Special Report

Securitisation in South Africa 2005

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■ Summary

This report, an update of the November 2004 special report "*Securitisation in South Africa 2004*", addresses the historical development, current status and future potential of the South African securitisation market. It provides a broad analysis of the transactions rated by Fitch Ratings and discusses the 2004 Securitisation Regulations, the South African sovereign (see Appendix) and the features unique to securitisation in South Africa. Fitch recognises that while the South African securitisation market is still young, it is maturing rapidly through innovation, increasing sophistication and new issuance. As such, this report is intended to be part of an ongoing, dynamic commentary on securitisation in this market for interested parties, including potential investors, originators and arrangers.

Securitisation Market Potential

Regulatory constraints limited the development of securitisation in South Africa prior to 2001. Some of the early securitisation initiatives included the following:

- in the late 1980s, the former United Building Society Limited securitised ZAR250 million of its mortgage book; and
- in 1991, Sasfin (Proprietary) Limited launched a securitisation programme that Fitch continues to rate: Equipment Rentals Securitisation No. 1 (Pty) Limited ("ERS No. 1").

Post 2001, following the introduction of the amended securitisation regulations and the removal of certain regulatory constraints, South Africa's first residential mortgage-backed securities ("RMBS") transaction, Thekwini 1 (Pty) Limited, was launched, followed shortly thereafter by the first asset-backed securities ("ABS") transaction. Since then, the market has grown consistently and steadily with 2005 the busiest year to date.

The primary avenues through which Fitch expects securitisation opportunities to be explored in the future are set out below.

Bank Assets typically comprise the bulk of securitisations internationally, which may consist either of funded or synthetic programmes. The former allow banks to diversify their funding sources from their core deposit base whilst at the same time facilitating their asset-liability management activities by matching long-term funding raised through securitisation programmes to long-term loans provided. The latter enable banks to more efficiently manage their capital and to reduce credit exposures whilst maintaining important client relationships.

Two securitisation programmes were set up by a South African bank in 2005 for the purposes of raising additional funding and Fitch expects further activity in this area during 2006 as banks seek to raise longer-term funding to match fund their assets.

Asset-Backed Commercial Paper ("ABCP") programmes may be used as a tool to help companies, including banks, improve balance sheet and capital management as well as a means of diversifying their funding source by accessing a new investor base. As in other transactions, the use of ABCP programmes to remove assets from a company's balance sheet may result in an improvement in key ratios, such as return on equity. Investors are able to achieve diversification through the purchase of commercial paper ("CP") issued by multi-seller conduits where the CP is traditionally backed by a wide array of assets. (For a more detailed explanation of Fitch's methodology for rating ABCP programmes please see "*Asset-Backed Commercial Paper Explained*" dated 1 December 2004, available at www.fitchratings.com.)

Auto Loan securitisations should remain a popular asset class given the continued demand for new and used vehicle finance, largely due to the limited availability of alternative transport. (For a more detailed explanation of Fitch's methodology for rating auto loan securitisations see *"Rating Auto Loan-Backed Securitizations: A Tune-Up"* dated 17 November 2005 and "*Kicking the Tyres: An Overview of European Auto ABS"* dated 24 October 2002, both available at www.fitchratings.com.)

Residential Mortgage-backed securitisations should continue to play a prominent role in the South African securitisation market. The system of registration of, and the "real right" of security over land in South Africa, is more than 95 years old, as is the mortgage bond market.

Home ownership in South Africa has, for many years, been skewed in favour of the more privileged or developed sector of the economy. A substantial proportion of the population still seeks shelter in informal settlements, suggesting that the securitisation of low-cost housing could become viable in the future. In this regard, the securitisation of pension backed home loans ("PBHLs"), which allow individuals typically not eligible for a residential mortgage to borrow money to purchase, construct or renovate a home using their pension fund as collateral could prove to be a significant asset class. (For a more detailed explanation of Fitch's methodology for rating mortgage-backed securitisations see "*South African Residential Mortgage Default Model"* dated August 2003, available at www.fitchratings.com.)

Commercial Mortgage-Backed Securities ("CMBS") securitisations are potentially the next big asset class to take off in South Africa. The country's young but relatively well-developed listed property sector may seek to diversify its funding sources and access more competitive funding via CMBS issuance. Banks may also seek to securitise their commercial property portfolios as part of their balance sheet management strategy. Whilst single-borrower CMBS transactions have been introduced to the market since the latter half of 2004, the market still awaits its first conduit-type or multi-borrower CMBS transaction. (For general guidance on Fitch's CMBS rating methodology see *"Rating Single-Borrower Commercial Mortgage Transactions"* dated 13 December 2005 and *"Rating Performing Loan Pools"* dated 4 November 2004, available on www.fitchratings.com.)

Trade Receivables is another area of growing interest, particularly with South African corporates seeking to raise additional capital and diversify funding. In Europe traditionally, this asset class has been funded via ABCP conduits, in part due to the small volume of the receivables. However, there is an increasing trend - particularly among larger corporates - to raise funds via the issuance of term trade receivables transactions. (For a more detailed explanation of Fitch's methodology for such transactions see "*Rating Trade Receivable Securitisations"* dated 22 August 2005, available on www.fitchratings.com.)

Equipment Leases, both operating and finance, have also been securitised in South Africa, and provide a potential for future growth. The benefits to originators are typically a diversification of funding sources and cheaper funding. (For a more detailed explanation of Fitch's methodologies for rating operational and financing leases, see "*Rating Equipment Lease and Loan Securitisations"* dated 29 March 2005, available at www.fitchratings.com.)

Public and Project Finance securitisation transactions appear to be a strong future possibility given the formidable social and structural challenges facing South Africa. Securitisation may play a role in the financing or refinancing of existing infrastructure projects debt, and certain public sector assets. Toll roads, airports, rail, utilities, telecoms and even the national lottery all have the potential to be securitised in the future. (For a more detailed explanation of Fitch's methodology for rating project and public finance deals see "*Rating Approach to Project Finance"* dated 12 August 2004, available at www.fitchratings.com.)

Cross-Border Future Flow transactions, capturing financial future flows due from off-shore obligors in off-shore SPVs, could prove a significant asset class in future (subject to exchange control approval) given the export nature of South Africa's economy.

Such transactions tend to mitigate currency risks by capturing payments to local exporters in hard currency through offshore vehicles. Furthermore, risks related to sovereign interference or redirection of flows are also potentially removed by mechanisms of notice and acknowledgement signed by offshore obligors. In this way, domestic originators seek to achieve international investment grade issues and access foreign funding at internationally competitive rates. (For a more detailed explanation of Fitch's methodology for rating cross border future flow transactions see *"Criteria Report on Future Flow Securitisation Rating Methodology"* and *"Emerging Markets – Future Flow Securitisations: Resident Flows"* dated 27 May 2003 and 10 December 2003, respectively, available at www.fitchratings.com.)

■ Fitch-Rated Securitisations

Fitch currently has public ratings on a wide variety of asset classes, as highlighted below:

Asset Backed Commercial Paper

There are currently seven bank sponsored South African conduits of which Fitch rates six, including two of the four ABACAS series.

- **Blue Titanium Conduit** Limited, the first South African ABCP programme, was structured to issue rand-denominated CP to fund the purchase of financial assets and rated securities. The conduit, which is sponsored and managed by The Standard Bank of South Africa Limited ("Standard Bank") ('AA+(zaf)/F1+(zaf)'), has a maximum programme size of ZAR20 billion, and Fitch has assigned an 'F1+(zaf)' Short-term rating to the CP it issues. (For a more detailed analysis of this rating please see Fitch's report dated 11 July 2002, available at www.fitchratings.com.)

- **Asset Backed Arbitraged Securities** (Proprietary) Limited ("ABACAS") is a segregated issuance ABCP programme structured to issue a number of distinct series of rand-denominated notes. ABACAS can purchase both financial assets and rated securities, issuing series-specific CP backed by these assets. The conduit has a maximum programme size of ZAR15bn and is sponsored and managed by ABSA Corporate and Merchant Bank ("ACMB"), a division of ABSA Bank Limited ('AAA(zaf)/F1+(zaf)'). Fitch has assigned an 'F1+(zaf)' Short-term rating to the CP issued under both the first series, ABACAS Premier Series (Series 1) and the second series, ABACAS Global Corporate Series (Series 2), both of which are backed by a portfolio of rated securities. (For more detailed analysis of these ratings, please see Fitch's reports dated 9 January 2006, both available at www.fitchratings.com.)

- **iNdwa Investments** Limited is an ABCP conduit structured to issue rand-denominated CP to fund the purchase of financial assets and rated securities. The conduit's maximum programme size is ZAR15bn and Fitch has assigned an 'F1+(zaf)' Short-term rating to the CP . The conduit is sponsored and managed by Rand Merchant Bank, a division of FirstRand Bank Limited ('AA+(zaf)/F1+(zaf)'). (For a more detailed analysis of this rating, please see Fitch's report dated 9 December 2005, available at www.fitchratings.com.)

- **Synthesis Funding** Limited is an ABCP conduit structured to issue rand-denominated CP to fund the purchase of financial assets and rated securities. The programme has a maximum size of ZAR15bn and is sponsored and managed by Nedbank Limited ('AA-(AA minus)(zaf)/F1+(zaf)'). Fitch has assigned an 'F1+(zaf)' Short-term rating to the CP issued under the programme. (For a more detailed analysis of this transaction please see Fitch's report dated 6 January 2006, available at www.fitchratings.com.)

- **Sanlam Home Loans 102** (Pty) Limited is a single-seller South-African residential mortgage warehousing programme that may issue up to ZAR5bn of ZAR-denominated securities. The CP is issued to fund the purchase of eligible home loans. Fitch has assigned a 'F1+(zaf)' Short-term rating to the CP issued by it. The programme is sponsored and managed by ACMB. (The full rating report for this transaction dated 28 June 2005 is available at www.fitchratings.com.)

- **The Thekwini Conduit** (Pty) Limited is a South-African residential mortgage warehousing programme that may issue up to ZAR15bn of ZAR-denominated securities. The Thekwini Conduit is a multi-seller programme that warehouses eligible pools of residential mortgage loans originated by South African Home Loans (Proprietary) Limited ("SAHL"), a lender specialising in home loans in South Africa, and eligible pools of RMBS. (The full rating report for this transaction dated 29 June 2005 is available at www.fitchratings.com.)

Residential Mortgage Backed Securities

- **Thekwini Fund 1** (Pty) Limited, was the first publicly rated South African RMBS. The loans were originated by SAHL and the notes were repaid in full in November 2005 on their scheduled maturity date. Subsequent issues, **Thekwini 3, Thekwini 4** and **Thekwini 5** have issued term paper amounting to ZAR2.0bn, ZAR2.5bn and ZAR3.0bn, respectively, to which the agency has assigned ratings of 'AAA (zaf)' on the class A notes, 'A(zaf)' on the class B notes and 'BBB(zaf)' on the class C notes. (For a more detailed analysis of the Thekwini transactions, please see Fitch's reports dated 5 November 2001, 30 October 2003, 11 June 2004 and 25 February 2005, all available at www.fitchratings.com.*)*

- **Sanlam Home Loans 103** (Pty) Limited is an RMBS securitisation programme that may issue up to ZAR5bn of ZAR-denominated notes. Eligible home loans were purchased from SHL 102. Term paper of ZAR970m was issued and Fitch assigned ratings of 'AAA (zaf)' on the class A notes and 'AA(zaf)' on the class B notes. (For a more detailed analysis of this rating please see Fitch's report dated 1 November 2005, available at www.fitchratings.com.)

- **Blue Granite** (Pty) Limited is an RMBS securitisation programme that may issue up to ZAR5bn of ZAR-denominated notes. The eligible home loans purchased for the first issue were originated by SAHL. Term paper of ZAR4.5bn was issued and Fitch assigned ratings of 'AAA (zaf)' on the class A notes and 'AA(zaf)' on the class B notes (For a more detailed analysis of this rating please see Fitch's report dated 1 November 2005, available at www.fitchratings.com.)

Commercial Mortgage-Backed Securities

- **Growthpoint Note Issuer Company** (Pty) Limited is a CMBS securitisation programme that may issue up to ZAR5bn of ZAR-denominated securities. The proceeds of the notes from the first issue were used to purchase a loan of ZAR805m secured by a portfolio of commercial properties originated by Growthpoint Properties Limited, a large South African property and investment manager. Fitch assigned ratings of 'AAA(zaf)' on the class A notes, 'AA-(AA minus)(zaf)' on the class B notes, 'A-(A minus)(zaf)' on the class C notes and BBB(zaf) on the class D notes. (For a more detailed analysis of this rating please see Fitch's report dated 28 November 2005, available at www.fitchratings.com.)

Collateralised Debt Obligations ("CDOs")

- **Fresco 1** Limited, the first, and to date only, synthetic CDO securitisation in South Africa, is backed by mainly South African corporate credits originated and managed locally by Rand Merchant Bank. Six tranches of funded notes (A through to F) totalling ZAR1,082bn were issued, of which Fitch rated classes A to E, assigning a 'AAA(zaf)' rating to the class A notes. This transaction required the development of a unique National scale South African CDO rating approach, which will continue to be refined as the market in South Africa develops. (For a more detailed analysis of this rating please see Fitch's report dated 16 May 2002, available at www.fitchratings.com.);

Asset-Backed Securities

- **Procul** Limited is a synthetic securitisation of retail instalment automotive loans originated and managed in South Africa by Wesbank, a division of FirstRand Bank Limited. Eight tranches of funded notes were issued (A through to G) totalling ZAR2bn. Fitch rated only the class A notes, to which it assigned a rating of 'AAA(zaf)'. (For a more detailed analysis of this rating please see Fitch's report dated 28 May 2002, available at www.fitchratings.com.)

- **ERS No.1** (Pty) Limited is a securitisation of equipment rental receivables. The issue is a restructuring of an earlier securitisation (referred to above), aimed at bringing the original transaction in line with current securitisation regulations and obtaining a bond exchange listing. Fitch has assigned ratings to the class A, B and C notes of 'AAA(zaf)', 'A(zaf)' and 'BBB(zaf)', respectively. (For a more detailed analysis of this rating please see Fitch's report dated 10 December 2003, available on www.fitchratings.com.)

- **NBC Future Guard** (Pty) Ltd is a securitisation of PBHL receivables and is the first publicly rated transaction of its kind in South Africa. PBHLs are loans extended for housing purposes that are secured by a borrower's provident fund withdrawal rights. Fitch has assigned a rating of 'AAA(zaf)' to the class A notes and 'BBB(zaf)' to the class B notes. (For a more detailed analysis of this rating, please see Fitch's report dated 3 August 2004, available at www.fitchratings.com.)

- **HomePlan Financial Solutions** (Pty) Limited is the second publicly rated securitisation of PBHL receivables in South Africa. Term paper of ZAR675m was issued under a ZAR2bn programme to which Fitch assigned a rating of 'AAA(zaf)' to the class A notes. (For a more detailed analysis of this rating please see Fitch's report dated 9 August 2005, available at www.fitchratings.com.)

- **Accelerator Fund 1** (Pty) Limited is a securitisation of auto loan receivables originated by Standard Bank. ZAR3bn of term notes were issued to which Fitch assigned ratings to the class A, B and C notes of 'AAA(zaf)', 'A-(A minus)(zaf)' and 'BBB(zaf)' respectively. (For a more detailed analysis of this rating please see Fitch's report dated 20 September 2005, available at www.fitchratings.com.)

Rating Challenges

As with any other jurisdiction, the requirements for a vibrant securitisation industry include a stable social, political and economic environment, predictable legal system and developed financial sector. On all these counts, Fitch believes South Africa to be a fertile market. The securitisation industry is, however, still in the early stages of its development compared with the US and Western Europe and, accordingly, the performance of transactions and the development of the market generally requires close monitoring. In this respect, Fitch surveils rated transactions on an ongoing basis, undertaking a formal credit review of their performance annually (or more frequently if needed), and will either affirm, upgrade or downgrade the rated notes. The outcome of the review is communicated to the investing public via press releases and notification on the Fitch website. Performance monitoring and data on all Fitch-rated transactions is available at www.fitchratings.com.

Securitisation is also information intensive, requiring an originator to clearly convey the characteristics of the underlying assets and quantify asset performance in very specific ways. In Fitch's experience, the lack of quality data, particularly historical or static data, is often a major impediment to rating emerging market transactions. (For more information on this issue, please see Fitch's special report "*Securitisation in Emerging Markets: Preparing for the Rating Process*" dated 15 January 2004 and available at www.fitchratings.com.)

Legal Framework

Fitch is of the view that the South African legal environment is sufficiently stable and robust to sustain a viable securitisation industry.

Prior to the introduction of the new regulations by the South African Reserve Bank ("SARB") on 4 June 2004 (the "2004 Regulations" or "the Regulations"), securitisation was regulated by Government Notice No. 1375 published in Government Gazette No. 22948 of 13 December 2001 ("the 2001 Regulations"). For the full text of the 2004 Regulations, readers may consult Government Notice No. 681 published in Government Gazette No. 26415 of 4 June 2004.

In terms of the Regulations, the acceptance of money by a special-purpose institution (also called a special purpose vehicle or "SPV") from the general public against the issue of CP in a securitisation scheme is excluded from the scope of activities falling within the definition of "the business of a bank" as provided for in the Banks Act, 1990 (Act No. 94 of 1990). The "business of a bank" may only be undertaken by a registered bank.

An SPV is defined as "a company or a trust, insolvency-remote, incorporated or created solely for the purpose of the implementation and operation of a traditional or a synthetic securitisation scheme".

In addition to allowing synthetic securitisation as an additional method of securitising a pool of assets, the 2004 Regulations also broaden the range of assets that may be securitised. Asset classes were previously essentially limited to monetary claims, but securitisable assets now include any resource that is controlled by a company and from which the company expects future economic benefits to flow (such as a stockpile of gold).

The 2004 Regulations also contain more detailed conditions for the securitisation of revolving assets (such as credit card or "*store card*" receivables), and further prescribe the specific disclosure of certain additional information in the offering circular, both in this regard and in general.

Further, whilst it was uncertain under the 2001 Regulations whether a facility that has not been fully utilised could be securitised, the 2004 Regulations provide specifically for the securitisation of such facilities.

From an income tax perspective, the SPV would, in general, be considered for the purposes of the Income Tax Act, 1962 (the "Income Tax Act") to be a trader in assets securitised. Accordingly, the consideration paid by the SPV for the assets securitised would be deductible as an expense incurred in the production of income and for the purposes of its trade in the year of assessment in which the SPV becomes unconditionally obliged to incur the expenditure. Where securitised assets are acquired at a discount, the discount will be taxable in the hands of the SPV. Interest expenditure incurred by the SPV on notes issued by it is deductible as having been incurred in the production of income and for the purposes of its trade. The deduction of the interest expenditure is made in accordance with the provisions of section 24J of the Income Tax Act on a yield-to-maturity basis.

From a VAT perspective (subject to two exceptions), the purchase of underlying assets (in the case of a traditional securitisation scheme) is a financial service for the purposes of the Value Added Tax Act, 1991 (the "VAT Act") and therefore exempt from VAT. Consequently, the SPV will not pay VAT on the purchase of assets securitised. Although strictly speaking the transfer of credit risk under a credit derivative instrument is not a financial service as defined in Section 2 of the VAT Act, thereby subjecting the premium paid to VAT, the South African Revenue Service ("SARS") has issued a directive to the Banking Council of South Africa that the premiums on credit derivative documents are to be regarded as exempt in terms of Section 72 of the VAT Act until such time as Section 2 of the VAT Act has been amended to formally cater for the exemption. Generally, the SPV will only make supplies that are exempt from VAT and is therefore not required to register as a VAT vendor. The VAT Act provides that, where goods or services are obtained partly for purposes not connected with taxable supplies, the VAT paid by the vendor must be apportioned to that input tax (claimed as a deduction) that relates only to that portion of the supply of goods or services that the vendor uses to produce taxable supplies. Since the SPV generally makes no taxable supplies, any VAT paid by the SPV is not allowable as an input tax deduction.

Regional Services Council Levies ("RSC Levies") are levied on the turnover and payroll of companies in South Africa under the Regional Services Councils Act, 1985. In general, the SPV will have no employees, thus no RSC levies will be payable arising out of the employment of staff, although RSC levies could be payable on the SPV's turnover. The rate of the RSC levies depends on the geographical region of South Africa in which the SPV carries on its business. The obligation to pay these levies or the amount thereof may also differ from one transaction to another, depending on the unique structural features of the transaction concerned. The RSC levies are deductible as an expense by the SPV under the Income Tax Act. It is proposed to abolish RSC levies on 30 June 2006. It is likely that RSC levies will, however, be replaced with an alternate tax of a similar nature.

The original issue of a listed note is exempt from stamp duty under the Stamp Duties Act, 1968. As at the date of this report, legislation has been proposed to abolish stamp duty on the original issue of securities (including notes and bonds). It is expected that this legislation will be effective as of 1 January 2006. The transfer of any note is exempt from stamp duty and/or uncertificated securities tax if listed on any financial exchange or stock exchange. The redemption of notes, whether early or otherwise, does not attract stamp duty or uncertificated securities tax.

The 2004 edition of this report made mention of the SARS document entitled "*Invitation for Comment on the Tax Treatment of Securitisations*" which invited comment on the draft proposals for the taxation of securitisation schemes. As of the date of this report, SARS has not taken these proposals any further. In the last special report it was intimated that securitisation schemes would become "reportable arrangements" under Section 76A of the Income Tax Act. This has not occurred and securitisation schemes are therefore not *per se* "reportable arrangements". However, each securitisation scheme would need to be examined to establish whether it satisfies the requirements for being reportable to SARS under Section 76A. If it does satisfy the requirements, certain information regarding the securitisation scheme must be furnished to SARS.

True Sale and Risk Transfer

The transfer of assets to an SPV to achieve a "true sale" for securitisation purposes can be achieved in that provision is made in the Regulations for the transfer of assets to the SPV, which totally divests the assets and all risks in connection with the assets from the transferring institution. However, the Regulations provide for conditions relating to limiting of association with the assets.

The Regulations also provide for synthetic securitisation, in that the transfer of risk by means of a credit derivative instrument is recognised as an acceptable method of risk transfer.

It is necessary, to comply with the regulatory requirements applicable in relation to both traditional and synthetic securitisation schemes, that there must be a transfer of an asset or a divestment of a risk, that is, the originator or repackager must have actually owned the relevant assets before the transfer.

In addition, a number of rules governing the eligibility of the transfer of assets or credit risk to the SPV are provided for in the Regulations. Amongst others:

- an asset or credit risk may not be transferred to the SPV if this will result in a breach of any terms of the relevant underlying transaction;

- a bank originator can replace assets or credit risks with an equivalent credit quality, as long as such assets have not become non-performing; and
- a bank or another institution within a banking group of which such bank is a member may repurchase assets or credit risk from the SPV, but only in compliance with market-related terms and conditions.

In the case of a traditional securitisation, the SPV must pay the purchase price of transferred assets to the originator by no later than the date of transfer of the assets to the SPV.

Where the originator in a synthetic securitisation is a bank, the provisions of Regulation 21(14) of the Regulations relating to banks as per the Banks Act, 1991 apply (published under Government Notice R1112 in Government Gazette 21726 of 8 November 2000 (as amended)). These regulations relate to banks' credit risk mitigation and prescribe (for instance) certain minimum requirements for credit derivatives to which a bank is a party if the bank is to receive capital relief, and the various ways in which banks must manage their risks arising from entering into credit derivative agreements.

The Regulations also prescribe that, in addition to an institution that acts in a primary role (such as an originator, sponsor or repackager), there must be at least two investors in the senior CP issued by an SPV pursuant to a synthetic securitisation scheme. This provision is aimed at promoting market discipline.

In addition, a credit derivative instrument may not contain terms and conditions that limit the amount of credit risk transferred. The agreement (for instance, an agreement documented under the master agreement published by the International Swaps and Derivatives Association, Inc ("ISDA")) may not include significant materiality thresholds (threshold amount clauses), terms that provide that the agreement will terminate if there is a deterioration in the credit quality of the underlying reference entity (credit event upon merger clauses), or clauses that increases the premium payable to the SPV, or the interest rate payable by the SPV to investors, as a result of a deterioration in credit quality of the underlying or reference assets.

In both traditional and synthetic securitisation schemes, no party acting in a primary role (such as an originator, sponsor or repackager) may provide support to the securitisation scheme beyond the contractual terms relating to the scheme.

Control of SPV

In terms of the Regulations, an originator, remote originator, sponsor or repackager (all defined as "the originator") is only afforded a limited degree of control over the SPV. Where the SPV is a company, the originator may hold up to 20% of the nominal value of all issued equity share capital in the SPV. The originator may also not have the right to decisively influence the outcome of voting at the general meeting of the SPV. Similar rules exist in the case of an SPV that is a trust. However, the requirements in this instance relate to the size of the beneficial or other interest, which may not be more than 20%, rather than to shareholdings.

The board of directors or body of trustees, as the case may be, of an SPV must be independent of the originator. Also, whenever the originator is a bank, the directors must be independent of any other institution within a banking group of which that bank is a member. However, an originator may appoint one director or trustee (under the Regulations a minimum of three directors/trustees must be appointed) to the board of directors/body of trustees of the SPV.

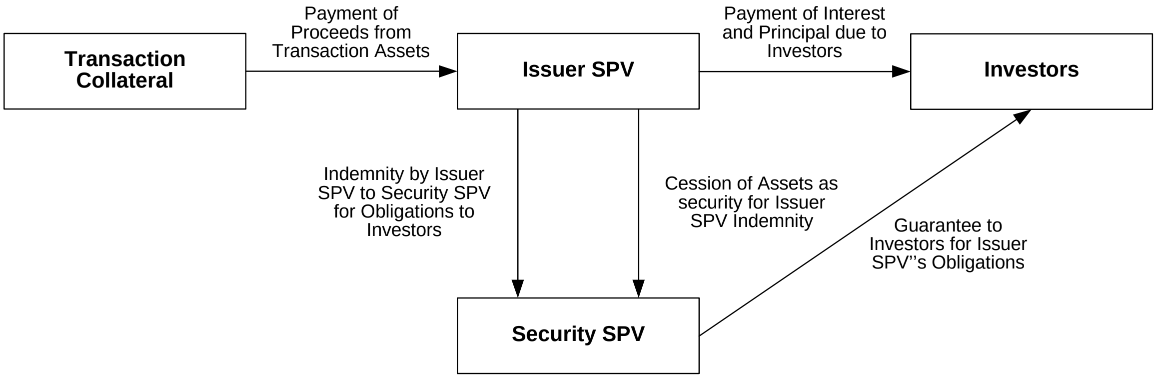
Furthermore, where the SPV is a company, the board of directors must comply with the applicable provisions of the Companies Act, 1973 (Act No. 61 of 1973), whilst where the SPV is a trust, the body of trustees must comply with the Trust Property Control Act, 1988 (Act No. 57 of 1988).

Credit Enhancement

Any bank, including originators to the securitisation scheme, may provide a credit-enhancement facility to the scheme provided a number of requirements are met, which prescribe, among others, that:

- there is to be no recourse to the bank beyond the fixed contractual obligations provided for by the credit-enhancement facility;
- subject to reasonable qualifying conditions, the parties involved in a securitisation scheme are to have the unequivocal right to select an alternative party to provide the credit-enhancement facility;
- the credit-enhancement facility must be sufficiently documented to clearly distinguish it from any other facility provided in the securitisation scheme; and
- the details of the credit-enhancement facility must be disclosed in the relevant disclosure document (offering circular or programme memorandum) to the securitisation scheme.

South African "Two SPV" Security Mechanism



Source: Transaction documents

Liquidity Facility

The Regulations currently provide that a bank acting in a primary role as repackager or sponsor (but not an originator) to a securitisation scheme may provide a liquidity facility to the scheme provided that a number of requirements similar to those mentioned above pertaining to the provision of credit enhancement are met. Importantly, a liquidity facility may not be associated with the credit risk of the underlying or reference assets.

In addition, a number of criteria relating to the underlying asset pool are set out, including that:

- a test of reasonable asset quality be implemented to ensure that the utilisation of the liquidity facility will not cover defaulted or deteriorated assets;
- the transaction documentation provides clear limitations regarding the use of the liquidity facility; and
- the subordination of the liquidity facility be restricted.

If a bank provides a liquidity facility that does not comply with the requirements stated above, that liquidity facility will be treated as a first-loss credit enhancement facility on the balance sheet of the bank concerned.

South African Security Structure

The security structure utilised in South Africa typically takes the form of two bankruptcy-remote SPVs, the purpose of which is to ensure the secured rights of transaction creditors.

Noteholders would ordinarily achieve secured status via the utilisation of a debenture trust mechanism. However, because various transaction creditors (such as servicers, facility providers, paying agents, etc.) are not noteholders, another mechanism is needed.

One solution involves a second entity in addition to the bankruptcy-remote issuer SPV, which is usually also a bankruptcy-remote SPV, commonly referred to as the "security SPV". The security SPV guarantees the obligations of the issuer to the various transaction creditors (including the noteholders as well as the transaction's service providers). The issuer SPV then provides the security SPV with a counter-indemnity for all liabilities that it may incur as a result of providing the guarantee, and simultaneously cedes its assets to the security SPV as security for this obligation.

Should the issuer ever default, the security SPV will be entitled to claim all the assets and will then distribute the proceeds to the transaction creditors in terms of the priority of payments. The effect is that all the transaction creditors will enjoy rights or security over the issuer SPV's assets.

■ National Scale Ratings

Fitch's National ratings were developed primarily for use in emerging markets with international sovereign ratings significantly below 'AAA'. They are not based on default history or probability, but indicate a relative creditworthiness within a particular sovereign only.

Under the National rating scale, a 'AAA' Long-term national rating is assigned to the best credit in a given country, relative to which all other credits are rated. Powers of taxation and foreign exchange control will often render the sovereign the best credit risk in a country, as is currently the case in South Africa. However, such powers are not limitless, especially in emerging markets, and Fitch has established criteria whereby entities may be assigned ratings above the sovereign. The sovereign cannot thus automatically be assumed to be 'AAA' on a National scale.

With a complete range of notches starting at 'AAA(nat)' on a separate national scale, national ratings avoid the bunching of international ratings at the, often low, sovereign ceiling, permitting better credit differentiation. These ratings are aimed primarily at domestic investors in local currency issues, but unlike international local currency ratings, national ratings are country specific, identified by a unique country suffix – in the case of South Africa "(zaf)". (For a more detailed explanation of Fitch's National scale rating methodology see "*National Ratings: Methodology Update*" September 2002, available on www.fitchratings.com).

■ Conclusion

The South African securitisation market continues to expand steadily. This growth is made all the more impressive by the diversity of the asset classes represented and the innovative structures employed. A developed legal system and stable economic environment are complimented by a sophisticated banking system that should provide the foundation for continued future growth.

Appendix

Sovereign Rating Rationale

The upgrade of South Africa's foreign currency rating to 'BBB+' reflects an improvement in South Africa's growth performance and a further strengthening of its external balance sheet, resulting from a sizeable build-up of official reserves. Fitch estimates that South Africa is likely to be a net external creditor by end-2006. Other financial and macro-economic indicators – stable and moderate public debt and a relatively low external debt burden, low inflation and a further decline in interest rates – continue to support creditworthiness.

South Africa achieved growth of 3.7% in 2004, which was much higher than the original estimate of 3% and followed revisions to GDP data in November 2004, which raised 2003 growth to 2.8% from 1.9%. Growth has benefited from a stronger macro-economic environment: low interest rates and an accommodative fiscal policy have boosted consumer spending and private and public investment. South Africa also benefited from high commodity prices, global growth and lower global interest rates, although the strong rand (ZAR) adversely affected net exports. Rising real incomes and strong lending growth have further fuelled consumer spending. Some of these factors are temporary or will taper off. However, over the medium term the substantial increase in public investment and other structural measures to improve the efficiency of the economy (for instance, in the transport and telecoms sectors) should help support higher trend growth. As such, Fitch sees average growth of around 4% over the medium term as feasible.

Growth has, however, been unbalanced – with the strong rand resulting in relatively weak exports and strong domestic demand and rapid consumer credit growth resulting in a surge in imports – reflected in a deterioration of the current account deficit. Rebalancing of the economy will require increased competitiveness and/or a further weakening of the currency. Thus far the current account deficit has been more than covered by strong portfolio inflows and foreign direct investment ("FDI") from the Barclays/ABSA deal this year. Beyond 2005, concerns will once again shift towards the vulnerability of the financial account to a reversal in capital flows, due to a variety of exogenous factors. The more robust monetary and exchange rate regime suggests a more orderly adjustment of the exchange rate in the event of this occurring. Nevertheless, this area remains a key vulnerability to South Africa's macro-economic outlook.

External credit indicators continue to strengthen as a result of a continued and sizeable build-up of official reserves following the closure of the forward book last February. This has been made possible by strong capital inflows and currency (over the last two to three years). Official reserves increased by USD11bn between February 2004 and July 2005. Previously, they had been stable at around USD8.5bn for several years. Following on from the considerable build-up of banks' foreign assets in 2003, net external debt ratios have fallen rapidly from 17% of GDP and 47% of current external receipts ("CXR") in 2002 to a projected 1% of GDP and 3.6% of CXR at end-2005, which is well below the 'BBB' median. Due to a further accumulation of official reserves, South Africa is likely to become a net external creditor for the first time in 2006, which means that reserves and other banks' foreign assets (liquid foreign assets) will more than cover its gross external debt – an important rating strength. Net public debt ratios have also converged towards the peer group norm and are in low single-digits. Thus, the public sector should in the short to medium term also become a net external creditor.

South Africa's sound and transparent public finances remain a key rating strength. Public debt has stabilised at around the 'BBB' median level – 36% of GDP – deficits are sustainable at around or just below 3% of GDP and within the context of continued expansion of social spending and acceleration of public investment, which should support growth and help address poverty and inequality. High investment by the public corporations will result in an increase of debt of the broader public sector by just 1.8% and is very manageable.

Monetary policy continues to deliver low inflation and interest rates, and has reduced inflation expectations. High oil prices and a weaker currency are threats to inflation, and rapid money and credit growth are a potential risk to future inflation. However, inflation is currently below the mid-point of its target range and the consensus is that it will remain within the 3%-6% target range over the next two to three years, indicating that the South African economy will continue to benefit from relatively low interest rates. The strong rand continues to complicate monetary policy. A 50 bp cut in April 2005 was, in part, prompted by the unreasonable pressure on manufacturing and the mining sector caused by the very strong trading range of the rand in Q404 and Q105. The weaker currency since has mitigated the need for a further cut for a while. But this option remains open to the SARB should these pressures resurface.

Peer Comparator 2005

(%)	South Africa	'BBB' Median
Real GDP Growth	4.2	5.1
Real GDP *Per Capita* Growth 5-yr Avg	2.4	4.3
Current Account Balance	-3.8	-2.7
Liquidity Ratio	147	147
General Gov't Balance	-2.7	-1.7
General Gov't Debt	36	36
Net Ext. Debt/Current Ext. Receipts	3.6	36.8

Source: Fitch

The major constraint relative to rating peers is the need for a higher growth trajectory necessary to tackle high unemployment and social inequality. South Africa's growth also remains weaker than its rating peers in real and in *per capita* terms. Social issues, such as HIV/Aids, set it apart from most of its rating peers, and though South Africa's unemployment is finally declining, it remains very high in overall terms as well as compared to its rating peers. Recent proposals to ease restrictions in the labour market demonstrate a willingness and recognition by the government of the need to broaden the ways in which to address the unemployment issue, with its emphasis on youth unemployment (currently 60%) and improving the flexibility of the small and medium-sized enterprise (SME) sector. Although these moves have been resisted by the ANC's (African National Congress) alliance partners, some (albeit slower) progress is likely to be made in the medium term.

The future direction of the rating depends on continued progress on structural reforms to push trend growth up to the 4%+ necessary to alleviate some of South Africa's unique socio-economic problems and further improvement in financial indictors. Over the medium term, measures underway to restructure the key public corporations and deregulate the telecoms sector, which are relatively straightforward, are likely to make an impact. Other areas include South Africa's ability to withstand external shocks that, for example, may result in a sharp adjustment of the exchange rate, threatening macro-economic stability. Visible progress on addressing HIV/Aids and further progress on addressing unemployment will become more critical for the rating.

South Africa remains politically stable. From a credit rating perspective, the sacking of vice-president Jacob Zuma in mid-June following implications in a corruption scandal is viewed positively for the "young democracy" and South Africa's international standing. However, the fallout from the sacking of the former vice-president has exposed sharp divisions between the ruling ANC and its alliance members – Congress of South African Trade Unions and South African Communist Party – increasing political and policy uncertainty.

Economic Performance and Outlook

(%)	2004	2005f	2006f
Real GDP	3.7	4.2	3.9
CPIX Inflation (Annual Avg.)	4.3	4.0	4.5
Budget Balance (GDP)	(2.4)	(2.7)	(2.9)
Current Account (GDP)	(3.3)	(3.8)	(3.7)

Source: SARB and Fitch estimates

Banking Sector

South Africa's banking system is fundamentally sound and is not viewed as a significant risk to the sovereign. With M3 (broad money) at 64% of GDP in 2004, and domestic credit to the private sector currently over 80% of GDP, the banking sector is also relatively well developed compared with its 'BBB' rating peers, where the median for these indicators is 55% and 37%, respectively. South Africa's fully privately-owned banking sector is well capitalised and highly profitable, and non-performing loans are just 2.6% (end-2004) of total loans and advances, so there is little risk of contingent liabilities to the sovereign. Following Barclays Bank's acquisition of ABSA, foreign shareholdings will rise to around 30% of assets (from 8.6% at the end of 2004).

Nevertheless, rapid credit growth, accompanied by asset price inflation and real exchange rate appreciation, signal a potential risk area. Credit extended to the private sector grew by 12.4% in 2004 (21.7% in the 12 months to June 2005), with credit to households (comprising mainly mortgages, vehicle leases and credit card loans) increasing by 25% in 2004. Corporate credit growth was more muted as a result of surplus liquidity and continued disintermediation through the capital markets.

All the four large banks are in compliance with the ownership criteria of the Financial Services Charter, where a 10% stake was transferred to black economic empowerment ("BEE") investors. All banks are also required to participate in empowerment financing for small businesses, low cost housing, rural development and infrastructure finance, for which they have agreed to fund ZAR74bn. Banks also play an active role as arrangers and funders of BEE deals. However, the provision of financing to higher risk areas, such as low-cost housing and mezzanine financing for BEE transactions, raise risk, potentially undermining financial soundness, and these areas need to be watched.

Key Facts: Banking System December 2004

M3 (% GDP)	64.3
NPL Ratio	2.6
Capital Adequacy Ratio	13.5
Public Ownership, % of Assets	0.0
Foreign Ownership, % of Assets	8.6

Source: SARB

(For the latest complete *South African Sovereign Report* please see www.fitchratings.com).