A FRESH APPROACH TO HOME FINANCE SA Home Loans

OVERVIEW OF SECURITISATION AS A FUNDING TOOL

SA Home Loans (“SAHL”) is not a bank and does not accept deposits from the public. As such, in order to be able to fund the home loans which are given out to clients, SAHL has set up a securitisation funding platform.

Securitisation is the process whereby cash flow producing assets (such as home loans, car loans etc) are pooled together and the value of such loans is packaged as securities which are then sold to institutional investors in the capital markets.

The capital markets are where long term funding (greater than one year in duration) can be obtained and it is, as such, the place where many lenders, banks included, would obtain long term funding for their longer term assets (such as home loans).

The process of funding a home loan in the capital markets can best be explained through the use of an example:

- Short term funding mechanisms (such as overdraft warehouse funding lines) are used to fund newly originated home loans.
- Once a sufficient pool of home loans has been built up large institutional investors (capital market participants) are approached, given details of the specific home loan pool (so that they can assess the risk of the pool of home loans) and then offered residential mortgage backed securities, which are secured by the specific, ring-fenced pool of loans in a securitised structure (legal entity).
- The securities offered to investors are generally between 3 - 5 years in duration.
- The proceeds from issuing securities to the investors are used to purchase the home loans from short term funding structures of the lender. In such a way the funding on the home loans gets converted from short term funding to long term funding.

The home loan borrower is not affected by where their home loan is funded given that, once they have received their home loan, they owe money to the lender and not vice versa. Therefore securitisation poses no risk to the borrower. Instead, it is the lender, and the funders within the capital markets, that are faced by the risk of the individual borrower defaulting on their home loan and the full balance not being recovered.

In order to facilitate the use of securitisation as a funding tool the bond over the property is registered in the name of The South African Home Loans Guarantee Trust (the "Guarantee Trust" - which in turn guarantees to each of the lenders payment in respect of the home loan agreement). All borrowers sign an Indemnity document which places the obligation for payment of the loan on the borrower and, as security for such obligation, allow the Guarantee Trust to register a bond over the property. When a borrower defaults on their obligation in terms of their home loan agreement the property is foreclosed upon and the trustee of the Guarantee Trust (Changing Tides 17 (Pty) Ltd) will realise the security (through sale of the property in terms of the bond thereon) irrespective of who the Lender is. The proceeds of the sale of the property will then flow to the Lender in terms of the guarantee which is a legally approved and binding structure and results in full recourse against the borrower should a default occur.

Securitisation in South Africa

Generally in South Africa the relevant Lender (under the home loan from time to time) holds the primary risk in a securitisation transaction. The Lender, being the securitised entity, which has acquired the home loan assets, thus incurs a certain percentage of initial losses in the structure, which is usually sized at a level to allow for the securities notes issued to the market to have an investment grade rating. This rating is supported by substantial cash reserves which are injected into the securitised entity at the outset (generally by the Originator – in our case SA Home Loans).

The South African model ensures that the Originator as well as the securitised entity which becomes the Lender has a significant vested interest in ensuring the high credit quality of assets originated, as it holds the rights under the agreement and the obligations to the borrower. This was not always the case in overseas transactions.

A further distinction from the overseas market is that South African securitisation transactions have remained relatively simple, and have primarily been used as a means of raising funding. This is unlike the international experience where structures became increasingly complex and risky.

As a result of the above, there have been no defaults by securitisation structures in South Africa, unlike the international experience, and securitisation remains a robust and viable funding and investment mechanism for both lenders and investors respectively.

Oversight and regulation of Securitisation in South Africa

Securitisation transactions are subject to stringent governance and oversight bodies:

- The Banks Act includes **Securitisation Regulations**, issued by the SA Reserve Bank, with which all securitisations, whether by a Bank or a non-Bank, must comply. Every new securitisation requires approval by SARB, and is required to be established in accordance with the regulations and in terms of robust legal documentation which properly documents the nature of the transactions and includes all key provisions required by the SARB.
- **Independent trustees** are appointed to ensure that the investors' interests are protected.
- **Rating agents** assign an initial rating to the various tranches of notes, and continue to monitor the structures after issue date and report on any changes in the risk faced by investors
- **Independent auditors** are appointed for every new securitization transaction, who provide an initial report on compliance with the Securitization Regulations, as well as annual audits of the securitisation legal entity.