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# **THE SECURITISATION OF MORTGAGE LOANS IN SOUTH AFRICAN LAW**

By

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## **ABSTRACT**

The introduction of securitisation in South Africa has brought about many benefits to the banking industry. However, the position of the mortgagor has been placed under the spotlight by various court cases. This dissertation will give an overview of the securitisation process and will focus on residential mortgage-backed securities. This study will include an analysis of whether securitisation can be used as a defence by defaulting mortgagors by examining the legislative framework governing the securitisation process and various reported and unreported cases.

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## CHAPTER 1

### Introduction

#### 1.1 Background

Securitisation can be defined as a scheme whereby a Special Purpose Institution (hereafter referred to as “SPI”) issues Commercial Paper to investors and uses the proceeds collected from the issuance to obtain or invest in assets (in the case of traditional securitisation schemes)<sup>1</sup> or to obtain credit risk exposure relating to an underlying asset through the use of credit derivative instruments or guarantees (in the case of synthetic securitisation schemes).<sup>2</sup>

As set out in Chapter Two of this dissertation, these schemes were introduced in South Africa in 1989 when the former United Building Society Limited pooled together mortgages to the value of ZAR 250 million.<sup>3</sup> Since then, the issuance volumes under traditional securitisation schemes have risen to ZAR 7, 870 million.<sup>4</sup>

According to a working paper issued by the International Monetary Fund, a well-regulated securitisation market can be favorable to the financial system as it reduces financing costs and enhances the capital utilisation of banks. This aids issuers and investors in diversifying risk and reshaping pools of illiquid assets which cannot be easily sold into tradable securities, thereby stimulating the flow of credit.<sup>5</sup> These advantages need to be measured against any disadvantages such as the costs involved and the considerable dependence of the securitisation market on credit ratings.<sup>6</sup>

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<sup>1</sup> See the definitions of Traditional Securitisation scheme in the Securitisation Notice.

<sup>2</sup> See the definitions of Synthetic Securitisation scheme in South Africa (2008) Designation of an activity not falling within the meaning of “the business of a bank” (securitisation schemes) (Proclamation No. R. 2, 2008) Government Gazette 2:3, January 1 (Regulation Gazette No. 30628) (hereafter referred to as the Securitisation Notice).

<sup>3</sup> Saayman (2003) 6 *SAJEMS* 751.

<sup>4</sup> This figure is as at May 2018. The Banking Association of South Africa (2018) Traditional securitisation transactions by the South African Banks <http://www.banking.org.za/securitisation> (accessed 30 June 2018).

<sup>5</sup> Segoviano M (2013) Securitization: Lessons Learned and the Road Ahead <https://www.imf.org/external/pubs/ft/wp/2013/wp13255.pdf> (accessed 30 November 2018).

<sup>6</sup> Segoviano M (2013) Securitization: Lessons Learned and the Road Ahead <https://www.imf.org/external/pubs/ft/wp/2013/wp13255.pdf> (accessed 30 November 2018).

## **1.2 Problem statement and objectives of the study**

The broad research statement of this dissertation is to investigate and evaluate the requirements for the securitisation of mortgage loans in South African Law. Also included is the cession of these loans to a SPI as a defence in cases where the mortgagor has defaulted on a home loan. This defence is based on the notion that banks have sold mortgages to a third party and therefore no longer have *locus standi* to act as an applicant for judgement against defaulting mortgagors.

## **1.3 Research methodology**

A critical analysis is conducted on the legal requirements for securitising mortgage bonds. The researcher adopted the following methodology: A literature review whereby numerous journal articles, case law and the relevant provisions of the legislation about the subject matter are studied. An interview with a legal expert followed the review.

## **1.4 Chapter outline**

The dissertation is organised in the following five chapters:

Chapter One serves as an introduction to this dissertation. It sets out the problem statement and objectives of the study, the research methodology, chapter outline and definitions of concepts frequently used.

The introduction to Chapter Two provides an overview of the origin of securitisation and its development in South Africa. This is followed by an explanation of the concept of securitisation and provides a general overview of the securitisation process. This chapter also includes a discussion of the advantages and disadvantages associated with this practice.

Chapter Three explores the legislative framework governing securitisation schemes. Furthermore, it touches on the Regulations issued in terms of the Banks Act, the National Credit Act, the Insolvency Act, the Income Tax Act, the Value Added Tax Act, the



Competition Act, the Credit Rating Services Act, the Financial Markets Act and the JSE Debt Listing Requirements.

Chapter Four of this dissertation involves a more in-depth look into the sale of assets to SPIs and the true sale requirements set out in the Securitisation Notice. This chapter also includes an investigation of how the true sale requirements apply to the securitisation of mortgage bonds. Furthermore, the chapter includes a discussion of case law where mortgagors have claimed that their bonds were ceded to SPIs.

Chapter Five is the concluding chapter and summarises the outcome of this dissertation by confirming whether mortgagors can raise securitisation as a defence in the event that they default on a home loan.

## 1.5 Definitions

The concepts set out below are used frequently in this dissertation hence the definitions are provided here for ease of reference.

**Commercial Paper** means:

- (a) any written acknowledgement of debt, irrespective whether the maturity thereof is fixed or based on a notice period. Also, the rate at which interest is payable in respect of the debt in question is a fixed or floating rate; or
- (b) debentures or any interest-bearing written acknowledgement of debt issued for a fixed term by the provisions of the Companies Act; or
- (c) preference shares, excluding bankers' acceptances.<sup>7</sup>

**Credit-Enhancement Facility** means any facility or arrangement where the provider of such a facility or obligor under the arrangement is obliged to absorb losses associated with:

- (a) the assets transferred in terms of a traditional securitisation scheme; or
- (b) the risk transferred in terms of a synthetic securitisation scheme, including both a first-loss credit-enhancement facility and a second-loss credit-enhancement facility.<sup>8</sup>

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<sup>7</sup> Par 1 of the Securitisation Notice.

<sup>8</sup> Par 1 of the Securitisation Notice.

**Credit Rating** means a rating assigned by an eligible institution to Commercial Paper issued in respect of a traditional or synthetic securitisation scheme.<sup>9</sup>

**Exemption Notice** means the regulations contained in Government Notice 681 published in Government Gazette 7975 of 4 June 2004, issued by the Registrar of Banks in terms of the Banks Act, 94 of 1990.

**Insolvency Remote**, in respect of a Special Purpose Institution, means that the assets of such a Special Purpose Institution shall not be subject to any claim of an institution:

- (a) transferring assets in terms of a traditional securitisation scheme; or
- (b) transferring risk in terms of a synthetic securitisation scheme as a result of such a transferring institution's insolvency.<sup>10</sup>

**Originator** in respect of:

- (a) a traditional securitisation scheme means an institution that, whether at the commencement or during the life of the traditional securitisation scheme, transfers assets from its balance sheet. These securities include assets other than national Government securities or qualifying items, in terms of a traditional securitisation scheme;
- (b) a synthetic securitisation scheme means an institution that, whether at the commencement or during the life of the synthetic securitisation scheme, uses a credit-derivative instrument to transfer the risk associated with a specified pool of assets, other than national Government securities or qualifying items, to investors without actually selling the assets.<sup>11</sup>

**Remote Originator** means an institution that directly or indirectly lends money to a Special Purpose Institution in order for it to take transfer of assets. The transfer is in terms of a traditional securitisation scheme, or risk, concerning a synthetic securitisation scheme.<sup>12</sup>

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<sup>9</sup> Par 1 of the Securitisation Notice.

<sup>10</sup> Par 1 of the Securitisation Notice.

<sup>11</sup> Par 1 of the Securitisation Notice.

<sup>12</sup> Par 1 of the Securitisation Notice.

**Repackager** means an institution that, whether at the commencement or during the life of a traditional or synthetic securitisation scheme, acquires and subsequently:

- (a) transfers the assets; or
- (b) transfers the risk relating to assets, consisting of national Government securities or qualifying items of third parties via its balance sheet in terms of a traditional or synthetic securitisation scheme: Provided that an institution that, whether at the commencement or during the life of the traditional or synthetic securitisation scheme, acquires and subsequently transfers the assets or risk(s) relating to assets, consisting of assets other than national Government securities or qualifying items of third parties via its balance sheet in terms of the said traditional or synthetic securitisation scheme.<sup>13</sup>

**Special Purpose Institution** means a company or trust, Insolvency Remote, incorporated, created or used solely for the implementation and operation of a traditional or synthetic securitisation scheme.<sup>14</sup>

**Transfer** in respect of:

- (a) a traditional securitisation scheme means the sale and transfer of assets, or
- (b) a synthetic securitisation scheme means the transfer of risk using a credit derivative instrument or guarantee, or such other method of transfer as may be directed or specified in writing by the Registrar.<sup>15</sup>

**Underlying Asset** means:

- (a) an asset transferred in terms of a traditional securitisation scheme; or
- (b) an asset that serves as collateral in terms of a synthetic securitisation scheme.<sup>16</sup>

**Underlying Transaction** means the transaction in terms of which:

- (a) an asset that is transferred by an institution concerning a traditional securitisation scheme; or
- (b) the risk that is transferred by an institution concerning a synthetic securitisation scheme, had its origin.<sup>17</sup>

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<sup>13</sup> Par 1 of the Securitisation Notice.

<sup>14</sup> Par 1 of the Securitisation Notice.

<sup>15</sup> Par 1 of the Securitisation Notice.

<sup>16</sup> Par 1 of the Securitisation Notice.

## CHAPTER 2

### The concept of securitisation

#### 2.1 Introduction

The operation of securitisation schemes in South Africa is based on the American and English models<sup>18</sup> and was not frequently used as a funding mechanism in South Africa before the 21<sup>st</sup> century.<sup>19</sup> The origination of securitisation can be traced back to 1934 when the National Housing Act was passed in the United States of America.<sup>20</sup> This Act aimed at reducing the dependence of financial institutions on core deposits after the collapse of the housing market during the Great Depression.<sup>21</sup>

Securitisation was piloted in South Africa 55 years later when, in 1989, the former United Building Society Limited pooled together mortgages to the value of ZAR 250 million.<sup>22</sup> Sasfin Proprietary Limited conducted the second securitisation in 1991<sup>23</sup> in which instalment rental loans served as underlying collateral for a ZAR 60 million issue.<sup>24</sup>

These schemes started to gain more traction with the publication of regulations under the Banks Act<sup>25</sup> in 2001 as they brought about more certainty in the industry. These new regulations, coupled with the growing need for alternative investment products, generated substantial development in the industry.<sup>26</sup>

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<sup>17</sup> Par 1 of the Securitisation Notice.

<sup>18</sup> Locke (2010) 3 *TSAR* 451.

<sup>19</sup> Van Vuuren N (2004) *The Awakening of Securitisation in South Africa*, 1 December 2004

<http://www.sasf.co.za/aboutsecuritisation/The%20awakening%20of%20securitisation%20in%20South%20Africa.pdf> (accessed 4 June 2017).

<sup>20</sup> Scott (2006) 18 *SA Merc LJ* 330.

<sup>21</sup> Scott (2006) 18 *SA Merc LJ* 330.

<sup>22</sup> Saayman (2003) 6 *SAJEMS* 751.

<sup>23</sup> Syndicate One (2009) *SWOT Analysis of Securitization within the South African Financial Sector*

[https://www.bankseta.org.za/downloads/IEDP\\_ALP/Bankseta\\_ALP\\_final\\_copy\\_Syndicate\\_1\\_securitisation.doc](https://www.bankseta.org.za/downloads/IEDP_ALP/Bankseta_ALP_final_copy_Syndicate_1_securitisation.doc) (accessed 4 June 2017) 7.

<sup>24</sup> Saayman (2003) 6 *SAJEMS* 752.

<sup>25</sup> Act 94 of 1990.

<sup>26</sup> Van Vuuren N (2004) *The Awakening of Securitisation in South Africa*, 1 December 2004

<http://www.sasf.co.za/aboutsecuritisation/The%20awakening%20of%20securitisation%20in%20South%20Africa.pdf> (accessed 4 June 2017).

The South African securitisation market saw no activity for the following eight years until 1999<sup>27</sup> when a renewed interest in securitisation led to the securitisation of certain transactions. These included a series of transactions by the Retail Apparel Group of ZAR 600 million worth of its debtor's book.<sup>28</sup> The Rand Merchant Bank completed South Africa's first international securitisation transaction in 2000 when USD 250 million worth of international Visa, MasterCard and Cirrus voucher receivables, generated by the usage of credit and debit cards by non-South African residents in South African organisations, were securitised and offered to European investors.<sup>29</sup>

The South African securitization market declined significantly in 2008 due to the Global Financial Crisis and reached a low annual issuance level of roughly ZAR 5 billion. The market subsequently recovered and reached a high of ZAR 23.02 billion in 2011.<sup>30</sup>

Issuance volumes dropped to ZAR 11.7 billion in 2016.<sup>31</sup> This amount reflected all the notes in issue at the time and comprised of notes issued under traditional securitisation schemes.<sup>32</sup> Since then, these figures declined significantly and are now at ZAR7, 870 million.<sup>33</sup> Such decline is considered to be the result of a slow economy as the market is unable to absorb securitisation paper at the pricing levels that issuers are anticipating.<sup>34</sup>

## 2.2 Defining Securitisation

Securitisation is a financial technique in which groups of similar assets or claims in similar assets are pooled together and the assets or the claims are sold to an insolvency-remote third party.<sup>35</sup> This entity is created for the sole purpose of entering into the securitisation transaction and is known as a Special Purpose Institution.<sup>36</sup> The assets or claims are

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<sup>27</sup> Saayman (2003) 6 *SAJEMS* 752.

<sup>28</sup> Saayman (2003) 6 *SAJEMS* 752.

<sup>29</sup> Saayman (2003) 6 *SAJEMS* 752.

<sup>30</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>31</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>32</sup> Interview with Karin Krisch (2018) Partner at Hogan Lovells (South Africa) Incorporated 10 July 2018.

<sup>33</sup> This figure is as at May 2018. The Banking Association of South Africa (2018) Traditional securitisation transactions by the South African Banks <http://www.banking.org.za/securitisation> (accessed 30 June 2018).

<sup>34</sup> Interview with Karin Krisch (2018) Partner at Hogan Lovells (South Africa) Incorporated on 10 July 2018.

<sup>35</sup> Meiring (2008) *Without Prejudice* 8. Dauds (2008) 8 *Without Prejudice* 7.

<sup>36</sup> Moyo (2008) *S. Afr.J. Bus.Manage* 27.

transferred to the SPI<sup>37</sup> by an Originator,<sup>38</sup> Remote Originator<sup>39</sup> or a Repackager.<sup>40</sup> The SPI then sells securities backed up by these loans to investors,<sup>41</sup> commonly in the form of Commercial Paper. The Commercial Paper provides the investors with a claim against the assets.<sup>42</sup>

Notably, assets must represent a regular payment stream that is collectable for it to be securitised<sup>43</sup> and can include the following asset classes, namely (1) residential mortgage-backed securities (residential mortgage loans);<sup>44</sup> (2) asset-backed securities (credit card receivables, vehicle loans or leases, equipment leases and trade receivable);<sup>45</sup> (3) commercial mortgage-backed securities (commercial mortgages may consist of a single property, a group of properties financed by a single borrower, or a pool of assets that combines numerous loans from different borrowers secured by diverse commercial properties);<sup>46</sup> and (4) collateral debt obligations (commercial loans to corporations).<sup>47</sup> As pointed out by Boshoff, residential mortgage-backed home loans are the dominant asset class in the South African securitisation market.<sup>48</sup>

### 2.3 Traditional securitisation schemes

A traditional securitisation scheme involves the legal and economic sale and transfer of assets to a SPI<sup>49</sup> which issues Commercial Paper<sup>50</sup> to investors. The proceeds are used to obtain or invest in the asset.<sup>51</sup> The different classes of Commercial Paper will give investors a different

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<sup>37</sup> Scott (2006) 18 *SA Merc LJ* 335.

<sup>38</sup> See the definition of Originator in Chapter 1.

<sup>39</sup> See the definition of Remote Originator in Chapter 1.

<sup>40</sup> See the definition of Repackager in Chapter 1.

<sup>41</sup> Moyo (2008) *S. Afr. J. Bus. Manage* 27.

<sup>42</sup> Gerstle (2007) 7 *Without Prejudice* 33.

<sup>43</sup> Gerstle (2007) 7 *Without Prejudice* 33.

<sup>44</sup> Moyo (2008) *S. Afr. J. Bus. Manage* 28.

<sup>45</sup> Moyo (2008) *S. Afr. J. Bus. Manage* 28.

<sup>46</sup> Moyo (2008) *S. Afr. J. Bus. Manage* 28.

<sup>47</sup> Moyo (2008) *S. Afr. J. Bus. Manage* 28.

<sup>48</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>49</sup> Gerstle (2007) 7 *Without Prejudice* 33. Par 4(1)(a)(i) of the Securitisation Notice.

<sup>50</sup> See the definition of Commercial Paper in Chapter 1.

<sup>51</sup> Meiring *Without Prejudice* 9. *Strydom NO and Others v Bakkes and Others* 2014 (4) SA 29 (GP) 44.

priority claim (a personal right)<sup>52</sup> against the underlying pool of assets that have been transferred or acquired.<sup>53</sup>

As indicated by Meiring, payments to investors will be determined by the performance of the Underlying Assets acquired by the SPI.<sup>54</sup> This means that investors will absorb losses in junior tranches<sup>55</sup> before investors in more senior tranches incur any losses.<sup>56</sup> Investors will further have no claim against the institution transferring the assets.<sup>57</sup> The transfer of assets to a SPI entirely divests the transferring organisation and its associated companies of its rights and obligations in respect of the Underlying Assets.<sup>58</sup>

## 2.4 Synthetic securitisation schemes

Synthetic securitisation is an amalgamation of traditional securitisation and credit derivatives. It involves the on-balance sheet transfer of credit risk exposure associated with pools of assets without actual asset transfer to the SPI.<sup>59</sup>

The SPI issues Commercial Paper and the earnings from these issuances are mainly put towards obtaining credit-risk exposure associated with the Underlying Assets.<sup>60</sup> The performance of the Commercial Paper and the risk of loss for investors in Commercial Paper issued by the SPI, largely depend on the performance of the underlying risk exposures obtained by the SPI.<sup>61</sup> Junior or subordinated tranches absorb losses without disturbing contractual payments to more senior tranches,<sup>62</sup> thereby becoming economically shock-absorbent as senior tranches are only called upon when junior tranches have been exhausted.<sup>63</sup>

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<sup>52</sup> Scott (2006) 18 SA Merc LJ 336.

<sup>53</sup> Competition Commission Practitioner Update (2015) 7. Par 4(1)(a)(iii) of the Securitisation Notice.

<sup>54</sup> Meiring (2008) *Without Prejudice* 8. Competition Commission Practitioner Update (2015) 7.

<sup>55</sup> Meiring (2008) *Without Prejudice* 8. Par 4(1)(a)(iii) of the Securitisation Notice.

<sup>56</sup> Par 4(1)(b) of the Securitisation Notice.

<sup>57</sup> Par 4(2)(e) of the Securitisation Notice. Competition Commission Practitioner Update (2015) 8.

<sup>58</sup> Par 4(2)(a) of the Securitisation Notice. Competition Commission Practitioner Update (2015) 7.

<sup>59</sup> Wessels (2015) *unpublished LLD theses* 38. See the definition of Originator in Chapter 1.

<sup>60</sup> Meiring 8 (2008) *Without Prejudice* 41. Locke (2010) 3 TSAR 450.

<sup>61</sup> Par 5(1)(a)(iii) of the Securitisation Notice.

<sup>62</sup> Par 5(1)(a)(ii) of the Securitisation Notice.

<sup>63</sup> Wessels (2015) *unpublished LLD theses* 39. Par 5(1)(a)(v) of the Securitisation Notice.

## 2.5 The securitisation process

An Originator will make loans to borrowers and warehouse them until there are an adequate number of loans<sup>64</sup> with the same characteristics (i.e. the same maturity, interest rate, class of specification) to be pooled together.<sup>65</sup> The loans are then analysed, packaged and sold to the SPI through securitisation.<sup>66</sup> The Securitisation Notice<sup>67</sup> requires that unless otherwise agreed to by the Registrar of Banks, the consideration for the Underlying Assets must be paid at the date of transfer of such assets.<sup>68</sup> The SPI pays for the pooled loan assets by simultaneously selling Commercial Paper and representing ownership of the loans to investors.<sup>69</sup>

The Commercial Paper issued by the SPI is rated by a Credit Rating agency to establish the quality of the securitisation issue.<sup>70</sup> Saayman explains that the rating offers a view of the credit risk of the security to investors and will continue on an on-going basis throughout the lifespan of the securitisation scheme.<sup>71</sup> The rating will confirm the performance of the assets in the portfolio.<sup>72</sup> As pointed out by Locke, the assessment by a Credit Rating agency will investigate and test the risks associated with the assets and the structure of the scheme but will cap the rating at the sovereign rating of the country in which the SPI is based.<sup>73</sup> Stolp however holds the view that this is problematic for South African issuances as the country was downgraded to junk status by Standard and Poor's Financial Services LLC and Fitch Ratings Incorporated in 2017. The downgrading was due to political uncertainty, the slowing economy and the weakening of institutional frameworks.<sup>74</sup>

Rating Agencies consider a variety of factors such as debtor insolvency, default by the debtor, debt prepayment and interest fluctuation rates when rating the Commercial Paper

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<sup>64</sup> Saayman (2003) 6 *SAJEMS* 747.

<sup>65</sup> White (2011) *unpublished MC theses* 19.

<sup>66</sup> Van Den Berg (1998) 27 *IAS J* 46. Saayman (2003) 6 *SAJEMS* 747. White (2011) *unpublished MC theses* 19.

<sup>67</sup> Par 5(a) of the Securitisation Notice.

<sup>68</sup> Gerstle *Without Prejudice* 2007 34.

<sup>69</sup> Saayman (2003) 6 *SAJEMS* 748. Van Den Berg (1998) 27 *IAS J* 46. White (2011) *unpublished MC theses* 19.

<sup>70</sup> Saayman (2003) 6 *SAJEMS* 748. Locke (2008) 3 *De Jure* 551: A Credit Rating agency will only issue a credit rating if satisfied that the true sale requirements discussed in Chapter 4 have been met.

<sup>71</sup> Saayman (2003) 6 *SAJEMS* 748.

<sup>72</sup> White (2011) *unpublished MC theses* 19.

<sup>73</sup> Locke (2008) 3 *De Jure* 551.

<sup>74</sup> Stolp (2017) 17 *Without Prejudice* 8 – 9.



issued by a SPI.<sup>75</sup> Analysts will also determine the performance pattern of the asset pool by conducting credit and cash flow analyses on the underlying receivables and considering the insolvency-remoteness of the SPI.<sup>76</sup>

Credit-Enhancement Facilities are a form of risk cover and can be purchased from insurance companies or banks<sup>77</sup> as a measure to protect investors in securitisation schemes from losses.<sup>78</sup> These facilities play an essential role in the Credit Rating process.<sup>79</sup> They are described in the Securitisation Notice<sup>80</sup> as “any facility or arrangement in terms of which the provider of the facility provides added credit protection to other parties involved in the scheme”.<sup>81</sup>

The Securitisation Notice also sets out the conditions relating to Credit-Enhancement Facilities in respect of securitisation schemes.<sup>82</sup> In this regard, it requires that the Credit-Enhancement Facilities have a specified maturity date,<sup>83</sup> be transacted on market-related terms and conditions<sup>84</sup> and that the details of the Credit-Enhancement Facility must be disclosed in the disclosure document issued in respect of the securitisation scheme.<sup>85</sup>

A servicing agent, usually the Originator, is appointed to service the loans on behalf of the SPI for the duration of the issue.<sup>86</sup> Other than collecting payments from debtors in respect of the Underlying Assets, the servicers’ duties also include managing arrears and client relationships.<sup>87</sup> The servicing agent is not required to fund payments owed in respect of the securitisation scheme or to absorb any losses incurred in respect of the Underlying Assets or

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<sup>75</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>76</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>77</sup> Dauds (2008) *Without Prejudice* 7.

<sup>78</sup> Par 6(1)(a) of the Securitisation Notice.

<sup>79</sup> Van den Berg (1998) 27 *IAS J* 45.

<sup>80</sup> Par 6(1)(b)(iii) of the Securitisation Notice.

<sup>81</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>82</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>83</sup> Par 6(2)(a)(ii) of the Securitisation Notice.

<sup>84</sup> Par 6(2)(a)(v) of the Securitisation Notice.

<sup>85</sup> Par 6(2)(a)(viii) of the Securitisation Notice.

<sup>86</sup> Par 9 of the Securitisation Notice. White (2011) *unpublished MC theses* 19. Van Den Berg (1998) 27 *IAS J* 46. Saayman (2003) 6 *SAJEMS* 748.

<sup>87</sup> Saayman (2003) 6 *SAJEMS* 748.

the risk transferred to the SPI.<sup>88</sup>

The SPI will pay the servicer a market-related fee<sup>89</sup> based on a predetermined percentage of the value of the payments<sup>90</sup> and the servicer will pay the collected proceeds to the SPI.<sup>91</sup> The SPI may use the payments collected by the servicer to pay interest to the investors who invested in the Commercial Paper<sup>92</sup> or it may reinvest the cash flow in other interest-bearing investments to enhance the total yield.<sup>93</sup>

The cash flow of a securitisation scheme is described as a “waterfall of payments” and creates different risk tranches.<sup>94</sup> This waterfall depicts the sequence in which cash distributions are made to the different parties and represents the priority of each party that is paid.<sup>95</sup> The first payments that are made are in respect of expenses and administration fees.<sup>96</sup> Following this, where applicable, the standby fees for liquidity lines or letters of credit are paid.<sup>97</sup> Thirdly, senior note holders<sup>98</sup> and swap expenses are paid, and only once all these payments have been made, will payment be made to junior note holders.<sup>99</sup>

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<sup>88</sup> Par 9(1)(a)(ii) of the Securitisation Notice.

<sup>89</sup> Par 9(1)(a)(iv) of the Securitisation Notice.

<sup>90</sup> Van Den Berg (1998) 27 *IAS J* 46.

<sup>91</sup> White (2011) *unpublished MC theses* 19.

<sup>92</sup> White (2011) *unpublished MC theses* 19.

<sup>93</sup> Van Den Berg (1998) 27 *IAS J* 46.

<sup>94</sup> Saayman (2003) 6 *SAJEMS* 751.

<sup>95</sup> Saayman (2003) 6 *SAJEMS* 751.

<sup>96</sup> Saayman (2003) 6 *SAJEMS* 751.

<sup>97</sup> Saayman (2003) 6 *SAJEMS* 751.

<sup>98</sup> Investors in the senior tranches of a Securitisation Scheme are the holders of Senior Commercial Paper. The Securitisation Notice defines senior Commercial Paper as “Commercial Paper which is issued in terms of a traditional or a synthetic securitisation scheme, the purchase of which commercial paper does not constitute providing a first-loss or second-loss credit-enhancement facility”.

<sup>99</sup> Saayman (2003) 6 *SAJEMS* 751. Junior note holders invest in the subordinated tranches of a Securitisation Scheme and will suffer a “total loss before the investors in more senior tranches incur any loss” (Par 4(1)(b) and Par 5(1)(c) of the Securitisation Notice). In this way, the junior tranches create a form of credit enhancement. Sandback A (2003) *Demystifying Securitisation for Unsecured Investors* <https://www.moody.com/sites/products/AboutMoodyRatingsAttachments/2001700000415918.pdf> (accessed 11 November 2018).

## 2.6 Advantages of securitisation

Securitisation is a valuable tool in establishing an alternative source of funding while also ensuring stability, diversity and a good return for investors.<sup>100</sup> Dauds remarks that what makes this tool so attractive is the fact that it can be used as an off-balance sheet form of financing,<sup>101</sup> which has the added benefit of reducing capital requirements<sup>102</sup> for banks.<sup>103</sup> These balance sheet benefits are the main reason for conducting securitisations in South Africa.<sup>104</sup>

Securitisation can further increase credit in the economy<sup>105</sup> as it releases capital for other investment opportunities.<sup>106</sup> Banks can also use the proceeds to fund further lending.<sup>107</sup> Lending leads to improved liquidity and funding risk as it allows banks to diversify the sources of funds.<sup>108</sup> Securitisation also improves profitability by preventing interest rate uncertainty<sup>109</sup> and reducing the cost of funding.<sup>110</sup>

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<sup>100</sup> Syndicate One (2009) SWOT Analysis of Securitization within the South African Financial Sector [https://www.bankseta.org.za/downloads/IEDP\\_ALP/Bankseta\\_ALP\\_final\\_copy\\_Syndicate\\_1\\_securitisation.doc](https://www.bankseta.org.za/downloads/IEDP_ALP/Bankseta_ALP_final_copy_Syndicate_1_securitisation.doc) (accessed 4 June 2017) 7.

<sup>101</sup> Dauds (2008) *Without Prejudice* 7.

<sup>102</sup> S 70A of the Banks Act read together with the regulations promulgated thereunder set out the minimum capital and reserve fund requirements in respect of a banking group. These provisions restrict the assets and loans of a bank with reference to its capital reserves and ensures that creditors and depositors are not negatively impacted by losses as they can be absorbed, Norton Rose Fulbright Publication (2010) An Introduction to Basel III – its consequences for lending <http://www.nortonrosefulbright.com/knowledge/publications/31077/an-introduction-to-basel-iii-its-consequences-for-lending> (accessed 11 November 2018).

<sup>103</sup> South African Reserve Bank Quarterly Bulletin (2015) Note on the impact of securitisation transactions on credit extensions by banks December 2015 60. Syndicate One (2009) SWOT Analysis of Securitization within the South African Financial Sector [https://www.bankseta.org.za/downloads/IEDP\\_ALP/Bankseta\\_ALP\\_final\\_copy\\_Syndicate\\_1\\_securitisation.doc](https://www.bankseta.org.za/downloads/IEDP_ALP/Bankseta_ALP_final_copy_Syndicate_1_securitisation.doc) (accessed 4 June 2017) 12.

<sup>104</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>105</sup> National Treasury Republic of South Africa (2017) Budget Review 22 February 2017 <http://www.treasury.gov.za/documents/national%20budget/2017/review/FullBR.pdf> (accessed 15 February 2018).

<sup>106</sup> South African Reserve Bank Quarterly Bulletin (2015) Note on the impact of securitisation transactions on credit extensions by banks December 2015 61.

<sup>107</sup> Moyo (2008) *S. Afr.J. Bus.Manage* 28. Syndicate One (2009) SWOT Analysis of Securitization within the South African Financial Sector [https://www.bankseta.org.za/downloads/IEDP\\_ALP/Bankseta\\_ALP\\_final\\_copy\\_Syndicate\\_1\\_securitisation.doc](https://www.bankseta.org.za/downloads/IEDP_ALP/Bankseta_ALP_final_copy_Syndicate_1_securitisation.doc) (accessed 4 June 2017) 12.

<sup>108</sup> Syndicate One (2009) SWOT Analysis of Securitization within the South African Financial Sector [https://www.bankseta.org.za/downloads/IEDP\\_ALP/Bankseta\\_ALP\\_final\\_copy\\_Syndicate\\_1\\_securitisation.doc](https://www.bankseta.org.za/downloads/IEDP_ALP/Bankseta_ALP_final_copy_Syndicate_1_securitisation.doc) (accessed 4 June 2017) 7.

<sup>109</sup> Moyo (2008) *S. Afr.J. Bus.Manage* 28. South African Reserve Bank Quarterly Bulletin (2015) Note on the impact of securitisation transactions on credit extensions by banks December 2015 61.

Another advantage is that if a SPI does not conduct the business of a bank and only conducts transactions that directly relate to a traditional or synthetic securitisation scheme, the SPI does not need to register as a bank.<sup>111</sup> This is discussed in greater detail in Chapter Three.

## 2.7 Disadvantages of securitisation

Several difficulties exist in the context of securitisation schemes. Subsequently, new participants are often deterred from entering the market. These difficulties include the high costs related to the administrative processes of managing these schemes<sup>112</sup> and the general lack of understanding of the risks involved in securitisation.<sup>113</sup> The fact that South Africa does not have a secondary market for the Commercial Paper issued by the SPI is also problematic as original notes are not resold and investors are locked in.<sup>114</sup>

It must also be considered that high levels of default of individual homeowners may result in foreclosures, ultimately affecting the quality of the Underlying Asset.<sup>115</sup>

## 2.8 Final remarks

The main reason for conducting securitisations in South Africa<sup>116</sup> is the fact that these schemes can be used as an off-balance sheet form of financing.<sup>117</sup>

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<sup>110</sup> South African Reserve Bank Quarterly Bulletin (2015) Note on the impact of securitisation transactions on credit extensions by banks December 2015 60. Syndicate One (2009) SWOT Analysis of Securitization within the South African Financial Sector

[https://www.bankseta.org.za/downloads/IEDP\\_ALP/Bankseta\\_ALP\\_final\\_copy\\_Syndicate\\_1\\_securitisation.doc](https://www.bankseta.org.za/downloads/IEDP_ALP/Bankseta_ALP_final_copy_Syndicate_1_securitisation.doc) (accessed 4 June 2017) 12. Moyo (2008) *S. Afr.J. Bus.Manage* 28.

<sup>111</sup> Meiring (2008) *Without Prejudice* 8.

<sup>112</sup> Syndicate One (2009) SWOT Analysis of Securitization within the South African Financial Sector [https://www.bankseta.org.za/downloads/IEDP\\_ALP/Bankseta\\_ALP\\_final\\_copy\\_Syndicate\\_1\\_securitisation.doc](https://www.bankseta.org.za/downloads/IEDP_ALP/Bankseta_ALP_final_copy_Syndicate_1_securitisation.doc) (accessed 4 June 2017) 13.

<sup>113</sup> Syndicate One (2009) SWOT Analysis of Securitization within the South African Financial Sector [https://www.bankseta.org.za/downloads/IEDP\\_ALP/Bankseta\\_ALP\\_final\\_copy\\_Syndicate\\_1\\_securitisation.doc](https://www.bankseta.org.za/downloads/IEDP_ALP/Bankseta_ALP_final_copy_Syndicate_1_securitisation.doc) (accessed 4 June 2017) 13.

<sup>114</sup> Syndicate One (2009) SWOT Analysis of Securitization within the South African Financial Sector [https://www.bankseta.org.za/downloads/IEDP\\_ALP/Bankseta\\_ALP\\_final\\_copy\\_Syndicate\\_1\\_securitisation.doc](https://www.bankseta.org.za/downloads/IEDP_ALP/Bankseta_ALP_final_copy_Syndicate_1_securitisation.doc) (accessed 4 June 2017) 13.

<sup>115</sup> Syndicate One (2009) SWOT Analysis of Securitization within the South African Financial Sector [https://www.bankseta.org.za/downloads/IEDP\\_ALP/Bankseta\\_ALP\\_final\\_copy\\_Syndicate\\_1\\_securitisation.doc](https://www.bankseta.org.za/downloads/IEDP_ALP/Bankseta_ALP_final_copy_Syndicate_1_securitisation.doc) (accessed 4 June 2017) 15.

<sup>116</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

Despite this and other advantages of securitisation schemes, as previously discussed in this chapter, the market declined significantly in 2008 due to the international financial crisis.<sup>118</sup> Even though the market subsequently recovered,<sup>119</sup> figures once again declined<sup>120</sup> as a result of a slow economy as the market is unable to absorb securitisation paper at the pricing levels that issuers are demanding.<sup>121</sup>

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<sup>117</sup> Dauds (2008) *Without Prejudice* 7.

<sup>118</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>119</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>120</sup> The Banking Association of South Africa (2018) Traditional securitisation transactions by the South African Banks <http://www.banking.org.za/securitisation> (accessed 30 June 2018).

<sup>121</sup> Interview with Karin Krisch (2018) Partner at Hogan Lovells (South Africa) Incorporated 10 July 2018.

## CHAPTER 3

### The legislative framework governing securitisation schemes

#### 3.1 Introduction

The regulations issued under the Banks Act<sup>122</sup> should be the point of departure when examining the legislature governing securitisation transactions in a South African context. One such regulation is the Securitisation Notice<sup>123</sup> as referred to in Chapter One and Two, which provides for the establishment and management of securitisation schemes.<sup>124</sup> Securitisation is a complicated matter. As such, the legislation governing a securitisation scheme can be comprehensive. This chapter will provide an overview of the legislation which impacts on securitisation transactions.

#### 3.1 The legislative framework governing securitisation schemes

##### 3.1.1 Securitisation regulations

The introduction of Basel II<sup>125</sup> resulted in capital adequacy requirements which banks must specifically apply to securitisation schemes. These requirements were introduced in South Africa when the Registrar of Banks issued the Exemption Notice relating to the designation of an activity not falling within the meaning of “the business of a bank”, on the 4<sup>th</sup> of June 2004 in terms of the Banks Act, 94 of 1990.<sup>126</sup>

The critical development in this regard was the restriction to the scope of the definition of “the business of a bank”. The Exemption Notice does not allow a SPI (in a traditional or a synthetic securitisation scheme) to accept money from the general public against the issuance of Commercial Paper.<sup>127</sup> The Exemption Notice was repealed on the 1<sup>st</sup> of January 2008 with

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<sup>122</sup> Act 94 of 1990.

<sup>123</sup> See the definition in Chapter 1.

<sup>124</sup> Roothman R (2012) *The International Comparative Legal Guide to Securitisation 2012: A practical cross-border insight into securitisation work* published by Global Legal Group April 2012 [https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012\\_South-African-chapter\\_FINAL.pdf](https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012_South-African-chapter_FINAL.pdf) (accessed 17 June 2017) 325.

<sup>125</sup> Matarirano (2009) 9 *Without Prejudice* 43: Basel II is an international standard in respect of the capital reserve held by banks. This is aimed at protecting banks against financial and operational risks.

<sup>126</sup> Meiring (2008) *Without Prejudice* 8.

<sup>127</sup> *Strydom NO and Others v Bakkes and Others* 2014 (4) SA 29 (GP) 48.

the promulgation of the new Securitisation Notice.<sup>128</sup> It is important to note that the securitisation schemes are still excluded<sup>129</sup> from the definition of “the business of a bank” as defined in the Banks Act.<sup>130</sup> This was illustrated in the case of *Strydom NO and Others v Bakkes and Others*.<sup>131</sup> In this case the plaintiffs instituted proceedings against the defendants for losses incurred due to the failure of a collective investment scheme and an ancillary traditional securitisation scheme. The SPI in this matter issued promissory notes which constituted Commercial Paper<sup>132</sup> and was not registered as a bank.<sup>133</sup>

The court held that for the issuance of Commercial Paper by a SPI in a traditional securitisation scheme to fall outside the scope of “the business of a bank”, the juristic person issuing the Commercial Paper needs the written authorisation of the Registrar of Banks to do so.<sup>134</sup> It was concluded that the required authorisation was not in place.<sup>135</sup> Therefore, the promissory notes issued by the SPI were not legal Commercial Paper. Consequently, the issuance of the Commercial Paper constituted “the business of a bank”. The SPI was held to be in contravention of section 11 of the Banks Act as the SPI was not registered as a bank.<sup>136</sup>

It can be noted that the Securitisation Notice introduced the “true sale”-requirement when assessing what differentiates the Securitisation Notice from the Exemption Notice. Paragraph 4(1)(c) of the Securitisation Notice stated that a true sale needed to take place in order for a bank to exclude assets transferred to a SPI in a traditional securitisation transaction from the calculation of its required capital and reserve funds. Thus, assets needed to be permanently transferred from the Originator to the SPI.<sup>137</sup> As indicated by Locke, this was closely linked to the requirement that a SPI needed to be Insolvency Remote.<sup>138</sup> The true sale requirement is discussed in greater detail in Chapter Four.

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<sup>128</sup> *Strydom NO and Others v Bakkes and Others* 2014 (4) SA 29 (GP) 50.

<sup>129</sup> Par 2(1) of the Securitisation Notice.

<sup>130</sup> Act 94 of 1990.

<sup>131</sup> *Strydom NO and Others v Bakkes and Others* 2014 (4) SA 29 (GP).

<sup>132</sup> *Strydom NO and Others v Bakkes and Others* 2014 (4) SA 29 (GP) 54.

<sup>133</sup> *Strydom NO and Others v Bakkes and Others* 2014 (4) SA 29 (GP) 20.

<sup>134</sup> Par 14(1)(b)(ii) of the Securitisation Notice.

<sup>135</sup> *Strydom NO and Others v Bakkes and Others* 2014 (4) SA 29 (GP) 53.

<sup>136</sup> *Strydom NO and Others v Bakkes and Others* 2014 (4) SA 29 (GP) 66. S11(1) of the Banks Act: “*Subject to the provisions of section 18A, no person shall conduct the business of a bank unless such person is a public company and is registered as a bank in terms of this Act*”.

<sup>137</sup> Locke (2010) 3 TSAR 452.

<sup>138</sup> Locke (2010) 3 TSAR 452.

After the implementation of Basel II, the Basel Committee on Banking Supervision published Basel III in December 2010.<sup>139</sup> The Basel III framework introduced higher capital requirements for complex securitisations and off-balance sheet exposures<sup>140</sup> and was enacted in South Africa through regulations to the Banks Act.<sup>141</sup> The implementation period for several Basel III requirements began on 1 January 2013 and included transitional arrangements which were phased in until 1 January 2018.<sup>142</sup> In addition to the Basel III framework, the Basel Committee on Banking Supervision published the securitisation framework in 2014.<sup>143</sup> This framework significantly increased the capital requirements in proportion to the risk of the securitisation exposure<sup>144</sup> and removes the complexity from the hierarchy of approaches which are used to determine the minimum amount of capital that must be held by a bank to reduce the risk of insolvency.<sup>145</sup> The particular approach followed by a bank is determined by several factors such as the information available to the bank as well as the nature of the analysis that is carried out in respect of a particular transaction.<sup>146</sup>

### 3.1.2 The National Credit Act 34 of 2005

The National Credit Act came into full effective operation on 1 June 2007 and prescribes more stringent underwriting credit practices and affordability testing. Subsequently, the enactment of this Act ensures that the loans originated by banks are of a higher quality.<sup>147</sup>

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<sup>139</sup> Wessels (2015) *unpublished LLD theses* 47.

<sup>140</sup> Basel III (2010) A global regulatory framework for more resilient banks and banking systems by the Basel Committee on Banking Supervision, 2010 revised June 2011 <https://www.bis.org/publ/bcbs189.pdf> (accessed 8 June 2018) 8.

<sup>141</sup> South African Reserve Bank Directive 8 (2017). Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>142</sup> South African Reserve Bank Directive 8 (2017). Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>143</sup> Basel III Document (2014) Revisions to the securitisation framework, 11 December 2014 revised July 2016 <https://www.bis.org/bcbs/publ/d374.pdf> (accessed 8 June 2018) 1.

<sup>144</sup> Basel III Document (2014) Revisions to the securitisation framework, 11 December 2014 revised July 2016 <https://www.bis.org/bcbs/publ/d374.pdf> (accessed 8 June 2018) 9.

<sup>145</sup> Moody's Analytics (2017) Capital calculations under the revised securitization framework <https://www.moodysanalytics.com/-/media/whitepaper/2017/capital-calculations-under-the-revised-securitisation-framework.pdf> (accessed 27 November 2018) 3.

<sup>146</sup> Moody's Analytics (2017) Capital calculations under the revised securitization framework <https://www.moodysanalytics.com/-/media/whitepaper/2017/capital-calculations-under-the-revised-securitisation-framework.pdf> (accessed 27 November 2018) 3.

<sup>147</sup> Syndicate One (2009) SWOT Analysis of Securitization within the South African Financial Sector [https://www.bankseta.org.za/downloads/IEDP\\_ALP/Bankseta\\_ALP\\_final\\_copy\\_Syndicate\\_1\\_securitisation.doc](https://www.bankseta.org.za/downloads/IEDP_ALP/Bankseta_ALP_final_copy_Syndicate_1_securitisation.doc) (accessed 4 June 2017) 12.



A credit provider, as defined in the NCA, includes a person who acquires the rights of a credit provider under a credit agreement after it has been entered into.<sup>148</sup> Therefore, Boshoff points out that if the Originator was required to register as a credit provider in terms of the National Credit Act, the SPI will need to do the same.<sup>149</sup>

The National Credit Act also provides for a national register of credit agreements.<sup>150</sup> Section 69(4) states that if a person transfers the rights of a credit provider under a credit agreement to a SPI, the person who transfers those rights must report the particulars of that transfer to the national register. Consequently, the Originator must report the particulars of the transfer to the national register if the rights transferred to a SPI in a securitisation scheme are subject to the National Credit Act.<sup>151</sup> Notably however no such national register has been established yet despite the Act being in existence for more than ten years.

### 3.1.3 The Insolvency Act 24 of 1936

The provisions of the Insolvency Act will apply if the Originator in a securitisation scheme becomes insolvent. As such, the liquidator will be in a position to set aside the sale of the Underlying Assets in the circumstances set out in the relevant sections<sup>152</sup> of the Insolvency Act.<sup>153</sup>

As this dissertation focuses on mortgage-backed securities, it is however submitted that the insolvency of an Originator (banks in this context), is highly unlikely due to the stringent capital adequacy requirements introduced by the Basel regulatory framework.

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<sup>148</sup> S1 of the National Credit Act 34 of 2005.

<sup>149</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018). S1 of the National Credit Act 34 of 2005: The definition of credit provider also includes the mortgagee under a mortgage agreement.

<sup>150</sup> S 69 of the National Credit Act 34 of 2005.

<sup>151</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>152</sup> S 26 (dispositions without value), S 29 (voidable preferences), S 30 (undue preference to creditors), S 31 (collusive dealings before sequestration).

<sup>153</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

### 3.1.4 Tax legislation

#### 3.1.4.1 The Income Tax Act 58 of 1962

Dauds points out that there are no provisions in the Income Tax Act that specifically apply to securitisation. Therefore, general tax principles and case law would apply to this financing tool.<sup>154</sup>

These tax principles will come into question when an Originator transfers the Underlying Assets to a SPI as it has to be determined if the proceeds from the transfer are revenue or capital in nature.<sup>155</sup> According to Dauds, it would be beneficial to the Originator if the Underlying Assets were capital in nature, i.e. sold as part of its income-earning structure.<sup>156</sup> This would allow for any gain to be taxed at the more favourable Capital Gains Tax rates.<sup>157</sup> Dauds remarks that the tax authority will most likely follow the approach that the sale constituted the “sale of an income stream”. Thus, the receipt of revenue which would be included in the gross income of the Originator<sup>158</sup> would be taxed at the corporate tax rate.<sup>159</sup> The matter of *Commissioner for South African Revenue Service v Creative Productions (Pty) Ltd*<sup>160</sup> may be of some assistance in cases where an Originator incurs a loss due to the discounted purchase price paid for Underlying Assets.<sup>161</sup> In this matter the court held that the loss from the discounting of a promissory note was of a revenue nature and therefore deductible under the Income Tax Act.<sup>162</sup> As such, the loss of an Originator may also be deductible.<sup>163</sup>

Dauds further explains that in terms of section 11(i) of the Income Tax Act, an Originator would be able to deduct the amount of bad debt from its income. This same provision will

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<sup>154</sup> Dauds (2008) 8 *Without Prejudice* 8.

<sup>155</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>156</sup> Dauds (2008) 8 *Without Prejudice* 8.

<sup>157</sup> Dauds Securitisations and their Tax Treatment Thumela Chambers blog: <https://www.thulamelablog.co.za/securitisations-and-their-tax-treatment/> (accessed 28 June 2018)

<sup>158</sup> Dauds (2008) 8 *Without Prejudice* 8.

<sup>159</sup> Dauds Securitisations and their Tax Treatment Thumela Chambers blog: <https://www.thulamelablog.co.za/securitisations-and-their-tax-treatment/> (accessed 28 June 2018).

<sup>160</sup> (1999)(2) All SA 14 (N) 21.

<sup>161</sup> Dauds (2008) 8 *Without Prejudice* 8.

<sup>162</sup> S 11(a). Dauds (2008) 8 *Without Prejudice* 8.

<sup>163</sup> Dauds (2008) 8 *Without Prejudice* 8.

apply to a SPI after the Underlying Assets have been ceded to it in a securitisation transaction.<sup>164</sup> Section 11(j) of the Income Tax Act provides for an allowance in respect of a debt which is considered to be doubtful. As such, Dauds submits that an SPI will be in a position to claim a deduction based on this provision.<sup>165</sup>

It is further indicated by Dauds that when an Originator sells the Underlying Assets to a SPI at a reduced rate, section 24(j) of the Income Tax Act will apply, thus allowing the SPI to spread the gain over the term of the loans.<sup>166</sup> The question as to whether or not the purchase price received by the Originator for the Underlying Assets is capital or revenue in nature will be determined by the tax authority. However, Dauds submits that a SPI should argue that the payment is of a revenue nature, and therefore deductible under section 11(a) of the Income Tax Act.<sup>167</sup>

#### 3.1.4.2 The Value Added Tax Act 89 of 1991

The sale of goods or services is subject to Value Added Tax<sup>168</sup> at a rate of 15%<sup>169</sup> however, the sale of receivables is a “financial service” and is exempt from this tax. Thus, Boshoff points out that Value Added Tax does not apply to the sale of receivables from an Originator to the SPI in a securitisation transaction.<sup>170</sup>

#### 3.1.5 The Currency and Exchanges Act 9 of 1933

The Exchange Control Regulations published under the Currency and Exchanges Act determine that if Commercial Paper issued by a SPI is issued to investors who are not residents of South Africa, the approval of the Financial Surveillance Department of the South African Reserve Bank must be obtained before issuance if the following two conditions are

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<sup>164</sup> Dauds (2008) 8 *Without Prejudice* 8.

<sup>165</sup> Dauds (2008) 8 *Without Prejudice* 8.

<sup>166</sup> Dauds (2008) 8 *Without Prejudice* 8.

<sup>167</sup> Dauds (2008) 8 *Without Prejudice* 8.

<sup>168</sup> S 7 of the Value Added Tax Act.

<sup>169</sup> National Treasury Republic of South Africa (2018) Budget review 21 February 2018

<http://www.treasury.gov.za/documents/national%20budget/2018/review/FullBR.pdf> (accessed 12 June 2018).

<sup>170</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018). Stretch *Taxgram* (2005).

met:<sup>171</sup> first, non-resident investors are not related to the SPI, and second, the securities are issued in South African Rand and bear interest at a rate which is in excess of the South African prime rate plus 3%, or the securities are issued in another currency and bear interest at a rate which is more than the relevant base rate for that currency as published by the South African Reserve Bank plus 2%.<sup>172</sup>

### 3.1.6 The Competition Act 89 of 1998

In 2015 the Competition Commission produced a practitioner update relating to the application of merger provisions of the Competition Act 89 of 1998 to securitisation schemes. This update was not binding on the Commission. However, it does set out the approach that the Commission is likely to follow.<sup>173</sup>

The Competition Act<sup>174</sup> defines a merger as occurring when “one or more firms directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another firm”. Such mergers “may be achieved in any manner, including through the acquisition of assets of the other firm”.<sup>175</sup> The transfer of assets to a SPI in a securitisation scheme could, therefore, result in a merger<sup>176</sup> as contemplated in section 12 of the Competition Act.<sup>177</sup> If this does occur, a merger notification to the competition commission would be triggered.<sup>178</sup>

The Competition Commission holds the view that it was not the intention of the legislature to include securitisation transactions within the ambit of the merger provisions.<sup>179</sup> In coming to this conclusion, the Commission took into consideration the fact that a SPI is not intended

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<sup>171</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>172</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>173</sup> Competition Commission Practitioner Update (2015) 1.

<sup>174</sup> S 12(1)(a) of the Competition Act.

<sup>175</sup> Competition Commission Practitioner Update (2015) 9.

<sup>176</sup> Competition Commission Practitioner Update (2015) 9.

<sup>177</sup> Competition Commission Practitioner Update (2015) 10.

<sup>178</sup> S 13 and S 13A of the Competition Act. According to S 13(3)(a) and S 13(3)(b) of the Competition Act, a party to a small merger is not required to notify the Competition Commission of a merger, unless the Commission requires such a notification within 6 months after the merger is implemented and is of the opinion that the merger may substantially prevent or lessen competition or cannot be justified on public interest grounds. Thus a merger notification will only be triggered in respect of intermediate and large mergers or small mergers where S 13(3)(a) or (b) apply.

<sup>179</sup> Competition Commission Practitioner Update (2015) 10.

to be a regular business entity and the execution of a securitisation scheme would not have an impact on competition.<sup>180</sup> Accordingly, the Commission has indicated that it would not require notification of the transaction where an Originator transfers Underlying Assets to a SPI, provided that the scheme is executed in compliance with the Securitisation Notice.<sup>181</sup>

### 3.1.7 The Credit Rating Services Act 24 of 2012

The Credit Rating Services Act was passed with the aim of providing for, *inter alia*, the regulation of the activities of Credit Rating agencies as well as the conditions for the issuing of credit ratings.<sup>182</sup> The Act also ensures that these agencies are accountable and plays a role in reducing systemic risk.<sup>183</sup>

The Credit Rating Services Act applies to all Credit Rating services carried out in South Africa, including the rating of Commercial Paper issued by a SPI<sup>184</sup> as required in terms of Par 5(2)(k)(ii) of the Securitisation Notice.<sup>185</sup> Also, the Commercial Paper may be tranching into different series of notes with different ratings, depending on the quality of the pool of assets underpinning each tranche.<sup>186</sup>

Thomson further points out that one should bear in mind that the Credit Rating Services Act does not apply to private Credit Ratings or private Credit Rating services produced under individual orders. Furthermore, the Credit Rating is provided exclusively to the person who placed the order and is not intended for public disclosure or distribution.<sup>187</sup> The Act also prevents the use of Credit Ratings that have not been issued or endorsed by a Credit Rating

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<sup>180</sup> Competition Commission Practitioner Update (2015) 11.

<sup>181</sup> Competition Commission Practitioner Update (2015) 11.

<sup>182</sup> Preamble of the Credit Rating Services Act.

<sup>183</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>184</sup> The Commercial Paper issued by a SPI falls within the meaning of structured finance instruments as defined in S1 of Act 24 of 2012: “*Structured finance instrument means a financial instrument or other asset resulting from a securitisation transaction or other structured financial transaction or scheme.*” Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>185</sup> This provision does however provide for the Registrar of Banks to allow unrated securitisation structures, subject to such conditions as the Registrar of Banks may determine. Wessels (2015) *unpublished LLD theses* 177.

<sup>186</sup> Interview with Karin Krisch (2018) Partner at Hogan Lovells (South Africa) Incorporated 10 July 2018.

<sup>187</sup> S 3(4) of the Credit Rating Services Act. Thompson (2013) *unpublished LLM theses* 27.

agency that has been registered in terms of the Act<sup>188</sup> or approved by the Registrar of Banks.<sup>189</sup>

### 3.1.8 The Financial Markets Act 19 of 2012 and JSE<sup>190</sup> Debt Listing Requirements

The Financial Markets Act governs the regulation of the South African financial markets.<sup>191</sup> The Act states that an exchange must make listing requirements which, *inter alia*, prescribe the manner in which securities may be listed or removed from the list. In addition, it sets out the requirements with which the issuers of listed securities must comply.<sup>192</sup>

The debt listing requirements of the JSE (hereafter referred to as the “debt listing requirements”) are applicable in respect of JSE listed Commercial Paper issued by a SPI in a securitisation transaction.<sup>193</sup> Section 6 of the debt listing requirements governs the disclosure requirements for securitisations and sets out the information that needs to be provided to the JSE. Such information includes a general description of the Underlying Assets, the legal jurisdiction of where the assets are located, the number and value of the assets in the pool, and the level of collateralisation.<sup>194</sup>

The Debt Listing Requirements also prescribe which documents are required for listing on the JSE. These include (i) a copy of the placing document, (ii) a certified copy of the certificate of registration and certificate of incorporation of the issuer, (iii) a copy of the board resolution of the issuer authorising the establishment of the programme memorandum or issue of debt securities, and (iv) annual financial statements of the SPI.<sup>195</sup>

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<sup>188</sup> S 4(1)(a) of the Credit Rating Services Act.

<sup>189</sup> S 4(1)(b) of the Credit Rating Services Act. Wessels (2015) *unpublished LLD theses* 179. Thompson (2013) *unpublished LLM theses* 28: in terms of section 3(2) of Act 24 of 2012, there is a duty on Credit Rating agencies to be validly registered.

<sup>190</sup> The Johannesburg Stock Exchange, hereafter referred to as the “JSE”.

<sup>191</sup> The Preamble of the Financial Markets Act.

<sup>192</sup> S 11 of the Financial Markets Act.

<sup>193</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>194</sup> S 6.2 of the JSE Debt Listing Requirements.

<sup>195</sup> S 8.3 of the JSE Debt Listing Requirements.

It should be noted that the JSE has proposed amendments to the debt listings requirements. Consequently, the requirements may be amended in the future.<sup>196</sup>

### 3.1.9 The Protection of Personal Information Act 4 of 2013

The Protection of Personal Information Act (also known as POPI) has not yet fully come into force. However, Boshoff indicates that this Act will place obligations on SPIs in respect of the requirements relating to the collection, processing, retention and transmission of consumer data.<sup>197</sup>

## 3.2 Final remarks

In its Budget Review for 2017 National Treasury states that if securitisation is not carefully regulated, a lack of disclosure and oversight could cause systematic risk.<sup>198</sup> This being said, it should be borne in mind that the legislative and regulatory framework governing securitisation schemes in South Africa is extensive<sup>199</sup> and banks are strictly audited, ensuring that they do not act in contravention of the regulations.<sup>200</sup> National Treasury and the Reserve Bank have also committed to introducing further regulations which will assist in ensuring more uniform and transparent securitisations which would lead to enhanced disclosure and more credit in fundamental asset classes like mortgage-backed securities.<sup>201</sup>

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<sup>196</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018). Announcement by the JSE (2018) Amendments to the JSE Debt Listing Requirements: Part 1A and 1B Amendments of 2018 (26 April 2018) <https://www.jse.co.za/content/JSEAnnouncementItems/Announcement1.pdf> (accessed on 29 June 2018).

<sup>197</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>198</sup> Budget Review 2017 National Treasury Republic of South Africa 22 February 2017: <http://www.treasury.gov.za/documents/national%20budget/2017/review/FullBR.pdf> (accessed 15 February 2018).

<sup>199</sup> Van Vuuren N (2004) The Awakening of Securitisation in South Africa, 1 December 2004 <http://www.sasf.co.za/aboutsecuritisation/The%20awakening%20of%20securitisation%20in%20South%20Africa.pdf> (accessed 4 June 2017).

<sup>200</sup> Syndicate One (2009) SWOT Analysis of Securitization within the South African Financial Sector [https://www.bankseta.org.za/downloads/IEDP\\_ALP/Bankseta\\_ALP\\_final\\_copy\\_Syndicate\\_1\\_securitisation.doc](https://www.bankseta.org.za/downloads/IEDP_ALP/Bankseta_ALP_final_copy_Syndicate_1_securitisation.doc) (accessed 4 June 2017) 12.

<sup>201</sup> Budget Review 2017 National Treasury Republic of South Africa 22 February 2017: <http://www.treasury.gov.za/documents/national%20budget/2017/review/FullBR.pdf> (accessed 15 February 2018).

## CHAPTER 4

### The sale of assets to the SPI in a traditional securitisation scheme

#### 4.1 Introduction

The agreement governing the sale of assets to a SPI must comply with the general requirements that need to be satisfied for all contracts under South African Law.<sup>202</sup> Thus the Originator and the SPI must be in general agreement on the three essential characteristics for a sale agreement: the *merx* to be sold, the price to be paid and the seller and buyer need to reach consensus to enter into an agreement of sale and purchase.<sup>203</sup>

As discussed in Chapter Three, paragraph 4(1)(c) of the Securitisation Notice introduces an additional requirement in respect of traditional securitisation transactions. This is referred to as the “true sale”-requirement and will be met when the conditions relating to the limitation of association with assets are satisfied.<sup>204</sup> These conditions include, *inter alia*, (i) ownership of the assets has to pass from the Originator to the SPI,<sup>205</sup> (ii) the SPI needs to be insolvency-remote,<sup>206</sup> (iii) the SPI is only entitled to funds that have actually been collected,<sup>207</sup> (iv) the replacement and substitution of assets transferred to a SPI is limited to performing assets of equivalent credit quality<sup>208</sup> and (v) the share capital held by the Originator in the SPI is limited to 20%.<sup>209</sup>

A true sale legal opinion must be obtained if the Originator is a bank, or any other institution within the banking group of which such a bank is a member.<sup>210</sup> Such a legal opinion will confirm the total divestiture by the transferring institution of all its rights and the insolvency-remoteness of the SPI.<sup>211</sup>

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<sup>202</sup> Gerstle *Without Prejudice* 2007 34.

<sup>203</sup> Gerstle *Without Prejudice* 2007 34. Nagel (2015) 197.

<sup>204</sup> Gerstle *Without Prejudice* 2007 34. See Par 4(2) of the Securitisation Notice: Conditions relating to limiting of association with assets.

<sup>205</sup> Par 4(2)(a) of the Securitisation Notice.

<sup>206</sup> Par 4(2)(b)(ii) of the Securitisation Notice.

<sup>207</sup> Par 4(2)(f) of the Securitisation Notice.

<sup>208</sup> Par 4(2)(k) of the Securitisation Notice.

<sup>209</sup> Par 4(2)(p)(ii)(A) of the Securitisation Notice.

<sup>210</sup> Par 4(2)(b)(i) of the Securitisation Notice.

<sup>211</sup> Par 4(2)(b)(i) of the Securitisation Notice, read together with Par 4(2)(a).



#### 4.1.1 The complete passing of rights, obligations and risk from the Originator to the SPI

According to the Securitisation Notice, the transfer of assets to a SPI should entirely divest the transferring institution and its associated companies of all rights, obligations and risks in connection with the assets that are transferred.<sup>212</sup> Locke opines that this is accomplished by cession of the Originators' rights to the SPI.<sup>213</sup> It is commonplace that cession is used as a mechanism to transfer incorporeal rights from one party to another, thus the transfer of a creditor's right to recover debt from a debtor is done by way of a cession.<sup>214</sup>

In terms of the standard law requirements for a valid cession, the Originator must have the intention to transfer all of its rights, title and interest to the SPI (*animus transferendi*) and the SPI must furthermore have the intention to acquire these (*animus acquirendi*).<sup>215</sup> There must also be an underlying *causa* for the cession which can be evidenced by the payment of consideration to the Originator.<sup>216</sup>

##### 4.1.1.1 The cession of a mortgage bond

Roothman states that it is important to note that a registered mortgage bond has a dual character and consists of a personal right (the principal debt, i.e. the loan agreement between the bank and the client) and a real right (the registration of the mortgage bond).<sup>217</sup> When a mortgage bond is transferred to a SPI, both the real right and the personal right must therefore be transferred.<sup>218</sup>

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<sup>212</sup> Par 4(2)(a) of the Securitisation Notice. Gerstle *Without Prejudice* 2007 34.

<sup>213</sup> Locke (2010) 3 *TSAR* 460.

<sup>214</sup> Lynn and Main Incorporated v Brits Community Sandworks 2007 (SCA) 6

<sup>215</sup> Johnson v Incorporated General Insurance Ltd 1983 (1) SA 318G. Roothman R (2012) The International Comparative Legal Guide to Securitisation 2012: A practical cross-border insight into securitisation work published by Global Legal Group April 2012

[https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012\\_South-African-chapter\\_FINAL.pdf](https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012_South-African-chapter_FINAL.pdf) (accessed 17 June 2017) 460.

<sup>216</sup> Johnson v Incorporated General Insurance Ltd 1983 (1) SA 318H.

<sup>217</sup> Roothman R (2012) The International Comparative Legal Guide to Securitisation 2012: A practical cross-border insight into securitisation work published by Global Legal Group April 2012

[https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012\\_South-African-chapter\\_FINAL.pdf](https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012_South-African-chapter_FINAL.pdf) (accessed 17 June 2017) 320. Gouws (2009) 18 *SADJ* 45.

<sup>218</sup> Roothman R (2012) The International Comparative Legal Guide to Securitisation 2012: A practical cross-border insight into securitisation work published by Global Legal Group April 2012

[https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012\\_South-African-chapter\\_FINAL.pdf](https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012_South-African-chapter_FINAL.pdf) (accessed 17 June 2017) 320.

The bank can cede its right freely<sup>219</sup> by way of an agreement, which agreement does not need to be registered. The cessionary will become the owner of the principal debt when the agreement is concluded and the terms and conditions fulfilled.<sup>220</sup> In contrast to this, the real right is transferred by an “out and out” cession<sup>221</sup> of the bond which needs to be registered by the relevant Registrar of Deeds.<sup>222</sup> The transfer is endorsed on the original mortgage bond in line with the provisions of the Deeds Registries Act 47 of 1937.<sup>223</sup> It must be noted that the SPI will then acquire *locus standi* to enforce instruments of debt.<sup>224</sup>

The question regarding *locus standi* has been the subject of various cases where mortgagors have claimed that their bonds have been ceded to SPIs, thereby precluding the original Mortgagee from instituting an action against them when they are in default. In the matter of *Thompson v Investec Bank Limited*,<sup>225</sup> the Applicant sought rescission of a judgment granted in favour of the Respondent after defaulting on a loan agreement. It was alleged that the loan agreement had been securitised and that the respondent, as the original creditor, had no *locus standi* to apply for judgment against the Applicant.<sup>226</sup> Counsel for the Respondent presented the original mortgage bond to the court thereby demonstrating that it was not endorsed as prescribed by the Deeds Registries Act. The court found that the bond was not sold on to a SPI<sup>227</sup> and consequently that the Respondent<sup>227</sup> had the necessary *locus standi* to institute the application for default judgement.<sup>228</sup>

In the unreported case of *Nedbank Limited v Dirk Arno Coetzee*,<sup>229</sup> an application for summary judgment was defended on the ground that an employee of the applicant indicated to the respondent that its mortgage bond was sold and ceded to a third party. The defendant claimed that this third party was the new owner of the bond, resulting in the plaintiff lacking the necessary *locus standi* to institute the proceedings. The court held that there was no

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<sup>219</sup> Paiges v Van Ryn Gold Mine Estates Limited 1920 AD 600.

<sup>220</sup> Gouws (2009) 18 *SADJ* 45.

<sup>221</sup> Gouws (2009) 18 *SADJ* 45.

<sup>222</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018). Locke (2010) 3 *TSAR* 461.

<sup>223</sup> S16 read together with the provisions of S3(1)(f) and S54. *Thompson v Investec Bank Limited* 2014 JDR (ECP).

<sup>224</sup> *Thompson v Investec Bank Limited* 2014 JDR (ECP) 17.

<sup>225</sup> *Thompson v Investec Bank Limited* 2014 JDR (ECP).

<sup>226</sup> *Thompson v Investec Bank Limited* 2014 JDR (ECP) 16.

<sup>227</sup> *Thompson v Investec Bank Limited* 2014 JDR (ECP) 69.

<sup>228</sup> *Thompson v Investec Bank Limited* 2014 JDR (ECP) 17.

<sup>229</sup> *Nedbank Limited v Dirk Arno Coetzee* 2012 (WCHC).

evidence to substantiate this defence.<sup>230</sup> The court further indicated that one should bear in mind that if a respondent pays the outstanding amount claimed by the applicant, and it later emerges that the bond was ceded to a third party, the respondent would have a solid defense that the debt has been extinguished should the third party, as the valid holder of the rights, claims payment of the same debt.<sup>231</sup>

The endorsement requirement was relaxed by Chief Registrar's Circular 11 of 2014. This was in response to a request by the South African Reserve Bank to assist with a process to facilitate the registration of cessions.<sup>232</sup> The Circular allowed for the use of copies of mortgage bonds for purposes of the required endorsement until 30 June 2016. The endorsement read "Certified a true copy of the registry duplicate and issued for securitisation purposes".<sup>233</sup> The circular also required that an affidavit by the bondholder be lodged, stating that the cession of the bond is required for securitisation purposes and that the client's copy of the bond is inaccessible. A single affidavit could be made in respect of the cession of up to 50 mortgage bonds.<sup>234</sup>

The circular was however withdrawn later that same year by Chief Registrar's Circular 14 of 2014. The latter circular stated that The Deeds Registries Act<sup>235</sup> does not provide for the issuing of copies of bonds for securitisation purposes<sup>236</sup> and that no applications for the issuing of copies would be accepted after 31 October 2014.<sup>237</sup>

In *Standard Bank v Border*,<sup>238</sup> the court held that reliance on the Chief Registrar's Circular 11 of 2014 and the lack of an endorsement on the bond deed does not support a defence of securitisation. The defendant is not in a position to know if the original deed was available at the time of the alleged securitisation. Furthermore, it cannot confirm that if securitisation had occurred, it was during the time that the circular was in operation.<sup>239</sup>

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<sup>230</sup> Nedbank Limited v Dirk Arno Coetzee 2012 (WCHC) 8.

<sup>231</sup> Nedbank Limited v Dirk Arno Coetzee 2012 (WCHC) 9.

<sup>232</sup> Par 1 of Chief Registrar Circular 11 of 2014.

<sup>233</sup> Par 3 of Chief Registrar Circular 11 of 2014.

<sup>234</sup> Par 4 of Chief Registrar Circular 11 of 2014.

<sup>235</sup> Act 47 of 1937.

<sup>236</sup> Par 1 of Chief Registrar Circular 14 of 2014.

<sup>237</sup> Par 3 of Chief Registrar Circular 14 of 2014.

<sup>238</sup> Standard Bank of South Africa Limited v Border 2015 (ECGHC).

<sup>239</sup> Standard Bank of South Africa Limited v Border 2015 (ECGHC) 25.

#### 4.1.1.2 Agreements prohibiting cession

South African courts generally give effect to non-petition clauses, viewing them as a waiver of a right under a contract.<sup>240</sup> Therefore, Scott remarks that an agreement prohibiting cession (*pactum de non ceto*) will hinder the smooth operation of securitisation transactions.<sup>241</sup>

This notion is evident from case law such as the matter of *Capespan (Pty) Ltd v Any Name 451 (Pty) Ltd*,<sup>242</sup> where the High Court confirmed the principle that parties are generally free to render their contractual rights non-transferable using a *pactum de non ceto*.<sup>243</sup> There is, however, a difference between restraint in the agreement creating the right *ab initio* and restraint in respect of existing rights.

Hutchinson states that a right which pre-existed the conclusion of the *pactum de non ceto* will not always be enforceable as it is contrary to the principle that *res in commercio* should not be withdrawn from commercial dealings. Such a *pactum* will therefore not prevent a liquidator of a creditor from executing an involuntary cession to a third party in the course of carrying out his duties as liquidator.<sup>244</sup> A *pactum de non ceto*, in respect of a pre-existing right, is only binding on the parties to the agreement. A breach thereof will result in a claim for damages.<sup>245</sup>

This is distinguished from a *pactum de non ceto* in respect of a right which is created as non-transferable from the outset. Such a *pactum* is valid<sup>246</sup> and Hutchinson points out that a cession contrary to such a *pactum* will be of no force and effect even when the cession is involuntary by a liquidator in insolvency.<sup>247</sup>

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<sup>240</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>241</sup> Scott (2008) 3 *STELL LR* 487

<sup>242</sup> *Capespan (Pty) Ltd v Any Name 451 (Pty) Ltd* 2008 (4) SA 510 (C)

<sup>243</sup> Hutchison (2016) 27 *Stell LR* 274

<sup>244</sup> Hutchison (2016) 27 *Stell LR* 281

<sup>245</sup> Hutchison (2016) 27 *Stell LR* 280. *Capespan (Pty) Ltd v Any Name 451 (Pty) Ltd* 2008 (4) SA 510 (C) 514.

<sup>246</sup> Hutchison (2016) 27 *Stell LR* 280

<sup>247</sup> Hutchison (2016) 27 *Stell LR* 280. *Born Free Investments 364 (Pty) Ltd v Firstrand Bank Limited* 2014 (2) All SA 127 (SCA): The Supreme Court of Appeal reinforced the principle that a restraint in the agreement creating the right will be effective, thereby preventing a cession of the right to a third party. *Capespan (Pty) Ltd v Any Name 451 (Pty) Ltd* 2008 (4) SA 510 (C) 515.

It is worth noting that in deciding on the *Capespan* matter, the court referred to and agreed with the views of Professor Susan Scott<sup>248</sup> who has expressed a dissenting view since the judgment was handed down.<sup>249</sup> Scott now supports an approach in line with modern developments<sup>250</sup> and suggests that a *pactum de non cedendo* should always be valid in terms of the principle of freedom of contract.<sup>251</sup> She is also of the opinion that a *pactum de non cedendo* should not apply to a third party, thus if cession takes place contrary to such an agreement, one would only have a claim for damages based on breach of contract.<sup>252</sup> Scott has therefore suggested the codification of the South African law of cession.<sup>253</sup> Until such time however, the approach of the court in the *Capespan* matter should be followed.

#### 4.1.1.3 Notice of cession

The next point of discussion is the question as to whether notice to a mortgagor is required for a valid cession of a mortgage bond.

The consensus in this regard is that the answer is dependent on the provisions of the relevant contract- to the extent that parties agree that notice is required, such notice must be given or obtained.<sup>254</sup>

In the case of *Home Obligors Mortgage Enhanced Securities (Pty) Limited v Louw*,<sup>255</sup> ABSA securitised the Defendants Mortgage Bond, thereby ceding it to the plaintiff.<sup>256</sup> The court referred to the conditions of the Defendants bond which included the upfront consent of the mortgagor to the sale and transfers of the Mortgagees rights under the mortgage bond. The court held that the ABSA was free to cede its rights and that notice to the mortgagor is not a

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<sup>248</sup> Scott (1991) 212 – 214.

<sup>249</sup> Scott (2008) 3 *STELL LR* 483: Developments such as the emergence of securitisation prompted Scott to relook agreements prohibiting cession.

<sup>250</sup> Hutchison (2016) 27 *Stell LR* 275.

<sup>251</sup> Scott (2008) 3 *STELL LR* 494.

<sup>252</sup> Scott (2008) 3 *STELL LR* 494.

<sup>253</sup> Scott (2008) 3 *STELL LR* 494.

<sup>254</sup> Roothman R (2012) *The International Comparative Legal Guide to Securitisation 2012: A practical cross-border insight into securitisation work* published by Global Legal Group April 2012 [https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012\\_South-African-chapter\\_FINAL.pdf](https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012_South-African-chapter_FINAL.pdf) (accessed 17 June 2017) 320.

<sup>255</sup> *Home Obligors Mortgage Enhanced Securities (Pty) Limited v Louw* 2016 JDR 1040 (KZP).

<sup>256</sup> *Home Obligors Mortgage Enhanced Securities (Pty) Limited v Louw* 2016 JDR 1040 (KZP) 8.

requirement for the validity of the cession. In this case, ABSA did, however, inform the defendants of the cession and the consequences thereof in writing.<sup>257</sup>

The conclusion of the court that notice to the mortgagor is not a requirement for the validity of the cession is aligned with section 69(4) of the NCA<sup>258</sup> which does not prescribe any requirement to notify obligors.<sup>259</sup>

#### 4.1.2 The SPI has to be Insolvency Remote:

Securitisation transactions are structured in such a way that the SPI and Originator are treated as separate entities in the event of insolvency.<sup>260</sup> The Originator may not have any effective or indirect control over the assets after they have been ceded to the SPI.<sup>261</sup> The Securitisation Notice<sup>262</sup> stipulates that an Originator will have effective control when it can repurchase the transferred assets from the SPI in order to realise their benefits, or when it is obligated to retain the risk relating to the transferred assets. It should be noted that the retention of any servicing rights by the Originator to the SPI does not constitute indirect control of the transferred assets.<sup>263</sup>

In short, the assets and benefits that relate to the assets will not be subject to the claims of a creditor or liquidator of the Originator.<sup>264</sup> The cession of financial assets to a SPI thus isolates the assets from the insolvency risk of the Originator.<sup>265</sup>

<sup>257</sup> Home Obligors Mortgage Enhanced Securities (Pty) Limited v Louw 2016 JDR 1040 (KZP) 11.

<sup>258</sup> S 4 of the NCA states that the Act applies to “every credit agreement between parties dealing at arm’s length and made within, or having an effect within the Republic.” As per S9(4)(a) of the NCA, this includes a large credit agreement. It should be noted that a mortgage agreement, defined in S1 as “a credit agreement that is secured by the registration of a mortgage bond by the Registrar of Deeds over immovable property” is also a large agreement in terms of the NCA: Kelly-Louw (2012) 24 SA Merc LJ 214: “All mortgage agreements, irrespective of the principal debt involved, are regarded as large credit agreements.”

<sup>259</sup> Interview with Karin Krisch (2018) Partner at Hogan Lovells (South Africa) Incorporated 10 July 2018.

Lynn and Main Incorporated v Brits Community Sandworks 2007 (SCA) 6: Notice to the debtor is not a prerequisite for the validity of the cession

<sup>260</sup> Gouws (2009) 18 SADB 45.

<sup>261</sup> Locke (2010) 3 TSAR 452.

<sup>262</sup> Par 4(2)(b)(ii) of the Securitisation Notice.

<sup>263</sup> Par 4(2)(b)(iii) of the Securitisation Notice.

<sup>264</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>265</sup> Par 4(2)(b) of the Securitisation Notice. Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018). Gouws (2009) 18 SADB 45.

The powers of a SPI can be limited in its founding documents by including the necessary ring-fencing provisions in its memorandum of incorporation.<sup>266</sup> Such provisions can include the restriction of the powers of the SPI so that it cannot undertake any other business or incur indebtedness to third-party creditors outside the securitisation scheme.<sup>267</sup> Locke remarks that the amendment of the provision in the memorandum of incorporation that restricts the capacity of the SPI should be prohibited or restricted so that amendments may only occur with the consent of the holders of the debt instruments.<sup>268</sup>

The SPI is further only entitled to funds that have been collected. When another institution collects funds in respect of the transferred assets in a traditional securitisation scheme,<sup>269</sup> the said institution shall not be under any obligation to provide the funds to the SPI unless and until the payments are received from the obligor.<sup>270</sup> The SPI is therefore only entitled to funds that have been collected and received by such other institution.<sup>271</sup>

#### 4.1.3 Replacement of assets

Paragraph 4(2)(k) of the Securitisation Notice determines that the replacement and substitution of assets transferred to the SPI in a traditional securitisation scheme must be limited<sup>272</sup> to performing assets of equivalent credit quality.<sup>273</sup>

#### 4.1.4 Share capital requirements

In terms of the Securitisation Notice an Originator may not directly or indirectly acquire or hold more than 20% of the equity share capital<sup>274</sup> (in the case of a company), or 20% of the

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<sup>266</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>267</sup> Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

<sup>268</sup> Locke (2016) 133 *SALJ* 163.

<sup>269</sup> Gerstle *Without Prejudice* 2007 34.

<sup>270</sup> Par 4(2)(f) of the Securitisation Notice.

<sup>271</sup> Gerstle *Without Prejudice* 2007 34.

<sup>272</sup> Gerstle *Without Prejudice* 2007 34.

<sup>273</sup> Par 4(2)(k) of the Securitisation Notice.

<sup>274</sup> Par 4(2)(p)(i)(A) of the Securitisation Notice. Boshoff A (2017) Structured finance and securitisation in South Africa: overview [global.practicallaw.com/4-521-4150](http://global.practicallaw.com/4-521-4150) (accessed 12 June 2018).

interest, beneficial or otherwise (in the case of a trust)<sup>275</sup> of the SPI. An Originator may also not have the right to determine the outcome of the voting at a general meeting of the SPI.<sup>276</sup>

## 4.2 Final remarks

The sale of a mortgage bond to a SPI will only be seen as a true sale when both the real right and the personal right portions have been transferred to the SPI.<sup>277</sup> Banks include a clause in mortgage deeds to facilitate this. The clause constitutes the upfront consent of the mortgagor to the cession of the loan.<sup>278</sup>

A mortgagor could request an amendment to this standard clause, thereby incorporating a provision prohibiting the cession of the mortgage bond to a third party. Furthermore, a mortgagor could stipulate that no valid cession will take place without the requirements of the clause relating to the prohibition of the assignment being fulfilled.<sup>279</sup> According to Roothman a supposed assignment in contradiction with such a prohibition may be treated as a breach of contract.<sup>280</sup>

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<sup>275</sup> Par 4(2)(p)(ii)(A) of the Securitisation Notice. Roothman R (2012) *The International Comparative Legal Guide to Securitisation 2012: A practical cross-border insight into securitisation work* published by Global Legal Group April 2012

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<sup>276</sup> Par 4(2)(p)(i)(B) and Par 4(2)(p)(ii)(B) of the Securitisation Notice.

<sup>277</sup> Locke (2010) 3 *TSAR* 452. Roothman R (2012) *The International Comparative Legal Guide to Securitisation 2012: A practical cross-border insight into securitisation work* published by Global Legal Group April 2012 [https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012\\_South-African-chapter\\_FINAL.pdf](https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012_South-African-chapter_FINAL.pdf) (accessed 17 June 2017) 320.

<sup>278</sup> *Paiges v Van Ryn Gold Mine Estates Limited* 1920 AD 600. Confirmed in an interview with Nadia Burger (Conveyancer) on 13 June 2018.

<sup>279</sup> Roothman R (2012) *The International Comparative Legal Guide to Securitisation 2012: A practical cross-border insight into securitisation work* published by Global Legal Group April 2012 [https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012\\_South-African-chapter\\_FINAL.pdf](https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012_South-African-chapter_FINAL.pdf) (accessed 17 June 2017) 320.

<sup>280</sup> Roothman R (2012) *The International Comparative Legal Guide to Securitisation 2012: A practical cross-border insight into securitisation work* published by Global Legal Group April 2012 [https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012\\_South-African-chapter\\_FINAL.pdf](https://www.werksmans.com/wp-content/uploads/2012/05/ICLG-Securitisation-2012_South-African-chapter_FINAL.pdf) (accessed 17 June 2017) 320.



## CHAPTER 5

### Final Remarks and Conclusion

#### 5.1 Introduction

The purpose of this dissertation was to investigate the defence of securitisation in instances of default of repayment by mortgagors of their home loans. In these cases, the question before the courts has been whether the banks that are claiming default are the legal creditors and whether they have the necessary *locus standi* to bring applications of default against the mortgagors.

#### 5.2 Final Remarks and Conclusion

Through an extensive discussion of various issues raised, the conclusion was made that mortgagors cannot sidestep their obligation to repay a bond by merely claiming that the bond has been sold on to a SPI. In the case law studied in this dissertation, courts have decided in favour of the banks as the mortgagors have not been able to prove securitisation and by implication that the banks do not have the necessary *locus standi* to approach the courts.

If a defaulting mortgagor can prove that their mortgage was sold on to a SPI, a claim against the mortgagor must be instituted in the name of the SPI who is the legal creditor of the mortgagor.<sup>281</sup> If such SPI brings an application against a defaulting mortgagor, they cannot defend the action by claiming that they were not notified of the sale. The absence of a notice does not invalidate the cession to the SPI as notification of the sale is not required in terms of the NCA. It can also not be said that the mortgagor did not consent to the sale of the mortgage to a SPI if the Mortgage Deed contains the upfront consent of the mortgagor to the sale and transfers of the Mortgagees rights under the mortgage bond.<sup>282</sup>

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<sup>281</sup> Locke (2010) 3 TSAR 460.

<sup>282</sup> Home Obligors Mortgage Enhanced Securities (Pty) Limited v Louw 2016 JDR 1040 (KZP).

A team of researchers sampled 600 mortgage bonds dating back to 2009<sup>283</sup> and established that approximately 120 to 200 of those mortgages were sold on to SPIs.<sup>284</sup> However, none of the sampled bonds was endorsed by the Registrar of Deeds as having changed ownership.<sup>285</sup> As the transfer of the real right was thus not transferred by way of registration by the relevant Registrar of Deeds,<sup>286</sup> the cession of these mortgage bonds will not be valid *vis-a-vis* third parties, and the SPI in these cases will not have *locus standi* to enforce instruments of debt.<sup>287</sup>

As a final remark, it must be added that non-compliance with the conditions of securitisation, can have several consequences. Banks will no longer be in a position to reduce their capital requirements as assets that were transferred in terms of a traditional securitisation scheme will be reflected as assets on the banks' balance sheet.<sup>288</sup> Further consequences include the imposition of additional capital requirements and the prohibition of a bank from participating in future securitisation schemes in a primary role.<sup>289</sup>

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