Accelerating Securitization in Africa to Scale Financing for the SDGs

A Milken Institute Webinar | Thursday, May 28, 2020

Overview

This Milken Institute webinar brought together government officials with key market participants from Nigeria, South Africa, Cote D'Ivoire, Kenya, Ghana, and select others, to share information on securitization transactions being done in these countries, demonstrate their benefits, and discuss steps needed to accelerate and scale securitization.

The Sustainable Development Goals (SDGs) have created an ambitious development agenda to reduce poverty by 2030 with an equally ambitious agenda to finance them—including an estimated US$2 to US$3 trillion per year from the private sector. Sub-Saharan Africa alone requires an estimated $600 billion per year. The COVID-19 crisis adds urgency and additional financing needs, placing more emphasis on financing the social elements of the SDGs, while the climate agenda remains ever demanding. The one positive of the COVID-19 crisis is that it has shown the ability for public and private entities to mobilize and take action at speeds not thought possible before.

Securitization can play a central role in financing the SDGs and help address the COVID-19 crisis. But securitization is nascent in Africa, as in many parts of the world. Future Flow Securitizations (FFS) can be one good place to start. They support the financing needs of many SDGs and are less complex and more transparent—making these transactions more attractive to investors still wary of securitization's potential abuse from the 2008 crisis.

Transcript

NICHOLAS GUNNING, Standard Bank

We want to spend some time today talking to you about SA Taxi and TUHF Urban Finance Limited as both provide good examples and guidance of opportunities for the rest of Africa.

To start with the SA Taxi.[1] It's a short period of time which I have to speak, so I will just give a little bit of context to their business and the South African context. In South Africa we have a

[1] SA Taxi is an independently owned commercial business that finances entrepreneurs who operate minibus taxis that may not otherwise have access to credit from traditional banks.

public transport system, and the public transport system is the primary mode of transport for the communities in South Africa. So roughly 40% of all commuters rely on some form of public transport and of the communities that rely on public transport about 67% of those rely on minibus taxis.

Now, I understand a lot of the people on this call haven't been to South Africa. So probably don't understand what we're referring to when we talk about minibus taxis, but these are essentially 16-seater or 14-seater vans. The majority of which are Toyotas and there's actually one brand in particular—the Toyota Quantum—that's the dominant brand within our markets. There are other makes, but the Toyota is the preferred make. The industry is a byproduct of the old South Africa Apartheid government policies that were put in place in the 1960s and that coincided with forced removal of black communities to the outskirts of South Africa's main commercial centers, and what that really required then is a transport service for these black communities to get back into these commercial centers. And again, for those who are not familiar with that, spatial segregation of population still largely exists today and so that need still persists today.

It's quite strange with COVID-19 going on at the moment to talk about today, but prior to COVID-19 the minibus taxi industry service completed approximately 15 million commuter trips daily through a network of fixed routes. And the numbers are quite astonishing if you ever get a chance to look at this business, but they estimate that the cumulative amounts of kilometers traveled per annum is in the billions—18 billion per annum. That's just amazing.

So how does the taxi industry work? It relies on a system of associations together with the Department of Transport. Essentially, what the Department of Transport is responsible for is the issuing of licenses. And then they allocate these fixed routes to the various associations. There are approximately 250,000 taxis that operate in South Africa, and each taxi operator is required to have a license as well as be a member of an association in order to operate on a route.

There are roughly 1,200 associations, and the membership in these associations is very closely scrutinized and guided to maintain some level of profitability on these particular routes. So you can imagine the amount of demand for these taxi vehicles and to operate on these routes. And if you think about that in the context of South Africa, where there's a scarcity of employment opportunities, there's this glut of demand coming from individuals who are looking to own their taxis. So that's one side of the equation in the industry.

The other side is the supply side, and historically we've seen a very short supply of vehicles into the taxi industry. That's largely as a result of under-investment from manufacturers. That has improved in recent years. Toyota increased their production in their local plants about two years ago. And I think they're always looking at ways they can increase production even more. Nissan recently reentered in the market as well. So vehicle supply is being constrained. On top of that, if you look at the taxi operators themselves, these are typically individuals from previously disadvantaged backgrounds. They aren't well served or have been underserved historically by the more traditional credit providers and that's largely due to their credit profile.

And so if you consider the demand-supply equation, you've got this great interest in people who want to own a taxi, but at the same time, there's not a sufficient supply of vehicles and there's not a sufficient supply of finance into this broad base of demand.

That's where SA Taxi has found themselves. And they've operated very successfully. Their approach is not just looking at the underlying borrower. They've actually been able to look at it from both the borrower perspective, as well as at the SME level, which is represented by the vehicles and the route that the vehicles will be operating on. There's a lot of detail on how they actually go about doing this, but they've got a lot of insights into these routes and they've got a lot of touch points into these various associations. So they're able to grant the needed credit in quite a robust way.
Standard Bank has been involved SA Taxi since the start. We were one of the earliest in the first asset-backed structure. That entity was asset-backed in nature but didn't necessarily conform with other structures of the time and was probably relatively narrow in its appeal. It was a rated structure, but it didn’t rate all the way up to AAA.

The securitization team became more involved with SA Taxi about eight years ago and assisted them in executing their warehouse structure. That was closely followed by the first Transsec[2] first time SA Taxi was able to issue instruments with a AAA rating and also listed. That had really been done through a structure that was very common and incorporated a lot of the structural features that we had used with other clients up until that time.

What we were able to say to investors around that time was that you've seen the structure features, you've invested in other structures that have these features, and we've only tweaked them a little bit so you don't have to spend a lot of time trying to get your head around the structure. Spend more of your time trying to get your head around the underlying creditor.

And by doing this, we actually helped SA Taxi broaden their investor base, increase the level of new funding into the business and lower their cost of capital. Together with SA taxi, what we've managed to do in each successive Transsec since then builds on this initial achievement. We're now sitting in Transsec 4; the initial issue in Transsec 4 was placed last year, I think, about Q3. That initial issue was the single largest issue that SA Taxi had. We also managed to increase again some new investor names in SA Taxi, which also lowers their cost of funding across the entire capital structure. That's really appealing from an investment banker’s perspective.

> *“What we managed to do through the Transsecs is to mobilize otherwise unavailable institutional capital through a fairly standardized structure. That was not only to fund the taxi operator, enable that small business, but also provide a means of employment for that operator, and to enable them to play a bigger role in the formal economy. They’re also supporting job creation in the broader taxi*

[2] Transsec is a ring-fenced securitisation vehicle issuing asset-backed securities.

> *industry that has also been reliant on those taxi operators. And in addition to that, we were also able to address the broader transport needs of our country, putting safer and more reliable vehicles on the road."*

From an investment bankers' perspective, normally we would just stop there and say, "That's great. That's a job well done." But in fact, if you look a bit deeper, what we managed to do through the Transsecs is to mobilize otherwise unavailable institutional capital through a fairly standardized structure. That was not only to fund the taxi operator, enable that small business, but also provide a means of employment for that operator, and to enable them to play a bigger role in the formal economy. They're also supporting job creation in the broader taxi industry that has also been reliant on those taxi operators. And in addition to that, we were also able to address the broader transport needs of our country, putting safer and more reliable vehicles on the road. So that's the good news stories from SA Taxi perspective.

I'm going to move quite quickly onto TUHF[3] because I think there's also very good learning out of TUHF that should also get some air time here. Again, I wouldn't be able to use this time adequately to discuss TUHF in a lot of details. They are an MBFI. They provide finance to inner city landlords of low-income housing blocks. Similar to the rest of Africa and in the broader context of the world, there has been a large population migration to urban centers in South Africa resulting in a substantial overdemand for affordable housing. What we've also seen over the last couple of decades is that businesses have been moving out of our city centers, which has resulted in under-investment in these areas and an increase in building vacancies, and a level of urban decay has set in. The combination of this rapid urbanization or migration, as well as these businesses moving out of these city centers, really presents an opportunity for landlords to come in and establish new apartment blocks.

An example that we've come across is a lady that used to clean and maintain an apartment building for a number of years, and then noticed that one of the block close by became available. The difficulty with these opportunities is that the traditional banking approach doesn't adequately cater for some of these types of opportunities. Exposures are too big to be considered part of a typical home loan against the borrower. Also, the exposure on the other side is too small to be financed through a commercial real estate team.

What TUHF has essentially done over the last 15 years is carve out a niche segment of the market by understanding the combination of the borrower and their ability to collect on the rentals together with the SME business represented by the building and supply fundamentals which underpin the business. In addition, TUHF provides construction loans which are used to either redevelop or repurpose some of the buildings or actually just build a new building.

In all cases, this is assisting with the rejuvenation of SA city centers and improving the overall living standards in this affordable housing segment. TUHF did their first securitization in 2018.

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[3] TUHF Urban Finance Limited is a specialized commercial property financing company that finances property investors in inner cities.

Standard Bank didn't assist them with that. But TUHF did look to build on their success and that's when we got involved and executed their warehouse facility towards the start of this year. What we're hoping to do is bring them to market with their next securitization within the coming year.

> *"The real success here is, again, the mobilization of otherwise unavailable institutional capital through a fairly standard funding program."*

Similarly, with SA Taxi, the real success here is, again, the mobilization of otherwise unavailable institutional capital through a fairly standard funding program for the purpose of enabling landlords and small business enterprises, as well as the associated job creation, but also allowing the upliftment of these previously decaying city centers and improving the living standards of the lower income market.

In a nutshell, what we do as a securitization—and in both of these examples what you find—is that there's the societal need that is not being adequately served by the traditional credit provider. These clients obviously don't have the means to attract traditional credit providers such as the banks. What we can see on the other side is that institutional funds have the available capital but have restrictive investment mandates that prevent them from applying that capital down to the client base. That's where securitization has really been quite handy in bringing institutional capital in. We've been able to bridge that gap quite nicely. We've been able to structure all the way up into the AAA level, which on a global scale exceeds any local corporate investment that you can find in South Africa. We've been doing it, and not on a charitable basis. We've been doing it and delivering good risk-adjusted returns for these institutional funds.

ALISON HARWOOD, Milken Institute

Thank you, Nick. That was a great introduction to the benefits of securitization—and how securitization is being used for sustainable finance purposes. We're going to move on to Nigeria and to Sonnie Ayere, who is the CEO of Dunn Loren Merrifield. Sonnie has been leading the way and doing pretty much all of the securitization transactions in Nigeria. Over to you, Sonnie.

SONNIE AYERE, DLM Capital

Thank you very much, Alison. And thanks for that, Nicholas. You talked about South Africa home loans. That was a deal I was also involved in when I was at the IFC. In fact, it was the first transaction IFC worked on and the first securitization for South Africa back in 2001, if memory serves me. It might surprise you to know that the first securitization done on this continent was actually in Nigeria. I think it was in the mid-90s. It was an oil and gas deal done by Credit Suisse. So there have been a few complex deals in Nigeria.

If I move away from the first one, which was sometime in 1995, the next transaction that occurred in Nigeria was in 2007, when we did a residential mortgage backed securitization. For that time, it was a large deal and it was basically under the monetization program of the government. The government wanted civil servants to own their homes. What happened then was that houses were sold to the occupants and the financing of the mortgages was done via securitization, which closed very successfully back in 2007. Following that, and looking at what Nicholas was talking about, was obviously home ownership, job creation, et cetera.

Following that, in 2017 or so, was the first successful future flow transaction that was done in Nigeria. The underlying receivables were effectively what I would describe as Nigerian green cards—the amounts paid annually by foreign workers who work in Nigeria. We did a future flow based on those receivables which has been very successful even through this very difficult period of COVID-19 when the forms could not be sold. These are some of the benefits of securitization—where you have reserve accounts and so on that are there to cover these sorts of shortfalls. Following that period, now that we have lockdown, and you can see the collections building back up again. So that transaction is ongoing. It's working as expected.

The next transaction I'll talk about, which is similar to the SA Taxi transaction, was a securitization of bus ticket receivables. A private company called Primera had acquired somewhere around 434 buses if memory serves me right. They had a lot of expensive bank debt which was also short term and killing the business more or less. Our job was to go in there and restructure the business.

The first thing we did was to try and erase the negative equity which was building up because of the depreciation of the buses on their balance sheet and was very painful. So we had to separate that. Secondly, we had to securitize the receivables as they were being bought. In this case, there was one major route going from one part of Lagos to the other part of Lagos—extremely busy and, if not for the very high interest rates we had here, extremely profitable also. The securitization has helped in terms of job creation by making the business a lot more sustainable. We've been able to explain to investors that the transportation sector is one of the key areas that drives GDP growth.

Then we've done a lot in the housing sector. You talked about warehousing: we set up a company called the Nigeria Mortgage Refinance Company (NMRC), which basically refinances mortgages. We supported the origination and growth of receivables and created an institution called the Mortgage Warehouse, which is an aggregation vehicle, bringing the mortgage banks together to provide them financing under the guise of an asset backed commercial paper program, where assets are the mortgages. That then feeds through NMRC for long-term financing.

Other areas we're looking at: one is again similar to taxis and concerns what we call Okada, which are the bikes that can get people back and forth to jobs. They were recently banned in Lagos, but they still operate in other parts of Nigeria. We're looking to securitize the underlying cashflow from the sale of the bikes to the riders. For every transaction we do, we're helping to create a job and importantly support others as one person is often supporting another five or six people from their income. We're also helping to improve the transportation system.

There are quite a few asset classes that we're looking at—from rental loans securitizations to all kinds of receivables. We're looking in the commodity space to use an asset-backed commercial paper program to fund the acquisition of produce upfront which can then be stored and then the off-takers pay for what's required, say on a quarterly basis. And that cashflow is then used to retire the notes to the investors.

There are a lot of potential asset classes. For us, the issue is no shortage of assets. It's really more getting the investors to understand the asset classes, get their heads around the credit and also get the various government agencies here to understand. There's a lot for investors, regulators, and issuers to still learn.

ALISON HARWOOD

Thanks very much, Sonnie. Now we're going to turn to Abdulkadir Abbas who is the Head of Securities and Investment Services at the Nigerian Securities and Exchange Commission. Abbas will talk about how the SEC and the government view the need for securitization and some of the steps they've taken to help move it forward.

ABBAS ABDULKADIR, SEC Nigeria

Thank you, Alison, and thank you, Sonnie, for that overview. I think from our own perspective at the SEC, we started this journey in 2013 when we recognized the need to have more market-based finance. And so we came up with a rule on securitization. We leveraged the Investment and Securities Act which gives the SEC the power to come up with rules to deepen the market. In 2013, we had this rule finalized, but we had not had any transaction going through the SEC until Sonnie came up with his first securitization transaction in 2017, as I remember. It was really a learning curve for us as a regulator. We were able to turn around that submission and approval was given.

From that, we learned a lot and we're now looking to finetune some of the provisions in the rule. Essentially, the rule focuses on a kind of true sale concept of securitization. We are trying to provide clarity to help open up that space of the market and trying now to see how we can improve further, because we believe that there is real value-add from securitization in terms of economic benefit. We need to get a lot of issuers coming onboard. Sonnie has done a lot to get issuers to showcase this concept.

At the SEC, in addition to having rules, we also want to have a team that not only collaborates with issuers and from the issuers perspective but collaborates more with other regulators. One key regulator we're in conversation with is PENCOM. But we need to have more engagement for all of us as regulators to really understand securitization. It is a bit complex, it's a bit novel in our market. We are trying to see how to get everybody on board—including the central bankers—to see the value-added of securitization. This is an ongoing effort and engagement.

In addition, to really deepen the market further, we recognize the need to review the entire Investment and Securities Act. We're embedding a securitization section in the Act. Initially we had planned to have a stand-alone law. The securitization section should be part of the Bill that we're taking to the parliament so we can institutionalize most of these issues. A critical issue of real concern is tax neutrality. We are trying to carry everybody on board to see how we can address that. Once we have the Bill, I believe it will really be a game-changer.

In our own market, we strongly believe securitization is the way to go. We have a large infrastructure deficit and we have many pools of assets that we can leverage and see how we can deepen this market further. For us at the SEC and from the government's side, we are really open and we are really engaging all the relevant stakeholders to ensure that we have a win, win situation. It's not just for us as the regulators, but for the market operators, the issuers, and all other stakeholders on the value chain. Securitization is something that everyone needs. We strongly believe it is the way to go in terms of the future financing structure in Nigeria.

ALISON HARWOOD

Thank you for that strong endorsement and recognition for how important this effort is. And for emphasizing the critical role of collaboration. There are so many different types of people who have influence over the ability to develop securitization. Bringing them together—from the public and the private sector—is key. It's important to hear how much you're doing that in Nigeria.

Now we will turn to Olivier Gui, who is the CEO of Africa Link Capital in Cote D'Ivoire. Olivier has been working on several very interesting securitization transactions, including one that involves a state-owned electricity company and so shows the value of having sub-sovereign entities involved.

OLIVIER GUI, Africa Link Capital

Thank you, and good morning. As Alison said, we've worked on several transactions in Cote d'Ivoire. The story started in 2010 when the financial market regulators adopted the regulatory framework to regulate securitization transactions. And we, African Link Capital, started our activities around 2015 with the license to operate. We landed our first transaction in 2018, with a microfinance entity called the COFINA Group. It was about securitizing microfinance loans of two of their subsidiaries, one in Cote d'Ivoire and another in Senegal to refinance their receivables and be able to expand their financing for small individuals and small entities. This was the first such transaction in French-speaking West Africa.

After that, we worked on the transaction with the national electricity company called CIE—the state-owned electricity company—which was about securitizing electricity receivables. This transaction was done privately with qualified investors to allow the company to finance working capital and be able to spread electricity across the country. We also recently worked on two other transactions—the last one was in 2018—that we landed this year. One was a replenishment of the electricity securitization fund, for another round. Another transaction was with a commercial bank called NSIA bank, which is an Ivorian bank, which was launched in March last month—IFC is an anchor investor—to encourage the development of securitization in our market because we have seen that, since the framework has been put in place, there were few transactions. The objective of IFC’s involvement was to encourage the use of securitization as a financial instrument to finance the economy and to finance the SMEs. This is what has been done so far.

> *“In terms of the structuring, what's been done so far are simple structures, like having a senior and an equity tranche, because the market is not very aware of this kind of transaction. Using very simple structures can help welcome them to this kind of financial instrument.”*

In terms of investors in these transactions, we have global institutional investors like insurance companies, pension funds, trade funds. Most of these funds are from our region—the West African Economic and Monetary Union. About 30% is coming from the rest of the world. In terms of the structuring, what's been done so far are simple structures, like having a senior and an equity tranche, because the market is not very aware of this kind of transaction. Using very simple structures can help welcome them to this kind of financial instrument.

In terms of maturity, so far we have done some short-term maturities from 15 months to 18 months. The commercial banking transaction was medium term—for five years. So far we have done electricity bills, microfinance, and commercial bank loans. What we use in terms of credit enhancement is mainly overcollateralization. We also use what we call a reserve portfolio—a portfolio we can draw on to replace or to switch nonperforming loans from the initial portfolio to improve the quality of the transaction. We also have a liquidity account and pledged account.

This is an overview to what we’ve done so far. We are expecting to look at some more impact transactions, like in the housing sector and maybe healthcare or transportation, like my friends from South Africa and Nigeria have done.

ALISON HARWOOD

Thank you very much, Olivier. If we have time, I’d like to come back and ask you more about the electricity deal. It is a somewhat new and unusual transaction but given that it is state-owned and has a performance history, deals such as that may be more attractive to investors and so good ones to start securitization markets with.

Now, we want to hear from James Doree, who is a Managing Director at Lion's Head Global Partners. James is running the Africa Local Currency Bond Fund, which is a fund that is supporting securitization transactions in various ways—such as an anchor investor, providing technical assistance, among other ways.

JAMES DOREE, Lion's Head Global Partners

In a way, it's funny to see everyone together like this, because I've worked with Sonnie, with Olivier, and Nick in different guises and with others on the call. The Africa Local Currency Bond Fund is one of the few entities working on these sorts of deals across markets.

The fund does three things to try and make it easier for companies and products to come to market. First, we act as a sounding board and provide a hand-holding role. If a company comes to us in Cote d'Ivoire, I might suggest that they speak to Olivier. If a company comes to us from Nigeria, I may suggest they speak to Sonnie. This is how you start figuring out a securitization structure that allows you to access the broadest and most cost-effective set of investors domestically. We do that as a function of our main activity, which is as an investor in the structure. We can be an anchor investor and invest in the senior or junior tranches of those notes. Our key requirement is that we are investing alongside local institutions and that we're pricing to market. We're not playing a distortive role, which I don't think is always the case when some DFI's get involved. Third, we also have some resources to cover some transaction costs. Usually this is for legal or ratings-related costs or even for more esoteric things like developing green bond frameworks.

All of these functions are designed to make it easier for companies to say that they'll go through the capital markets process.

I'll just quickly run through how we've thought about securitization as a sector. If I look across our portfolio, we've invested in securitization structures that touch on the SME sector. Olivier mentioned COFINA. On the consumer sector, we've invested in Baysec—which is short for Bayport securitization—in South Africa, which is comprised of consumer loans but the use of proceeds focuses on housing, home improvement, and education. We participated in the NSIA deal that Olivier mentioned with the IFC.

In housing, which I guess is the most active area for asset-backed finance in some markets, we've participated in mortgage-backed securities. Nick mentioned TUHF—the Trust for Urban Housing Finance. We've been a long supporter of them through bridging and various structures to try and move them towards the capital markets. In regard to some of the examples mentioned by Nick, we didn't invest for various reasons. We did not participate in SA Taxi's securitization. Despite them having a great developmental story, they didn't need our involvement. The South African market has the JSE structured finance board which has grown in terms of the size and depth of investor interest. SA Homeloans is interesting as well, but again we weren't needed for that.

A few areas where the Fund is looking to push securitization structures are trade finance, refinancing receivables, or inventory finance structures. We can look at asset-backed commercial paper and even longer-dated securitizations. One subset of that area that we think about a lot is solar home systems where you have increasing data and track record to underwrite, quite apart from the debate about the physical assets behind those financings.

What are the challenges that we see? I think when I first spoke to Sonnie about the securitization market in Nigeria, one of the perceptions that has historically existed in Nigeria is that securitization is a way of selling what you don't want rather than a way to try to optimize your capital and financing structure. That perception is still something to be overcome in some markets. I think that's fair to say to some extent in Nigeria. I think getting a standard analytical framework through the rating agencies is a challenge. Outside of what Moody's is doing in South Africa or a handful of the other agencies in the rest of Africa, we don't see enough detail on sensitivity analysis and rating reports, for example. That's something that will be synonymous with the development of the market as well better waterfall and analysis scenario and sensitivity analysis. Obviously transaction costs are also a barrier.

We're here to help with that when you have clients that need encouragement to go through this process. On today's call we have the thought leaders and pioneers of securitization in their markets. What we don't have necessarily are all the other separate service providers in place yet—i.e. who is the backup servicer in a transaction where there's only been one or two deals in the past, or can banks provide balance sheet to securitization structures through liquidity or warehousing in the same way that Standard Bank does in South Africa, for example? And then progressing some of what we see in South Africa to the other markets. I think Olivier touched upon this in relation to sponsor commitments in securitization structures. Since the financial crisis, it's become the market standard in a lot of markets. We've seen this in South Africa, for sponsors to commit not just assets to the structure but cash as well to optimize incentives. I think we ought to be seeing a lot more of that. I think it was a feature of Sonnie's mortgage-backed commercial paper program in Nigeria as well.

Outside of South Africa, we don't see much in the way of tranching. Obviously, that will have to evolve in relation to investment tastes and track records of the deals that take place. But I think the key progress in this market is really being driven by the people on this call. And my message would be to look at what we've done in the past and then look at what we're keen to do going forward. We're here to help with these deals.

ALISON HARWOOD

Thank you, James. It's good for everyone to know that the ALCB Fund is out there and the kind of support you're providing to transactions. As you've said, there are challenges to doing these transactions, but it's good to see progress being made, who the people are out there getting the deals done, and then work together, and with the regulators and other parts of the government and private sector, to get different pieces in place.

We are now going to look at a transaction that was done in Ghana, and James Nelson, who is a managing director and head of debt capital markets at Standard Chartered, is going to talk about that. it's a very good example of getting scale when you have the government as the originator of the transaction.

JAMES NELSON, Standard Chartered

It’s nice to see so many familiar faces. Nick, I guess you were one of my last trips before we were told to stop flying around, so good to see you again, and, James, always good to hear from you as well. I feel like I'm slightly cheating: A) I'm not a securitization guru, and B) the ESLA (Energy Sector Levy Act) transaction was not, as my securitization colleagues remind me, a proper securitization deal. But I think in terms of the region and looking at Sub-Saharan Africa, it is a very good example of how we have managed to utilize a very stable cashflow to effectively raise some very important funding and solve a build-up of arrears in government debts that were non-performing.

For those of you that don't know the background to the ESLA program, this was designed and implemented in 2017 to help raise local currency Ghana Cedi as opposed to US dollars. The program relies on an assignment of cash flows that are based in law in Ghana. And that's a really important point to make because unless a cashflow is a legally standing set of cashflows, it is very hard to see any value to that. The ESLA Act was actually put in place by the prior government before they were voted out, ironically, but that laid the groundwork for us to create a structure that would enable us to take receipts of those cash flows.

The program has now successfully raised in excess of 5 billion Cedi (around US$865 million). What we do, with the help of auditors and KPMG as the administrator, is to refresh the cashflow analysis on a regular basis and see what room there might be in the program to draw down on a continual basis. The funds that are raised are then used to either do a debt swap with the independent power producers (IPPS) that were owed money by the government. By now, a lot of those IPPS have sold the nonperforming loans to the commercial banks at deep discounts, so the commercial banks are swapping out those discounted notes for fresh ESLA issued notes and then have a performing asset on their books.

The ESLA notes are also traded fairly widely in the local market. They are bought by pension funds, insurance companies, as well as the commercial banks. We haven't found much traction internationally. I think the international investor base, if they're going to invest in local currency, prefer to do that through the liquidity that the government directly provides, in terms of the Cedi government issuance. However, you could argue that actually ESLA, because of the structure, is a much better credit than naked government debt by virtue of the lockbox. There's a very robust trigger point of 180 days before the next payment is due, where cash is supposed to flow into that service account. Any excess goes into a lockbox account, which only flows back to the sponsors once all interest and principle have been serviced.

If there's not enough for 1.25 times cover and the debt service reserve account (DSRA) drops at any point, and particularly within 90 days before an interest payment date, then the government of Ghana has a top-up requirement where they would need to take that coverage back up to 1.25 times. So it's not a 100 percent government guarantee but it is a guarantee in terms of making sure that that DSRA is always at 1.25 times the requirement.

I think where this deal makes a lot of sense is that it was a locally designed solution for a local investor market. It does not rely on offshore interest. It managed to raise the money—yes, initially at a bit of a margin over government rates. I think the original deal came in at something like 3 percent above the relevant Ghana government issuance, which was a pretty decent premium to pay. But I think it was a good premium to get the program up and running. The subsequent issuances we have done, and the latest drawdown, which was actually as recently as February, have had much tighter spreads to government—I think only around 25 basis points or thereabouts. So we're now printing at much better levels and I think will in time, as this cash performance is able to demonstrate years of performance.

What will be very interesting now is to see whether the ESLA flows are impacted negatively by the pandemic—how the structure stacks up as fewer people presumably are going to the petrol pump to buy fuel, which is the origin of this cashflow. The actual cashflow is a tax on fuel as you fill your car or truck. KPMG and the joint leads will be making that information available in due course.

Overall, I think it is a very important precedent for the region, not just in Ghana. II think there are plenty of government, non-performing debts in Nigeria and Kenya and various other Sub-Saharan cases. If we can roll this out into some of those other jurisdictions, that would be a great example of securing a cashflow like that.

ALISON HARWOOD

Thank you, James. In terms of the goal of financing the SDGs, it's good to explore these types of deals where the government is the originator because of their potential scale and because many activities that governments are doing have a performance history, which might make it easier to start and grow securitization markets. Regardless of what the source of the receivable is, the money that's raised could be invested in an SDG area. It’s an area to think about.

We’re now going to move to Kenya. Kenya has done a lot of work to get their enabling environment in place. They are working on several transactions. We will hear about a few of them. We're going to start with Luke Ombara who is Director of Regulatory Policy and Strategy at the Capital Markets Authority. Please go ahead, Luke.

LUKE OMBARA, Capital Markets Authority of Kenya

Good morning. Good afternoon. Good evening, depending on your geographical zone.

Apparently, it seems like Kenya is among the jurisdictions that doesn't have a true securitization yet, but there's a lot of demand for it. I think, all the way from 2009, you may have heard about the government infrastructure bond. The government had a policy of trying to crowd in the private sector by investing substantially on infrastructure. So the key receivables that were being looked at were those that would support investment in infrastructure, which was estimated to have a shortfall of around US$2 to US$3 billion dollars annually. There have been quite a number of what I would call "potential securitizations" in the pipeline, but none has come to fruition for a number of factors.

And the demand grows further with the agenda around the Kenya vision 2030, which is very heavy on development projects—the estimate over the next five years is at about US$122 billion. Initially it was focused on infrastructure, but other projects came to mind that could benefit from this type of structured financing as well.

We had the asset backed securities regulations in 2007, that's pre- the global financial crisis. But later we realized that there were limitations on the scope of receivables for the various structured projects that could be utilized on the same. So there was a diagnostic review of the regulations in 2009—that is of course with the realization that from 2007 because of the crisis there was really no take up.

One issue we were trying to address was that the 2007 regulations dwelt on a lot of precedents from other jurisdictions that did not take into consideration—for example, whether this was under a civil or common law foundation. So you'd find a lot of provisions that couldn't be appreciated by potential arrangers or issuers. There were also issues about the clarity of the relationships between the parties to an asset securitization – including whether we were to take the form of a trust for the SPV or a company and the various parties around it, from the originator to the administrators, to the servicer and all that. Then there were also issues around disclosure; the regime around disclosure was also not taking into consideration circumstances where the SPV would take the form of a company or in the form of a trust.

There was also a need to look especially at the case of mortgages, particularly in relation to financial institutions. You'd find instances where, for example, the primary regulator of the regulated financial institution, for example a bank, probably would have their own views as regards to what it would mean to transfer an asset into an SPV or the impact on the balance sheet. So there were a lot of bottlenecks around that, which was sorted out through a review of the regulatory framework and development of what we call a policy guidance note on asset backed securities, So a lot of these efforts have been able to address most of the gaps.

So that's with regard to the regulatory framework. I'll just touch on another area. You'd expect ABSs to be a tax neutral vehicle. We had made inroads around providing the requisite incentives, especially the tax incentives. I'm talking of income tax incentives on receivables that are actually passed on to the investors. Then there's VAT, for transfer of an asset into an SPV, we were able to get that exemption. We were also able to get some exemption on stamp duty.

So overall, there were issues with the regulatory framework which have largely been resolved, except for the case where other regulators such as the central bank need to also review the credentials, framework, or guidelines to create some level of comfort that there would be no issues after the transfer of the assets.

With regard to the actual deals, I'm sure my team from Kenya will be able to get into that. I’m just giving an overview of what the situation has been. And again, what we are saying is that we effectively had a tax neutral regime. But with the current COVID-19 situation, there have been some current policy decisions that may take us a little back: there was an amendment to the tax bill, which has already been signed by the president, that removes some of the tax incentives, especially the one on income tax on interest from receivables. There was also one on VAT. We are trying to see how we can reinstate the exemptions because without that full tax neutrality, we might not be able to move farther even with the few transactions that are almost completed.

In terms of the scope of receivables, there are very many options we've had. We’ve even gone into education loans. We've engaged with various, particularly public, entities that would be very interested. There are also discussions around lease financing, how that could be securitized. There's also opportunity for nonperforming loans being securitized, but we haven't really quite got them on board. So the issue is really about uptake. The prerequisites in terms of the framework policy, legal framework is already fully in place. I'll stop there. Thank you.

ALISON HARWOOD

Thanks very much, Luke. It sounds like there are some very good deals being looked at, including the water utility receivables one. Hopefully, the tax and some of the macro issues that have been challenges in Kenya can be addressed so that these deals can come to market.

We're going to hear now from Irene Gathiaka, who is the regional head for East Africa at Total Impact Capital. Irene is working on a very interesting transaction to finance medical invoice receivables, which has some obvious relevance these days. It also has some interesting angles, including how it's trying to provide transparency about the receivables to give investors more comfort about their performance and the ability also to pool invoices and receivables from different originators for scale implications.

IRENE GATHIAKA, Total Impact Capital

Thank you, Alison. Total Impact Capital is headquartered in Washington, DC, and Kadana Development is in Amsterdam. We've come together and created this entity called IMFact Kenya—IMFact derived from *impact* and *factoring*. The idea is to provide liquidity in the pharmaceutical distributor space. It was good to hear Luke make his comments because some of what will drag this out a bit is the limitations we have in the regulatory space right now. It would be great, for instance, to have a national asset registry where, if you buy a receivable or whatever, the underlying asset is recorded to ensure that it doesn't belong to three or four other people.

How this came about was that our founder, Ambassador John Simon, found a bottleneck in Kenya where getting quality medicine to everybody in the country affordably and consistently was quite an issue. The reason was that along the way, Kenya stopped manufacturing a lot of what we used to manufacture in the 1980s and 1970s and started importing a lot. When you get too many small distributors, what they can import is limited by how much finance is available to them. And the cost of importing a small truckload of supplies is the same as if you had imported in bulk.

The idea now is to release capital into the market, making sure that the receivables that are held and delayed in payment are still refinanced early enough. That's where we come in, to buy the receivables and release financing to the distributors so they can go on and do their business. We can wait to get repaid.

The way this structure works, as you can see on the slides, is that IMFact is in the middle. The idea is to finance whole portfolios of distributors instead of invoice per invoice.

We have an IT platform that is superior to most that I have seen because it's live. Basically, if you want to know how a portfolio is performing on a daily basis or an hourly basis, just press a button. You'll see the ups and downs of the portfolio. What that means is that if you have set a limit of dilution at whatever percentage, you can assess daily whether that's happening or not. You can track the number of credit notes issued by a portfolio and that reduces the amount of advanced money that you would give to a distributor. You can assess the aging of the portfolio. If it goes beyond a certain date, you can reduce the advance amount that you give the distributor. So the key here is that you can track risk and mitigate it before it becomes too much to handle, by observing the portfolio on a daily basis.

So we buy the receivables from medical distributors, but the underlying creditors are your pharmacies, maybe government institutions like your big hospitals, or the other entities like your clinics. That's pooled together and it forms the portfolio. So you have your homework to do in terms of single obligor concentration, the aging, the distribution in the country and things like that. And once it’s clear that it’s met all your criteria, you will be able to give it an advanced rating.

The good thing about this is that you buy the whole portfolio, but you advance a portion of it, depending on the rating—maybe 60 percent or maybe 70 percent. The rest goes to the distributor, but only after the invoice is paid. What that means is that the onus is on the distributor to make sure that the invoices are collected and on time, because the first loss will sit with the distributor.

There's always that buffer that says you maintain a balance, depending on the rating of the portfolio, before you can decide that you can finance a distributor. What that does is to cushion the senior investors. There are quite a bit of other investors that we envisage to come into the deal who we are already talking to.

So if the first loss sits with the distributor, the next loss will sit with the equity portion and the equity portion is coming from the equity partners of Kadana Investment and Total Impact Capital, which is the company that I work for. What that means is that the first loss is with distributors. The next is with the equity investors or reserve amount, which is junior debt. And after that you have your institutional investors.

We want to prove these concepts in the market. The reason we haven't gone to market is that conceptually people get this, but the uptake, especially to institutions like pension funds—they're not quite there yet. As Luke said, no one has quite issued a securitization in the country before.

So our goal is now to go to market, prove that this concept works, and prove that we have buffered all the areas that we think could be risky. That way we can invite more senior debt and then we can go to market and issue an asset-backed security.

Again, I think the take away from this structure is that you have the first loss sitting with the distributor who is the owner of the portfolio. And then the next loss is sitting with the equity investors, that's Kadano and Total Impact Capital, and then you have some DFI money that can take on a bit more risk than perhaps your pension funds. That will help us go to market and prove that the concept works. And then in year 2022 or 2023 we can go to market and issue an asset backed security.

ALISON HARWOOD

Thank you very much. I think that deal has some very interesting angles to learn from. Maurice, you had aspects that you wanted to add.

MAURICE OPIYO, NCBA Investment Bank

Thank you, Alison. I'll comment on one element that Irene mentioned regarding registering the receivables. I think we have got the Moveable Property Security Rights Act, which can be used for registering your receivables.

Separately, I think the regulations state that private enterprises can issue an ABS, but there are a few challenges with the state-owned enterprises. Yet they are the potentially scalable transactions which you can bring to the market. Two critical items that we need to figure out concerns the Public Procurement and Asset Disposal Act as well as the State Corporation Act. Both need to be harmonized. In terms of bringing a transaction to market and creating a new asset class for investors in this region, we have been looking to work with a potential anchor investor who can give us surety on the success of the transaction. Then, of course, continuous engagement with potential issuers to help them understand what this asset-backed security is. A good example that we have looked at in the past, not to disclose the name, is an energy utility company, the only one in this market owned by the state corporation. That's a transaction that we worked on from 2018, and to date we have not finalized all the discussions at the board level.

I think with the appreciation of this new asset class, an education forum has to be done with ourselves, as the arrangers as well as other stakeholders in the market, and the regulators. So those are the three points that I would have within the time.

Transcript of Q&A

ALISON HARWOOD

There are a few questions that have come in, many about the development challenges that countries face. Paul Muthaura, the former CEO of the Capital Market Authority in Kenya, was wondering about how countries are able to get the right kind of tax regime in place. A lot of countries, and several of you have mentioned this, suffer from the flows to the SPV being taxed, which they shouldn't be because the flow is not an income generating activity. How do you get a government to not tax that flow and to not see the flow as taxable income? So that was one question that came in. Sonnie, there's a question about renewable energy in Nigeria and doing deals there. Does anybody want to comment about the tax point?

SONNIE AYERE

Yes, let me talk about it from the Nigerian perspective. We don't actually have that problem. Like you said, income to the SPV is not seen as taxable income. We've not really had any problems with that because it's not the asset itself that has been transferred but the beneficial interest of the asset. Then again, it's not really seen as a sale, which then requires a VAT and a gain on sale accounting approach.

What we try to do with securitization, generally speaking, is to focus on the cash flows rather than the asset itself. We only perfect interest in the asset where it becomes necessary and at that point, you actually can take ownership of the asset. So from that perspective, we've never really had a problem.

There are other areas where, as Abbas said earlier, we would like the law to come into place. One is so we can set securitization vehicles as trusts rather than companies. Because by definition, trusts are not taxable and therefore the transfer is seen as a pass through than an actual owner of the assets.

ALISON HARWOOD

Paul, you probably have a follow-up because I think the challenge is how do you convince the tax authorities to see it the way it really should be seen? Which is that the transfer is not an income to the SPV.

PAUL MUTHAURA

Thanks, Alison. I think it's just what you said and more so, even the point Maurice made about just issue/originator education. Everyone in the ecosystem needs to be really sensitized and made aware, but often it's a problem that until they see it work, they don't know why it's necessary. That's why forums like this are so important. Giving perspective on what has actually been achieved elsewhere.

ALISON HARWOOD

Yes, there has to be a separate meeting to talk through these different challenges that countries are facing and how they have been dealt with in different countries. Here's a question from Olumide Lala from the Climate Bonds Initiative about the renewable energy sector in Nigeria.

OLUMIDE LALA

My question is for Sonnie, as I suspect he's in best place to answer this. In lieu of the high cost of finance and commercial banks apathy to concessional financing from development banks: learning from your experience in the transport sector, how can securitization be used to accelerate much needed investments in the renewable energy sector in Nigeria?

SONNIE AYERE

Thanks. I'll take your question in three areas. One is the issue of high costs of financing. From the end of last quarter, when the Central Bank of Nigeria created a dichotomy between monies that can go into OMO-bills, which are open market operation bills, and what can go into other instruments, what we've found is that domestic investors, especially pension funds, had to then divert a lot of their monies from OMO bills, which were paying very high interest rates, into T-bills and into the bond markets. And what's happened, like everywhere else when you have a lot more demand vis-a-vis supply, the price comes down.

What's happened is that yields on T-bills today, for instance, are around I think for a one-year T-bill just over 3 percent and I think the five-year is about 9 percent. It's made the market a lot more attractive. In fact, you've had more commercial paper issues. And you've had people like Dangote actually issue his first corporate bond, five-year, bullet issuance which priced at 12.5. percent, which I actually thought was a bit high at about 300 basis points above the benchmark. But that was obviously also due to the perceived illiquidity of the balance sheet, even though some of the money was used to pay dividends and things like that.

Now looking from transport to other renewable energies, it depends on the kind of asset we're looking at. Can it be done? Absolutely, yes. But like we've mentioned, there are certain challenges from different levels of understanding. If we look at South Africa, I think they are way ahead in terms of investor understanding of the asset class and even the rating agencies' approach in terms of allocating the required ratings to these asset classes.

In Nigeria, I think regulatory wise, we have the support. I think there's some level of skill set to get these transactions done, with say for instance, renewable energy. From my perspective where we're really struggling with is getting the investors to get a lot more comfortable with these kinds of structures. More importantly, getting the rating agencies to understand these and the know how to rate them and assign ratings to them with the appropriate level of credit enhancement. But, yes, it can be done.

ALISON HARWOOD

Let me ask you another question that came in which we've kind of alluded to. It's about having information on the performance history for deals you're working on. Again, this is something that Irene's transaction is working on—setting up a database and creating a few years of performance history before securitizing the medical invoices so investors can feel comfortable that they understand the performance. It's a point that comes up when you think about securitizing flows to a government, because certain government flows may have a long performance history.

What do you do when you're starting to do transactions with companies or activities that may not have been keeping very good data? Or do you mostly focus on activities where you know that the data is there going back at least a few years? Who would like to start with that?

OLIVIER GUI

I want to take this one. I think it can be quite complicated if there are some gaps in the data. What is done is during some securitizations, if there is no data or if there is a gap for periods, it will be quite difficult to quickly structure these transactions. But if it's more about singular periods, and for which we can make some assumptions, credit enhancements like overcollateralization can help prevent all the risky periods that we have not been able to assess. But if there is almost no clear data on what has been happening in the past, it will be really difficult to work on the transaction.

SONNIE AYERE

If I may add something. What Gui said is correct, but if I go back to previous slides, what generally happens is this. Obviously when you have a very long history that can give you fantastic vintages and you can look into each cohort analysis, then it's much easier to set the level of credit enhancement required to attain the desired rating. However, where you have a very short history, what generally happens is that the rating agency would then overcompensate for the expected loss. I'll give an example. If I was looking at a deal and in only one year, 29 percent defaulted and 71 percent did well, for instance. Now that's telling me, well, in one year I have a 29 percent probability of default. But that may not necessarily be correct. So I might increase that default probability to get, in terms of setting my loss severity and expected loss, a much higher credit enhancement required to reach a certain rating. What then happens is that over time, as the underlying receivables begin to season and the performance becomes clearer, the rating agency can decide to reduce the credit enhancement required.

Nine out of ten times, at least from my own experience, what I've seen over the last 20 years or more is that generally speaking, you would set credit enhancement higher than required and then expect it to reduce as you get more performance information and you can actually understand better the asset class. But one thing I can say is that that has never stopped a securitization happening. It just depends on whether, in putting on that level of credit enhancement, the economics of the transaction still make sense. That's what then becomes what the issuer and the arrangers consider.

ALISON HARWOOD

Thank you. Does anyone have a last word they want to say before we wrap up?

GRACE KIBUTHU

Alison, this is Grace from the IFC, just by introduction leading the Africa capital markets work. I worked a lot in Kenya on the framework regulations. I think a common theme that has come out to think about is the work with investors. As we work on the deals and structuring and putting everything together, we have to do that concurrently with investors—the pension funds, insurance companies, and their whole authorizing environment from the fund managers to the trustees all the way down. Because of the complexity of the instrument, the authorizing environment is much more detailed and requires a lot more than making a case in negotiation. And to also work with the regulators of the investors, particularly of the pension funds and insurance companies. What we've encountered in Kenya is how this instrument is treated on the investment guidelines.

And you see, as a new instrument, there's a sense in which, especially in the countries that we've worked in, investors want to see very clear guidance from the regulator that this is an instrument that is allowable rather than one of those that is in the category of other, as in other countries. This is a key area that I think we need to focus on. And then also as we work on the transactions, having investors involved is critical to help them understand the risks, to appraise the risks appropriately of investing in these instruments. It requires working with them early on and bringing them on so they can understand the structures as they're being put together. I wanted to highlight that because it is a gap I see and we’ve encountered, and I think it probably may make it more challenging to have a consistent flow of deals that we're putting together. Thank you.

ALISON HARWOOD

Thank you, Grace. Absolutely, the investors are the ones with the money, so if you can't do it in a way that attracts them, nothing's going to happen. Several countries have shown that countries that work this way are the ones who are more successful at getting things done. There really does need to be a separate meeting that looks at what the challenges are to moving forward, because that's what it's really about. And being able to use this as a more extensive instrument in your different markets.

With that, we will close. Thank you all very much for sharing all this information.