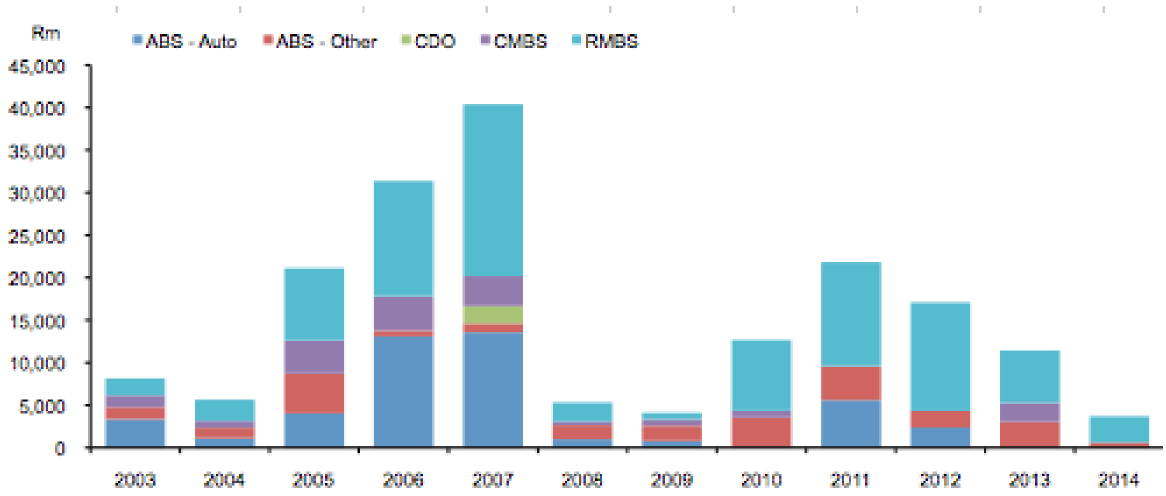

Figure 4: Graphical presentation of South African securitisations issuances

2.3.2 *Factors affecting the South African securitisation market*

Tensfeldt et al. (1993); Van den Berg (1998); Saayman and Styger (2003); Moyo and Firer (2008), found that access to cheaper sources of capital was a reason why banks were securitising, while investor demand was driven by a need for diversification of investments.

In a report written by the credit rating agency, Fitch, banks were securitising in order to effectively manage their capital by matching long-term loans that were funded by long-term funds raised from securitisation transactions. This benefit was in addition to the diversification of funding provided by securitisation, which helps reduce credit risk.

The research done by Moyo and Firer (2008), revealed that banks were starting to securitise more assets because of pressure from the SARB to improve their term funding. Previously the banks did not have a need to securitise their loan books as a source of alternate funding as they depended on deposits (Moyo & Firer, 2008; A. Saayman & Styger, 2003; Tensfeldt et al., 1993). After the year 2000, the economy grew and the demand for loans increased, putting pressure on banks to securitise more to access other sources of funding (Moyo & Firer, 2008).

There are other findings, noted by both Tensfeldt et al. (1993) and Van den Berg (1998a), that differed to the later research done by Moyo and Firer (2008) and Saayman and Styger (2003). In the 1990s, the research done by Tensfeldt et al. (1993) and Van den Berg (1998a) found that banks were driven to securitise because of the increased profitability on the return on assets sold and the reduced risk once the assets were no longer on the balance sheet. A. Saayman and Styger (2003) suggested instead that South African banks had an asset-driven culture preferring to keep large amounts of assets to show how well the bank was doing. Moyo and Firer (2008) had similar findings that the bigger banks did not securitise as they were satisfied with the rate of growth of their assets. Only when the regulatory capital requirement for banks was increased, did the banks shift their focus to securitisation as a means of better managing their balance sheets.

Most of the authors stated the benefit of reduced liquidity risk and interest rate risk as a major advantage of asset-backed securitisations (Moyo & Firer, 2008; Saayman, 2003; Saayman & Styger, 2003; Tensfeldt et al., 1993; Van den Berg, 1998a). In his research, Saayman (2003) was able to show that securitisation leads to a higher degree of liquidity with the bank being able to sell assets continuously to the SPV to obtain funds. He also found that when the bank's access to liquidity sources improves, market perception of the bank's liquidity position improves, leading to lower costs of other sources of funding for the bank.

Engome and Noelle (2014) examined the impact of securitisation on the bank-lending channel and also discovered that securitisation activity enables banks to increase their liquidity.

Despite the benefits of securitisation discussed above, many authors also presented reasons for the slow growth in securitisation activity during the 1990s.

One of the major reasons given for slow growth was the credit rating of the issued securities. Tensfeldt et al. (1993); Van den Berg (1998a); Saayman and Styger (2003); Moyo and Firer (2008) agree that the general lack of historical data on the asset-backed securities was a huge concern to investors, because they could not assess the risk of the pool of assets. There was limited trust in credit rating agencies (Moyo & Firer, 2008; Saayman & Styger, 2003).

Both Tensfeldt et al. (1993) and Van den Berg (1998a) concluded that market participants found the securitisation process to be complicated, time-consuming and also expensive. A. Saayman and Styger (2003) also had similar findings on the time and financial costs involved with securitising assets. Moyo and Firer (2008) also reported securitisation as an expensive process but not a deterrent to the banks to securitise their assets. The banks at the time were securitising more and more, including classes of assets that were not previously securitised, such as credit card receivables. The major constraint to growth of the securitisation market during that time was the demand, because of a narrow investor range. This supports the findings from the earlier studies done by (Saayman & Styger, 2003; Tensfeldt et al., 1993; Van den Berg, 1998a)). The authors found the growth of securitisation in South Africa to be limited due to the underdeveloped secondary market in the country.

Effective securitisations require a legislative environment favourable for all the stages of the securitisation process. In the early years, there were no regulations in place to support securitisations in South Africa and hence a great deal of uncertainty with regard to compliance requirements (Saayman & Styger, 2003). There was initial slow growth of securitisation activity observed in South Africa from 1989 until 2000 which was followed by an exponential growth in the period 2000 – 2007 (Moyo & Firer, 2008). The period of exponential growth was soon after the change in securitisation regulations in December 2001 by the South African Reserve Bank (Saayman & Styger, 2003; Van Vuuren, 2004). Van Vuuren (2004) stated that South Africa had a good regulatory framework governing the securitisation market and banking industry. This good regulatory system was the primary reason why South Africa came out of the global financial crisis unscathed (De Jager et al., 2010; White, 2011).

Tensfeldt et al. (1993) and Van den Berg (1998b) both concluded from their research that securitisation provided savings on the regulatory capital requirements for banks. However, Saayman and Styger (2003), in their study, found that securitisation did not offer a capital arbitrage opportunity for the banks in South Africa. The banks had adequate capital and were not securitising much. These authors' conclusions were all based on interviews conducted with key market participants, including investors, structured finance specialists from the banks, and securitisation specialists.

A more recent study carried out by Moyo and Firer (2008), revealed the capital arbitrage offered by securitisation. In the discussion at a Securitisation conference, it was noted that the Basel II risk-weighting requirements would have an impact on securitisation issuances. The specialists pointed out that banks would prefer to securitise auto loans to mortgage loans because of the savings on regulatory capital. Auto-backed securities had a risk weighting of 100% while the risk weighting on the mortgage-backed securities was only 50%. This finding is consistent with the data from the JSE (2014), showing the highest issuance volume of auto-backed securities was in 2006 and 2007.

2.3.3 *The global financial crisis and the South African securitisation market*

Securitisation played a central role in the recent financial crisis and has also altered the traditional role of banks as originators of loans that remain on the balance sheet until maturity (Gorton & Metrick, 2012a). Securitisation is a significant source of funding for the US economy. However, securitisation issuances have slumped in the US and globally as a result of the global financial crisis (Blommestein et al., 2011).

The main cause for the problems faced by the banks and financial institutions during the financial crisis was the lack of liquidity (Esterhuysen et al., 2012). The financial crisis has also been referred to as the "liquidity crisis" or "credit crisis" (Blommestein et al., 2011).

The research carried out by the Securities Industry and Financial Markets Association (2008) was a comprehensive study involving in-depth interviews with more than 100 active market participants and also an online survey sent out to members of the large securitisation fora around the world. The findings pointed to the following factors as the main contributors to the financial crisis:

1. Deterioration of loan underwriting standards. The existing regulations were not robust enough to keep up with the complex products of securitisation.
2. Too much reliance on rating agencies. The agencies were not always accurate in their assessments of the quality of the securitised products.
3. Complex highly leveraged market positions. Many banks were highly leveraged and the products, such as collateralised debt obligations, became too complex for their risk management systems.
4. Dealers and investors misjudged liquidity risk. There was an overall wrong assumption that Triple-A rated securities would be liquid and not affected

At the time of the global financial crisis, there was no major bank or firm that received government bailouts or defaulted in South Africa. Several authors have discussed the lack of a direct impact of the global financial crisis on the South African securitisation market (De Jager et al., 2010; Engome & Noelle, 2014; Esterhuysen et al., 2012; White, 2011). Recent research has therefore been limited and has focused on understanding how securitisation works in the South African context and why banks and other financial institutions were not directly impacted by the financial crisis.

In the research carried out by White (2011), the role of securitisation in the credit crisis was analysed by comparing the nature of the securitisation market pre-crisis (i.e. pre 2008) and post crisis (2011) in South Africa. The author found that South Africa's sound framework of policies and regulations prevented the misuse of securitisation for credit extension. This view was also shared by Saayman and Styger (2003) who described the new SARB regulations of December 2001 as being supportive of securitisation. Prior to that, there was a lot of uncertainty from both the supply and demand side of the securitisation market, but after 2001 perceptions changed and the market grew considerably.

White (2011) also defined the South African Reserve Bank's robust monetary policy, which was able to absorb the large external shocks during the crisis to maintain the stability of the economy.

De Jager et al. (2010) analysed the asset backed commercial paper (ABCP) conduits issued in South Africa in the period 2002 – 2008. The authors were motivated by the fact that Canadian Banks had refused to honour liquidity requests by non-bank conduits during the financial crisis. The results of their study showed that the conduits (which are the SPVs) would not suffer from a lack of liquidity support during a crisis. South African banks would not have an option to decline the drawdown requests. These findings are significant because the financial crisis started in the ABCP securitisation market and not in the bond market (De Jager et al., 2010).

Esterhuysen et al. (2012) focused on liquidity creation by banks in South Africa before and during the global financial crisis. The authors found that the banks were able to create sufficient liquidity during the crisis and did not require any capital injections from the government. Many large banks in the US and Europe suffered from a lack of liquidity and had to be bailed out by their respective governments.

2.4 Global securitisation markets

Global securitisation markets have not recovered from the impact of the financial crisis and some markets have almost ceased to exist (Securities Industry and Financial Markets Association, 2008). Many recent studies still point out the benefits of securitisation as a financing technique and hence, the need to restore confidence in the market (Blommestein et al., 2011; Juhas, 2013; Steen, 2011).

2.4.1 *Regulatory reforms*

Steen (2011) provided a summary of the regulatory reforms that can help prevent future crises in the securitisation market:

1) The International Organisation of Securities Commissions (IOSCO) published new reforms in 2009. These regulations mainly address the need for better standards of disclosures for securitised offerings.
2) The Basel Committee measures were introduced in 2010, which had higher risk weightings for some securitisation transactions.
3) The work done by the IASB and FASB towards the convergence of standards.
4) The Dodd-Frank Act with new requirements for the residential mortgage backed securities (RMBS) market.

Steen (2011) stated that it is important to have an international regulatory regime to ensure compliance with the standards and enforce penalties for non-compliance. Blommestein et al. (2011) are in agreement with Steen (2011) that the regulatory reforms are essential for the recovery of securitisation. The regulatory reforms would restore investor confidence through improved disclosure requirements and increased product transparency. However, some authors also point out some potential negative consequences of the new regulatory reforms:

1) The full cumulative effects of the reforms on the securitisation market may be too high (Blommestein et al., 2011)
2) The stricter Solvency II capital requirements for insurance companies and pension funds may dampen investor demand (Blommestein et al., 2011; European Central Bank, 2011; Segoviano et al., 2015)
3) The new retention rules requiring issuers to retain 5% ownership interest in securitised assets lead to higher administrative and capital costs for originators (Blommestein et al., 2011; European Central Bank, 2011). In its report, the European Central Bank (2011) goes further to acknowledge that some originators already held the minimum 5% as risk retention or “skin in the game”.

According to Blommestein et al. (2011), it is important for market participants and regulators to consider the costs associated with regulatory change versus the benefits of securitisation. The regulatory reforms need to support sustainability of the securitisation market. The regulatory reforms also include regulations targeted at credit rating agencies (CRAs). The authors also discuss the effects of new accounting changes, which make it difficult to get off-balance treatment for securitisation. Fender and Mitchell (2009) also discussed how the new accounting rules related to holding loans on balance sheet would eliminate "capital arbitrage", an important indirect benefit of securitising. The new changes were aimed at preventing the trend in the USA where securitisation was used as a means to gain capital arbitrage and the originators did not have "skin in the game" (Blommestein et al., 2011).

2.4.2 *Credit Rating agencies*

Securities Industry and Financial Markets Association (2008), Choudhry and Landuyt (2009), Steen (2011) and Blommestein et al. (2011) all recommend that improving transparency in the credit rating processes is important in order to restore market confidence in securitisation. There are several different ways identified by the authors to tackle the issue of transparency.

The findings by the Securities Industry and Financial Markets Association (2008) reveal that investors had miscalculated the potential risk in asset-backed securities because they did not understand the limits of CRAs and were over-dependent on their ratings. They further suggest that the credit rating performance of securitisation products should be in line with ratings of other asset classes. There is a need for a standardised disclosure of CRA rating methodologies to allow investors to understand the processes involved in the limitations. Investors may then also conduct their own analyses where necessary.

Steen (2011) states that there is a need to address deficiencies in the ratings process, such as the time it takes before ratings are revised to reflect market changes. Choudhry and Landuyt (2009) suggest neutrality and accountability of CRAs. The remuneration should be linked to the quality of ratings delivered over the medium term. In addition, to maintain neutrality, CRAs should not issue ratings for the companies to which they provide consultancy services.

2.4.3 *Trends in the global markets*

According to Blommestein et al. (2011), during the global financial crisis of 2007 - 2008, there was a slump in securitisation issuances in the USA and also in Europe. The authors go on further to discuss the increase in issuances observed in 2009 and 2010 as a result of support from the US federal mortgage agencies and the European Central Bank (ECB). The ECB's liquidity programme supported securitisation by allowing the repackaging of existing downgraded structures. In the USA, two-thirds of the securitisation mortgage products were issued by the federal mortgage agencies. This shows a commitment by the US government to support the securitisation market.

The global financial crisis prompted the Bank of International Settlements (BIS) to revise the prudential regulations of banks. The BIS Committee secretariat is based in Basel, Switzerland and serves the purpose of ensuring global financial stability by strengthening the regulation and supervising the practices of banks worldwide (Settlements, 2015). Part of the new Basel III regulations were related to the capital required to be held by banks and also new liquidity requirements. Central banks around the world set up "Committed Liquidity Facilities" (CLFs) to assist banks in meeting the required Basel Liquidity Coverage Ratio.

In their report by Gruić et al. (2014) to the BIS, the authors revealed that there was a change in the composition of issuances in Europe. There was an increase in *"retained securitisations"* which are not publicly placed but kept on the issuer's balance sheet as collateral for the central bank CLF.

In another paper, authored by Agresti et al. (2013) in Europe, the findings revealed that out of the 1,6 trillion Euros in debt securities outstanding in 2013, 56% were held as *"retained securitisations".*

In Australia, the banks were found to be buying more RMBS because these instruments qualified as an asset class eligible to be collateral of a bank's committed liquidity facility with the Reserve Bank of Australia (Dalton, 2014).

The South African Reserve Bank (SARB) also set up a R240 billion "emergency" facility to assist banks with their liquidity requirements (Venter, 2012).

2.5 Conclusion of the Literature Review

The literature review reveals that the South African securitisation market is now well established. There is a general acceptance of the benefits of this financial technique. The global financial crisis negatively impacted the securitisation industry. Many banks in the USA and Europe were shut down or received government bailouts. However, the South African market only experienced indirectly the effects of the financial crisis. There were no bank defaults or bailouts because of a good regulatory framework that shielded the local securitisation market.

This study seeks to identify the most important factors affecting the South African securitisation market. In particular, factors constraining growth of the market will be considered by analysing the current trends.

The literature reveals a new trend in the global market of "retained securitisations"; this trend was also investigated as part of this research.

2.5.1 *Research Question*

What are the main factors affecting the development of the South African securitisation market and what is the future outlook?

CHAPTER 3. RESEARCH METHODOLOGY

This chapter describes the methodology that was followed to answer the research question identified in Chapter 2. Literature on the qualitative research methodology is discussed, followed by descriptions of the research design, the population and sample, and the research instrument used. The procedure for data collection, and the analysis of the data is also discussed. The section concludes with comments on the limitations, validity and reliability of the study.

3.1 Research Methodology/Paradigm

Bryman (2012) stated that there are three types of research strategies: quantitative research, qualitative research and mixed methods research. The research strategy selected depends on the research problem that needs to be addressed.

In this research, the qualitative research method was used to explore and identify the development of the South African securitisation market within a specified period. An outlook for the future was drawn from the perspectives of the individual market participants interviewed.

Qualitative research was found to be an appropriate method because, as explained by Creswell (2007), the qualitative approach is useful when trying to establish understanding of a phenomenon from the views and experiences of participants. The researcher is then able to build themes or patterns from the data obtained.

Qualitative research is more flexible and unstructured allowing the researcher to get meanings of the behaviours of participants from the data collection (Bryman, 2012).

3.2 Research Design

This section gives a description of the procedures for data collection and analysis. There are four different types of designs that can be used in qualitative research: comparative, case study, longitudinal and the cross-sectional design. A case study design is an approach for researchers to analyse a complex phenomenon in detail within a single or multiple settings (Creswell, 2007). A comparative design is used when comparing two or more contrasting situations (Bryman, 2012). The cross-sectional design also known as the survey design is analysis done at a single point in time and the longitudinal design is over a sustained period in time (Creswell, 2007).

This research is a cross-sectional study where data were collected through semi-structured, in-depth interviews. The advantage of the in-depth interview is that the respondents had the liberty to describe experiences in their own words and the interviewer was able to pick up other points about which to follow up (Leedy & Ormrod, 2010).

In the research done by Moyo and Firer (2008), the qualitative research methodology was used to analyse the South African securitisation over the period 2000 – 2007. In-depth interviews were conducted with active market participants who were issuers, investors, arrangers, servicers and also credit rating agencies. The interviewer was able to gain an understanding of issues that were not obvious from the initial review of issuance secondary data.

The Securities Industry and Financial Markets Association (2008) also applied a qualitative research in a study designed to identify the factors that would help restore confidence in the securitisation markets. Again here, the data collected from the responses was analysed in order to identify any similar patterns within the different groups.

However, qualitative research has its own disadvantages. The main critique is that this method is too subjective because it depends on the researcher's views about what is important and will be focused on (Bryman, 2012). As a result, the study becomes difficult to replicate. Another critique of qualitative research is the use of purposive sampling and so one cannot generalise the findings to the greater population (Leedy & Ormrod, 2010).

3.3 Population and Sample

3.3.1 *Population*

A population can be defined as the set of units, such as people from which a sample can be selected (Bryman, 2012). The target population for this research was all the participants in the South African securitisation market. This included originators, arrangers, rating agencies, trustees, and investors.

3.3.2 *Sample and sampling method*

Bryman (2012) defined a sample as the subset or portion of a population that has been selected for a research. The selection approach for the sample can be a probability (using random sampling) or a non-probability approach (Leedy & Ormrod, 2010). According to Bryman (2012), there are three types of non-probability sampling techniques, snowball sampling, convenience sampling and quota sampling. This study used convenience sampling, in which individuals were selected because of their availability. The aim of the study was to get opinions from market participants who have knowledge of the securitisation industry, so the sample was selected from:

- The members of the South Africa Securitisation Forum (SASF).
- The individuals who attended the 2015 SASF annual general meeting.
- Employees working for the Debt Capital Markets department in the five largest banks in South Africa.
- Individuals working for credit rating agencies.
- Individuals working for other non-bank originators of securitisation transactions (obtained from listings on the Johannesburg stock exchange).
- Investors for large pension funds and insurance companies.

- Individuals from the South African Reserve Bank.

Initially, a target sample size of at least 18 respondents was set. The aim was to have at least 3 participants from each one of the market groups: originators, arrangers, SPVs, trustee, rating agencies and investors

3.3.1 *The Research Instrument*

The three main data collection tools in qualitative research are an observation schedule, an interview schedule and a questionnaire (Bryman, 2012). The type of data collection method used depends on whether the researcher wants to employ a fully structured approach where the researcher knows exactly what questions he or she needs to be answered or a semi structured or unstructured approach (Bryman, 2012). In this study, the research instrument that used to collect the data was a semi-structured interview schedule. Open-ended questions were asked so that there was less restriction on the kind of information provided.

The research instrument is included below as Appendix A.

3.4 Procedure for data collection

Emails were sent to invite the different individuals to participate in the study. Then telephone calls were made as follow-up for those who did not respond. The individuals were provided with a "study information sheet" and given adequate time to consider whether or not to take part in this study. All interviews were set at least one week in advance to accommodate busy schedules. High-level questions were sent in advance of the interviews to those participants who requested them.

The interviews were done face-to-face and at the respondents' offices, with the exception of three interviews done telephonically. Face-to-face interviews allow the researcher to establish rapport with the participants and also to capture changes in body language and tone of voice (Leedy & Ormrod, 2010). At the beginning of each interview, the respondents signed the consent form shown as Appendix C.

The interviews were audio-recorded with permission from the interviewees and then transcribed to text later. This allowed the interviewer to pay detailed attention to conversation analysis and to be alert in order to follow up on interesting points by probing (Bryman, 2012). During the interview, written notes were also taken to capture any non-verbal cues from the respondents.

Bryman (2012) suggests that transcripts should not include any participant names in order to maintain confidentiality. For this study, no participant names and addresses were stored on hard drives. Identifier codes were used on all data files and the list of participants' names and their identifier codes were stored separately in a locked cabinet.

3.5 Data Analysis and interpretation

Data analysis and interpretation gives an understanding of what the data are saying and what it all means. In qualitative analysis, the richness of the data makes it cumbersome to analyse. The three main approaches used to analyse data in qualitative are: thematic analysis, narrative analysis, and content analysis (Bryman, 2012).

This study employed content analysis, which is the systematic analysis of documents and texts to quantify the content into different categories (Bryman, 2012). This technique is well suited for this research because the use of open-ended questions will generate large amounts of data, and content analysis allows for new categories to emerge from the data collected and this is important since literature on securitisation in South Africa is scarce.

The following steps in the data analysis were followed to carry out the analysis:

Step 1 was the initial processing of the raw data. The raw data were checked for any obvious flaws before transcription (Bryman, 2012). This involved listening to the audio recordings and reading the notes taken during the interview.

Step 2 was the transcribing of the data. This again involved listening to the audio recordings and writing down any ideas that came to mind. The notes were read several times in order to understand the data. Memo-ing (memo-writing) is important at this stage in order to write down any preliminary thoughts, such as comparisons, connections or other interpretations that come to mind while reading the notes (Leedy & Ormrod, 2010). The transcripts and the field notes were then coded.

In **Step 3,** the data were reduced into meaningful segments. They were classified into the categories/themes developed from the literature review and also some new categories that emerged during the interview process. The data were assessed to pick up any patterns, or connections and relationships between the categories/themes.

Step 4, the final step, was the visual representation of the findings. The data were all tabulated before interpretation.

3.6 Limitations of the study

The research was limited to the Gauteng Province due to time and resource constraints. An exception was one telephonic interview with an employee of a financial institute with headquarters in Durban. This participant was important because his firm was the largest non-bank originator in South Africa in terms of issuance volumes.

There were uneven numbers of participants in each of the categories involved in the securitisation and this had an impact on the research. For example, there were a large number of respondents in the originators category and only two respondents from the rating agencies category.

A non-probability sampling technique was used for this research so the results cannot be generalised to the rest of the population.

3.7 Validity and reliability

Denzin and Lincoln (1994) suggest that qualitative researchers think in terms of trustworthiness instead of the quantitative accuracy measures of validity and reliability. Qualitative research findings are oriented to a specific context and the significance of a social aspect being studied. Application of validity and reliability will not work because there can be several possible accounts of the social reality (Bryman, 2012). Trustworthiness is made up of four criteria: credibility, transferability, dependability and conformability, which correspond to the quantitative measures of internal validity, external validity, reliability and objectivity (Denzin & Lincoln, 1994) .

3.7.1 *External validity*

Transferability, which parallels external validity, means that the findings of a research can be applied to other studies (Bowen, 2005). In order to provide for transferability, Bowen (2005) suggests giving 'thick" descriptions of the phenomena being studied. It was not possible to capture detailed accounts of the field experiences as "thick" descriptions.

3.7.2 *Internal validity*

The qualitative measurement of internal validity is *credibility*, which refers to how believable the findings of the research are. The method of data triangulation was used to check the credibility of this research. Triangulation is the use of various methods or sources of data in research for cross-checking (Bryman, 2012). Some of the respondents were contacted to verify some of the information they had provided during the interviews.

3.7.3 *Reliability*

In qualitative research *dependability* is the equivalent of reliability, which refers to the stability of the findings over time (Bowen, 2005). To accomplish dependability, Denzin and Lincoln (1994) recommend the use of an “audit trail”. This involves keeping records of all the stages of the research process.

In this study, details of the complete research procedure were captured so that any future researcher wanting to repeat this study will know exactly what was done.

CHAPTER 4. PRESENTATION OF FINDINGS

4.1 Introduction

This chapter presents the findings from the semi-structured interviews conducted. The first section provides a demographic profile of the respondents. This is followed by the results of the interviews presented as responses to the questions asked to understand the development of the South African securitisation market. A summary of the results concludes this chapter.

4.2 Demographic profile of the respondents

The initial aim was to conduct a total of 18 interviews with three respondents from each group of the key market participants: originators, arrangers, SPVs, trustees, credit ratings agencies and investors. However, it was not necessary to interview any representatives for the SPVs category because these entities have no employees. The trustees control the SPVs.

In South Africa, the banks play the biggest role in securitisations, usually fulfilling multiple purposes as originators, arrangers and servicers. So in some cases, a respondent in one interview would answer questions from the perspective of more than just one role. There were three telephonic interviews conducted with respondents who were unable to meet face-to-face. One interviewee was a respondent working for an international credit rating agency with no offices in South Africa. The second interviewee worked for a financial institution based in Durban, South Africa. The last telephonic interview was done because, after several postponements of the face-to-face meeting, the respondent requested to speak over the phone. In all, a total of 16 interviews were conducted with representatives from two credit rating agencies, two trustee organisations, three non-bank originators, three investment firms and the remaining six respondents worked for banks in roles as originators or arrangers.

The respondents were all professionals including attorneys, chartered accountants, economists, certified financial analysts and bankers. Between them, they showed deep knowledge about securitisations. They had between 4 – 17 years' experience dealing with securitisation transactions.

The interviews were semi-structured and conducted using probing questions to encourage respondents to participate in a discussion or conversation about securitisation rather than treat it as a "question and answer" session. As a result, the interviews ranged from 13 – 36 minutes each depending on the role of the respondent and whether they were still active in the securitisation market or not. The majority were very passionate in their responses and very interested in knowing what the findings of the study would be.

4.3 Overview of the securitisation market in South Africa

The findings from the interviews assisted with answering the research question below:

> *What are the main factors affecting the development of the South African securitisation market and what is the future outlook?*

Content analysis of the responses from the 16 semi-structured interviews revealed four key themes that were relevant to answer the research question:

- The benefits of securitisation
- The trends observed in the local securitisation market
- The constraints to growth of the securitisation market
- A comparison of the local market to the European and USA markets
- Future outlook of the securitisation market

4.3.1 *Benefits of Securitisation*

From all the interviews conducted, it was clear that the securitisation of income producing assets is a technique beneficial to the financial markets. All groups of participants recognised that there were benefits for the suppliers of securitisation paper (originators) and also for the buyers (investors). Asset managers get an opportunity to diversify their portfolios and invest in new types of asset classes, such as mortgage securities, auto-loan securities and other securities backed by cash flows from consumer debt. Out of the 16 participants interviewed, six mentioned the diversification benefit for investors. Below are two quotations, one from the trustee category and the other from the investor group.

"It gives investors an access to assets they would not normally be able to access, by buying paper backed by these assets and they get returns from mortgages, vehicle loans and other loans ". (Respondent D)

"I get the highest returns with the lowest risk for my clients". (Respondent A)

According to the respondents, loan originators benefit from lower cost funding or alternative funding sources and banks also get capital relief when they meet the accounting requirements to get assets off their balance sheets. One respondent referring to the funding benefits of securitisation, said:

"For originators it is an alternative source of funding, so you don't have to go to the bank to borrow, you can go to the capital markets and you grow your name in that market. Generally speaking you will get better rates in the capital markets than you do from the banks". (Respondent B)

However at the time that the interviews were conducted, it was found that the banks were not driven to securitise their receivables for cheaper funding; it was mainly to diversify their funding sources. The banks could raise funding more cheaply in the corporate bond market than from securitising their assets. The corporate bonds they issued had lower rates than the rates on securitisation bonds. According to Respondent M, at the time the bank paper was priced at 30 basis points lower than the AAA rated securitisation notes. Respondent G also confirmed this:

"Right now, the bank notes are pricing 20 – 30 basis points better than securitisation paper yet they are unsecured. So banks can raise funding cheaper than through securitisation vehicles".

The non-bank lenders, however still found it cheaper to obtain funding from securitisations. Both the respondents interviewed who worked for non-bank lending institutes stated that securitisation was a significant funding source for their organisations. Also interesting to note was that one other respondent employed by a small bank, not the one of the big five banks, stated that securitisation was still a cheaper source of funding for them. They got better pricing from the high rated asset-backed securities than from their low rated corporate bonds. One of the lenders had a business model completely dependent on securitisation for funding.

Another interesting finding was that when one of the lenders issued a securitisation deal at the end of 2015, not only did they receive an oversubscription in the AAA tranche but also oversubscription in the unrated tranche. The explanation given for this was that the investors buying the unrated notes were comfortable with the risk of the company. This finding confirms a statement made by Respondent B about a corporate growing their name in the capital market:

"For originators it is an alternative source of funding, so you don't have to go to the bank to borrow, you can go to the capital markets and you grow your name in that market".

The findings in this research also revealed that banks were no longer driven to securitise their assets for the "capital arbitrage benefit". The process of getting a 'true sale" to get assets off the balance sheet and reduce the amount of regulatory capital needed, had become much more difficult. One of the respondents, working for a trustee pointed out that,

"You can sell the assets legally, but the accountants may still say that you have not gotten rid of a significant amount because you have purchased a portion of the risk when you buy a portion of the subordinates notes yourself" (Respondent B)

There were two additional benefits of securitisation that emerged from the interviews:

- Some lenders also played an "advisory role" for third party deals and would charge a "fee" for structuring and packaging securitisation deals and sometimes sourcing investors. The originators of loans also get a matching benefit from securitisation because it allows them to fund long-term loans.

"Securitisation is a great product. It gives you a benefit in terms matching which is important, because it has a long-term funding component to it". (Respondent D)

"It is also gives diversification, it is an additional funding instrument. I sell instalment sale agreements for people buying vehicles on a 5-year credit term. So I can borrow money from the investors for 5 years and I match the interest cash flows". (Respondent I)

4.3.2 *Current market trends in Securitisation*

All the respondents interviewed were working in organisations that had been involved in securitisations before, during and after the global financial crisis, except for one investor. The view of the respondents was that the downward trend in securitisation issuances, which started during the GFC, was still going on in the South African market. Originators were not securitising as much as they used to before the crisis and also the sizes of the deals were now significantly smaller.

"At the height of securitisation in South Africa in 2008 there was just short of ZAR 20 billion worth of issuances in that year, then it dropped down to about ZAR 5 billion, then last year it was ZAR 10 billion and this year we think it will be ZAR 10 billion". (Respondent O)

The market has also changed with respect to the kind of assets being securitised. During the peak of securitisations issuances in South Africa, transactions involved a wider variety of assets such as auto loans, commercial loans, credit card receivables and other unsecured loans, but it is was now mainly residential loans with less of the other asset types. According to one of the investors interviewed:

"There are hardly any transactions done with unsecured consumer loans these days." (Respondent A)

Investors were now very cautious because of how securitisations were blamed for the GFC, even though there were no South African securitisation transactions that failed during the crisis. The wider credit spreads were because the few investors buying securitisation paper were demanding high premiums. A few respondents described the investor issue with phrases like

“Investors had gone”

“Investors have disappeared”

“There is a smaller pocket of investors”

“ Big institutional investors have said outright that they won’t touch this kind of paper”

Respondent O, who was a banker, brought up an interesting fact about using the public issuance activity as a means to measure the growth of the industry. He explained that the public reports of securitisation issuances did not include some “privately” placed deals between lenders and investors which may not have been credit rated and hence not publicly reported. Another three respondents agreed that there was now more focus on the privately placed deals.

“The route now is to do the private placements and not go the auction route. You engage your investor and structure the deal according to what they want” (Respondent D)

“You see ZAR 10 billion listed. There is possibly another unlisted ZAR 20 billion that happened last year”. (Respondent O)

“This is a fairly new trend started over the last two years. The cost to actually rate and list these transactions is just unnecessary so we will only go rated if it is truly required ”. (Respondent N)

According to Respondent O, the credit rating process was a very long tedious process lasting that took almost six months and also very costly at about ZAR 1 – 1.5 million. Respondent I, who stated that it cost about ZAR 1 million to rate a securitisation deal, confirmed this figure. To avoid this high cost and expedite fund raising, the originators did tap issuances.

“ We set up once a year a new vehicle that’s out initial securitisation then we do what we call a tap issuance, during the year we add on more assets”. (Respondent L)

“It is extremely expensive to administer a securitisation. There are lots and lots of things to be done from an accounting, tax and regulatory point of view. That is why we set up

programs over a revolving period. We top up with new assets every few months and try to keep the structure going for as long as possible.” (Respondent I)

Another trend that emerged from the findings was that the banks, which are the largest originators in South Africa, were all doing self – securitisations also known as “retained transactions” for the purpose of meeting their liquidity requirements with the SARB:

“Recently you are finding that there is a lot of bank activity, so internally the banks are doing it for the committed liquidity facility, there has been a massive shift in the market”. (Respondent O)

“Banks need to meet certain ratios that are set out in Basel III so they need High Quality Liquid Assets which they do not have. So the SARB created a facility to help the banks so they can securitise their assets and use this as collateral with the SARB. There are tens of billions of self-securitisations out there. Most arrangers are spending 60% of their time on self-securitisations”. (Respondent F)

4.4 Factors affecting the securitisation market in South Africa

Table 2: Factors constraining growth of the local securitisation market

Constrains to growth	No. Respondents
1. Regulation	13
2. Complexity Premium Liquidity Premium	11 10
3. Economy	8
4. Investor pool smaller	7
5. Uneducated Investors	7
6. No Capital Arbitrage	6
7. Basel III negative impact	6
8. Credit rating agencies	4

4.4.1 *High investor premiums*

From the interviews, it was found that the credit spreads in the securitisation deals were much wider than spreads seen before the crisis in 2008. There was a smaller pool of investors willing to invest in asset-backed securities and they were demanding a complexity premium. As stated by one of the bank representatives interviewed:

"There are too few investors so there is no competition for pricing. Investors make the price, which is not attractive for issuers". (Respondent J)

The banks had also turned to cheaper sources of funding rather than securitisation because of the higher yield spreads. The process of structuring and arranging securitisation is very complex and time-consuming, making it costly for the originators who in turn, would price deals higher, so the high premiums demanded by investors were deterring a lot of originators. Out of the 16 interviews, 14 respondents brought this up as the main factor constraining the growth of securitisation in South Africa.

Many of the participants referred to the complexity of securitisation deals. They described securitisation, as a "complex" financial tool and the need to educate investors so they could better understand it. The originators pointed out that even though the structures were complex, the securitisation paper still did not carry as much risk as the corporate notes. As one respondent put it,

"Banks right now in the current market can raise funding cheaper in the bond market than securitising their assets". (Respondent H)

The general sentiment was, however that securitisation paper should be cheaper because it is less risky. Most of the respondents stated that with the asset-backed securities, investors have recourse to the underlying assets in the event that something goes wrong. Corporate bonds on the other hand are not secured. Respondent L who was working for a non-bank institution explained it well:

" In Europe you see that securitisation bonds are much more stable in terms of rating than corporate bonds which is a normal thing. A corporate rating rates the unsecured

debt of a corporate. A corporate is an operating company; it has its own life, has employees, it can incur more debt and can change its strategies anytime. Securitisation is ring fenced, its like freezing it you know what you are investing in, the type of asset remains the same, nothing changes, there are no employees and no liabilities".

The stigma associated with securitisation investment paper comes from the defaults that happened in Europe and the USA during the global financial crisis. However, there were no defaults of any securitisation deals in South Africa during the global financial crisis. One investor interviewed explained the reason why South African securitisation deals did not fail,

In the USA and Europe there were a lot of deals that incurred losses, we haven't had any. No investor has ever taken a loss on a securitisation deal in South Africa. The originators always keep 2 - 8% of the deal, what we call "skin in the game". It ensures the ongoing monitoring and continued focus on collecting on those receivables remains robust". (Respondent A)

Three other originators, all the arrangers and the two trustee representatives interviewed also echoed this view. In all the securitisation deals originated in South Africa, the structure was such that the originator always had "skin in the game" meaning that they kept a percentage of the securities in the first loss tranche. Originators would have the first loss before any losses trickled down to the investor.

Respondent K stated that, in the structure of their deals, not only did they have 5% skin in the game, they also had a loan from another bank which covered 12.5% of the securities as second loss. So the bank's default rate of 3% would have to increase at least five times before any losses got to the investor. This demonstrates the robust nature of the transactions originated in South Africa.

4.4.2 *Elimination of capital arbitrage*

Another reason given by the interviewees for the lack of growth of the market was the elimination of the capital arbitrage previously gained by securitisation. New regulation, accounting standards and tax implications have made it difficult for banks to get assets off their balance sheets after securitising. A total of six respondents shared this view.

“The capital benefit that we used to get through securitisation has been completely eliminated except for certain very isolated geographies like Australia where they do not fully subscribe to Basel III. When you do a securitisation you are trying to remove the risk off your balance sheet. So if you do a securitisation and the risk remains on your balance sheet now you will have to hold capital against that risk”. (Respondent F)

4.4.3 *Macroeconomic factors*

One participant also had the opinion that in an economy where the housing market is subdued, it followed that the banks were not lending as much and so would not securitise as much as they did before. Another participant representing a credit rating agency made a similar statement.

Six other respondents from this research shared the same opinion, stating the performance of the overall economy as a factor affecting the securitisation market. They pointed out the fact that the securitisation industry in South Africa was doing well in 2014 until the collapse of African Bank Limited (ABL).

“Investors are now demanding a premium. This is an outflow from ABL. They had to liquidate some funds and just couldn’t find buyers. It’s not like a traded market like it is in the USA. There were a number of deals in the pipeline in 2014. 2014 was looking good then ABL happened and it also stuffed up the corporate bond market”. (Respondent D)

“Because of ABL and First Strut people have become very cautious. Since ABL we have seen a contraction of the market for example, the transaction we did just before ABL we were able to issue around ZAR 750 million but after ABL we only managed ZAR 40 million. People are a bit reluctant to buy securitisation paper”. (Respondent L)

Two participants, one from a small bank and another participant representing a non-bank lender mentioned that the “First Strut” incident had a negative impact on securitisations. The participant working for the small bank described the effect of ‘mini crises” in our economy as a constraint on the growth of the securitisation market.

“We have had quite significant “mini crises” in South Africa, within our own economy. The global financial crisis did not affect our market that much; it was just the banks taking a

more conservative view to this type of financing. But if you look at it, in 2013 there was this major bond default, First Strut within the country and in 2014 it was the ABL collapse. These mini crises were just as radical to our market as the global financial crisis of 2008". (Respondent K)

The respondent, who worked for the local rating agency, shared the same view and stated that the more recent economic changes in South Africa have had more of an impact on the securitisation market than the global financial crisis.

4.4.4 *Basel III*

The respondents differed in their opinion about the effects of the Basel III accord on the securitisation market. Five respondents raised the issue that the new Basel requirements were very stringent and would be punitive to the originators hence further constraining the supply side of the market. Another five respondents also agreed that the Basel III requirements were stringent, but had a positive effect on the securitisation market. The Basel regulation encouraged banks to securitise more in order to meet the requirements of the "committed liquid facility" (CLF) with the central bank, South African Reserve Bank (SARB). All the representatives from the four large banks confirmed that there were already doing "self –securitisations" for the purpose of meeting the CLF with SARB. Only one respondent felt that Basel III would also bolster investor confidence in securitisation products.

4.4.5 *Credit Rating Agencies*

The two respondents representing non-bank lending institutions stated that the credit rating agencies were the number one constraint of growth within the market. In their view, credit rating agencies were requiring a lot of unnecessary information and making the rating process complicated, hence delaying the securitisations. The complex process then becomes too expensive for the originators. As a result more originators are bringing fewer new deals to the market and instead, doing more refinances of existing deals. In the case of banks, they turn to alternate sources of funding which are cheaper than securitisations.

For the non-bank lenders there is not much choice for funding. Securitisation offers a cheaper funding option because the resulting asset-backed securities are highly rated, getting AAA or A- rating as compared to issuing unrated corporate bonds. This makes securitisation a very important funding technique for non-bank lenders. One of the respondents representing a non-bank lender mentioned that their company's business model was centred on securitisation.

4.4.6 *Demand for securitisation paper*

All respondents raised the issue of wider credit spreads as a major constraint to growth of the securitisation market. Investors were demanding a complexity premium and a liquidity premium. Securitisations are very complex by nature and the asset managers buying the securities found it difficult to apply their own models for risk assessments and to explain to their approval committees who did not fully understand securitisation. This was the justification for the complexity premium demanded.

Out of the 16 interviews conducted, 10 respondents cited lack of a secondary credit market, as another reason investors were not buying asset-backed securities. Investors would have to hold the securitized paper until maturity because there was no secondary market to trade the securities. Respondent H and respondent B gave the statement below:

"One of the big things that were raised by investors were the complexity of the structures and that the paper is not liquid"

"The investors themselves are expecting unreasonable prices for the paper and they are arguing that the paper is illiquid and complex".

4.4.7 *Regulation*

Most of the market players blamed regulation for the lack of growth in the industry because it limited instead of encouraging investors to buy securitisation paper, as shown in Table 2. The two respondents employed by non-bank lenders and an employee of one of the small banks stated that investor mandates were restrictive to securitisations. A respondent working for one of the credit agencies confirmed this, *“The current regulation is ambiguous for investors wanting to participate in securitisation”.* (Respondent Q)

On the other hand, seven of the market participants interviewed also stated that the South African regulatory system was very good and contributed to the robustness of the securitisation market. This should give the investors confidence to buy securitisation paper. Regulation also played an important role in the current market to ensure standardisation and transparency of the securitisation structures, which are very complex by nature. This would allow investors to understand the deals better and to do their own modelling to assess risk.

4.4.8 *Investor Education*

Another reason given by market players for the low demand for securitisation paper by investors was the lack of specialists, i.e. investors who had the expertise and focused solely on securitisations. As one respondent pointed out:

“More investor education around securitisation can possibly boost it. Investors can look to this secured credit rather than unsecured bank papers for example with the situation that happened to ABL”. (Respondent H)

“I think investors have got to realise the actual true risk of these transactions and be willing to accept lower yields in return for it. Because the transactions are quite stable and performance has been very good”. (Respondent P)

4.5 Comparison of the South African market to the overseas securitisation markets

Table 3: Differences between the local securitisation market and overseas markets

Difference	No. Respondents
Regulation	10
Size	7
Secondary market	5
Structures	4
Assets	4
Rating	3
Defaults	2
Cross-border	1

According to the respondents, the main difference between the overseas market and the local securitisation is the regulatory framework. There were 10 respondents who pointed out the main differences in regulation as:

- South Africa has a robust regulatory framework. The financial regulations prevented the misuse of securitisation in the local market as was seen in the USA.
- The South African regulation is outdated and is mainly focused on the fact that securitisations were driven by the need for capital relief.

Compared with the overseas market, the South African securitisation market was considered to be much smaller. Out of the 16 interviews conducted, seven spoke about the USA and European securitisation markets being much larger than the local market and hence having a more liquid secondary market. There were three respondents who did not make a comment because they were not familiar with the overseas securitisation markets.

Another finding from this study was that the securitisation structures in South Africa were much simpler compared to the structures issued in the USA and Europe.

"The structures that are put together for securitisation overseas especially in the USA are a lot more complex than what you get here. Here the ones that we do here are very straightforward when compared to the ones done in the states. Definitely a lot more complex and I suppose that's one of the reasons that caused the 2008 defaults with the subprime loans". (Respondent H)

Four of the specialists interviewed also mentioned the fact that the quality of underlying assets in the securitisation deals in South Africa was better than that of the transactions overseas. This is also the reason some participants gave for the robustness of the South African securitisation market. Words like *"prime assets"* and *"fantastic performing assets"* were used to describe the quality of assets used in securitisation deals in South Africa.

Both credit rating agency respondents stated that in South Africa only one rating is required for a securitisation deal whereas most of the deals in Europe and the USA require two different credit ratings. Another respondent offered an explanation for this:

"The reason for this may be that South African transactions are mainly domestic issuances while overseas markets are dealing with cross-border issuances". (Respondent Q)

Overall, the data from this research clearly suggests that the overseas market is different to the local market. However, two respondents had a different view, mentioning that the markets are similar in regulation and also in the structures of the securitisation deals. Three respondents did not comment.

4.6 Future outlook for the South African securitisation market

All the respondents interviewed agreed that the global financial crisis of 2007/2008 had a negative impact on the South African securitisation market. However, five respondents mentioned that the impact felt in South Africa was not as bad as the effects overseas. There were no defaults in the South African securitisation market during the GFC.

From the 16 respondents interviewed, 13 thought that the government could play a role in promoting securitisation. Two participants stated that the government was already helping and one participant was convinced that the government's help would not make much difference. The government's role in this case refers to the Regulator as the oversight for the financial industry. Respondent D pointed out that the regulations around securitisation need to be updated so that they were relevant to the current market and are free from ambiguity.

With the implementation of the Basel III regulations on the capital required by banks and the new liquidity ratios of bank, 10 of the respondents agreed that it would have a positive impact on the local securitisation market. This is because the banks would have to securitise more in order to meet the committed liquid facility (CLF) requirements with the Reserve Bank. One respondent was of the view that the new Basel III requirements would be punitive to the originators and hence negatively impact the securitisation market. Another respondent perceived that Basel III would be good for investors because it was aimed at addressing the issues that caused the financial crisis, where investors lost huge amounts of money. There were three respondents who did not comment on the effects of the Basel III regulations on securitisation.

It emerged from the interviews that the issue of investor education was very important for the development of the securitisation market. Investors need to understand that securitisation transactions have a lower risk than senior unsecured paper. All respondents agreed that the wider spreads on yields seen in the current market were due to investors demanding a complexity and liquidity premium. Of the 16 interviews conducted, only three respondents suggested a need to focus on standardisation in order to simplify the securitisation structures.

4.7 Summary of Findings

The results of this study address the research question on the views of the market players regarding the future outlook for securitisation in South Africa. Although securitisation issuances have declined since the global financial crisis, the market is still active and beneficial to the South African economy. The main benefits were found to be: diversification benefits to lenders and investors, cheaper funding source for non-bank institutions, and to be able to meet the requirements of the CLF with the Reserve Bank (SARB).

However, there are several factors constraining the growth of the securitisation market:

- The high premiums demanded by investors due to complexity of the structures and the lack of a secondary market to trade securitisation paper
- The widening credit spreads lead to a pricing that cannot justify the complicated, time consuming process for the issuers to complete a transaction
- An investor base not well-educated about the true risk of asset-backed securities
- Regulation: restrictive investor mandates and outdated securitisation regulations

Whether the local securitisation market will grow or not would be dependent on how the constraints mentioned above are dealt with.

CHAPTER 5. DISCUSSION OF RESULTS

5.1 Introduction

In this chapter, the findings of the research are discussed and explained with reference to the literature review in chapter 2. The results in chapter 4 are compared and contrasted with the information from the literature on the securitisations in South Africa. The goal is to predict the future outlook for the South African securitisation market using the findings from this research. The chapter ends with a conclusion of the research question.

5.2 Profile of respondents

The respondents comprised originators, arrangers, trustees, credit rating agencies and investors. According to the literature, the trustee's role is to control and monitor the SPVs and SPVs have no employees, therefore no respondents representing SPVs (Fender & Mitchell, 2009). The four large banks all have multiple roles as originators and arrangers. Two of the investors interviewed were asset managers working for the investment departments of the banks. The one investor interviewed works for the regulatory body for investors and life insurance companies. All respondents had very strong financial backgrounds and thorough knowledge of investments.

Only one large bank required a non-disclosure agreement to be signed before the interview. None of the respondents had any objection to having an audio recording as long as it remained confidential. It was interesting to note that almost all the bankers were well informed about their competitor's deals in progress and spoke freely about them.

5.3 Benefits of Securitisation

This study found out that the overall main reason that banks and other financial institutions would securitise their receivables was for diversification of their funding. Out of the 16 interviews conducted, 14 respondents stated that securitisation was an alternative funding source for originators. This confirms the literature that diversification of funding is a benefit for securitisation ((Moyo & Firer, 2008; Saayman & Styger, 2003).

The other finding from this research that banks securitised their loan books to access cheaper funding is also consistent with the literature on the reasons why banks were securitising in the period from 1993 – 2007 described by different authors (Moyo & Firer, 2008; Saayman & Styger, 2003; Tensfeldt et al., 1993; Van den Berg, 1998b). Access to cheaper funding was a reason given by seven of the respondents, when they were asked about the benefits of securitising.

However, this research revealed that bank originators were now turning to other funding options because of the high premiums demanded by investors buying securitisation paper. This finding further confirms the literature finding from different authors that banks will securitise their assets to obtain cheaper funding (Moyo & Firer, 2008; Saayman & Styger, 2003; Tensfeldt et al., 1993; Van den Berg, 1998b)

Another reason for securitisation that came from the findings of this study is the matching benefit. Two respondents mentioned the fact that originators will securitise their loan books in order to match long term loans with long-term funding. Respondent I, an employee of one of the non-bank lenders interviewed, stated that securitisation allowed their company to sell off 5-year securities to fund the 5-year consumer loans. Respondent D stated that,

“Securitisation is a great product. It gives you a benefit in terms of the matching which is important; it has a long-term funding component to it”.

There is support in the literature for this finding that securitisation helps alleviate the problem of mismatching. According to Moyo and Firer (2008):

“Instead of using short-term deposits to fund a long-term loan, mortgage loan book securitisation allows a bank to pool the assets in the loan book, sell these off and use the proceeds to fund further lending” (p. 2)

When describing the role of arrangers, Paligorova (2009) stated that a fee was charged for their work. There was no literature discussing the “fee income” as a benefit of securitisation. However from the findings of this research, two respondents suggested that the “fee” income was another reason why institutions in South Africa were securitising their assets.

It may be that the fees charged by the arrangers for advisory services in South Africa is significant compared to the fees charged overseas. The arrangers overseas may also be mainly providing the services internally within their corporations instead of arranging for third parties. Lastly, South African arrangers could be doing third party securitisation deals in order to get the names of their organisations out in the market to build a good reputation. As one respondent stated:

“For originators it is an alternative source of funding, so you don’t have to go to the bank to borrow, you can go to the capital markets and you grow your name in that market”.

When asked directly about the benefits of securitisation, only three out of the 16 respondents mentioned the capital arbitrage the banks received when they got assets off the balance sheets. It was interesting that, on the other hand, when asked about the constraints to securitisation growth, six respondents had the view that fewer banks were securitising less because they were no longer gaining the capital arbitrage. The new accounting standards have made it more difficult to get assets off the balance sheet:

“The banks benefit from securitising their assets because they don’t have to reserve capital against those assets. However the Basel III calculations have become more tricky and more stringent”. (Respondent B)

All respondents identified diversification as the reason investors were buying securitisation paper. The investment managers gain access to different grades of investment paper so they can have better matching with investment objectives. Respondent A, who was working for an investment firm acknowledged that buying securitisation paper gets them the “highest return with the lowest risk” for their investors. Respondent K also confirmed the matching of different investments objectives when he discussed the demand from investors for both AAA rated notes and unrated notes. This finding is consistent with the literature by Mpundu et al. (2013) about how “tranching” helps produce asset pools of different grades to satisfy varying investor appetites.

5.4 Current market trends in securitisation

The finding that after the financial crisis of 2008/9 there was a decline in securitisation issuance activity aligns with the literature. The market instability caused by the global financial crisis resulted in securitisation issuance volumes falling from ZAR 40 billion to a low ZAR 5,28 billion in 2007 and just ZAR 4.10 billion in 2009 (JSE).

Table 4: South African Securitisation issuance data (JSE, 2014)

Sum of Issued Amount	Issuer Type	Notes				
	Securitisations					Grand Total
Year Issued	**ABS Auto**	**ABS - Other**	**CDO**	**CMBS**	**RMBS**	
2003	3,360	1,397	-	1,400	2,000	8,157
2004	1,100	1,252	-	800	2,500	5,652
2005	4,058	4,670	-	3,875	8,499	21,103
2006	13,085	695	-	4,035	13,543	31,358
2007	13,575	1,047	2,060	3,501	20,225	40,408
2008	1,000	1,640	-	442	2,205	5,287
2009	800	1,793	-	750	760	4,103
2010	-	3,526	-	812	8,315	12,653
2011	5,595	4,006	-	-	12,210	21,811
2012	2,391	1,930	-	-	12,747	17,068
2013	-	3,034	-	2,225	6,169	11,428
2014	-	615	-	-	3,049	3,664
Grand Total	44,964	25,606	2,060	17,840	92,221	182,691

All the respondents interviewed agreed that the market had declined after the global financial crisis. However, the market players differed in the way they viewed what was happening in the current market. Two of the participants (Respondents C and P) in the interviews stated that the market would continue to see a decline in issuance volumes, while respondents A and B were of the view that the market was starting to pick up again. Respondents B, D and I did not expect to see any growth soon. The rest of the respondents were rather vague, stating that it all depended on how the mentioned constraints to growth were dealt with.

From the literature, listings on the Johannesburg Stock Exchange show that after the decline in issuances in 2007 – 2009, the volumes climbed again peaking at ZAR 21 billion in 2011. There were further declines in issuance volumes in the years 2012 to

2015 as shown in Table 3, so only four of the respondents were in agreement with the trend coming out of the listings data. It is difficult to gain an accurate figure of the total issuance volumes because the listings data only reflects public issuances. According to respondent O, any new securitisations that are privately placed with investors and not rated by the credit agencies will not appear on the JSE listing. Most of the international literature on issuance data reflects both publicly placed and retained securitisations (Birouk & Cassan, 2013; European Central Bank, 2011; Millán, 2014)

According to Blommestein et al. (2011), the US securitisation market started to see an increase in issuance volumes from 2009, while in the European market during the same period issuances declined. From the findings of this study, the South African market was not experiencing the same growth seen in the US market in 2009. This may be because the initiatives by the US government to support the securitisation market (Blommestein et al., 2011) contributed to a quick recovery of the securitisation market. In Europe, the recovery was not so quick, the downward trend in issuances which started in 2009 continued through to 2013 (Agresti et al., 2013). According to the respondents in this study, there was no such programme from the government or the central bank (SARB) to stimulate the securitisation industry in South Africa.

Post global financial crisis there was an increase in European "retained" issuances in proportion to the placed issuances (Agresti et al., 2013; Blommestein et al., 2011). A similar trend emerged from the findings of this study, that there was an increase in self-securitisations, which were used as collateral for the committed liquidity facilities with the Reserve Bank. Respondent O commented that there were tens of billion rands in self-securitisations out there and respondent F stated that most arrangers were spending around 60% of the time working on self-securitisations.

The finding that securitisation issuance volumes declined in 2014 in South Africa is consistent with the trend coming out of the international literature for the European securitisation markets. In their recent journal article, Segoviano et al. (2015) looked at the total securitisation issuances in the US and European market. They found that while the US market had been recovering from the financial crisis, 2012 and 2013 had low issuance volumes but there was a significant increase in volumes in 2014. In the European market on the other hand, issuance volumes have continued to fall since

2011, as shown in Figure 2 below. This finding may support the view by Respondent O in the study that the South African market is more similar to the European market than the US market.

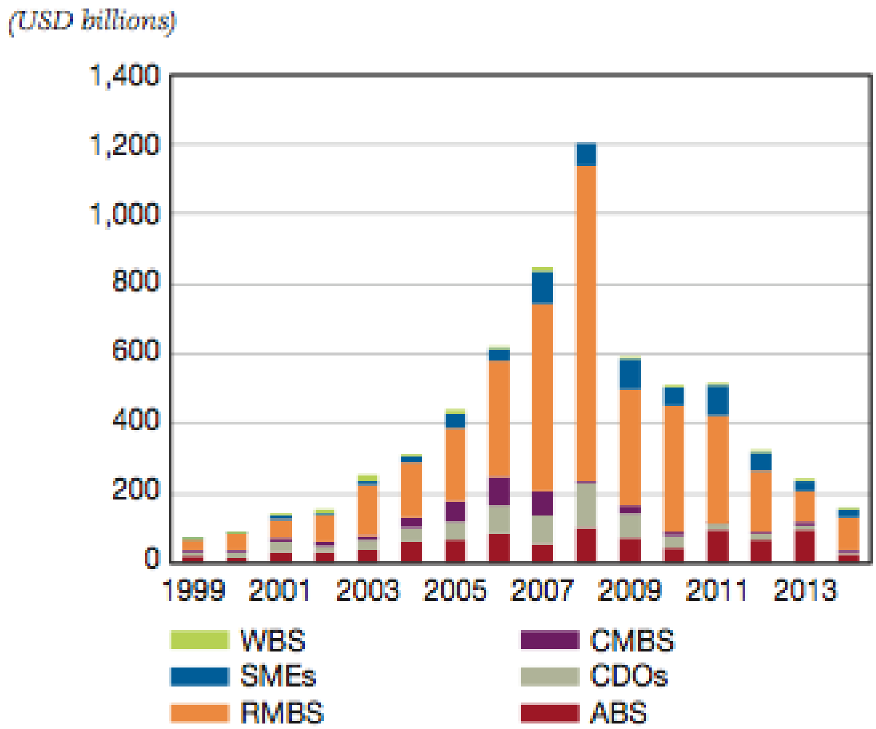

Figure 5: European Securitisation issuances (Segoviano et al., 2015)

5.5 Factors affecting the securitisation market in South Africa

5.5.1 *High investor premiums*

This research also found the high premiums demanded by investors to be the biggest constraint to growth of the South African securitisation market. Out of the 16 interviews conducted, 14 respondents brought it up as a factor affecting the industry. According to the market participants, investors were demanding both a complexity premium and a liquidity premium. The complexity premium was because the investors found the structures to be very complex, making it difficult for them to apply their own risk assessment models. In line with global trends, investors in South Africa were also doing their own risk assessments in addition to the work done by rating agencies. From the international literature discussing ways to restore confidence to the securitisation market, investors were encouraged not to rely solely on the credit rating agencies, but instead to also carry out their own risk assessments (Securities Industry and Financial Markets Association, 2008). It therefore seems fair for investors to demand more since they have to do more work.

The lack of a secondary market to trade securitisation paper has always been a major constraint of growth of the local securitisation market. From the research done by some authors beginning in the 1990s, investors were also concerned about the lack of liquidity in the asset-backed securities (Moyo & Firer, 2008; A. Saayman & Styger, 2003). The data from this research points to the same problem, the investors were demanding a liquidity premium because of the lack of a secondary market to trade the securities. The need for the securities to be tradable is understandable given the “stigma” associated with securitisation since the crisis of 2008.

5.5.2 *Elimination of capital arbitrage*

Fender and Mitchell (2009) and Blommestein et al. (2011) stated that the updated accounting measures would have an effect of making it difficult for banks to achieve off-balance sheet treatment for securitisation transactions. The findings of this research are consistent with the literature regarding the elimination of capital arbitrage. The results from the interviews showed that the market participants stated capital arbitrage as a benefit from securitisation. Another six respondents went on further to explain that banks were no longer securitising as much because they could not get capital arbitrage anymore.

5.5.3 *Macroeconomic factors*

The market players interviewed felt that the overall performance of the local economy has an impact on the securitisation market. A slow growing economy, with a subdued housing market and any crises in the corporate bond market will hamper the development of the securitisation market.

This is consistent with the literature by authors Moyo and Firer (2008), who found that as the economy grew in 2000, there was an increased demand for loans and securitisation activity increased too. Similarly, as the corporate bond market was growing, credit grew as an asset class.

5.5.4 *Basel III*

According to Venter (2012), the revision of the Basel prudential requirements was prompted by the global financial crisis. The aim of the new regulations was to address the problems the banks faced during the crisis by improving the inadequacies of the previous Basel II accord. Most central banks, including the South African Reserve Bank, had set up committed liquidity facilities to help the banks meet the new Basel III liquidity requirements (Agresti et al., 2013; Gruić et al., 2014; Venter, 2012). The results from this research confirm that the committed liquidity facilities really do assist the banks. The banks in South Africa are all doing self-securitisations to meet the requirements of the CLF with the SARB and as one respondent put it:

"There are tens of billions of self-securitisations out there. Most arrangers are spending 60% of their time on self-securitisations". (Respondent O)

This finding is consistent with the literature on the European securitisation because retained securitisations were found to be more than 50% of the total outstanding European issuances in 2013 (Agresti et al., 2013).

5.5.5 *Credit Rating Agencies*

Choudhry and Landuyt (2009) and Steen (2011) suggested the need to improve the credit rating of securitisation deals and Blommestein et al. (2011) stated that regulatory reforms in the USA and Europe had also been targeted at rating agencies in order to improve on their rating methods which were revealed to be flawed during the credit crisis. The respondents in this research mentioned that the credit rating process was very complicated and time consuming and the rating agencies had become very conservative. The new regulations aimed at improving securitisations were also hurting the process by making it more complex and expensive. Non-bank lenders and smaller banks seemed to be affected more by the rating process than the larger banks because only one respondent from the larger banks complained about the rating process. This may be because the larger banks have deeper pockets and may not feel the same effect of the high costs.

5.5.6 *Demand for securitisation paper*

It emerged from this research that since the financial crisis of 2008/9, investors were now demanding a complexity and a liquidity premium and as a result, the credit spreads are much wider. This finding is in line with the literature that after the credit crisis, investors were seeking attractive yield in order to be compensated for the limited liquidity (Blommestein et al., 2011). However, in the UK and the USA, a few years after the crisis, there were signs that investor appetite for securitisation products was improving. In South Africa, the investor demand was found to be low. This may be related to other events that have taken place locally and affected the market i.e. the collapse of the African Bank Limited in 2014. As pointed out by many respondents in this study, there is a need to educate investors so that they understand that securitisation offers lower risk than unsecured bank paper. To address the issue of low demand for securitisation paper, there is a need for continued efforts on investor education.

5.5.7 *Regulation*

The first securitisation issue in South Africa was in 1989, but the next transaction was done ten years later in 1999 and then there was accelerated growth from 2000 to 2007 (Moyo & Firer, 2008). According to A. Saayman and Styger (2003) the regulatory environment in South Africa was not conducive to securitisation and only after a change in the Reserve Bank regulations and a change in the accounting rules did the securitisation activity increase in 1999. The findings of this research are consistent with the literature because more than half of the market participants interviewed felt that regulation of securitisation was an impediment to growth. While some of the respondents stated the securitisation regulation needed to be updated, the majority were blaming the investor mandates, which were ambiguous and restrictive for investors wanting to buy asset-backed securities.

The studies by Saayman and Styger (2003) and Moyo and Firer (2008) both found that growth of the local securitisation market to be slow because of a narrow investor base. From the findings of this research, the same conclusion can be reached. Market participants felt that the investor pool was getting smaller as the investors who are knowledgeable about securitisation are moving on to other departments within their organisations. The “stigma” that follows securitisation as the main cause of the global credit crisis is still felt today.

5.6 Comparison of the South African market to the overseas securitisation market

The four major differences mentioned by respondents comparing the local market to the overseas securitisation were: the South African market is smaller and has a limited secondary market; the overseas structures are more complex; and the regulations in South Africa are more stringent.

The findings that the local market was smaller and had a limited secondary market are consistent with the literature. The total securitisation issuance volume in Europe in 2009 when the market was at its lowest was approximately EUR 400 billion (Blommestein et al., 2011). South Africa, during its peak in 2008, had a total issuance volume of about ZAR 41 billion (Moyo & Firer, 2008). This clearly supports the findings that the South African market for securitisation is much smaller than the overseas markets, Europe and the USA. The USA market is much larger than the European market (Segoviano et al., 2015).

There is limited literature comparing the structures of the deals overseas and in South Africa. In their analysis of the USA securitisation market, Blommestein et al. (2011) describe the securitisation products coming out of the USA as being very complex and opaque. There is limited literature comparing the structures of the deals overseas and in South Africa. The findings of the research point to the fact that the deals structured overseas were more complex than the transactions done in South Africa. This may be a reflection of the conservatism of South African banks that already had “skin in the game” in all their deals even before the financial crisis.

5.7 Future outlook for the securitisation market in South Africa

It is clear from the findings that the South African securitisation is not expected to be growing in the near future. Only one respondent stated that the market would definitely grow while 13 respondents stated that it would only grow if:

- The securitisation regulations and the investor mandates were updated
- There was more transparency and standardisation of structures and reporting
- The credit rating agencies conservatism changed.

These findings are consistent with the literature from around the world where the focus has been on updating regulations to promote transparency and standardisation (Fender & Mitchell, 2009; Segoviano et al., 2015)

CHAPTER 6. CONCLUSIONS AND RECOMMENDATIONS

6.1 Introduction

The objective of this research was to identify the factors affecting the South African securitisation market and to determine the future outlook. This chapter firstly summarises the findings of the study, and then presents implications for the industry and lastly suggestions for any future research.

6.2 Summary of findings

The study found that the securitisation industry market in South Africa still plays an important role in funding the real economy. While banks are the largest originators, it was found that the non-bank lending institutions benefited more from the cheaper funding alternative offered by securitisation. The banks are no longer driven by the need to securitise their assets to gain capital arbitrage, since the new accounting standards have made it much more difficult to achieve a "true sale" to get assets off the balance sheet. With access to cheaper funding, the banks will continue to securitise less and less for public issuances. The trend is for the banks to self-securitise their assets to produce the High Quality Liquid Assets that qualify for the committed liquid facility with the South African Reserve Bank. This trend is likely to continue in the future.

The investor base is small and the few investors buying securitisation paper still benefit from the diversification of the portfolios to meet different investment objectives. Some of the investors still lacked interest because they perceived these securities as complex and risky after the losses suffered by investors overseas during the financial crisis of 2007/8.

After the global financial crisis, securitisation issuances volumes declined drastically in South Africa, as expected in line with the deterioration of global securitisation markets. While the overseas markets have recovered and are experiencing an upward trend, the local market has taken a knock from recent major economic issues, such as the collapse of African Bank Limited and poor performance of the overall economy. Growth in the securitisation is likely to remain slow because of the struggling economy with a predicted growth rate of under 1% (International Monetary Fund, 2016).

The view of market participants was that regulatory changes are necessary in order to facilitate the growth of the market. The view was that securitisation regulations are old and need to be updated while the Solvency II regulations were found to be prohibitive to investors wanting to buy securitisation paper.

The lack of a secondary market for asset-backed securities will continue to constrain the growth of the market. Investors would buy more securitisation paper if they knew there was a secondary market to trade it. The local securitisation market is much smaller and less developed than the overseas market, hence the differences in the trends observed in the markets.

The wider spreads on securitised products because of the high premiums demanded by investors are a deterrent to originators. Investor education is necessary to help investors understand these structures better and realise the true risk of the deals. Investor education is essential to increase the number of specialists in the industry and promote growth of the market.

Although beneficial for non-bank lenders, a lot of corporates will continue to be excluded from the market because of the high costs to securitise assets. The costs of rating the deals alone is prohibitive but a necessary part of the securitisation process. The few non-bank lenders active in the market will continue, as they are dependent on securitisation for funding. We are likely to continue to see more private placements as issuers seek to make the process less complex and save on costs of securitisation.

6.3 Recommendations

- We recommend that market participants, through groups such as the Securitisation Forum, continue to engage the regulator on the securitisation regulations.

- The findings show as long as the credit spreads are reasonable, securitisation paper will be issued. The supply is hampered by unattractive yields. It is therefore important for originators to continue focusing on investor education.
- Credit rating agencies are more conservative than they were prior to the crisis of 2008 and the result is a complicated and long rating process. Perhaps if the rating agencies set up local offices in South Africa and are on the ground, they could have a better understanding of the structure of the deals and this will speed up the rating process and reduce expenses.

6.4 Areas for further Research

This study focused on the views of 16 market participants based in the Gauteng Province only due to time constraints. The following areas have been identified for further research:

- Further research can be carried out to include all other provinces. The number of participants can be increased to at least 100 respondents and then have the research done as a quantitative study instead.
- Research can also be carried out that focuses on securitisation regulation. This could involve interviews with SARB employees
- A similar study to this one could be done comparing the growth of the South African securitisation market to that of another developing country, for example, Brazil or another that also lacks an efficient secondary credit market
- Given the similar trends in recent issuance volumes, a study could be conducted to compare the South African and European securitisation markets.

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APPENDIX A

Actual Research Instrument

1. What role does your organisation play in the securitisation process?
- Significance of the role

2. How long has your organisation been involved in securitisations?
- When was your first securitisation transaction?
- When was your most recent securitisation?
- If no longer involved, why not?
- What has changed?

3. What are the benefits of securitisation?

4. What factors constrain growth of the South African securitisation market?

5. What could be done to aid the growth of the Securitisation market in S. Africa?
- Can the government help?

6. Do you think securitisation activity could ever rise again to the levels seen before the global financial crisis?

7. How have the requirements of the Basel III accord affected securitisations?

8. How does the local securitisation market compare to overseas markets?
- What are the differences?
- What are the similarities?

APPENDIX B

Invitation to participate in a research project

Project Title: "Perceptions on the outlook for the securitization market in South Africa"

Researchers: Patience Dhliwayo, Wits Business School student

Professor Eric Schaling, PhD Economics – Research Supervisor

Dear Sir/Madam

We will be conducting interviews as part of our research study to investigate the development of the South African securitisation market. Our research is based on how the securitisation industry is perceived and experienced by key market participants. You have been identified as being affiliated with an organisation that participates in the securitisation market and hence we believe that you can give us valuable information from your own perspective.

The interview will take about 30 minutes and your responses to the questions will be kept confidential. The questions will be about your thoughts and perceptions of the securitisation South African securitisation market. The information you give us will help us better understand the current market trends and the outlook for the future.

Participation in this study is voluntary and there will be no compensation. I am more than happy answer any other questions you may have about the study, so feel free to call me on +27 82 884 0074.

If you are willing to participate please suggest a day and time that suits you and I will try to my best to be available.

Yours, sincerely

Patience Dhliwayo

APPENDIX C

Interview Consent Form

- I, the undersigned have read and understood the Invitation letter to participate in this research.
- I have been given the opportunity to ask questions about the study.
- I understand that taking part in the Study will include being interviewed and audio recorded.
- I have been given adequate time to consider my decision and I agree to take part in the Study.
- I understand that my personal details such as my name, employer name and employer address will not be revealed to people outside the project.
- I understand that my words may be quoted in publications, reports, web pages and other research outputs but my name, employer name and employer address will not be used.
- I understand that I can withdraw from the Study at any time and I will not be asked any questions about why I no longer want to take part.

Name of participant:__________________________ Date:

Researcher Signature:________________________ Date:

APPENDIX D

CATEGORY 1 - Benefits of Securitisation

THEMES	CODES
Capital Relief;	Off-balance sheet
Cheaper source of funding;	basis points
Diversification of risk	reduce risk

CATEGORY 2 – Current market trends and constraints

THEMES	CODES
Trends;	less new deals, more refinances; self-securitisations;
Investor Demand (buyers)	gone because of GFC; education; complex & time consuming; pricing; liquidity & regulation
Originators supply	complexity; time-consuming; cost; pricing; housing market subdued; no capital arbitrage; cheaper funding options
Regulation	Solvency II; participation by large institutional investors; credit ratings

CATEGORY 3 – Comparison with overseas markets

THEMES	CODES
Similarities	structure, regulation
Differences	deal sizes; liquidity (secondary market); types of assets; complexity of deals; central bank involvement;

CATEGORY 4 – Perceptions of future outlook

THEMES	CODES
Government intervention	
Education	
Basel III	