



# **DEVELOPMENT OF ASSET SECURITIZATION MARKET IN NAMIBIA**

Legal and Policy Challenges

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### **Disclaimer**

The author, Martin Mwinga is the fund manager of First Capital Treasury Solutions (FCTS), a fund manager specializing in mortgage portfolio management. While FCTS has an interest in the development of mortgage securitization, the opinions expressed in this paper are those of the author only and does not reflect and represent the view of FCTS.

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## **Abstract**

This paper investigates the status of asset securitization in Namibia. It reviews the institutional and legal frameworks that will govern securitization schemes, including special purpose vehicles (SPV). The development of securitization vehicles has become a major policy objective for central banks, governments, and private investors in several countries, including Namibia. Governments and central banks encourage and spearhead the development of securitization because they see these schemes as a means to an end, with the end the unlocking of funding from institutional investors, such as pension funds and insurance companies, and an increase in the flow of funds to different sectors of the economy, including housing. A well-developed and functioning securitization market provides the means to accomplish this end by bringing together the originators of assets, such as mortgage loans, with the ultimate investors, such as pension organizations.

***Keywords: Asset Securitization, True Sale, Asset Transfer, Credit, Risk, Policy, Legal Issues***

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### Abbreviations

ABS	Asset Backed Securities
BON	Bank of Namibia
CDO	Collateralized Debt Obligations
CMO	Collateral Mortgage Obligations
ECAI	External Credit Assessment Institution
FCHF	First Capital Housing Fund
GDP	Gross Domestic Product
GIPF	Government Institutions Pensions Fund
LFP	Liquidity Facility Provider
IFC	International Finance Corporation
IFRS	The International Financial Reporting Standards
IMF	International Monetary Fund
NSX	Namibia Stock Exchange
NAMFISA	Namibia Financial Institutions Supervisory Authority
RMBS	Residential Mortgage-Backed Securities
PTS	Pass-Through Securities
SPV	Special Purpose Vehicle
SPE	Special Purpose Entity
VAT	Value Added Tax
VKC	Vinod Kothari Consultants

## **Chapter 1. Introduction**

The current credit market dilemma facing Namibia where many Namibians cannot access funding for business and housing despite the country generating excess liquidity exemplifies the need for the Government to revisit the sufficiency and effectiveness of its financial sector public policies. Namibia needs to implement a systematic innovative public policy solution that will ensure and guarantee the provision of the ‘public goods’ of a minimum level of liquidity and credit channeled to sectors such as housing, agriculture, small business enterprises among other sectors of the economy (Joye and Gans 2008). The excess liquidity that the country has generated and exported to developed and other emerging markets could be channeled back in the country if attractive financial instruments such as securitization instruments (asset-backed securities) are developed and promoted by policy makers in government. Failure by government to act with a coordinated and systematic public policy response have witnessed the innovative initiatives of pension funds, fund managers and private sector at large remain scattered, uncoordinated and in most cases not aligned to government sector priorities.

In this paper, the author argues that there is a role for government to actively support the development of asset securitization to address the market failures of the type that we are seeing in the country ‘s credit market. Asset securitization offers significant benefits and tremendous opportunities for a country’s economy, in particular to lenders, investors, issuers, business organizations, and the government (Prabhakar 2010). It has emerged as a major vehicle to mobilize funds for banks and housing finance institutions and has enabled these institutions to transfer some of their portfolio risks to parties more willing or able to manage those risks. By using the securities markets to fund portions of the loan portfolio, banks can allocate capital more efficiently, access diverse and cost-effective funding sources, and better manage business risks. Asset securitization

is the process by which assets, such as loans originated by lenders (e.g., mortgage loans), are sold to investors through the issuance of asset-backed securities (ABS). Although the genesis of securitization can be traced back to the great depression of the 1930s, the modern foundations of securitization originated from developments in the residential mortgage market in the 1970s (Kendall and Fishman 1996). Securitization took off in 1971 in the United States when Fannie Mae (Federal National Mortgage Association) and Freddie Mac (Federal Home Loan Mortgage Corporation) began buying large quantities of mortgage loans from originators and bundling them into pools that could be traded like any other financial asset. This process was called securitization, and it included the issuance of mortgage-backed securities (Bodie, Kane, and Marcus, 2017).

### **1.1 Purpose and Research Questions**

This paper investigates the status of asset securitization in Namibia and reviews the institutional and legal frameworks that will govern securitization schemes, including special purpose vehicles (SPV). The main hypothesis is that Namibia's financial infrastructure, its legal and policy framework, its economy, its institutional arrangement, and the quality of assets generated enables potential originators/entities to engage in traditional securitization transactions. To test this hypothesis, the study analyzes data, evaluates laws, and evaluates regulating and governing entities that would be the main participants in securitization transactions. The paper aims to answer the question of whether Namibia is ready for securitization as well as what needs to be put in place before a full securitization program can be launched. The paper ultimately seeks to assess whether the existing legal framework governing securitization is sound and fit for the purpose. In highlighting its shortcomings, several observations are laid out. The aim is to map out how the securitization market will evolve and identify bottlenecks and constraints that may hamper a successful implementation of a securitization program.



## 1.2 Research contributions of the study

The Bank of Namibia Securitization Notice<sup>1</sup> assumes that: (a) income generating entities (originators), such as banks and non-bank institutions, can engage in securitization transaction arrangements without legal difficulty; (b) SPVs can be established by originators, without an analysis and recommendation of which legal structures/entities (trust or public companies) are best suited for these transactions; (c) the laws and regulatory environment are conducive for both originators and SPVs but are silent on which legal reforms ought to be implemented to create a functional and risk-mitigating securitization-enabling financial infrastructure; and (d) assets from originators can be transferred to an SPV without legal hassle, but also without an analysis of the appropriate asset transfer methods, the true-sale concept, and the risks that typically afflict securitization asset transfers. Many countries that have implemented securitization under these assumptions have faced legal battles and challenges and have painted a bad picture of securitization as a funding mechanism. This study also aims to provide information for policymakers and market players so that Namibia can avoid some of the mistakes and ill effects experienced by some countries that have experimented with securitization. Apart from the Bank of Namibia research report of 2008 and the Bank of Namibia Securitization Notice, there is scarce literature on securitization in Namibia. To this extent, it is one of the objectives of this study to pioneer academic study on securitization that focuses both on legal and policy issues and identifies measures necessary for the creation of a successful securitization program. The findings of this study and the answers to the research questions that are posed will provide policymakers with a

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<sup>1</sup> Bank of Namibia. " General Notice No. 493 Determination under the Banking Institutions Act, 1998 as amended: Securitization Schemes, 2019.

model and a framework to address barriers that may impede the structuring of securitization transactions and the smooth takeoff of securitization in Namibia.

### **1.3 Scope of study and methodology**

This study is narrowly focused on Namibia to audit the country's financial and legal infrastructure and make recommendations for public policy and legal reform. The paper will mainly use literature on securitization from South Africa, the United States, and different parts of the world, especially Asia and Latin and South America. This research does not seek to establish the econometric benefits of securitization, analyze the extant domestic economic conditions, or determine the optimum economic conditions necessary for effective securitization propagation. These issues are beyond the scope of this study. Due to the nature of the research subject, a desk research-based methodology has been utilized.

## **Chapter 2. True Definition of Asset Securitization and Key Players**

Lipson (2012) indicated that there are many definitions of securitization, but most of them are vague and omit one or more crucial elements of what he defines as “true” securitization. He argues that unless there is agreement on a true and correct definition of securitization, there will be different interpretations of securitization transactions by courts.

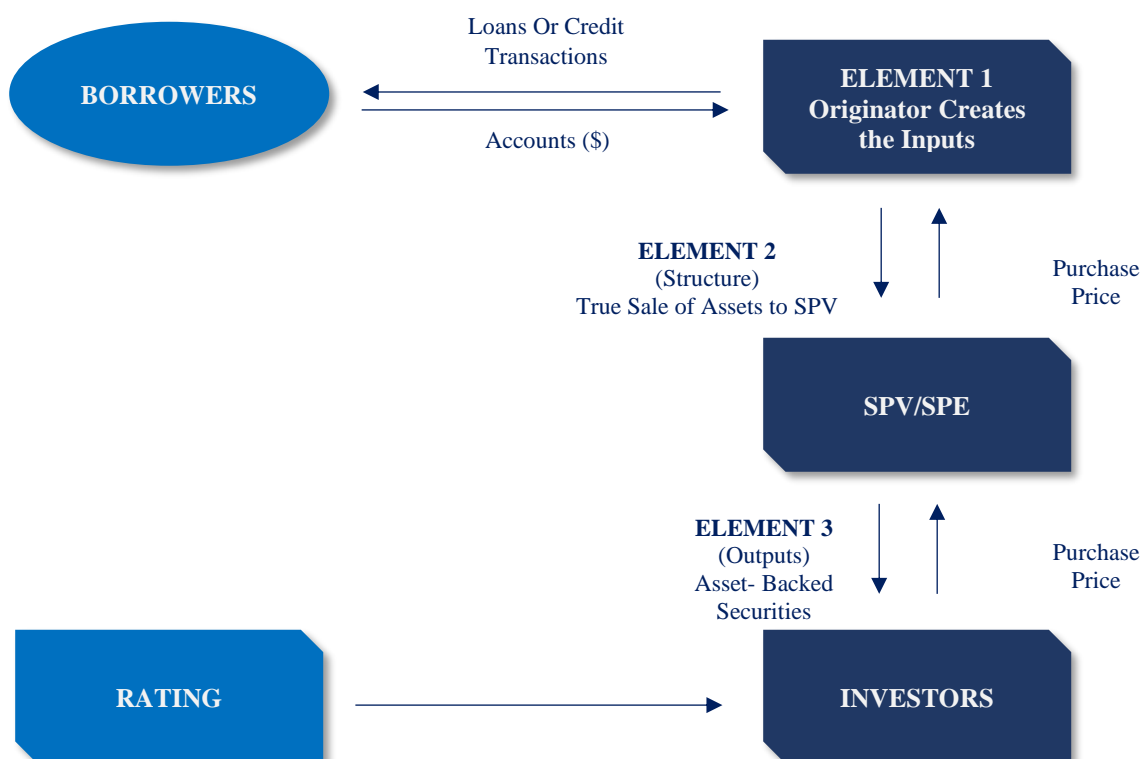
### **2.1 True Definition of Asset Securitization**

In its simplest form, asset securitization involves the pooling of groups of assets, such as mortgages, trade receivables, and consumer and student loans, and then financing them with securities that are sold to investors (OSFI 1994). Locke (2008, 15) defined securitization as the pooling of a homogenous group of income-producing assets, the sale of these assets by the original holder (originator) to an insolvency-remote third party (a special purpose vehicle or SPV), and the issuance by the SPV of marketable securities to finance the purchase of the assets. From these definitions, we can see that securitization provides a framework in which illiquid loans and assets of a lender or a financial institution are transformed into a package of securities backed by these assets and sold to investors to raise new funding for lending or balance sheet restructuring (Sundaresan 1997, 359). This definition of asset securitization is in line with the definition of the Bank of Namibia, in which asset securitization is defined as the process by which assets originally created by a banking institution or non-bank financial institution are pooled and sold to a special purpose vehicle/entity that issues marketable/tradable securities against the pooled assets (Bank of Namibia Securitization Schemes 2019).

According to Lipson (2012), a true definition of securitization would have to capture the transaction's three essential elements, namely, its inputs, structure, and outputs, as well as its capacity to connect the buyers and sellers of capital more efficiently than other methods of

financing. To this end, Lipson defined a true securitization as: “A purchase of (1) primary payment rights by (2) a special purpose entity that (3) legally isolates such payment rights from a bankruptcy (or similar insolvency) estate of the originator, and (4) results, directly or indirectly, in the issuance of securities (5) whose value is determined by the payment rights so purchased.” This definition distinguishes “true” securitizations from other transactions, such as collateralized debt obligations and other structured financings, which may satisfy current legal definitions of a securitization but which, in fact, lack one or more essential elements of securitization (Lipson 2012). The purchase of primary payment rights is the key input element of a “true” securitization and will be the account debtor’s regular obligation to repay a loan or to pay for goods or services received on credit, such as a monthly mortgage, auto loan, student loan, or credit card payment. These rights may be in existence at the time of the transfer, or they may be expected to arise in the future (Lipson 2012). The basic elements of securitization as per this definition are depicted graphically in Figure 1. The three basic, essential elements of securitization are: (a) inputs, (b) a particular structure, and (c) outputs.

**Figure 1: Securitization Structure (Elements)**



Source: Defining Securitization (Lipson 2012)

From this definition of securitization, we identify several players/participants that are critical in the securitization value chain and briefly discuss each of them.

## 2.2 Key Players in Asset Securitization

**2.2.1 The Originator/Promoter:** The originator is central to any securitization program. According to International Finance Corporation (Alfa Bank et al 2004), the originator or promoter, which could be financial institutions, corporates, governments, or municipalities, is the owner and generator of the assets to be securitized. The originator is also the seller of the assets to be securitized although this is not necessarily the case, as for instance, an entity may purchase assets from its affiliates and then act as central seller in a securitization program (Alfa Bank et al 2004). The originator creates and, in many cases, is the sponsor of the special purpose vehicle (SPV) and

also determines the assets from its portfolio to be transferred. The Bank of Namibia Securitization Notice defines ““Originator”” as ‘the institution that acts as an entity or a person who (1) through an extension of credit or otherwise, creates an asset that collateralizes an asset-backed security; and (2) sells the asset directly or indirectly to an issuing entity or Special Purpose Entity (SPE), the term originator has a similar meaning to originating entity” to the SPV. The originator is a separate legal entity from the SPV.

**2.2.2 The Special Purpose Vehicle (SPV):** The SPV is the entity created by the originator and the “purchaser” who buys the assets to be securitized from the originator. The SPV acts as a cash flow conduit, it receives payments, structures them, and passes the cash on to investors through the issuance of asset-backed securities (ABS). The agreement that is signed between the originator and the SPV is structured in such a way as to restrict the SPV from engaging in businesses other than the business stipulated in the agreement. The Bank of Namibia Securitization Notice defines an SPV or Special Purpose Entity as “a company or trust that is insolvency remote, incorporated, created, or used solely for the purpose of implementation and operation of traditional or synthetic securitization schemes”

**2.2.3 The Trustee:** The SPV is required to have a board of trustees to oversee the affairs of the entity. The trustees are responsible for overseeing the proper administration of the securities and proper processing of all payment flows to the investors. Trustees are basically appointed to look after the interests of the investors. They hold the securities in trust for the investors.

**2.2.4 The Servicer:** When receivables are securitized, the servicer (in many cases the originator) is responsible for the administration and collection of principal and interest payments on the assets and then passes them to the SPV who, in turn, pays them to investors after charging administration

and management fees. According to the Bank of Namibia Securitization Notice (2019), a Servicer is an entity that acts as a servicing agent in relation to the collection of the amounts due in terms of a traditional or synthetic securitization scheme (for a fee or charge due in terms of traditional or synthetic securitization schemes).

**2.2. 5 The Investor:** The investor is critical in securitization, and without a strong investor base, securitization cannot takeoff. The SPV which buys assets directly from the originator is not classified as an investor. The investors do not have any direct access to the assets acquired by the SPV but buy the credit portfolio in the form of securities (asset-backed securities), and this entitles the investors to receive interest payments and repayment of the principal. The investors are liable only because of the payment claims they have acquired. Investors could be individuals or other corporate bodies.

**2.2.6 The Rating Agencies:** The rating agencies play a significant role in securitization as an investor's decision on whether or not to invest is greatly influenced by the rating awarded by these institutions. These agencies analyze the quality of the assets and the structure of the transaction and award a rating for all of the asset-backed securities (ABS) that are issued. They also monitor the issue and the underlying credit portfolio and analyze the risk associated with the structure, that is, bankruptcy remoteness of the SPV. The three key rating agencies in securitization are Standard & Poor's, Moody's, and Fitch. According to the Bank of Namibia Securitization Notice (2019), "Credit rating" means a rating assigned by an External Credit Assessment Institution (ECAI) to a commercial paper issued in respect of a traditional or synthetic securitization scheme. It refers to an assessment of the credit worthiness of individual borrowers and corporations based upon their history of, but not limited to, borrowing and repayment, financial performance, profitability. In the

context of securitization, credit ratings are limited to the note issued and the assessment is conducted on the securitization structure.

**2.2.7 Liquidity Facility Provider (LFP):** An LFP provides liquidity facility in relation to certain tranches of the asset-backed securities (ABSs). The liquidity facility is provided in conduit transactions in which the SPV issues revolving short-term commercial paper to fund the purchase of the assets. The SPV or purchaser may draw upon the liquidity facility if it is unable to refinance maturing commercial paper because of a market disruption. In such a case, the liquidity facility secures commercial paper investors against a default. According to the Bank of Namibia, “Liquidity facility” means a facility provided with respect to a traditional or synthetic securitization scheme to cover deficiencies in cash flow within the said securitization scheme(s), resulting from, amongst other things:

- a) Time difference between the payment of interest and principal on assets transferred, or other payments due in terms of a traditional securitization scheme, and payment in respect of the senior commercial paper, or
- b) Time difference between the payment of interest and principal on assets that serve as collateral, purchased in terms of a synthetic securitization scheme, and payment in respect of the senior commercial paper; or
- c) Market disruption: or a combination of any of the matters specified above, and where the liquidity facility does not constitute a credit-enhancement facility.

**2.2.8 Qualifying Assets:** The assets to be securitized may include a variety of receivables, such as residential mortgages, commercial mortgages, credit loans, student loans, vehicle loans, lease receivables, and hire purchase receivables. The Bank of Namibia Securitization Notice (2019, 3) defines Assets as follows: “for the purpose of securitization transaction assets are defined as those



assets with generally predictable revenue streams or similar features and can be transformed into a marketable debt security. These assets can for example take the form of mortgage loans, auto loans, credit cards, trade receivable and other loans.”

**2.2.9 Credit Enhancement Facility:** Credit enhancement in securitization transactions is a strategy for improving the credit risk profile of the underlying portfolio that is transferred to the SPV in order to obtain better terms from rating agencies. It reduces the default risk and helps to protect a transaction against potential losses in the underlying assets of the SPV. Credit enhancement also allows securities backed by a pool of collateral (such as mortgages or credit card receivables) to absorb losses from defaults on the underlying loans. According to Bank of Namibia, “Credit enhancement facility” means any facility or arrangement in terms of which the provider of such facility or obligor under the arrangement is obliged to absorb losses associated with:-

- a) The assets transferred in terms of a traditional securitization scheme.
- b) The risk transferred in terms of synthetic securitization schemes; and
- c) Include both a first-loss credit-enhancement facility and a second-loss credit enhancement facility.

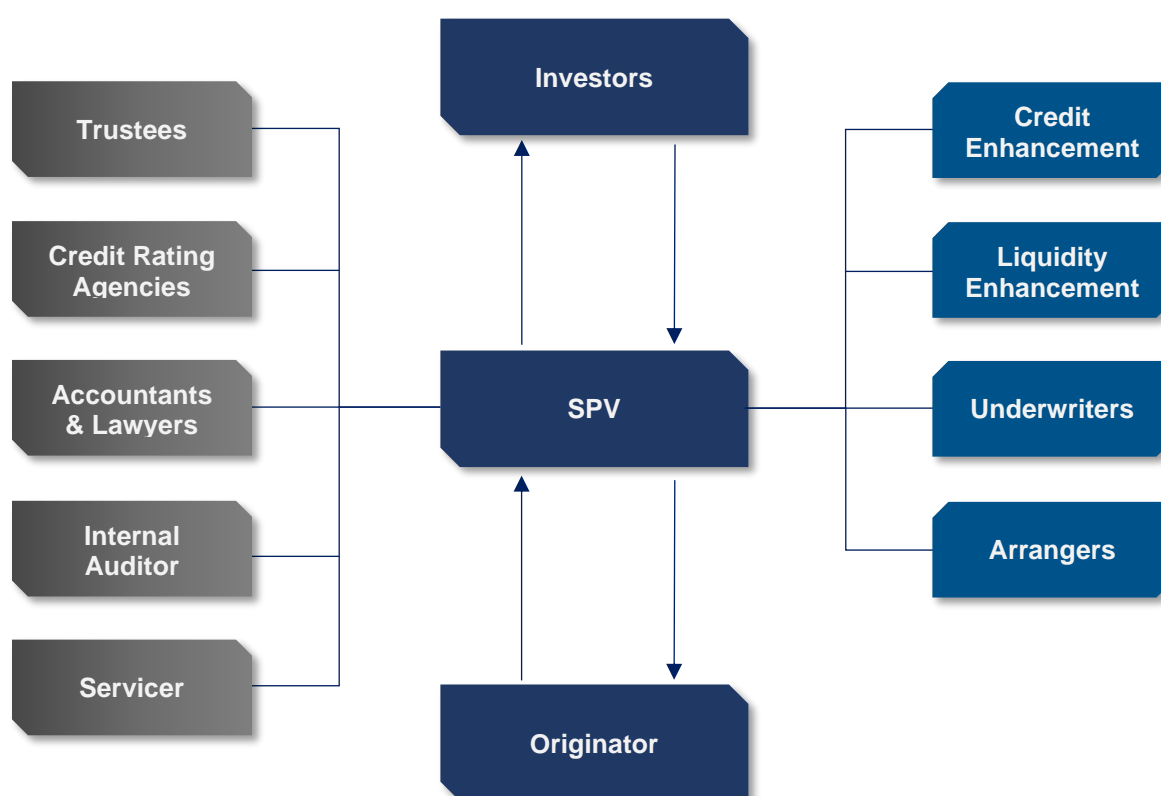
**2.2.10 The accountants:** Accountants are important in the securitization process because they provide audit reports and financial statements of the SPV.

**2.2.11 The Internal Auditor:** The Bank of Namibia Securitization Notice (2019) makes it compulsory for an SPV to have an internal auditor.

**2.12 The Lawyers:** The lawyer plays a significant role in securitization which ranges from giving advice on regulatory and legal matters, creating the structure, preparation of legal documents, ensuring compliance with regulatory requirements, etc.

The players in a securitization transaction are captured in Figure 2 and are a requirement as per the Bank of Namibia Securitization No. 900.

**Figure 2: Bank of Namibia Proposed Securitization Structure**



Source: Author's own design based on Bank of Namibia Securitization Notice (2019)

### **Chapter 3. Overview of Asset Securitization in Namibia**

The Namibian Government through the gazetting of the Securitization Notice of 2019 identified asset securitization as a key strategic initiative to further develop and deepen the country's capital market. The concept of asset securitization is relatively new in Namibia, and as of June 2021, no formal asset securitization transactions were recorded nor were asset-backed securities (ABS) issued or listed on the Namibia Stock Exchange (NSX); there were also no formal regulatory guidelines for asset securitization in Namibia. The government of the Republic of Namibia signaled its intention to introduce a securitization program with the gazetting of the securitization law in November 2019. Unlike other countries where a separate and standalone law governs securitization schemes, securitization in the Namibian market will be governed by the regulations published under the Namibia Banking Institution Act 1998 (Act No. 2 of 1998), as amended in Government Notice No. 378 of 2019 (Determination on Securitization Schemes [BID-32]). Provision is made in this securitization regulation to exempt a non-bank financial institution and a special purpose vehicle (SPV) from the obligation to register as a bank to participate in a securitization program.

The promulgation of the securitization framework is in line with the demands from market players and concerns expressed by the International Monetary Fund (IMF) about rising debt levels and rising impairments in Namibian banks. According to the IMF, the banks are running a risk of crashing the economy of Namibia in the event their indebtedness and impairment reaches critical levels and a liquidity crisis erupts (Lund and Härle 2017). Considering this, it is the responsibility of the Government of Namibia to allow securitization as a funding and a risk management tool. The Bank of Namibia securitization guidelines are foundational in that they set out the broad framework for asset securitization in the country, specifically:

- Describes the asset securitization process or value chain.
- Describes the role and obligations of all key participants, such as originators, SPV, Servicer, credit enhancement, and liquidity facility providers.
- Establishes baseline criteria for true sale, SPV construction, credit enhancement, liquidity provision, underwriting, representations, warranties, etc.
- Defines prudential norms for investments in securities issued by SPV
- Sets out accounting treatment and income recognition norms Sets out disclosure requirements for all the parties

### **3.1 The Performance of Namibia's Capital Market**

The existence of a robust primary market for originating assets and a well-functioning bond market is a prerequisite for securitization. IFC (1994) points out that the key requirements for successful implementation of a securitization program in a country is the existence of a primary market for assets, such as mortgage loans, to be securitized. Pinto (2014) pointed out that the volume of securitized assets in a population can also determine the demand for securitization of mortgage assets. In his paper “The Economics of Securitization: Evidence from the European Markets,” he notes that the volume of securitized assets is what indicates a good market for securitization. In a country where securitization is legal and practiced but the volume of securitized assets is low, investors view the situation as an indicator of the poor performance of the industry. Consequently, they decide against investing in the country which contributes to driving the market's downfall. With respect to this factor, the Government can play a role in driving the market by enabling conditions that will incentivize an increase in the volume of securitized mortgage assets.

Namibia's capital market is divided into two segments: the fixed income (the bond market) and the stock market. Financing through the capital market has risen significantly since the establishment of the Namibia Stock Exchange in 1992. The domestic capital market for both bonds and equity has grown significantly over the past two decades. Table 1 below presents data on the number of listed companies and market capitalization and presents the size and growth of the bond market. The number of listed companies in 1995 stood at 23 with market capitalization of N\$689 million. By 2020, the number of listed companies on NSX increased to 51 with a market capitalization of N\$27.4 billion. The bond market has also registered phenomenal growth over the same period with the market value of the bonds issued increasing from N\$942 million in 1995 to N\$46.4 billion in 2020 (Table 1). Although there are pockets of private sector bonds that were issued, government bonds account for close to 90% of the value of the bonds issued. This is in line with rising government deficits and a total debt that increased from around 10% of GDP in 1995 to 55% of GDP in 2020. The importance of capital market funding in Namibia is also captured in Table 1 which shows that the share of the nominal value of shares plus bonds as a percent of GDP rose from 11% in 1995 to 42% in 2020.

**Table 1: The growth of stocks and bonds on the Namibia Stock Exchange (NSX)**

<b>Year</b>	<b>Number of Listed Companies</b>	<b>Market Capitalization Value N\$</b>	<b>Market Value (Bonds) N\$</b>	<b>GDP N\$</b>	<b>Nominal Value (Shares &amp; Bonds) as % of GDP</b>
1995	23	689	942	<b>14 300</b>	11%
1996	29	2 215	1 045	<b>16 962</b>	19%
1997	38	3 354	1 212	<b>18 905</b>	24%
1998	40	2 515	1 878	<b>21 154</b>	21%
1999	41	4 258	1 933	<b>23 332</b>	27%
2000	36	2 356	2 169	<b>26 607</b>	17%
2001	37	1 805	2 695	<b>29 929</b>	15%
2002	35	1 728	3 018	<b>34 528</b>	14%
2003	35	2 054	3 527	<b>36 401</b>	15%

2004	32	2 212	4 832	<b>41 862</b>	17%
2005	28	2 630	5 727	<b>45 287</b>	18%
2006	28	3 819	6 738	<b>53 055</b>	20%
2007	27	4 781	5 782	<b>61 583</b>	17%
2008	29	5 720	5 985	<b>70 111</b>	17%
2009	33	7 126	6 667	<b>75 214</b>	18%
2010	33	7 782	5 988	<b>82 599</b>	17%
2011	32	9 304	8 147	<b>90 108</b>	19%
2012	33	11 057	9 236	<b>106 863</b>	19%
2013	34	19 501	10 891	<b>117 423</b>	26%
2014	38	22 322	12 485	<b>134 836</b>	26%
2015	41	29 430	15 330	<b>146 019</b>	31%
2016	42	32 017	24 791	<b>157 708</b>	36%
2017	44	36 018	28 400	<b>171 570</b>	38%
2018	44	35 406	32 703	<b>181 054</b>	38%
2019	49	36 508	38 053	<b>181 555</b>	41%
2020	51	27 440	46 443	<b>176 327</b>	42%

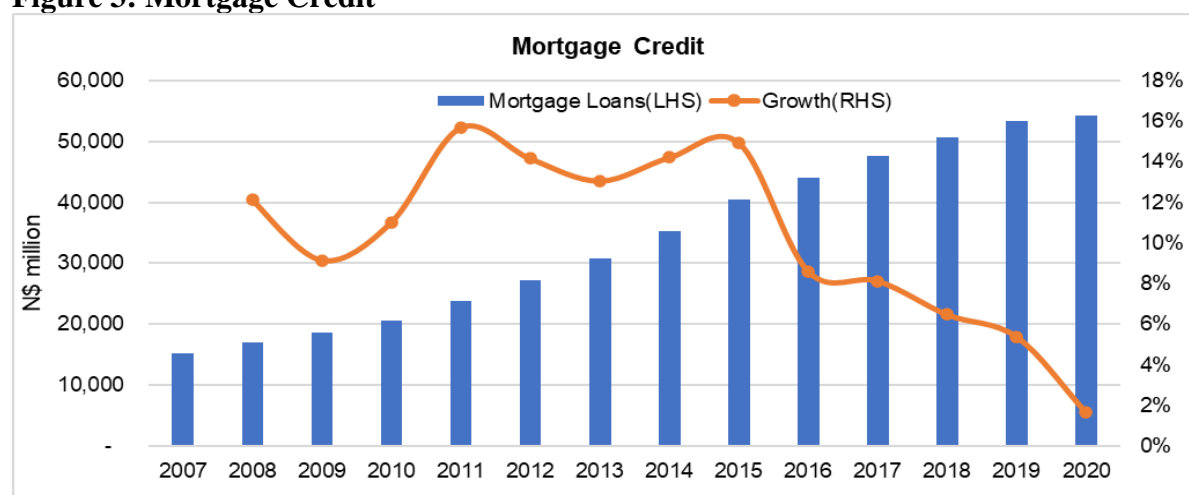
The holders (investors) of the instruments (bonds and shares) presented in Table 1 are non-bank financial institutions, such as insurance companies and pension funds. Table 2 presents the growth in assets of institutional investors (pension funds and insurance companies). The Table shows that over the past eleven years, the assets of non-bank financial institutions (NBFIs) have grown substantially. Pension fund assets more than tripled from N\$55.9 billion in 2009 to N\$180.5 billion in 2020. Long term and short-term insurance assets stand at N\$61.7 billion and N\$6.1 billion in 2020, respectively, from N\$22.5 billion and N\$1.9 billion in 2009. Medical fund assets stood at N\$2.4 billion in 2020 from N\$523 thousand in 2009. Currently, 90% of the bonds held by institutional investors in Namibia are government bonds due to a limited supply of private sector bonds. The introduction of securitization in Namibia will enable institutional investors to diversify their asset holdings and help reduce the portfolio concentration risks to which these entities are currently exposed.

**Table 2: Non-Banking Financial Institution Assets (Investor Base)**

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Pension funds	55,870	63,903	69,478	85,757	105,267	119,569	133,089	137,462	152,885	158,528	173,427	180,526
Growth		14%	9%	23%	23%	14%	11%	3%	11%	4%	9%	4%
Long-term insurance	22,489	25,158	26,736	31,654	36,424	40,224	44,746	47,554	53,934	56,640	60,165	61,681
Growth		12%	6%	18%	15%	10%	11%	6%	13%	5%	6%	3%
Short-term insurance	1,949	2,357	2,624	3,002	3,461	4,749	5,587	5,769	6,233	6,540	6,830	6,056
Growth		21%	11%	14%	15%	37%	18%	3%	8%	5%	4%	-11%
Medical aid fund	523	674	768	858	1,002	1,162	1,360	1,445	1,772	1,933	2,028	2,359
Growth		29%	14%	12%	17%	16%	17%	6%	23%	9%	5%	16%

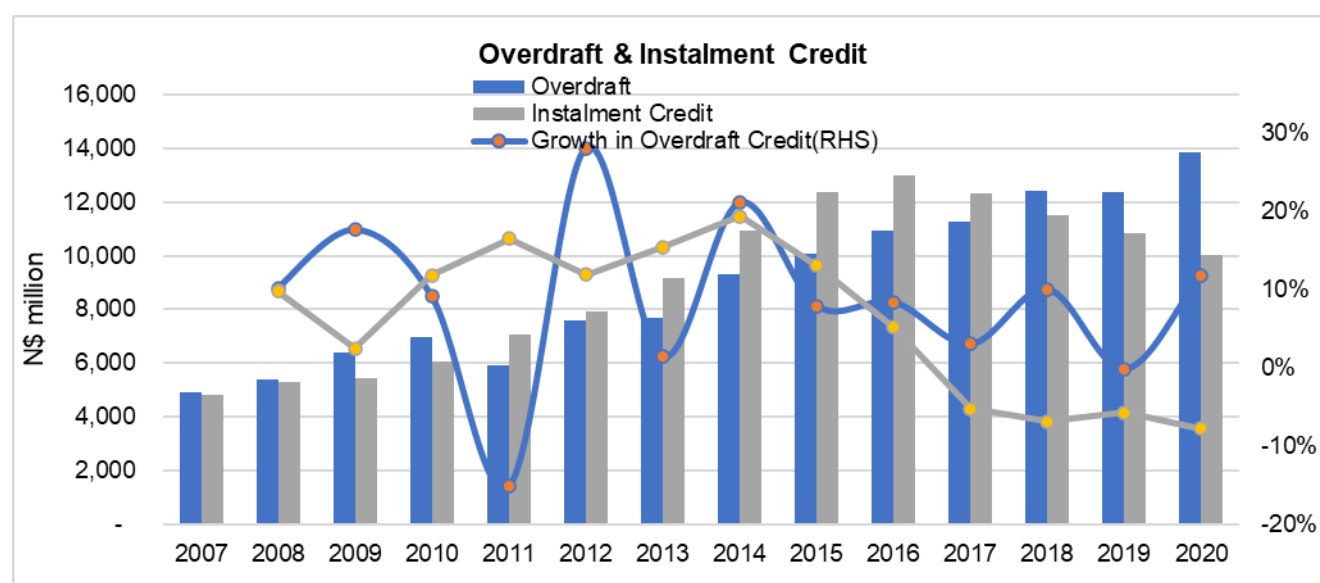
Source: NAMFISA and Bank of Namibia

As mentioned previously, without a growing primary market for assets, such as mortgage loans, credit cards, student loans, and other receivables, securitization cannot be viable. We next present the size and growth in these assets. Despite its small population, Namibia's mortgage market is larger than countries in Africa that have large populations, such as Nigeria and Ghana. Figure 3 shows outstanding mortgage credit with banks. Total mortgage loans outstanding in 2007 stood at N\$16 billion, and by 2020, mortgage loans outstanding reached N\$55 billion. Namibia seems to have a healthy and profitable mortgage market that has attracted huge capital inflows into the sector within a short period of less than fifteen years. This increased demand for mortgages is currently met by commercial banks and is mainly funded from their short-term deposits.

**Figure 3: Mortgage Credit**

Source: Bank of Namibia

Figure 4 presents total outstanding overdraft and installment credit which have grown from N\$4.8 billion and N\$4.9 billion, respectively, in 2007 to N\$13.8 billion and N\$10 billion in 2020. Over this period, the growth in overdraft credit exhibited a high volatility relative to installment credit. Over the same period, the trend of installment credit, largely made of vehicle financing installments, tracked economic cycles.

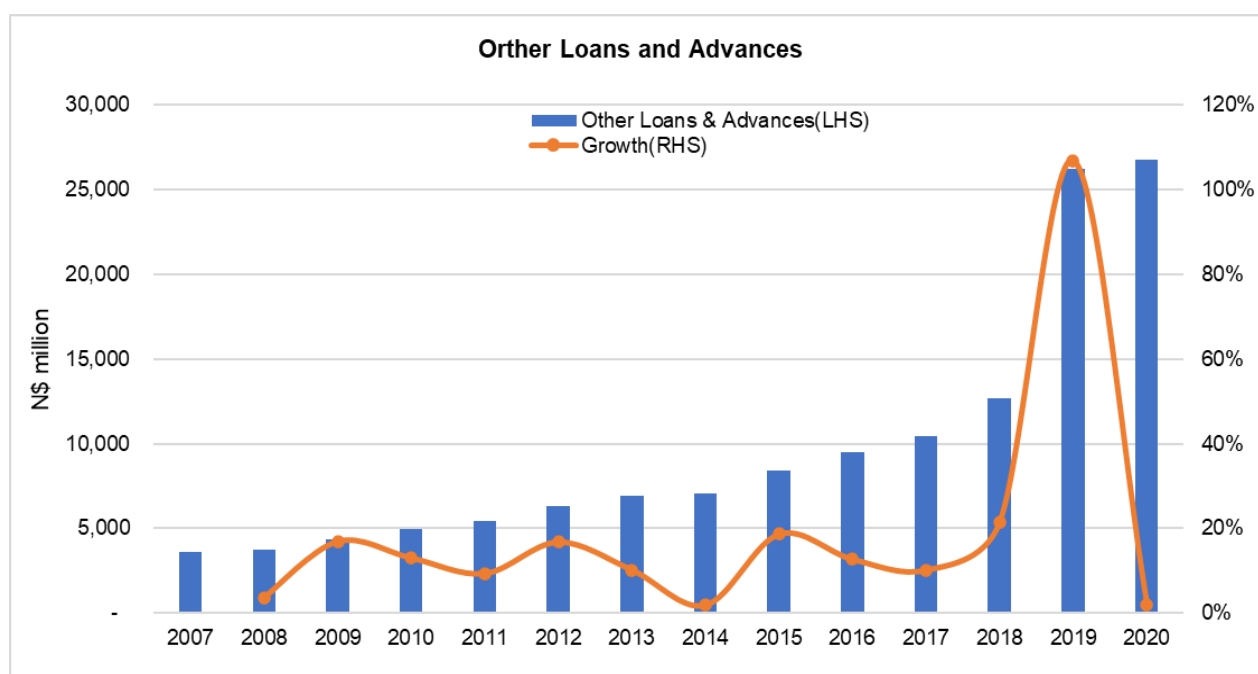
**Figure 4: Overdraft and Installment Credit (Vehicle Loans)**

Source: Bank of Namibia



Figure 5 presents the total outstanding of ‘other loans and advances,’ mainly composed of credit cards and personal and term loans which have grown steadily since 2007 (N\$3.6billion), reaching N\$12.6 billion in 2018 before a spike in growth of 107% in 2019 as businesses showed a strong appetite for these credit lines as opposed to mortgage and other types of credit lines. After a sharp increase in 2019, this credit category stabilized in 2020, closing at N\$26.7 billion.

**Figure 5: Other Loans and Advances Credit (Credit Cards)**



Source: Bank of Namibia

All in all, it appears that Namibia has a sizeable and growing primary market with assets that are eligible for securitization.

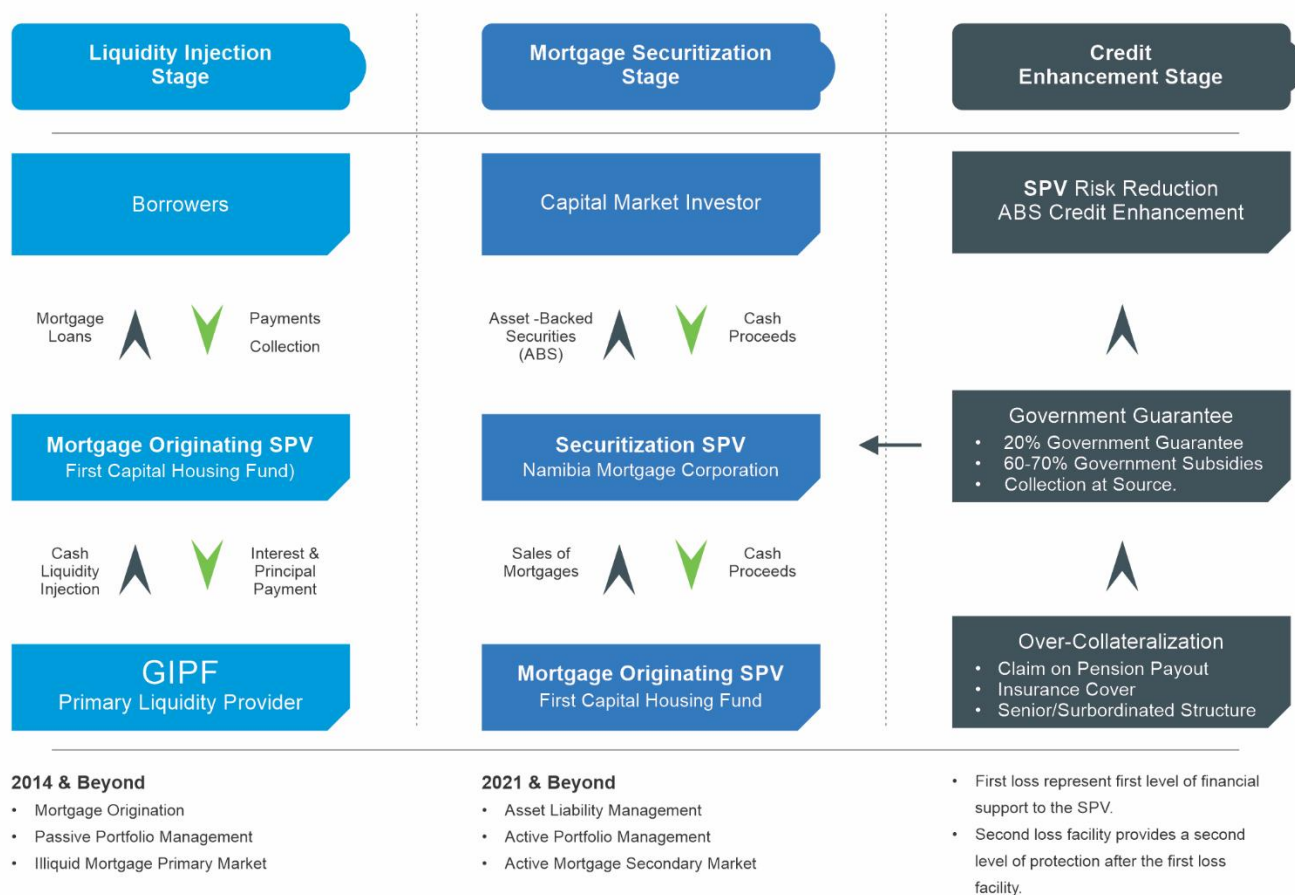
### 3.2 Case Study: The GIPF Mortgage Securitization Model

*Even though Namibia does not have a legal framework governing asset securitization, the market has experimented with the securitization concept through the establishment of special purpose vehicles (SPVs), with the Government Institutions Pension Fund (GIPF) at the forefront of this process. Although the GIPF has created many SPVs and structured products that have features of a securitized product, this paper will only focus on the GIPF's mortgage special purpose vehicle which was created to channel long-term pension savings into the housing market. In 2011, the GIPF invested and established an SPV called First Capital Housing Fund (FCHF) with the sole mandate of building a portfolio of mortgages and then creating a secondary market for mortgages in Namibia.*

*In addition to originating home loans, one of the key objectives of FCHF (SPV) is to “Develop an active secondary market for residential properties through mortgage securitization (issuance of residential mortgage-backed securities) to ensure that long-term funding from pension funds and other long-term investors are channeled to the residential property market especially low-income groups.” The GIPF is contributing to the building of a sustainable mortgage finance system in Namibia through a three-legged mortgage business model that encompasses a liquidity model, a securitization model, and a credit enhancement model to promote home ownership (Figure 3). By directly participating in the primary mortgage market by injecting liquidity, the GIPF closes the funding gap and accommodates mortgage borrowers who are not accommodated by commercial banks. The liquidity model provides liquidity facilities to mortgage lending institutions to facilitate the flow of funds to the primary mortgage market. Currently, GIPF channels funds through FCHF, which originates and builds a portfolio of mortgage loans that will be used in the securitization phase. The trust deed that established*

*FCHF makes provision for the creation of a mortgage securitization SPV that cannot be activated due to the absence of a legal framework for securitization schemes. With the gazetting of the securitization notice in 2019, the GIPF mortgage securitization process can now move from the liquidity model to the securitization model as presented in Figure 3. In the securitization leg, the mortgages originated by FCHF will be sold to the new securitization SPV called Namibia Mortgage Corporation (NMC). NMC does not yet exist but is used for the sake of this paper. The SPV (NMC) will, in turn, issue mortgage-backed securities or mortgage bonds to the market in which investors in the capital market will participate and will inject more liquidity into Namibia's housing market. The securitization leg provides funds to FCHF and other primary market lenders to lessen their dependence on the GIPF which provides initial liquidity and also provides an exit route for itself in the event it wants to exit the mortgage market. The third leg of the GIPF securitization model is credit enhancement (Figure 3). Credit enhancement is provided by a government guarantee to home loan lenders to reduce credit risk and the probability of defaults. This is in line with the Bank of Namibia Securitization Notice that requires a securitization transaction to have credit enhancement measures to improve the credit ratings of the SPV.*

**Figure 6: GIPF Housing Finance and Mortgage Securitization Model**



## **Chapter 4. Requirements for a Successful Asset Securitization**

While the idea of securitization as a means of improving the health and efficient functioning of any economy seems attractive to the market and policymakers, it is important to remember that it first requires certain infrastructure to be in place before it can be successfully implemented. Davis (2000) identifies two conditions that are required for successful implementation of asset securitization, namely, (a) a robust financial infrastructure and (b) strong investor demand.

### **4.1 A Robust Financial Infrastructure**

According to Davis (2000), a country's financial infrastructure comprises the legal environment, the regulatory environment, the accounting environment, the taxation environment and the back-office systems. The first and the most basic requirement for a successful securitization program is a robust financial infrastructure capable of protecting the interests of the investors and enables the efficient transfer of assets from the originator to the SPV (Davis 2000). The financial infrastructure must include enforceable security interests (registration and foreclosure), transferable security interests (ability to sell the loan), and an ability to create structures such as trusts that are bankruptcy remote and tax efficient. Davis (2000) further advised that a robust financial infrastructure is critical to the success of securitization because it encompasses key environmental requirements, one of which is a legal environment that ensures a true sale.

The true sale is at the heart of any securitization scheme, and the legal system in Namibia will also need to determine when a true sale has taken place. In their research paper, Rajapakse and Senarath (2019) wrote that a framework in which a true sale is distinguishable from the financing of assets will protect the investor from the damages realized due to insolvency of the individuals or entities servicing the original loans. Such a law will ensure the safety of all parties involved and, as a result, give them a legal avenue to pursue their rights to compensation. A robust financial

infrastructure also creates the favorable regulatory environment required for successful privatization to occur. As part of the regulatory environment, Schwarcz (2017) advised that a country requires the right regulations that govern company information, corporate governance, financial reporting, securities laws, and the establishment of trustees. A robust financial infrastructure must provide the country with a comprehensible taxation environment, which is important to securitization. In his essay, García (2020) warned that the taxation environment will need to allow for the taxation of profits earned on the income generated during the securitization process.

#### **4.1.1 The Legal and Regulatory Environment**

Davis (2000) pointed out that there are key aspects that a legal system is required to have before it is considered capable of allowing any transaction concerning securitization. The first requirement is that the legal system must restrict the securitization of assets to only those that can be sold and transferred from the originator to the SPV. Second, the legal system is required to be able to control the process of a true sale. Effectively, a legal system should ensure that once a true sale takes place and the assets have been transferred, they cannot be reversed or affected by the insolvency of the originator (Rajapakse 2011). Third, according to Green (2013), the legal system is required to provide a framework that enables a smooth and simple transfer of assets. Green warned that a legal system that causes cumbersome securitization transactions reduces the scope of securitization which, in turn, has the potential for lawsuits among the investors based on unfair competition.

Roever and Fabozzi (2003) also contributed to the issue by advising that a legal system should allow the purchaser to enforce his or her ownership rights. Once purchased, the assets or securities should be legally fully owned by the new owner, and the new owner should be allowed the freedom to appoint another backup servicer if need be. In doing so, the law will protect the purchaser from

interference from the outside and dictation on how to manage the securities. Moreover, the law should allow the parties involved in the transaction to mitigate the risk involved, appoint, and install a security trustee, as well as to provide a credit arrangement.

This section discusses a wide array of legal, regulatory, tax and accounting issues which may, if not well-addressed, inhibit and impede the smooth take off of asset securitization program in Namibia. In countries such as Malaysia, South Korea, and India, the absence of an efficient, facilitative, and transparent legal, regulatory, tax, and accounting framework in the initial stage caused a delay in the smooth takeoff of the asset securitization market. The absence of a robust legal, tax, and accounting framework causes the structuring of such transactions to be high risk and inefficient and necessitates the revision of and amendments to various laws due to legal interpretations and rulings by courts on securitization transactions. For asset securitization to be successfully implemented, there are three steps that must be understood by both policymakers and market participants. These steps represent stages designed to usher in the implementation of securitization as a whole and have all the involved players ready for the transactions between the parties involved. In this chapter, the three stages that serve this purpose will be elaborated to understand their importance to the entire process of the securitization value chain. The impediments faced in securitization can be categorized based on the three key stages of a securitization transaction:

Stage 1: Prior to the transfer of assets by originator to SPV.

Stage 2: During the process of asset transfer from the originator to SPV; and

Stage 3: When issuing asset-backed securities (ABS).

### **Three Stages of a Securitization Transaction (Legal and Regulatory Challenges)**

The impediments faced in securitization can be categorized based on the three key stages of a securitization transaction, which are:

Stage 1: Prior to the transfer of assets by originator to SPV.

Stage 2: During the process of asset transfer from the originator to SPV; and

Stage 3: The issuance of asset-backed securities (ABS).

#### **Stage 1: Prior to the transfer of assets by the originator to SPV.**

In a securitization transaction, there are contractual agreements and legal and regulatory issues that may prohibit the originator to sell, dispose of, or transfer the assets to the SPV without prior written approval from regulatory bodies. In addition, the originator may fall under multiple supervisory authorities so that permission and approval may be required from all to dispose of its assets to an SPV. In countries like Malaysia, it was seen that interest in securitization may wane rapidly if the approval process is lengthy as it affects the ability of an originator to raise funds quickly via asset securitization.<sup>2</sup> Before assets on the balance sheet of the originator are transferred to the SPV, these assets or receivables must be generated and owned by an operational business organization, which can be a financial institution or a registered company (originator). Receivables that can be securitized can arise from different financial obligations, including settling debts from payments owed on loans or goods bought on credit.<sup>3</sup> In the case of mortgages as assets to be transferred, the originator will have entered into a contractual agreement with the property owner or borrower and

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<sup>2</sup> RBI releases the Report of the Committee on the Development of Housing Finance Securitisation Market, September 2019.

<sup>3</sup> RBI releases the Report of the Committee on the Development of Housing Finance Securitisation Market, September 2019.



there might be clauses in the contract that may prohibit the sale or transfer of those receivables to another entity, in this case, the SPV.

Lack of transparency is one of the regulatory issues that is experienced before the transfer of assets by the originator to the SPV. SPVs are complex and are characteristically presented in the forms of layers over layers of various securitized assets, and this nature often presents the challenge of monitoring and tracking.<sup>4</sup>

In such a case, the clarity of the level of risk involved and who owns it must be identified. The other regulatory issue is that the credit quality perceived by the firm (originator) may be flawed by the underperformance or a default record by an associated sponsored SPV.<sup>5</sup> This issue makes it an unworthy risk for the firm to abandon the SPV when difficulties are experienced. A signaling issue is also witnessed in some cases as the underperformance of collateral in an SPV leads to a high level of scrutiny and poor perceptions regarding the quality of the firm. The organization's balance sheet can also be discredited based on similar speculations. The franchise risk in an affiliated SPV is also a regulatory issue that investors disapprove, affecting the relationship between the sponsors and potential investors who may pose as the holders of unsecured debt.<sup>6</sup> The liquidity and funding risk is another issue that denotes that the flawed performance of an affiliated SPV may jeopardize the firm's access to capital markets.

Regulatory issues witnessed before the transfer include that the overall regulatory standards are inapplicable to assets within the jurisdiction of an SPV compared to the assets of the firm recorded on its balance sheet.<sup>7</sup> This is one of the primary reasons why many firms consider such vehicles.

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<sup>4</sup> Buur, Lars, Steffen Jensen, and Finn Stepputat. *The security-development nexus: Expressions of sovereignty and securitization in Southern Africa*. Nordiska Afrikainstitutet; HSRC Press, 2007.

<sup>5</sup> Report of the Committee on the Development of Housing Finance Securitisation Market

<sup>6</sup> Buur, Lars, Steffen Jensen, and Finn Stepputat.

<sup>7</sup> Odhiambo, Ojijo, and John E. Odada. "Effects of zero rating value added tax on government revenue in Namibia: A partial equilibrium analysis." *African Journal of Economic and Management Studies* (2015). 23

However, this kind of regulatory practice portrays laxity; hence, it poses an indirect risk to the originator. Poor risk management and misunderstanding in transferring assets from the originator to the SPV is a common factor that has instigated strict regulations in the last three decades.<sup>8</sup> Some of the large profile failures include Tower Financial in 1994, Enron in 2001, Bear Stearns in 2008, and Lehman Bros in 2008.<sup>9</sup>

Due to such high-profile failures, recent regulatory changes seek to address whether SPVs should be combined and recorded on or off balance sheets with respect to the accounting standards used. Vinod Kothari Consultants (VKC), an internationally consultant on housing finance, securitization, and credit derivatives has argued that what will distinguish securitization from collateralized lending is that it allows the investors a privileged, preponderant right over the assets being securitized.<sup>10</sup> According to the VKC, the genesis of securitization lies in giving the investors rights over specific assets of the originator such that the investors are not affected by the performance or bankruptcy of the originator. This would obviously necessitate that the investors or the SPV as a conduit on behalf of the investors has legally acquired the assets. The legal methodology of the "transfer" of assets is achieved by a sale of the subject assets, and if the asset is receivables, such transfer is often called an assignment (Kothari, Vinod, 2021). The question of how assets should be transferred from the originator to the SPV is answered next. According to the VKC (2021), the transfer of assets from the originator to the SPV could be by way of:

- **novation**, that is, alteration in the terms of the original contract with the obligor (borrower).

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<sup>8</sup> Wittinghofer, Sandra and McKenzie, Baker. "Structured finance and securitisation in Germany: overview." 2017.

<sup>9</sup> Report on asset securitization in Malaysia: The way forward for the Malaysian Market by Asset Securitisation Consultative Committee (ASCC) in collaboration with the Securities Commission, November 2002, Malaysia.

<sup>10</sup> Vinod Kothari Consultants: Asset Securitisation, September 2021, India.

- **participation**, that is, the creation of a right in favor of the transferee in the proceeds of the assets.
- **assignment**, that is, full legal transfer. To achieve full legal transfer, the proper method is assignment or sale. In order for the assignment to be regarded as a proper sale or legal transfer, it must comply with some conditions which differ from jurisdiction to jurisdiction.

The VKC advises that as the assignment or sale is made, mostly in respect of receivables which is a right against a third party, the following legal problems may be faced depending on the jurisdiction involved:

- notification to the obligors/consent of the obligors (borrowers)
- stamp duty/transfer duty

**What kind of receivables can be the subject of a true sale?** Kothari. Vinod (2021) helps to answer this question as follows: “First, the local legal framework may have provisions and clauses that help answer this question. However, common international practices in securitization transactions normally require that the receivables or assets should **be existing and identifiable for a true sale to take place**. Sale of future receivables may take place as a promise to sell in the future. Sale of unidentifiable receivables might only create an interest in a pool of receivables but not transfer the receivables.”

**What if a transfer is not a true sale?** In answering this question, the VKC points out that the consequences of a failure of the transfer to be recognized as a true sale could be really disastrous.

If the transfer of assets for the benefits of investors is not a true sale, it might mean:

- the investors in securities issued by the SPV are unsecured lenders.
- the transfer is regarded as creating a security interest in favor of investors; thus, the investors are secured lenders; and

- worst of all, since the transaction would not have been backed by loan documentation, the investors may not be regarded as lenders as well, meaning they might only have an equitable right to recover their money but would not stand as unsecured lenders.

**Does the law governing securitization in Namibia allow the transferability of assets from the originator to the SPV?** According to Umarji (2017), a loan given by a bank with securities obtained for a loan is property under the general principles of contract law, and such property is transferable. It is permissible in the law to settle such property in trust for the benefit of investors, who decide to invest fully in that property or in a share of that property (Umarji 2017).

Securitization can be costly if not well understood and structured. Prior to the transfer of assets by the originator to an SPV, proper research must be done to ensure that the envisaged securitization transaction will create wealth for the originator. Failure to do this will create additional complications for the business model of the originator. Securitization is attractive for investment bankers and advisors due to fees charged but it can be costly and less profitable to the originator if not well structured. Thus, prior to the transfer of assets, originators need to be well-informed on the cost implications of the securitization in which they plan to engage.

## **Stage 2: During the process of asset transfer from the originator to the SPV**

This stage is the most critical and complicated stage with the transfer of receivables or assets from the originator to the SPV forming the cornerstone of any asset securitization transaction. During the process of asset transfer from the originator to the SPV, the transaction is structured to serve a special purpose according to the agreement between the originator and the SPV. The standard securitization structure follows clearly defined criteria that reciprocate risk exposure to the fundamental receivables and is commonly pursuant to the actual sale of the receivables to the

designated SPV.<sup>11</sup> The originator is the party who initiates and facilitates the entire process of securitization. The originator also initiates the establishment of the SPV and, in most cases, mandates the organizer to set up the structure for how the transaction should be implemented and directs the investors on how to acquire the bonds that define the SPVs secured liabilities.<sup>12</sup> The various pieces of laws which affect the transfer of assets broadly cover insolvency, assignment, and registration issues. In this section, we review the implications of some of the existing laws that may impede securitization, including the Bank of Namibia Securitization Notice, the Companies Act, the Namibia Competition Act, the Insolvency Act, and the Income Tax Act.

#### **(a) Bank of Namibia Securitization Guidelines on the SPV and True Sale**

Securitization schemes in the Namibian market will be governed by the regulations published under the Namibia Banking Institution Act 1998 (Act No. 2 of 1998), as amended in Government Notice No. 378 of 2019 (Determination on Securitization Schemes [BID-32]). Provision is made in this securitization regulation to exempt a non-bank financial institution and a special purpose vehicle (SPV) from the obligation to register as a bank to be able participate in a securitization program.<sup>13</sup> An SPV is founded on the legal jurisdiction of its mandate, which is usually securitization. In such cases, the jurisdiction will direct that an SPV be established as a thinly capitalized organization or a partnership entity, which is an entity with low equity capital compared to a debt ratio.<sup>14</sup> Although the SPV is established by the originator, the Bank of Namibia securitization notice guidelines provide for criteria to be met by the SPV to ensure that it is

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<sup>11</sup> Cummins, J. David.

<sup>12</sup> Lahny IV, Peter J. "Asset Securitization: A Discussion of the Traditional Bankruptcy Attacks and an Analysis of the Next Potential Attack, Substantive Consolidation." *Am. Bankr. Inst. L. Rev.* 9 (2001): 815.

<sup>13</sup> Bank of Namibia. "General Notice No. 493 Determination under the Banking Institutions Act, 1998 as amended: Securitization Schemes, 2019.

<sup>14</sup> Wittinghofer, Sandra and McKenzie, Baker. "Structured finance and securitisation in Germany: overview." 2017.

independent of the originator. The following are the criteria to be met by the SPV to ensure that it is independent of the originator:

- The SPV cannot bear any name which may imply any connections or relationship with the originator of assets sold to the SPV.
- In other countries, the originator cannot hold shares in the SPV. However, the BoN guidelines direct that the originator cannot “directly or indirectly acquire or hold any equity share capital in an SPV of which the nominal value represents 20 percent or more of the nominal value of all the issued equity share capital in the Special Purpose Entity.”<sup>15</sup>
- The SPV is established for the sole purpose of holding the assets bought from the originator for the sole benefit of the investor.
- The SPV is prohibited from engaging in business not expressly contemplated under the transaction documents and is not permitted to form or own a subsidiary.
- The SPV must maintain separate books and records, pay liabilities and expenses from its own funds, and maintain separate bank accounts.
- The SPV must conduct business with the parent company and its affiliates or asset originator on an arm's-length basis.

The Bank of Namibia securitization guidelines lay down stringent criteria for recognizing the sale of assets as a true sale. For a true sale in a securitization transaction to take place, the investors should receive a legal right over the specific receivables/assets of the originator such that the investors are not affected by the performance or bankruptcy of the originator. The SPV,

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<sup>15</sup> Bank of Namibia. " General Notice No. 493 Determination under the Banking Institutions Act, 1998 as amended: Securitization Schemes, 2019.

which is a conduit on behalf of the investors, should legally acquire the assets, and those assets should be transferred from the originator to the balance sheet of the SPV. With regard to “True Sale,” Paragraph 5(5)(a to c) of the Bank of Namibia Securitization Notice states that a true sale needs to take place in order for the originator to exclude assets transferred to an SPV in a traditional securitization transaction from its balance sheet and for the bank to exclude the assets from the calculation of its required capital and reserve funds<sup>16</sup>. Thus, assets need to be permanently transferred from the originator to the SPV and the SPV needs to be insolvency remote. The Bank of Namibia Determination on securitization explains that a “true sale” is likely to occur when there is no obligation:

- to repurchase or exchange any of the assets or risks transferred.
- for any kinds of legal recourse through which any risk of loss from the assets sold or risks transferred could be retained or put back to the originator.
- to any party for the payment of principal or interest on the assets sold or risks transferred (other than those arising as services).

The Bank of Namibia Securitization Notice does not address or override the other laws, including the Companies Act. As a result, all entities to be created under the securitization program must comply with the requirements of different pieces of legislation. We next discuss laws/Acts that will have a bearing on securitization transactions.

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<sup>16</sup> Bank of Namibia. " General Notice No. 493 Determination under the Banking Institutions Act, 1998 as amended: Securitization Schemes, 2019.

**(b) The Companies Act, 2004 (Act No. 28 of 2004)**

The legal and ownership status of the SPV must be in line with the aim and principal objectives of the SPV. Since the main purpose of a securitization program is to raise funds from the capital market, the recommended legal form of the SPV is to register a private or a public company to conform to the listing requirements of different stock exchanges. The Companies Act 2004 (Act No. 28 of 2004) applies generally to companies and regulates the establishment and governance of the issuer SPV which is registered as a company. The SPV is the issuer of the asset-backed securities (ABS) and usually takes the form of a ring-fenced public or private company if its securities or notes are to be listed on the Namibian Stock Exchange (NSX). Under section 123 of the Companies Act, the SPV if so authorized by its memorandum or by its articles, may create and issue secured or unsecured debentures. The issuer SPV is established by registering a memorandum of incorporation with the Companies Act and is a separate legal entity capable of owning its assets and suing and being sued in its own name. The shares in the issuer SPV are owned by an independent owner. Under section 17(a)(i,ii) of the Securitization Regulations, an institution acting in a primary role (that is, an originator, remote originator, sponsor, or re-packager), by itself or together with its associated companies (and if it is a bank, by itself or together with any institution(s) within the banking group), cannot directly or indirectly acquire or hold any equity share capital in the issuer SPV of which the nominal value represents 20% or more of the nominal value of all the issued equity share capital in the issuer SPV.<sup>17</sup> In addition, the originator cannot maintain effective or indirect control over the assets once they have been transferred to the issuer SPV. The memorandum of incorporation of the issuer SPV will

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<sup>17</sup> Bank of Namibia. " General Notice No. 493 Determination under the Banking Institutions Act, 1998 as amended: Securitization Schemes, 2019.



incorporate restrictive conditions, as referred to in section 60 of the Companies Act, thereby limiting the powers of the issuer SPV to those powers necessary for purposes of the securitization scheme. Compliance with clauses and provisions of the Companies Act will be critical at both stages 2 and 3 of the securitization transactions, especially if the SPV is a public or private company and if the aim is to list a note or commercial paper on the NSX or any other stock exchange.

### **(c) The Namibian Competition Act 2 of 2003**

The Competition Act 2 of 2003 does not directly address securitization schemes but section 42 of the Act deals with the effect of the merger and acquisition provisions that may have a bearing on the relationships between the originator and SPV based on the transactions between the two. Section 42 (1) of the Competition Act defines a merger as occurring when one or more undertakings directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another undertaking. Such mergers may be achieved in any manner, including through the purchase or lease of shares, an interest, or assets of the other undertaking in question or through amalgamation or other combination with the other undertaking. According to the Bank of Namibia (Securitization Regulation), a “true sale” is likely to occur when there is no obligation:

- a) to repurchase or exchange any of the assets or risks transferred;
- b) for any kinds of legal recourse through which any risk of loss from the assets sold or risks transferred could be retained or put back to the originator; and
- c) to any party for the payment of principal or interest on the assets sold or risks transferred (other than those arising as services).

It appears that the definition of mergers in the Competition Act 2 of 2003 aligns with that of the Banking Institutions Act 1998 (securitization schemes), in which the true sale of the originator's assets to the SPV (as a going concern) appears to be a sale of income generating assets and thus a sale of part of the business of the seller (originator). This sale may, therefore, constitute a merger as contemplated in section 42 of the Competition Act. As a result of the sale of the concerned assets, the SPV will acquire control over a part of the business of the seller which it did not have prior to the transaction. In terms of section 42 (3), a person controls an undertaking if that person (a) beneficially owns more than one half of the issued share capital of the undertaking.

Section 43 (1) of the Act applies to every proposed merger that does not fall within a class which the Minister, with the concurrence of the Commission, has determined and specified by notice in the Gazette to be excluded from the provisions of this Chapter. Securitization schemes could be excluded from the provisions of this Act if the Minister concurs.

In South Africa, the Competition Commission holds the view that it was not the intention of the legislature to include securitization transactions within the ambit of the merger provision of the Competition Acts. In coming to this conclusion, the Commission took into consideration the fact that an SPV is not intended to be a regular business entity and the execution of a securitization scheme would not have an impact on competition. Accordingly, the Commission has indicated that it would not require notification of a transaction in which an originator transfers underlying assets to an SPV, provided that the scheme is executed in compliance with the Securitization Notice.

Similarly in Namibia, a SPV is not intended to be a regular business entity as its operations are clearly stipulated by Regulation 29 of the Amendment of Regulations for Pension Funds: Pension

Funds Act, 1956. According to the Regulation 29 a SPV is incorporated or registered as either a public or private company under the Companies Act, 2004 (Act No. 28 of 2004) or a trust under the Trust Moneys Protection Act, 1934 (Act No. 34 of 1934) and is solely organized and operated for purposes of holding unlisted investments on behalf of investors. Although earlier highlighted that securitization can be considered as a merger under this Act, its diverse structures might require it to be exempted from falling within the ambit of the definition of a merger under this Act. Thus, requiring its exemption as per the position of South Africa provided that full compliance to the securitization regulations and notices is adhered to.

#### **(d) The Insolvency Act 24 of 1936 as Amended**

The question of whether the courts can consider referencing the assets of the SPV as the originator's assets in case the originator is subjected to insolvency proceedings is answered by insolvency law. In developed countries such as Germany, there exists no substantive consolidation. The insolvency law considers each legal entity as an independent insolvent subject. The interpretation here implies that any independent entity separate from the originator cannot be consolidated for insolvency purposes with the originator. Thus, the assets of the SPV can only be connected to the originator if the true sale of the asset fails or if they are "clawed back" to the originator. Legally, SPVs are thus independent entities that stand alone and are not treated as originator assets.

Insolvency laws and the ability of the securitization scheme to withstand the insolvency of the originator and other participants in the scheme are key considerations in the rating of a securitization scheme (Locke 2008). According to Locke, the structure of the securitization scheme also depends on insolvency legislation. The provisions of the Insolvency Act will apply if the originator in a securitization scheme becomes insolvent. As such, the liquidator will be in a

position to set aside the sale of the underlying assets in the circumstances set out in the relevant sections of the Insolvency Act. According to the Bank of Namibia Securitization Notice (2019), “insolvency remote” with respect to a special purpose entity means that the assets of such a special purpose entity shall not be subject to any claim of any institution transferring assets in terms of a traditional securitization scheme or transferring risk in terms of a synthetic securitization scheme.<sup>18</sup>

This means that an SPV is insolvency remote from its originator when the assets transferred to the SPV from the originator cannot be reclaimed in any manner from the SPV should the originator subsequently go into insolvency liquidation (Locke 2008). Locke argues that the concept of insolvency remoteness is so closely linked with the requirement of a true sale of the assets to the SPV that it may be difficult to distinguish between the concepts of a true sale and insolvency remoteness. Paragraph 5.5 of the Securitization Notice reads: “A banking institution that transfers assets to a Special Purpose Entity in terms of a traditional securitization scheme may be allowed to exclude from the calculation of its required capital and reserve funds the assets so sold when the transfer constitutes, amongst other things, a “true sale.”<sup>19</sup>” A “true sale” is likely to occur when there is no obligation on the part of the originator:

- a) to repurchase or exchange any of the assets or risks transferred;
- b) for any kinds of legal recourse through which any risk of loss from the assets sold or risks transferred could be retained or put back to the originator; and
- c) to any party for the payment of principal or interest on the assets sold or

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<sup>18</sup> Bank of Namibia. " General Notice No. 493 Determination under the Banking Institutions Act, 1998 as amended: Securitization Schemes, 2019.

<sup>19</sup> Bank of Namibia. " General Notice No. 493 Determination under the Banking Institutions Act, 1998 as amended: Securitization Schemes, 2019.

risks transferred (other than those arising as services).

Creation of the SPV should ensure that it is “bankruptcy remote.” Such status ensures that assets disposed of to the SPV are risk free in case the SPV or the company whose assets are undergoing securitization develop insolvency. Another case is that if the SPV has no debts other than the one contained in the asset-securitized loans or what is owed to trade, the SPV cannot become insolvent from of its own activities.<sup>20</sup> It is essential to ensure that the SPV remains insolvency remote as far as legislation is concerned. This implies that the SPV is created so that it cannot be subject to insolvency activities. However, the SPV is inaccessible to the originator’s liquidators if the originator unexpectedly becomes insolvent. Liquidators, such as administrators and other insolvency officers, thus cannot reach the SPV during insolvency proceedings.<sup>21</sup>

In Namibia securitization transactions, clear customary and market standard methods can be established to ensure that the SPV is insolvency remote. Such measures include ensuring limited business activities, limiting the recourse and non-petition language, and preventing commingling of funds with other entities. Income and expenses should also be matched, and all assets should be transferred as securities to a security trustee. The last measure is to ensure that there are no liabilities other than taxes and those arising during securitization. Such measures are also mirrored in the insolvency remoteness criteria used by the rating agencies, which indicates that rated transactions must be observed. When express statutory and case law are absent, then the validity of the limited recourse and non-petition clauses are upheld using general rules. General laws provide for statutory and case law, but they cannot exist independently since there is no clearly defined case law for securitization.

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<sup>20</sup> Packer, Frank.

<sup>21</sup> Olivier, Albert.

Steps that need to be undertaken to ensure that the insolvency remoteness of the SPV is achieved are determined by the jurisdiction in which it is established, which can also apply in Namibia. The first step is to ensure that the SPV is operated on a solvent basis; it's a new entity and never had a limited operating history. The second step is to ensure that the appointment of directors or managers is de-linked from the originator which has the sole role of approving internal resolutions connected to the SPV's insolvency. The third step is to restrict the purposes and actions of the SPV as contained in the constitution and all other transactional documentation to mitigate risks that might lead to the creation of liabilities outside the ones that arise from securitization.

#### **(e) The Income Tax Act of 1981**

An important consideration in establishing an SPV relates to tax issues, as they are considered critical when selecting the ideal location for the establishment of an SPV. Some countries with low or no taxation, such as Ireland, Jersey, the Cayman Islands, and Luxembourg, could be more favorable for securitization than jurisdictions with high taxation. The Namibian Income Tax Act 24 of 1981 as amended is silent on the treatment of transactions and income or expenses that may arise from securitization schemes. Gross income in the Act is defined in relation to any year or period of assessment as the total amount in cash or otherwise received by or accrued to or in favor of such person during such year or period of assessment from a source within or deemed to be within Namibia, excluding receipts or accruals of a capital nature. It appears, therefore, that the Income Tax Act will come into question when an originator transfers the underlying assets to an SPV as it has to be determined if the proceeds from the transfer are revenue or are capital in nature. The tax authority will most likely follow the approach that the sale constituted the "sale of an income stream" and that the receipt of revenue which would be included in the gross income of the originator would be taxed at the corporate tax rate.

To get around this issue, we will look at a court case in South Africa in which an originator incurred a loss due to the discounted purchase price paid for the underlying assets. In the case of the matter of Commissioner for South African Revenue Service v Creative Productions (Pty) Ltd [1999] 2 All SA 14 (N), the court held that the loss from the discounting of a promissory note was of a revenue nature and therefore deductible under the Income Tax Act. As such, the loss of an originator may also be deductible. In terms of provisions of the Income Tax Act, an originator would be able to deduct the amount of bad debt from its income. This same provision will apply to an SPV after the underlying assets have been ceded to it in a securitization transaction. Section 17 (1) (m) of the Namibian Income Tax Act 24 of 1981 provides for an allowance in respect to a debt which is considered to be doubtful. As such, it is argued that an SPV will be in a position to claim a deduction based on this provision. The question as to whether or not the purchase price received by the originator for the underlying assets is capital or revenue in nature will be determined by the tax authority. However, it is asserted that an SPV should argue that the payment is of a revenue nature and, therefore, deductible under section 11(a) of the South African Act Income Tax Act, 1994 Act No. 21, 1994.

In many jurisdictions, the treatment of purchase or revenue received by the originator depends on several factors. How the tax legislation treats the originator depends on the intentions behind the sale. For example, in South Africa, if the originator engages in a scheme with the intention to make a profit, then the cash flow is taxed because the receipts will be of a revenue nature.<sup>22</sup> However, in the event the originator sells its cash flow, such a move is interpreted as one in which making a profit was not the intention. In such cases, tax legislation treats the transaction as worth exempting

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<sup>22</sup> Rajapakse, Pelma, and Shanuka Senarath. 2019. *Commercial Law Aspects of Residential Mortgage Securitisation in Australia*. Springer EBooks.

from taxation in the interest of protecting its creditors in the event of liquidation. On the other hand, a sale of cash flow in which the originator has sold the better part of their businesses through securitization is regarded as one of a capital nature and hence subjected to tax (Cummins 2014, 12).<sup>23</sup> Such legislation has proved to be helpful to securitization and has made the related transactions flourish. In light of this, it is essential that Namibia conducts the treatment of purchase price/revenue received by the originator in a manner that takes into account the intentions behind the transaction.

**Value Added Tax:** The value added tax (VAT) in securitization is an issue that has been the subject of legal battles in most countries. For example, in the United Kingdom, the court ruled that the transfer of securities from an originator to a special purpose vehicle in a transaction conducted as part of a securitization deal cannot be regarded as a supply for UK VAT purposes.<sup>24</sup> In doing so, the court essentially meant that originators, are at the risk of being burdened with increased VAT treatments. In the same ruling, the court pronounced that those inputs in securitization can be attributed to the services supplied to the special purpose vehicle by the originator. Therefore, this part of the ruling meant that originators are susceptible to greater VAT treatment in so far as they carry out the servicing functions.<sup>25</sup> Section 1 of Namibia Value Added Tax Act, Act 10 of 2000 ('the Act') defines the following terms as follows: 'goods' means all kinds of corporeal movable property, but does not include money''

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<sup>23</sup> Schöniger, Sandra. "Overview of the German securitisation market." *Global Securitisation and Structured Finance* (2007): 263-266.

<sup>24</sup> Njonyo, Fred.

<sup>25</sup> Gorton, Gary, and Andrew Metrick. "Securitization." In *Handbook of the Economics of Finance*, vol. 2, pp. 1-70. Elsevier, 2013. 23-98



“services mean anything that is not goods or money, and includes any incorporeal movable property other than shares in a company or an interest held by any member or in a partnership close corporation;”

“ taxable supply” means any supply of goods or services in the course or furtherance of a taxable activity, other than an exempt supply”

The term taxable activity is defined in Section 4(1) of the VAT Act as:

( a) activity which is carried on continuously or regularly by any person in Namibia or partly in Namibia, whether or not for a pecuniary profit, that involves or is intended to involve, in whole or in part, the supply of goods or services to any other person for consideration....”

Para 2 (a) of Schedule IV of the VAT Act exempts the following supplies:

- (a) A supply of financial service referred to in –
  - (i) Paragraphs (a) – (c), inclusive, of the definition of financial services, to the extent that the consideration payable in respect of such services is not any fee, commission or similar charge.....”

**Financial Service is detailed as follows in paragraph 1 of Schedule IV:**

Financial service means: Granting, negotiating or dealing with loans, credit, credit guarantees or any security for money, including management of loans, credit or credit guarantees by the grantor;

From the above definitions it appears home loans are regarded as exempt supply and do not attract any VAT as they fall in the category of financial services. The sale of these loans from the Originator to an SPV should also not attract any VAT as this represents sale of an exempt supply. This is almost similar in principle when one financial institution makes a bond over from another

financial institution no VAT is charged as a result. However in the case where the originator charges origination fee to the SPV, this fee shouldn't be exempted and should attract VAT on the origination fee charged to the SPV.

**Deductibility of Bad Debts:** The deductibility of bad debts in securitization is an issue that requires a careful examination of the nature of the debt and the positions assumed by the partners involved. In all jurisdictions in which securitization of asset-backed securities is practiced, the deductibility of debts is conducted based on the consideration of an array of factors.<sup>26</sup> For example, in South Africa, taxation legislation directs the tax authorities to establish whether the originator assumed the role of a moneylender and, if so, whether the special purpose vehicle that bought the securities took over the position of the moneylender from the originator. Second, the law also requires the taxation authorities to determine the owner of the receivables involved in the debt.<sup>27</sup> Before determining the deductibility of bad debts, tax authorities are required to consider whether the originator can either substitute or buy back the bad debts from the special purpose vehicle.<sup>28</sup> These considerations, among others practiced in other jurisdictions, are designed to ensure that the securitization of asset-backed securities runs as smoothly as possible.

Deductible Expenditure, in terms of Section 17 (1) (a) read with Section 24(g) of the Namibian Income Tax Act, expenditure incurred in the production of income in carrying on a trade can be deducted to determine taxable income to the extent that the expenditure is incurred for the purposes of the taxpayers' trade and provided the expenses incurred are not of capital nature. An expense

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<sup>26</sup> Gutuza, Tracey, Anina Boshoff, and Natalie Napier. 2019. Legal aspects of financing corporates. Durban [South Africa] : LexisNexis, 2019.

<sup>27</sup> Gutuza, Tracey, Anina Boshoff, and Natalie Napier. 2019

<sup>28</sup> Ibid.

has been incurred once a contingent obligation has arisen to pay it or it has been paid and it is not refundable.

Based on the definition above, the expenditure incurred in acquiring the loans, would qualify to be of capital nature. A review of the financial statements of South Africa Home Loans' SPV, reveals that the acquired loans are regarded as of capital nature and are not deductible for tax purposes in the financial statements of the SPV. The acquired mortgage loans are also classified under assets in the balance sheet. However, the interest paid to note holders for the purpose of financing the acquisition of mortgage loans is deductible for tax purposes.

**Withholding Tax:** Namibia should not subject payments of receivables to withholding taxes. This practice is a relief to many businesses undergoing securitization. Some other exceptions can be applied regarding receivables, especially when the debtor resides in the jurisdiction for tax purposes.<sup>29</sup> Interest payments carried out by a bank or a financial service institution attract withholding tax on interest and can also be passed on with regard to securities, given that such an institution stands out as a custodian in the host country.<sup>30</sup> However, no tax is withheld upon the payment of the interest or transfer to a recipient that happens to be a bank or a financial service institution as long as certain critical requirements are observed.

**Accounting Issues (Criteria for True Sale):** True sale is an accounting standard used to ascertain the legal and financial dealing of a defined sale or disposition of a given financial asset. Ascertaining the disposition value of an asset as a true sale is vital in securitization and other involved financial transactions.<sup>31</sup> The International Financial Reporting Standards (IFRS) defines

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<sup>29</sup> Rosenberg, Richard, and Jason Kravitt.

<sup>30</sup> Cummins, J. David. "Securitization of life insurance assets and liabilities." In *Presentation at the 31st Seminar of the European Group of Risk and Insurance Economics*. 2014. 11-12

<sup>31</sup> Njonyo, Fred. "Mitigating African Conflicts Through Securitization of Development." *DBA Africa Management Review* 3, no. 2 (2013).

the true sale as a financial treatment of a transaction that includes legal differentiation or isolation of all assets quoted in the transfer.<sup>32</sup> Such action places the assets beyond the accessibility of the originator's creditors. The PSV's right to pledge or exchange the already transferred assets is also included. According to the IFRS, the last clause is the relinquishment of the originator's effective control over all referred assets.

### **Stage 3: When issuing asset-backed securities (SPV).**

#### **(a) The SPV Receiving Funds from the Public/Conducting Business of Banking**

Prior to the amendments to the Banking Institution Act 1998 (Act No. 2 of 1998), funds received by the SPV in a securitization transaction through the issuance of asset-backed securities were classified as the conduct of the business of a bank and thus a violation of the Act. Section 71(3) of the Banking Institution Act 1998 (Act No. 2 of 1998) as amended, read together with Government Notice No. 378 of 2019, relates to the designation of an activity of a special purpose entity or SPV that does not fall within the meaning of "receiving funds from the public" or conducting "the business of a bank."<sup>33</sup> This amendment enables non-bank financial institutions to participate in securitization without contravening the provisions of the Banking Institution Act 1998. The exemption notice allows an SPV (in a traditional or a synthetic securitization scheme) to accept money from the public against the issuance of commercial paper or an asset-backed security (ABS). Originators or promoters of the SPV are, however, required by the Bank of Namibia to apply in writing to the Registrar of Banks for the exemption in order to fall outside the business of banking in terms of the securitization amendments. Without a written approval from the Registrar,

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<sup>32</sup> Njonyo, Fred. *DBA Africa Management Review*.

<sup>33</sup> Bank of Namibia. "General Notice No. 493 Determination under the Banking Institutions Act, 1998 as amended: Securitization Schemes, 2019.

the SPV will be in contravention of the Securitization Schemes Determination under the Banking Institutions Act 1998 as amended.

Namibia can learn from some court rulings pertaining to securitization cases in South Africa. In the High Court case of *Strydom and Others v Bakkes and Others*, the plaintiffs instituted proceedings against the defendants for losses incurred due to the failure of a collective investment scheme and an ancillary traditional securitization scheme. The SPV in this matter issued promissory notes which constituted commercial paper without the approval of the Registrar of Banks and was not registered as a bank. The court held that for the issuance of commercial paper by an SPV in a traditional securitization scheme to fall outside the scope of “the business of a bank,” the juristic person issuing the commercial paper needs the written authorization of the Registrar of Banks to do so. It was concluded that the required authorization was not in place and, therefore, the promissory notes issued by the SPV were not legally commercial paper. Consequently, the issuance of the commercial paper constituted “the business of a bank.” The SPV was held to be in contravention of section 11 of the South African Banks Act as the SPV was not registered as a bank.

The lessons from the South African experience as illustrated in this case appear to have provided lessons for the Bank of Namibia as the Namibia Banking Institution Act 1998 (Determination on Securitization Schemes [BID-32]), section 2, subsection (b), exempts non-bank entities acting in the capacity of a primary or secondary role or both a primary and secondary role with respect to a synthetic or traditional securitization scheme from complying with the requirements of paragraphs 4 to 21 of the Securitization Determination. Banks, on other hand, are required to comply with the requirements of paragraphs 4 to 21 of the Securitization Determination. However, to avoid a violation of section 2 of the Banking Institutions Act 1989, the promoter of the SPV must obtain

the written approval of the Registrar of Banks in Namibia before issuing commercial paper or any other securities. The three stages elaborated in this chapter have demonstrated that securitization is a complex process that requires meticulous planning and then competent execution of the plans. From the content provided pertaining to all three stages, it is evident that securitization requires strong institutions that will oversee the program's success.

#### **4.1.2 Robust Primary Market and Efficient Back-Office System**

A robust primary market for originating assets to be securitized needs to exist in a country and must be supported by a strong back-office systems. Davis (2000) advises that the terms of the loans or receivables and the documentation supporting them must be sufficiently standardized to permit the assembly of pools of homogeneous assets. The following characteristics of the primary mortgage market are important prerequisites for the development of a mortgage or any other asset securitization scheme:

- ***Mortgage instruments must be standardized.*** To reduce the transaction costs of evaluating mortgage loans and the processing costs of issuing and administering mortgage-backed securities, the characteristics (rate adjustment, amortization schedule, term) of the mortgages should be uniform. In addition, standardized documentation (note, deed, application, appraisal, credit report) must be available for all loans.
- ***The underwriting of mortgages must be standardized.*** An assessment of the ability to pay generally consists of relating borrower income, assets, liabilities, and net worth to proposed mortgage payments and overall housing expenses. Debt-to-income guidelines help to standardize underwriting. Willingness to pay is based on the down payment (borrower investment in the property) and credit history. The appraisal determines the value of the property.

- ***Enforceable security interest.*** This depends on the clarity of the land title, the ability to establish a priority of liens on the collateral (an effective title and lien registration system), and the ability to enforce foreclosure and repossession over a reasonable time period.
- ***Transferable security interest.*** For transactions which involve asset sale or pledging (as collateral), security interests must be transferable, and investors must have the ability to perfect their security interest after transfer. Furthermore, the transfer of an interest must be at a relatively low cost. Transfer and recordation fees should be nominal, and borrowers should not have to approve the transfer.
- ***Bankruptcy protection.*** An additional legal concern for investors is the solvency of the seller, servicer, or other third parties (such as credit enhancers or trustees) and their rights in the event of bankruptcy. Investor priority rights must be protected, and investors should have the right to pull or transfer servicing.
- ***Mortgages must be attractive investments.*** The interest rates on the mortgages must be market determined and provide investors with a positive, real risk-adjusted rate of return.
- ***High-quality servicing of mortgages must be available.*** The collection of mortgage payments and the periodic remittance of these payments to the investor (or conduit) is the major task of servicers (whether they are originators or third parties). They must also maintain accurate and current information on mortgage balances, status, and history and provide timely reports to investors.

### 4.1.3 The Ideal Securitization Structures/Vehicles

Bank of Namibia Securitization Notice makes provision for either a traditional or synthetic securitization. A mortgage securitization market can be structured in two primary ways, namely, collateral mortgage obligations (CMO) or pass-through securities (PTS). These two types of mortgage securities differ in their form of payment to the investor and are suited to different types of economies. In pass-through securities, the mortgage payments are made to an intermediary who links the investors and the debtors. Once collected, the intermediary deducts their fee from the monthly payments and passes the remainder of the money to the holders of the securities, who are, in this case, the investors who bought the securities from a bank or a lending institution (Seiders 1983). Therefore, investors who buy pass-through securities are paid monthly, the date of which coincides with the period or day of the month that the people servicing the involved loans are supposed to make their loan payments. The payments are also fixed because they are predetermined by the payment agreement between the banks and the individuals who received the mortgage loans from the banks. This structure of mortgage security contains the risk of a drop in the value of payments caused by a drop in interest rates. A reduction in interest rates will cause a drop in the amount paid to investors because the interest rates determine the amount paid back to the bank by the servicers of loans. Second, the investors in this structure have risk-reduced payments if the debtors pay most of their loans ahead of time because the interest on a loan is reduced when a debtor pre-pays the debt in large amounts (Seiders 1983).

In the collateral mortgage obligations structure, groups of mortgage securities are sold to investors as bundles. The grouping of the mortgages is done based on their risk factors, which are determined by the interest rates, maturity dates, and potential for debtors to default. Once purchased, the investors make money on the bundles of securities, referred to as tranches, from the principle and



monthly interest rate payments (Fabozzi and Ramsey 1999). However, this type of mortgage security structure involves more risk than that of pass-through securities because it is sensitive to economic changes, the rate at which houses are sold, refinance rates, and foreclosure rates (Fabozzi and Ramsey 1999). As a result, there are more ways by which investors can lose money and affect the entire economy, as was experienced throughout the world during the 2008 financial crisis. In light of these two structures, the best structure that would suit the Namibian economy compared to other countries is that of pass-through securities. PTS will be better suited to the economy of Namibia because it is shrinking, which increases the chances of a financial crisis if the CMO structure is used. With the PTS structure, the interest rates are within the control of the Bank of Namibia and can therefore be maintained at levels that ensure the continuation of economically beneficial securitization of mortgages. Moreover, since the PTS structure is not as sensitive to changes in the economy as is the CMO structure, it can withstand a period of a poor economy, hence serving the economy longer. Compared to more developed countries, the PTS structure will do better in Namibia because the chances of a shrinking economy and debt default are higher in Namibia. Since developed countries have more individuals who are likely to fully pay their mortgage loans, the CMOS can be more suitable in their markets but not in a frailer economy such as that of Namibia.

## **Chapter 5. Benefit of Securitization on the Namibian Economy**

There are many benefits of asset securitization and in this chapter, we look at how securitization can benefit the housing sector, the agricultural sector, the banking and financial sector and the economy as a whole. Davis (2000) argues that the main benefits from asset securitization are provision of cheaper funding, improved balance sheet structure, better risk management, enhanced fiscal credibility and efficient financing.

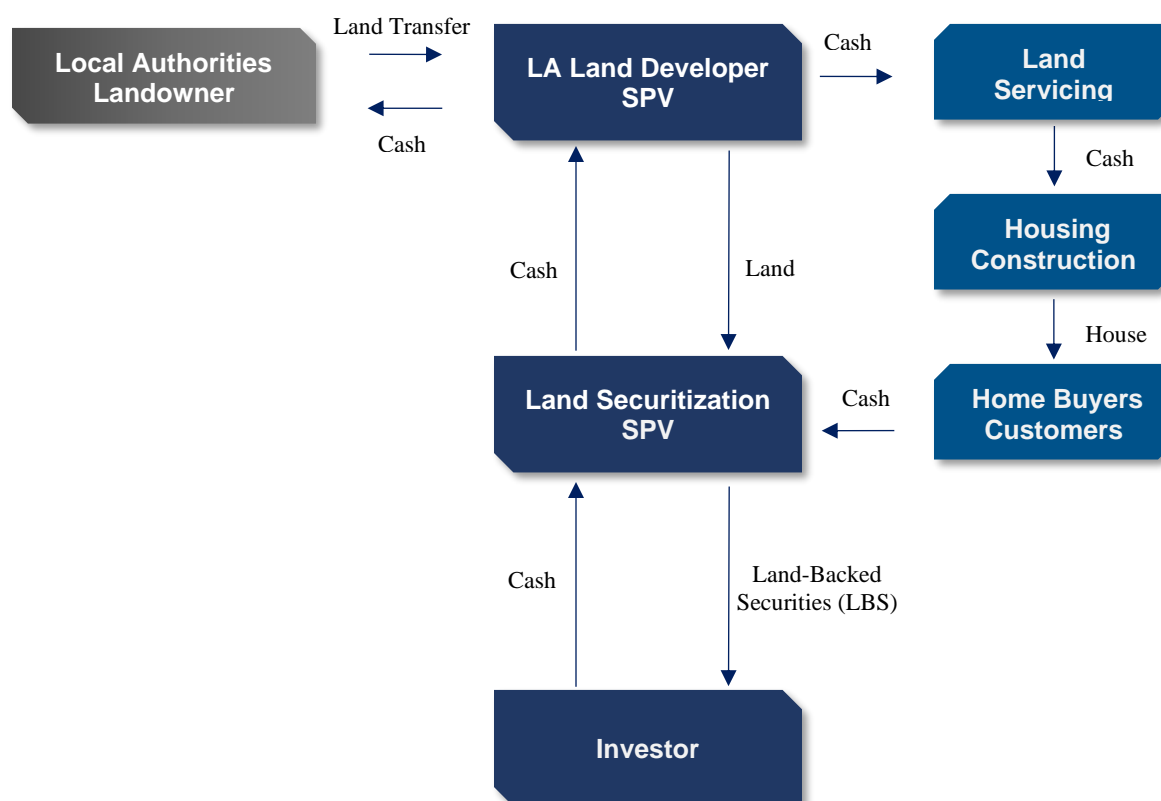
### **5.1 Securitization Widens Sources of Funding for the Economy**

A well-functioning securitization market broadens and widens the sources of funding, provide cheaper funding and enhances liquidity. The Bank of Israel identified the following benefits of asset securitization on the economy.

- Traditional Securitization can provide a bridge between sources of long-term funding (pension funds and insurance companies) and uses of funds (lending to SMEs, housing market, businesses, infrastructure projects etc). As highlighted in this paper Namibia currently has excess savings by pension funds and insurance entities but there are currently no appropriate instruments to link the needs and risk profile of users of funds and suppliers of funds (institutional investors). Securitization has been identified as the most effective and appropriate mechanism to serve as a bridge between the source and use of funds.
- Traditional Securitization contributes to high and sustainable economic growth by increasing the supply of credit in the economy and bringing the cost of capital down. Institutional investors such as pension funds will now be able to channel their savings into sectors that they could not because of legal impediments and risk considerations.
- Freeing up of capital in the banking system. Securitization can help banks to free up capital in order to provide new loans including loans to sectors perceived as high-risk sectors.

## **5.2 Land Securitization as a Source of Funding for Local Authorities**

Urban land is the most superior asset on the balance sheets of many local authorities in Namibia. This land including un-serviced land provide stable income and predictable cash flow and securitization can be used to unlock the value of this idle land and especially LA with limited funding. Globally, many cities and municipalities have successfully used future-flow receivables, such as town tax revenues and other income-generating assets, to raise finance through securitization transactions. It is, therefore, possible that municipalities with substantial income generating assets on their balance sheet, such as the City of Windhoek, could significantly benefit from land securitization. A local authority or a land developer in a land securitization scheme issues land backed securities or certificates to investors to raise funds for land servicing and housing/property construction. Part of the revenue received from the sale of serviced land and new houses will be used to redeem the bond. The investors who buys these securities/bonds does not base their investment decision on the LA's balance sheet but on the predictable cash flow from the new housing development. Land securitization could be the only way to enable local authorities with weak financial position access funding from the capital market. Figure 7 shows how the land securitization works.

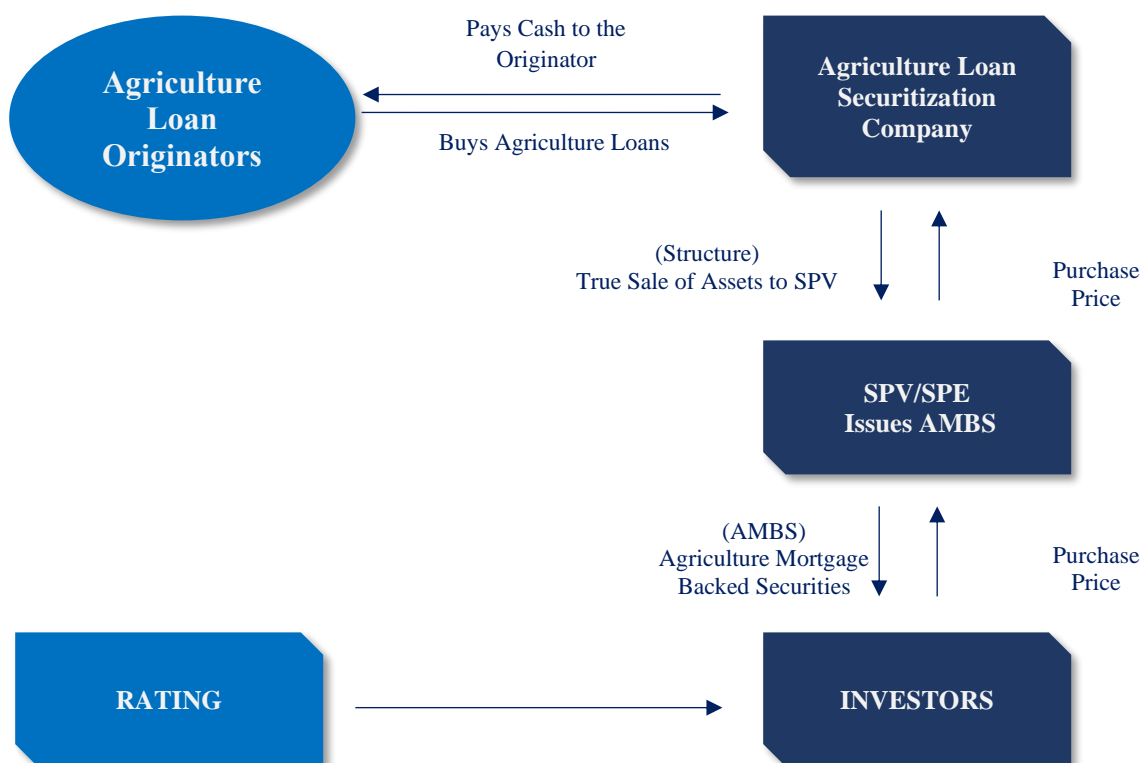
**Figure 7: Land Securitization**

### 5.3 Agriculture Loans Securitization as a Source of Funding for Agriculture Sector

Namibia, like many African countries, faces challenges in attracting risk and long-term capital to finance the agricultural sector. The latest monetary statistics compiled by Bank of Namibia shows that commercial banks allocate less than 5% of their total lending to the agriculture sector. In an effort to boost and channel financial resources to the agriculture sector, Agribank of Namibia was created with the mandate of providing both long- and short-term finance to the agricultural sector. The loan book of Agribank almost doubled over the 10 year period from N\$1.4 billion in 2010 to N\$2.8 billion in 2020. Agriculture asset securitization in Namibia will enable the inflow of funds to the agricultural sector from long-term funders such as pension funds and insurance companies. In their paper on financing the agriculture sector through agricultural loan securitization (figure

8), Vera Mirović, Dragana Bolesnikov (2013) pointed those agricultural loans securitization would bring numerous benefits to originators such as Agribank and commercial banks who originates agriculture loans. First, by the sale of agricultural loans the lender receives funds that may use for approval of new loans. Thus, the lender improves liquidity and profitability, and diversifies sources of funding. Then, the sale of agricultural loans means their removal from the originator's balance sheet, and therefore the risk is transferred to another entity. The buyer of agricultural loans obtains the right to charge interest and principal, but also takes default risk of the borrower. Figure 5 shows how this process will work. The originators (Agribank, Commercial banks and other agriculture lenders) transfers and sells a portion of their loans to a government sponsored or jointly owned company (Agricultural Loan Securitization Company). The SPV buys these agricultural loans from Agricultural Loan Securitization Company and issues securities and raises funds from investors in the capital markets. The securitization process of selling agricultural loans would stimulate the originators in Namibia to grant new loans and finance agriculture. The originator who can sell the loan increases its liquidity, profitability and reduces risk. It is also stimulated to obtain funds from the sale of the loan and use it for new lending activities. Loans can be made for the purchase of seeds, fertilizers, land, livestock, plants, machinery or the construction of buildings.

**Figure 8: Agricultural Loan Securitization**



Although agricultural loans securitization in Namibia could be done by the private sector, it would be desirable if the government by establishing a separate agency carries out the first securitization of agricultural loans. The involvement of the government would encourage banks, investors, and other stakeholders to be engaged in the process of securitization. As farmers pay instalments of the loan, collected funds are forwarded to investors.

#### **5.4 Securitization as a Risk Management & Balance Sheet Management Tool**

One of the biggest problems that Namibian lenders, especially banks are currently facing is the rising amount of distressed assets, rising non-performing loans and the imbalance between assets and liabilities in their balance sheets. The country's shrinking economy has rendered most borrowers unable to service their debt obligations. As a result, most lenders including banks are dealing with huge credit risk as well as liquidity risk that can be realized in the future should the situation persist (Paavo, 2018). Banks in Namibia are at the heart of the financial system and once a bank's risk asset is impaired, it has significant implications on its going concern and can erode the bank's capital base and put its capital adequacy in jeopardy (Akintola, Fikayo Benjamin, 2018). This may lead to illiquidity, which if not properly managed, may end up in insolvency and liquidation. In the past, countries in the same position have managed to solve the problem by securitization of assets such as receivables and mortgage loans and sell them to investors as asset backed securities (ABS). Such moves have historically improved the economies of the involved countries by restructuring the banks' balance sheets, injecting capital in their capital markets, and ultimately strengthening their economies (Hayre, 2002). In addition to the role of asset securitization as a risk management tool, it has over the past two decades become a convenient method of raising funds from institutional investors for investment purposes through transformation of marketable assets (receivables) into tradable securities (Harwood, 2021). While Namibia has never tried securitization, the country has a chance of utilizing the potential of the financial practice in a bid to inject liquidity in the economy and enable lending institutions manage risks effectively.

## **Chapter 6. A Roadmap for Asset Securitization in Namibia**

The objective of this paper was to analyse the potential for the development of asset securitization market in Namibia, and to assess key obstacles and challenges that may hinder the smooth take off of securitization. The main findings of the study are that, Namibia has all the building blocks to develop vibrant asset securitization in the country. The country has ample excess liquidity with well-established money and bond markets and a primary market that is well-established for the creation of assets, such as mortgage loans and other assets suited to securitization transactions. Such a well-established primary market leads to the conclusion that asset securitization is set to provide further impetus to the already active domestic bond market by offering tremendous opportunities and benefits to market participants. As has been highlighted, asset securitization is still at a nascent stage in Namibia, and this paper's aim was partly to promote a greater understanding of the general concept of securitization and the transaction mechanics involved in the securitization process. A concerted effort and attempt have also been made in this paper to identify factors and issues that may serve as impediments to the development of asset securitization in Namibia. The conclusion is also reached that the Namibian Government must not be passive but take an active role in spearheading the development of an asset securitization market in Namibia, especially in the early stages, as this will instill confidence in investors. It is the government's duty to ensure that a sound infrastructure is in place for asset securitization to flourish.



The development and launch of securitization market in Namibia will involve the concerned regulators (Bank of Namibia and NAMFISA), government ministries and agencies, market players, and other stakeholders. To ensure a buy-in from all critical parties and enhance the smooth take off for securitization, this paper proposes an Action Plan (Road Map) to guide the development of Namibia's Securitization Market. The proposed road map shall include specific objectives and tasks to be undertaken as informed by the findings of the paper.

**Task 1: Early-stage conversations with Government and all key Stakeholders.**

According to IFC (2021), unless there is a political buy-in from key officials in government, and the public sector at large, securitization may not take-off smoothly. The promoters of the securitization project need to socialize the concept and gauge appetite and clear any misunderstandings and suspicions. Without a buy-in from politicians and policy makers in government, the full benefits of securitization on the Namibian economy will not be realized. It is this paper's objective to provide information that will help government officials and policy makers to engage in fruitful and meaningful discussions on the topic of securitization.

**Task 2: Engagements between Regulators and all Stakeholders.**

Securitization initiatives is not a one man show and cannot be driven and spearheaded by a single government ministry, agency or a single regulatory authority. It is a multi-faceted process and will require the involvement of many players and stakeholders. Any proposed changes to Namibia's policies, legal and regulatory framework to support securitization must not be done in silos. There must be a collaboration with relevant stakeholders including multilateral institutions interested in the development of securitization market (IFC 2021). Institutions such as the World Bank and International Finance Corporation (IFC) could be critical at this early stage and should be engaged to provide technical support.

### **Task 3: Conduct a Market Research on the attractiveness Securitization**

Although this paper has touched on many aspects of asset securitization and identified some impediments, a focused detailed market research on the topic is critical. The aim and importance of the market research is to determine the motives of why securitization is attractive to participants. The market research analysis should include market mapping, determine market size, investors, and originators' interest in securitization (IFC 2021). The report must also investigate the existing funding mechanisms and structures for originators, the attractiveness of securitization for local banks and other potential originators, the demand for securitization as a funding instrument from the local market and a market assessment for each asset class from an issuance perspective (IFC 2021). Interviews must be conducted with key market players such as institutional investors, brokers, asset managers, insurance companies, Government and potential international investors to assess:

- Assess Investors' appetite towards such transactions and their role (amounts, tenor, spread/yield, risk/rating, and credit enhancement mechanisms)
- Guarantors' interest to provide credit enhancement (amounts, tenor, guarantee fees, risk/rating)
- Transaction costs and the relevant impact on the commercial feasibility of the transaction.

### **Task 4: Asset Classes to be prioritized for Securitization**

Policy makers in government, regulators and market players must agree at this early stage as to which asset class will be prioritized in line with Namibia's Vision 2030, Harambee Prosperity Plan (HPP) and national development plans (NDPs). It is critical at the early stage to identify the asset class that will be attractive to investors and meet policy objectives of government. As discussed in this paper, one of the aims of securitization is to channel credit and savings to sectors that cannot

access funding from traditional markets (bank credit) and to release more funding from banks to government priority economic sectors. The assessment for each of the selected asset classes must cover the size, volumes, potential growth. Asset classes could include mortgage loans, agriculture loans, SME/micro-finance loans, credit cards and NPL portfolios etc).

### **Task 5: Managing the Roadmap's Implementation**

The suggested tasks and actions in this paper cut across several government ministries, regulators and involve several market institutions, as well as the private sector firms. Successful implementation of this roadmap can only be achieved through a high-level Working Group, comprised of the senior leaders from each interested body. The Government of Namibia and regulators (Bank of Namibia and NAMFISA) must therefore establish a Task Force or an Advisory Committee on Securitization (ACS) comprising of market participants, such as representatives of originators (banks and mortgage lenders), fund managers, legal advisers, accounting firms, and representatives from Regulators. The main objectives of ACS will be to:

- Identify current impediments in legal, regulatory, tax, and accounting aspects of asset securitization and advise the government, BoN, and NAMFISA on the steps needed to develop asset securitization and the measures necessary to address the impediments.
- Develop a comprehensive framework encompassing legal, regulatory, tax, and accounting aspects which would facilitate the development of asset securitization in this country.
- Map out strategic initiatives crucial to the establishment of a financial infrastructure and an institutional framework for efficient functioning of asset securitization schemes.
- Study various reports, including this report, and extract recommendations which would be put forward to the government and various regulatory bodies for their further consideration and adoption as appropriate.

## **Task 6: Review of the Legal and Regulatory Framework for Securitization Market**

This paper has identified a host of legal, regulatory, tax, and accounting issues which need to be addressed to facilitate the introduction of asset securitization in Namibia. It is therefore critical in early stages to engage and identify professionals and experts to identify and prioritize specific gaps in the legal and regulatory, tax and accounting framework that may be obstacles to successful securitizations. A review of the existing laws and legislation indicates that Namibia will require a set of laws that are designed to ensure that the securitization process takes place under a legal framework through which the involved parties can be held accountable. This paper has identified some of the legal and laws that may need to be amended and we recommend the following:

### **6.1.1 The Companies Act, 2004 (Act No. 28 of 2004)**

Since the main purpose of a securitization program is to raise funds from the capital market, the recommended legal form of the SPV is to register a private or a public company to conform to the listing requirements of different stock exchanges including the NSX. The Companies Act, 2004 (Act No. 28 of 2004) applies to companies generally and regulates the establishment and governance of the issuer SPV which is registered as a company. Compliance with clauses and provisions of the Companies Act will be critical at both stages 2 and 3 of the securitization transactions (as highlighted in this paper), especially if the SPV is a public or private company and if the aim is to list a note or a commercial paper on the NSX or any other stock exchange.

### **6.1.2 The Namibian Competition Act 2 of 2003 – Apply for Exemptions**

The acquisition/purchase of the assets of the originator by the SPV is treated as a merger by section 42 of this Act which may complicate securitization transactions. It is recommended that the Namibia Competition Commission be engaged to seek for

exemptions from the provisions of the Act by providing that an SPV is established for a specific objective and is not intended to be a regular business entity and that the execution of a securitization scheme should not have an impact on competition.

### **6.1.3 Namibia Income Tax Act**

The revenue or proceeds resulting from the sale of assets by the originator to the SPV may be classified by the tax authority as part of the gross income of the originator and thus become taxable. In addition, the revenue received by the SPV from the investor may be classified by the tax authority as gross income of the SPV for which it has tax liability. It is important that the purchase price received by the originator for the underlying assets be clarified and that the tax authority determine whether it is of a capital or revenue nature for exemptions to be obtained. In addition, the SPV and originator should be able to claim a deduction based on this provision and argue that the payment is of a revenue nature and therefore deductible under section 11(a) of the Income Tax Act.

### **6.1.4 The Insolvency Act**

This Act will have a major impact on securitization transactions, especially with regard to the bankruptcy of the originator. It is asserted in this paper that the concept of insolvency remoteness is so closely linked to the requirement of a true sale of the assets to the SPV that it may be difficult to distinguish between the concepts of a true sale and insolvency remoteness. Provisions of this Act that may conflict with the securitization notice should be addressed before implementation of the securitization program. Review and analysis should include but is not limited to the following:

- Legal aspects of asset transfer to SPV
- Bankruptcy remoteness of SPVs

- Liquidation accountability (waterfall chart)
- SPV dissolution upon liquidation
- Legal form, ownership, governance, and dissolution of SPVs
- Regulatory treatment of asset transfers, off balance sheet treatment, risk weightings of retained risk tranches by banks, ability to select assets for sale, regulatory treatment for investments in senior tranches of asset backed securities.

## **Chapter 7. Conclusion and Recommendation**

In this paper, the issues to be considered as part of an overall strategy to implement an asset securitization program in Namibia were discussed in detail and a road map was developed. It is recommended that a review of the existing state of asset securitization in Namibia should be undertaken, including the legal, tax, and accounting regulations already in place that will have a bearing on securitization. A securitization market depends on the existence of a strong primary market in which assets or mortgages are regarded as attractive assets with good and well-documented performance. A major prerequisite is a strong legal infrastructure which supports registration, enforcement, and eventual pledging and sale of assets or mortgage loans. Implementation of the securitization program will require action and commitment by government and several agencies.

Although the Bank of Namibia Securitization Notice is silent on the role of government in securitization, international experience supports an active role for government in the early development of a securitization program. Countries that have established an active market for asset-backed securities (securitization) are ones in which the government took a leading role in the establishment of the asset securitization market. Countries such as the United States, South Korea, and a number of countries in Latin America that have successful and developed asset-backed securities markets were spearheaded by government-sponsored entities. The United States created Fannie Mae and Freddie Mac, South Korea has the Korea Housing Finance Corporation, and Malaysia established Cagamas Berhad (Cagamas) so that the government could spearhead the establishment of a securitization program in those countries. It will, therefore, be wise for the Namibian government to establish a housing corporation that will be at the forefront of establishing and supporting mortgage securitization in the country.

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