CROSS-BORDER FINANCE ESSAY

A Framework For Championing Securitization in Africa to Mobilize Capital and Drive Economic Development

BY KABIR VASSANJI

Earlier this year, SFNet announced its second Cross-Border Finance Essay Contest, sponsored by Goldberg Kohn Ltd. Members of SFNet's International Finance and Development Committee judged the essay submissions on content, originality, clarity, structure and overall contribution to furthering and expanding understanding and discourse within the field of cross-border finance. This essay won third place.

The authors of the winning essays have been invited to participate on a panel at SFNet's 79th Annual Convention in Orlando, FL, November 15-17. The second place and first place winners will be published in the October and November issues of *TSL*, respectively.

Framing Securitization's Role in the Global Development Context

The potential of securitization to meet a range of financing needs in African markets is yet to be fully realized.

The United Nations has established Sustainable Development Goals (SDGs), which formalize 17 global targets aimed at eradicating poverty and inequality by 2030.[1] However, the annual financing gap faced by the SDGs is estimated between (all figures in $USD) $2 trillion and $4 trillion,[2] (which cannot be bridged by government and multilateral institutions (i.e., development banks) alone. Mobilizing private capital will be essential to advancing the SDGs. Redirecting even a fraction of the global asset and wealth management industry's portfolios (over $100 trillion[3]) towards SDG-aligned investments would significantly reduce the funding gap. On the other side of the equation, a growing number of global institutional investors and asset managers are seeking to invest in ways that create a sustainable future and embedding SDGs into their mandates.[4] However, a common constraint they face is a dearth of attractive opportunities in emerging markets.[5]

The emergence of securitization markets in developing economies presents a promising solution. The underlying premise of securitization is that any asset that produces recurring cash flows can theoretically be securitized. Focusing the credit decision on the strength of an asset's cash flows is especially important in developing economies where credit markets are underdeveloped and restricted to only well-known corporates. Securitized transactions pool the cash flows from hundreds or thousands of consumers, via mortgages, credit cards, or even commuter bus fares, and raise capital by issuing bonds backed by those cash flows. These bonds can be structured to provide risk and return profiles tailored to a range of investor preferences. Securitization is undoubtedly effective in raising capital and enhancing transactions, but it is important to recognize its broader potential in attracting and accelerating investment towards large-scale problems, reflecting a compelling opportunity to achieve both financial returns and social impact. As such, securitized investments in developing regions represent a uniquely positioned asset class that intersects emerging market, fixed-income credit, and broader impact-investing mandates.

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Although there is a growing need for infrastructure financing in Africa, securitization is still in its infancy on the continent. Multilateral organizations and export credit agencies currently facilitate most significant securitizations, and the overall market is fragmented.[6] An analysis of the transactions executed in Africa reveal that certain markets, namely South Africa and Nigeria, are advanced in their respective lifecycles,

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

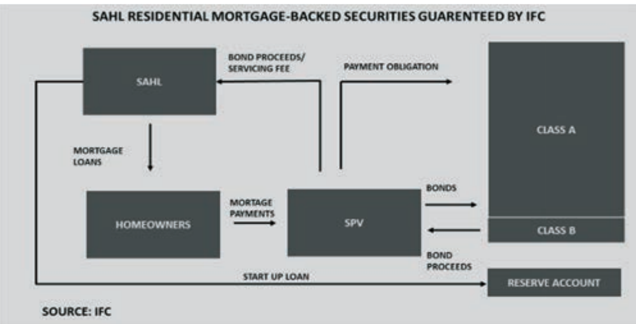
Source: "Issuance of Mortgage-Backed Securities in Kenya." Structured Finance Association, March 2022, https://structuredfinance.org/wpcontent/uploads/2022/03/Issuance_of_MBS_in_Kenya.pdf.

while others such as Kenya show the potential and regulatory willingness to catch up. By examining the advancements and challenges in these economies, one can carve out a series of actionable steps to promote the development and eventual maturity of most nascent securitization markets, which in turn can help bridge the global SDG funding gap.

South Africa – A Benchmark for Securitization Markets Across the Continent

South Africa is generally considered to be the most developed African securitization market, with an established track-record of issuances across Mortgage-Backed Securities (MBSs), Asset-Backed Securities (ABSs), and other structured finance products.

Until 2001, South African banks monopolized the domestic mortgage market and were averse to securitizations due to corporate bond illiquidity and a distrust of regional ratings agencies.[7] Further, South Africa's Banking Act precluded banks from executing on multiple sides of a transaction, a nuance that effectively restricted originations to banks.[8] This was later clarified in reformed legislation in 2001 that permitted corporations and banks alike to execute securitizations in different capacities.[9] Subsequently, a wave of issuances unfolded, including the landmark introduction of MBSs to Africa through South African Home Loans (SAHL).[10] SAHL was structured as a private partnership – majority-owned by the IFC, Standard Bank of South Africa and JP Morgan – and aimed to provide alternative mortgage financing to homeowners, directly competing with the commercial banks.[11] SAHL had already originated over $100 million worth of mortgages by the time of its MBS issuance in 2001,[12] however the MBSs expanded its capital base, enabling the company to re-package a sizeable mortgage pool (secured against domestic properties) to institutional investors through a AAA tranche of $118 million and a BBB tranche of $10 million.[13] The deal was co-led by JP Morgan and Standard Chartered, with the secured notes traded on the Bond Exchange of South Africa.[14] As a credit enhancement to senior investors, IFC purchased 15 percent of the subordinated tranche and provided partial



Source: "Issuance of Mortgage-Backed Securities in Kenya." Structured Finance Association, March 2022, https://structuredfinance.org/wpcontent/uploads/2022/03/Issuance_of_MBS_in_Kenya.pdf.

guarantees.[15] The senior tranche was twice oversubscribed, and all 20 investors were South African institutions (banks and fund managers).[16] By re-capitalizing through an MBS raise, SAHL was able to increase originations of discounted mortgages, which forced down mortgage rates in the broader market.[17] SAHL's success thus had the dual impact of improving the South African housing market while exemplifying the continent's maiden MBS structure which other emerging markets could follow.

The South African securitization market has since evolved to encompass a breadth of structures (including residential and commercial MBSs, vehicle loans, bus-ticket receivables and credit card receivables) and regularly produces AAA transactions, which outrank even the most senior issuances in the domestic corporate bond market.[18] The market has benefitted from the Financial Markets Act of 2013 (FMA) which provides a comprehensive legal framework for securitizations, including requirements for disclosure, investor protection, and governance.[19] The FMA was also expanded to cover the secondary market for securitized instruments, conferring the Financial Sector Conduct Authority (FSCA) with the power to regulate trading and impose protective restrictions.[20] Any securitizations must also be registered with the FSCA. [21] Despite their hierarchical structures, both bodies operate efficiently with minimal bureaucracy, expediting the flow of capital.

South Africa's tax treatment of securitizations is also generally favorable for issuers and investors. The transfer of assets to an SPV is tax-neutral, meaning that the transfer does not trigger any immediate tax liabilities for the issuer.[22] Instead, the tax liabilities associated with the assets are transferred to the SPV, which is typically subject to a lower tax rate than the issuer.[23] Additionally, interest and other payments that the SPV distributes to investors are generally tax-deductible for the SPV.[24] South Africa introduced a tax regime specific to securitizations in 2008 which includes an exemption on residential MBSs and permits tax-loss carry-forwards for the SPV.[25] Foreign investors in securitized assets also enjoy generally favourable tax treatment, promoting international participation in the market.[26]

Overall, the FMA provides a robust legal framework, and an articulated and supportive tax regime, which has helped to establish a well-functioning and mature securitization market in South Africa.

Nigeria - Rapid Growth Fuelled by Regulatory Support

Nigeria's securitization market is also considered among the most developed in Africa. The issuance of country's first MBS by the Nigeria Mortgage Refinance Company (NMRC) took place in 2015, and has been followed by regular issuances, which have helped to boost the liquidity of the domestic mortgage market (similar to SAHL's impact in South Africa).[27]

The most recent transaction of note was executed in 2019, through Primero Transport Services Limited, a domestic transport company. Primero issued securitized bonds of $43.2 million through its SPV, backed by future ticket-sale receivables from its bus transit operations in Lagos.[28] Primero's equity position had been depleted by the depreciation of its vehicles and expensive bank debt, but was restructured with the assistance of its advisor, DLM Advisory Partners.[29] The ticket receivables were regarded as a strong cash-flow generator in isolation of the distressed balance sheet. Enhanced by Primero's guarantee, a cash-reserve account and a standby Letter of Credit from Sterling Bank and framed in the broader context of Nigeria's transportation sector fuelling economic growth, the issuance attracted strong investor demand and full subscription.[30] The bonds were rated a BBB rating with a "stable outlook" by Global Credit Ratings (GCR), though it is unclear how they have performed to date.[31]

Cytonn Report: KMRC Global Credit Rating Scorecard

Rated Entity	Rating Class	Rating Scale	Rating	Rating Description	Outlook
Kenya Mortgage Refinance Company Plc	Long Term Issuer	National	AA-(KE)	Very high credit quality relative to other issuers or obligations in the same country	Stable Outlook
	Short Term Issuer	National	AA+(KE)	Highest certainty of timely payment of Short term obligations relative to other issuers or obligations in the same country	

Source: "Update on Kenya Mortgage Refinance Company (KMRC)." Cytonn Investments. https://cytonn.com/topicals/update-on-kenya-mortgage-refinance-company.

Nigeria's regulators have shown their collaboration and adeptness, moving in lockstep with the evolving needs of the market, hence the emergence of these innovative structures in such a short timeframe. The Nigerian Securities and Exchange Commission (SEC) was granted legislative authority by the Investment and Securities Act in 2013 to establish regulations that would deepen the securitization market.[32] From a tax perspective, the SEC has clarified that securitizations would be treated as "pass-through" arrangements, i.e. the income generated by the securitized assets would be taxed only once, at the level of the investor.[33] Further, the issuing SPV is not subject to tax on income generated by the securitized assets.[34] The SEC also clarified that stamp duties would be payable on the originator's transfer of securitized assets to the SPV, but not on the SPV's issuance of the instruments.[35] Albeit after some refinements to the regulatory process, the SEC has further provided the required clarity concerning disclosure requirements for issuers and underwriters, minimum credit ratings, requirements for independent trustees to oversee the securitization process, and the eligible SPV structure.[36]

The trajectory of Nigeria's securitization market can be attributed in large part to its economic fundamentals, which are characterized by abundant natural resources and a well-developed transportation industry, both of which signify the existence of sizable assets in scope for securitization. With regulatory support evident, Nigeria has been successful in bringing new types of investors and financing into the country.

Kenya – Progress Evident but Challenges Abound

Like Nigeria and South Africa, Kenya boasts deep capital markets, but has faced challenges in launching its securitization market, as evidenced by the limited scale of transactions to date.

A milestone has potentially been reached with the country's largest issuance of MBSs, placed in February 2022 through Kenya Mortgage and Refinance Company (KMRC). KMRC aims to fulfill the Government of Kenya's housing affordability agenda, as a key pillar of the ambitious development targets outlined under "Kenya Vision 2030," which have earmarked ~$122 billion towards project investment.[37] The housing pillar is focused on delivering 200,000 affordable homes annually[38] and reducing the cost of home ownership, hence KMRC's creation in 2018.[39] As a Public-Private-Partnership, KMRC is 25% owned by the Government of Kenya, with 75% allocated between commercial banks and multilateral organizations.[40] Note that while parallels could be drawn to South Africa's SAHL, Nigeria's NMRC is more comparable. Unlike SAHL, which competes directly with conventional mortgage lenders, NMRC and KMRC are positioned as wholesale refinancers, funneling liquidity to commercial banks for on-lending to consumers at longer tenors and fixed rates.

KRMC's Medium-Term Note of ~$93 million[41] was floated in March 2022 as the first tranche, and later traded on the Nairobi Securities Exchange.[42] By tapping the capital markets, KMRC is injecting liquidity into the housing market which will likely deflate residential mortgage rates towards single digits as envisioned by the Government. While the tranched structure is devoid of guarantees, the strong collateral pool and IFC's anchor investment of 40% enhanced the issuance, culminating in 479% oversubscription and an exemplary AA+/AA- on the domestic scale by GCR (rating breakdown highlighted below).[43]

The strength of the issuance further drove 12.5% p.a. pricing, considered attractive; in comparison, 10-year Government bonds are priced to yield 14%-15%, embedding an illiquidity premium.[44] Increased mortgage availability and uptake, at progressively lower rates, has already manifested since the transaction was executed. It is estimated that KMRC has benefitted approximately 11,124 individuals, while creating and sustaining 9,900 jobs in the mortgage industry and related sectors.[45] Through a successful MBS structure and placement, KMRC has been instrumental in expanding homeownership in Kenya, promoting the housing affordability and financial inclusivity agendas. Additionally, as commercial banks de-risk their balance sheets to meet regulatory requirements and expand their operational capabilities, the domestic mortgage market infrastructure is likely to be strengthened as an interrelated outcome. As KMRC aims to expand its influence as the nation's primary refinancer, it will depend on a more advanced regulatory framework, that could replicate Nigeria's or even South Africa's.

Loose regulations for asset-backed transactions were introduced in 2007 through Kenya's Capital Markets Authority (CMA) but have been continuously refined. The rudimentary regulations failed to understand nuances for example, between the common-law and civil-law jurisdictions which had been clubbed together as precedents.[46] The lack of clarity on how the SPV would be structured, and the limited scope of eligible receivables were also areas of concern.[47] Encouragingly, these fundamental issues have been mostly resolved in recent years. A pain point remains, however, with respect to the tax-neutrality of ABS vehicles. Certain tax incentives that were in place at inception – related to VAT (Value-Added Tax) on asset transfers to SPVs, and income tax on receivables – were rolled back as part of the Government's economic response to COVID-19.[48] It is also worth noting that KMRC withholds a 15% tax charged to its investors, whereas Nigeria's NMRC imposes no such tax.[49]

Apart from modernizing the tax regime, the CMA could sharpen its focus on the use of securitization for infrastructure financing, identifying suitable assets, developing standardized deal structures, and legitimizing securitization as a means of unlocking capital for development. As well, developing the secondary market for securitized instruments would improve liquidity and attract more participants. As more issuances are brought to market, improved standards for investor protection will be integral – and can be achieved through transparency on securitized assets, as well as independent verification of asset quality and promotion of credit enhancement mechanisms. These will be challenges for the CMA, which is broad in scope, overseeing the entirety of Kenya's financial markets. However, as transactional experience is gained, completing the securitization infrastructure should only be a matter of time. Concurrently, the CMA is exploring opportunities to securitize lease receivables and even education loans in order to bring more deals to market and bridge the gap with South Africa and developed economies.[50]

Key Learnings

It is worth clarifying that securitization is not mutually exclusive with, nor a replacement for cross-border finance. On the contrary, it provides an innovative mechanism to facilitate cross-border financing, by tapping into the global institutional investment community, namely asset managers with aligned mandates and an orientation towards non-traditional assets.

Securitization markets are partly a function of overall economic development and endogenous factors; South Africa's securitization infrastructure is enabled by its sophisticated financial sector, which includes sizeable pension assets.[51] Nigeria's is enabled by its resource-intensive economy with a vibrant transportation sector.[52] A supportive macro environment is also difficult to prescribe – for example, securitizations in Nigeria and Kenya have to compete with government bonds which carry higher returns (though they are priced for risk). But although developing markets have distinct characteristics and challenges, there are still opportunities to significantly advance their securitization ecosystems through broad-based and actionable measures which draw on the experiences of South Africa, Nigeria, and developed markets.

For one, coordinated efforts between central banks, securities regulators, and pension and insurance markets are required to collectively gain comfort with securitization, and understand its contribution to economic growth, before it can be promoted to the private sector. Further, accommodative legal frameworks are fundamental in developing robust securitization markets, as originators and investors depend on well-articulated regulations with institutional backing. Ideally, these regulations should be tailored to the securitization space (as in South Africa) with the aim of fostering investment and protecting foreign investors. By extension, a clear tax code that accommodates such structures is essential. In Kenya's case, the absence of codified tax treatments and inadequate standards for safeguarding investor interests currently pose challenges in navigating its securitization space; whereas South Africa and Nigeria have prioritized and strengthened these layers with granularity, resulting in strong investor uptake. Accessible performance data is also crucial for investors and analysts to assess the quality, risks and cash-flow trends of securitized assets, particularly as economic development expands the range of eligible assets, and corresponding risks. Compilation of such data is only feasible through proper record-keeping practices but is critical in de-risking transactions and building investor confidence. Furthermore, coverage of ratings agencies should be expanded to include the local debt markets, particularly in situations where other financial information is lacking. Performance data on Africa's securitization markets is largely inaccessible or opaque, and the domestic rating systems are novel and unharmonized, which has created a reliance on the Global Credit Rating System. Implementation of the above measures would advance nascent securitization markets to a level which can support high-profile transactions and enable arrangers and originators to execute with confidence.

Finally, educating stakeholders – in a way which underscores the value in cash-flows of pooled assets in isolation from their originators' balance sheets – will help mobilize capital into the space, as will bespoke marketing efforts that highlight overall collateral strength and credit enhancements. While the influence of multilateral institutions here cannot be understated, diversifying the investor base will become more important, particularly as the anchor institutions face capital constraints. Encouragingly, global investors are increasingly focused on Africa from a securitization angle, recognizing the opportunity to re-allocate fixed-income portfolios away from traditional concentrations in treasury, money-market, and corporate debt securities.[53] From a thematic perspective, such securitized placements can be aligned with mission-driven investment mandates to provide investors with a sustainability lens. Through securitization, investors can access diverse opportunities in Africa, while financing stakeholder efforts that drive positive impact.

As the demand for infrastructure finance converges with rising investor appetite, securitization is poised to assume a pivotal role in shaping African capital markets, and progressing economic development agendas.

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