ombudsman for banking services
SOUTH AFRICA

Consumer Note 13

Securitisation Complaints

Disclaimer

Please note that the information provided does not constitute expert legal or financial advice. You should consult a legal professional or financial adviser for expert advice. We have only mentioned sections of the various Acts where they are applicable to the complaints we receive. These Acts however contain many other sections and details that may not have been mentioned. There may also be other applicable legislation. For more information and detail on the Acts and other applicable legislation you should consult a legal professional.

The purpose of the document is to provide you with practical information based on our experience. Each case we investigate is however assessed on its merits.

Introduction

This Consumer Information Note deals with the approach of the Ombudsman of Banking Services to complaints of securitisation against a bank.

Whilst it is possible to securitise various types of contractual debt such as residential mortgages, commercial mortgages, motor vehicle loans or credit card debt obligations, this note deals only with the securitisation of residential mortgages.

Briefly, a complaint of securitisation against a bank entails an allegation that the bank has securitised (sold and/or ceded) a consumer's loan to an outside party. The bank therefore no longer has legal title to the loan and consequently it has no legal standing to bring any action against a consumer for non-payment of the loan.

Several terms and/or phrases are used peculiarly within the context of securitisation. We have provided the definitions of some of the most common.

Definitons

Securitisation

The Banks Act[1] defines securitisation as a scheme whereby a special purpose institution issues commercial paper[2] and where the payments by the special purpose institution in respect of the commercial paper so issued are made from the cash flows arising from or

[1] Regulations to the Banks Act 94 of 1990 published in Government Notice 1375 in Government Gazette 22948 on 13 December 2001.

[2] Commercial Paper is an unsecured short-term promissory note with a fixed maturity of no more than 270 days, typically issued to finance short term-credit needs of large institutions.

proceeds derived from the assets, consisting of claims sounding in money, transferred to such special purpose institution by an originator, remote originator or re-packager.

Reis-Roy [3] defines securitisation as a process utilising the historical and predicted performance, the collateral, the creditworthiness and cash flow of an entity's assets as security to raise finance from the capital markets.

Whilst Locke[4] defines securitisation 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 ("SPV")] and the issue by the SPV of marketable securities (commercial paper or other debt instruments) to finance the purchase of the assets.

A typical example of securitisation is a mortgage-backed security (MBS), which is a type of asset-backed security that is secured by a collection of mortgages.

Special Purpose Vehicle (SPV)

A Special Purpose Vehicle ("SPV"), or issuer, is an entity specifically created for securitisation that issues securities which are sold to investors and traded on capital markets. The SPV or issuer becomes the new legal owner of the asset.

A Special Purpose Vehicle, or special purpose entity is set up for a specific, limited purpose by another entity, the sponsoring firm. The SPV can take the form of a corporation, trust, partnership or a limited liability company. In securitisation, the SPV most commonly takes the legal form of a trust.[5]

Locus Standi

A litigant who claims relief must show that he has an interest in the subject matter of the litigation which is recognised at law as sufficient to give him legal standing.

The general rule is that it is for the party instituting proceedings to not only allege, but also to prove that he has *locus standi.*[6]

[3] Journal of International Banking law 1998. An Analysis of the Law and Practice of Securitisation by Calvin Reis-Roy at page 3 paragraph [1].
[4] Aspects of Traditional Securitisation in South African Law by Natania Locke submitted in accordance with the requirements for the degree in Doctor of Laws. November 2008.
[5] Special Purpose Vehicles and Securitisation by Gary B Gorton and Nicholas S Souleles published by the National Bureau of Economic Research. 1050 Massachusetts Avenue, Cambridge. 2005. At page 555.
[6]Ex parte; Futter, In re: Walter v Road Accident Fund and Another ZA ECPEHC page 7 at paragraph [8]

Cession

Cession is an act of transfer from a creditor, as cedent, to the cessionary, of a right to recover a debt from a debtor. Although it entails a triangle of parties, viz the cedent, cessionary and debtor, the cession takes place without the concurrence of the debtor.[7]

Base Money

Base money is a term used in Economics and refers to the monetary base (or base money), in a country and is defined as the portion of the commercial banks' reserves maintained in accounts with their central bank plus the total currency circulating in the public which includes the currency, also known as vault cash, that is physically held in the bank's vault.[8]

Fractional Reserve Banking

Fractional reserve banking is the practice whereby a bank holds reserves (to satisfy demands for withdrawals) that are less than the amount of its customers' deposits.[9] This is a function of the banking business. Banks borrow funds from their depositors and in turn lend these funds to borrowers.

Background

Complaints against banks all emanate from loans granted by the bank on the security of a mortgage over immovable property.

The borrower falls into arrear with payment.

The bank claims that the borrower is in breach of the home loan agreement and the mortgage bond which entitles the bank to the repayment of the full amount loaned, since the bond contains an acceleration clause, and to an order declaring the property executable.

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[7] Lynn and Main Incorporated versus Brits Community Sandworks CC ZA SCA page 4 at paragraph [6]
[8] The Crisis and the Policy Response. Lecture by Ben S. Bernanke at Stamp Lecture, London School of Economics, London, England – January 2009
[9] Macroeconomics. Andrew B Able, Ben Bernanke and Dean Croushore. 4th Edition at pages 3-5.

The bank accordingly sues the borrower for:

- Payment of the monies loaned and advanced; and
- An order declaring the property executable.

The borrower resists the bank's claim and raises certain defences.

Summary of Defences

Several court challenges have been brought by borrowers. All these challenges raise identical or similar defences to the banks' claims. These defences can, for the sake of convenience, be referred to as:

- The securitisation defence; and
- The agency defence.

To a lesser extent, some of the borrowers also challenge the amount of the banks' claim by alleging that it has not been correctly determined and that the entire claim should be subjected to a forensic audit to determine the indebtedness of the borrower.

The Securitisation Defence

The defendant (borrower) claims that:

The plaintiff bank participates in the practice of securitisation, which is a financial practice whereby various types of contractual debts such as mortgage bonds, are sold as bond securities or mortgage obligations to investors.

The plaintiff bank has sold its rights in terms of the mortgage bond to a special purpose vehicle (SPV) or issuer, an entity specifically created for securitisation that issues securities which are sold to investors and traded on the capital markets.

The plaintiff bank has ceded its rights in terms of the mortgage bond to a third party and accordingly lacks locus standi in the proceedings.

It is the SPV or issuer that is the new legal owner of the asset, and the bank loses title to foreclose on the loan.

The plaintiff bank, upon selling the bond and/or the debt, loses the right to enforce the claim.

The plaintiff bank has already received payment from the SPV for the money sought from the defendant and it cannot be paid twice for the same debt.

The Agency Defence

The plaintiff bank was not the institution that advanced the monies to the defendant as it received the loan by means of South African Reserve Bank bonds. Accordingly, the plaintiff bank advanced the Reserve Bank's money to the defendant.

The plaintiff bank was never the "owner" of the money it advanced and was merely acting as an intermediary or agent in relation to the Reserve Bank.

The plaintiff bank failed to disclose these facts to the defendant at the time of contracting which constitutes a breach of the Banks Act.

The plaintiff bank was not acting as a principal but merely as an intermediary or agent and therefore has no locus standi to sue.

The money lent was not the plaintiff bank's money but the money of the principal, being the South African Reserve Bank, the latter being entitled to claim repayments of any amounts paid out.

Court Findings

The disputed claims and the defences raised were considered in a number of decided case[10] and the courts collectively, inter alia, held that:

- It is unlikely that a transaction such as securitisation would be structured in such a manner that it permanently divests the mortgagee bank of its right to institute legal proceedings against the defaulting mortgagor.

- Even if the rights under the mortgage bonds had been ceded, should the defendants pay the amount presently claimed by the plaintiff and should the "true" holder of those rights at some stage in the future emerge and claim payment of the same debt from the defendants, they would have a solid defence that the debt has already been extinguished.

[10] Standard Bank of South Africa Limited versus Tellinger [2011] ZA GPJHC 70
ABSA Bank Limited versus Hill [2012] ZA WCHC 292
Nedbank Limited versus Coetzee [2012] ZA WCHC 229
ABSA Bank Limited versus Terblanche and Another [2012] ZA WCHC 369
Birch versus Firstrand Bank and related matters [2016] JOL 36051 (ECG) / Case Number 1050/2011

- There was no evidence to support a conclusion that the plaintiff has transferred, sold or ceded its rights in terms of the relevant mortgage bonds to a third party.

- The defence of possible or actual securitisation, where there is no actual proof, only a suspicion that securitisation has taken place, has no prospects of success.

- It is not correct that the Banks Act 94 of 1990 precludes the plaintiff from utilising its clients' deposits for making loans. The business of a bank, as defined in the Banks Act, specifically includes the use of deposits for making loans.

- The suggestion that the plaintiff must have utilised monies obtained from the Reserve Bank to make the loan to the defendants because it is precluded from using its clients' deposits to make loans, is unfounded. The definition of the business of a bank makes it clear that the plaintiff is perfectly entitled to utilise monies received from deposits to grant loans.

- Even if it could be established that the monies which the plaintiff used to make the advance to the defendants did emanate from funds loaned by the Reserve Bank to the plaintiff, that would not justify the conclusion that:

    - The plaintiff was not the owner of the monies loaned to the defendants,
    - It was merely acting as the agent of the Reserve Bank in advancing the monies to the defendants.

- It is trite law that the loan of money, a consumable thing, is classified as a loan for consumption (*mutuum*).[11] A loan for consumption (*mutuum or verbruikleen*) is a contract in terms of which one person ("the lender") agrees to deliver something, or things, that can be consumed by use to another person ("the borrower") for a certain period or to achieve a purpose with the intention that the borrower become the owner. However, it is understood that the borrower is bound subsequently to return to the lender, in the case of money lent, a sum of money equal to that lent, or, in the case of other fungibles, objects of the same kind, quality and quantity.

[11] Willie's Principles of South African Law. 9th Edition. Page 948/949

- The contention that the plaintiff was acting as an agent for the Reserve Bank in making the loan to the defendant's flies in the face of Section 13(c)[12] of the Reserve Banks Act (Act 90 of 1989) which expressly precludes the Reserve Bank from lending or advancing money on the security of a mortgage of immovable property.

- Banks are registered credit providers in terms of the National Credit Act ("NCA").[13] The effect of such registration is that a bank is duly authorised to provide credit and to enter into credit agreements in terms of the NCA, including mortgage loans such as the one in question.

- Section 50(1) of the NCA reads as follows: "*A registration issued in terms of this Act is valid throughout the Republic and authorises the registrant to conduct, engage in, or make available the registered activities at any place within the Republic.*"

- The granting of loans on the security of mortgages over immovable property forms part of the legitimate business of banks which are duly registered credit providers in terms of the NCA. This conduct is not part of the business of the Reserve Bank and, indeed, the Reserve Bank is expressly precluded from engaging therein.

- Interestingly enough, none of the allegations against the banks contain a denial that:

  - The plaintiff bank had advanced money to the defendant; and,
  - The defendant acquired the property on the strength of the mortgage loan.

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The OBS will be guided in its approach to this issue by:

- A number of salient points emanating from the court decisions.
- Its Terms of Reference ("ToR").

[12] Section 13(c) of the Reserve Bank Act, Act 90 of 1989 has been deleted according to Section 53 of the Financial Services Laws General Amendment Act, Act 45 of 2013.
[13] Section 40(1) of the National Credit Act, Act 34 of 2005.

Salient Points

- It is inconceivable that a bank would totally divest itself of all rights and obligations originating from transactions which underlie the assets (mortgage loans) sold to the special purpose vehicle and from all risks associated with the assets transferred.

- The practice of securitisation and the alleged failure by the banks to disclose this practice does not violate the Banks Act or the National Credit Act.

- The cession of mortgage loans does not result in the bank losing its legal title to foreclose on these loans.

- None of the allegations against the banks contain a denial that the plaintiff bank had advanced the money to the defendant and that the defendant acquired the property on the strength of the mortgage loan.

ToR

- It is evident that in cases of securitisation there are considerable disputes of fact between the banks and the defendants. The appropriate forum to deal with disputes of this nature is a court of law.

- The ToR[14] limits the OBS' jurisdiction. The OBS may not consider a complaint or dispute that, "*would more appropriately be dealt with by a court of law or through any other dispute resolution process*."

Conclusion

The fact that several court challenges have already been brought (reinforcing our view that the appropriate forum for disputes of this nature is indeed a court of law) coupled with the limitation on jurisdiction imposed on the OBS by its ToR, leads us to conclude that we should not entertain complaints of this nature.

[14] OBS' Terms of Reference Section 3.2(c)(iv). Page 7

Decision of the OBS

Disputes of this nature are more appropriately dealt with by a court of law. The OBS should not, and accordingly will not, entertain any complaints of securitisation against banks.

The Ombudsman for Banking Services
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