**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 fund the home loans which are advanced to clients, SAHL has set up a securitisation funding platform.

Securitisation is the process whereby assets which produce a regular cash flow (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 debt capital market. The debt capital market is the market in which debt instruments are traded. It is the market where corporates and lenders typically look to raise long term debt to fund their operations or their lending.

The process of funding a home loan in the debt 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 special purpose vehicle (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 (with the short term funding being paid down following this sale). 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 borrowers defaulting on their home loans.

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, allows the Guarantee Trust to register a bond over the property. When a borrower defaults on obligations in terms of the 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) 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 Originator of the loans holds the primary risk in a securitisation transaction. Initial bad debts in the structure will be absorbed by the profit generated by the Lender (which typically flow back to the Originator) and losses in excess of profit being generated (if any) will first be absorbed by a 'first loss loan' that is typically advanced to the structure by the Originator. It is only once both these layers of protection are exhausted that the Debt Capital market investors will be impacted by losses. This model ensures that the Originator has a significant vested interest or "skin in the game" which encourages the originator to underwrite high quality business and service the loan pool in a manner which best mitigates against loss.

In many of the overseas transactions which came under scrutiny during the Global Credit Crisis, the Originator had no "skin in the game" which resulted in poor asset quality and ultimately, significant investor losses. 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, the performance of South African securitisation structures has been extremely sound and it therefore 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 Securitisation Regulations, as well as annual audits of the securitisation legal entity.