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Abstract

Purpose: This paper aims to explain the benefits of securitization in Kenya's economy that is to both the government, the private sector, and the Kenya capital market. The paper provides a road map on how the government and private sector can diversify their funding sources, lower borrowing costs, improve liquidity, and transfer risk. It will help offer clear policy direction to government policymakers in efforts geared towards the introduction of asset securitization in the country which will increase liquidity, economic growth, and expansion of capital in the country. The regulator of the financial market Capital Market Authority (CMA) will therefore formulate guidelines and regulatory requirements that can enhance the performance of the securitization industry. The paper will also be useful to corporate strategists of companies as they seek to optimize return considerations in driving shareholder wealth margins. The paper is expected to motivate and be a key reference for future research work in the securitization industry in Kenya. Securitization is one of the innovative products that may be used by government and private firms and investors to increase wealth.

Methodology: The study adopted a desktop methodology. Desk research refers to secondary data or that which can be collected without fieldwork. Desk research is basically involved in collecting data from existing resources. Thus, the study relied on already published studies, reports and statistics. This secondary data was easily accessed through the online journals and library

Findings: Securitization will bring benefits in terms of growth in the economy and expansion of capital markets and hence wealth creation. Securitization involves the conversion of a pool of assets with a regular and predictable cash income such as mortgage repayments receivables, and credit card receivables e,t,c into a security or marketable instrument that allows the institution to transact a large number of its assets, which would otherwise not be attractive as individual. The originator who will be the financial institution or the government then creates a legal entity known as a Special Purpose Vehicle (SPV). The special purpose vehicle may be in the form of a Limited Liability Company, a trust, a partnership, or even a subsidiary of the Originator. These selected receivables are then transferred to the special purpose vehicle which then becomes the owner of these receivables. The securities to be issued by the special purpose vehicle are usually rated by a rating agency. This is due to the fact that such instruments are unsecured, which will require that investors are protected.

Unique Contribution to Theory, Practice and Policy: Profit maximising theory and theory of innovation can be used to anchor future studies on securitization enhancing liquidity. If the Government or the financial institution wants to issue 'AAA' rated asset-backed securities or mortgage-backed securities, collateralized mortgage securities, or collateralized debt obligations (CDOs)then they must choose first-class loans not prone to prepayment and default risk where originators conduct their own rating, they select all the best asset bundles for investment. In order to get a favorable rating, the special purpose vehicles can provide credit enhancement to the securities.

Keywords: *Securitization, Liquidity, Capital Markets*

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INTRODUCTION

Kenya has an outstanding internal and external debt which is both interim and continuing debt in a trillion Kenya shilling. Kenya's public debt stood at 9145.98 KES billion in, domestic debt at KES 4,472.84 (48.9% of the country's total debt), and external debt at 4,673.14(51.1 in December of 2022 according to The National Treasury and Central Bank, of Kenya weekly bulletin. Commercial Banks are the leading holders of the Government's domestic debt as of December 2022, at 46.83%, followed by pension funds (33.27 %), insurance firms (7.38%), other investors (6.5%), and Parastatals (6.01).

The World Bank last year in December 2022 warned Kenya about its soaring debt. The debt stock at debated 67.3 % of GDP. If the high ratios are prolonged for long periods, this may lead to a significant slowdown in economic growth and increased default risks, according to the annual public debt management report for the year 2021/2022). Domestic debt service is the highest representing 69.9% of the total debt service while external debt service represented 30.1% in FY'2020/2021, and Interest payments take the bulk of Kenya's debt servicing cost at 63.4% in FY'2020/2021. Notably, domestic debt interest payments incur the highest cost, contributing an average of 53.8% in FY2020/2021(National Treasury). Towards the end of last year 2022, the government was negotiating for Sh123 billion from the World Bank. This was brought down to Sh92.3 billion according to National Treasury and Economic Planning CS Njuguna Ndungú. Treasury says, the loan will help cover government funding needs for the current financial year 2023.

The depreciation of the Kenya shilling has complicated matters, given that Kenya's debt is denominated in US dollars. In a new report launched on December 6th, 2022, the World Bank warned Kenya that the country's risk of debt distress is high, though Kenya's debt remained sustainable. The Global Economic Prospects Report published by the Word Bank on 10 January 2023, noted that "If global inflationary pressures intensify further or persist longer than expected, global interest rates may rise by more than assumed, leading to an even greater deterioration of financing conditions and increased difficulty in regaining access to international borrowing markets." "This could trigger financial distress and government debt defaults. Government debt distress would have large adverse spillovers on growth and financial stability."

The scarcity of capital also threatens private sector borrowers because of strict credit rationing in the arena. According to KIPPRA Discussion Paper, No. 176 2015 says that Kenya Vision 2030 identifies several constraints facing Kenyan manufacturing SMEs, among them Limited access to capital. According to central bank data, it was a challenge for manufacturing and agriculture to access credit in Kenya. Creative monetary advancements will be needed for the capitalist debtors (World Bank, 2013). Accompanied by the securing of property, enterprises can get funding straight from the financial marketplace, instead of fiscal connections such as banks (Fabozzi& Kothari, 2007). By way of having innovative mechanisms.

Kenya's economic well-being as measured by the overall goods and services produced (GDP) dropped to 5.2% in the second quarter of 2022, a drop from 7.77% in 2021, and it has slowed for the fifth quarter consecutively, according to a report by the Kenya National Bureau of Statistics (KNBS). This indicates a contraction of the money supply. Economic growth fell from 6.2 percent to 5.3 percent compared to the same period in 2022, according to the Kenya National Bureau of Statistics.

The KNBS third-quarter report in 2022 indicated that the Balance of Payment recorded a deterioration of 283.9% to a deficit of Kshs 112.7 bn from a deficit of Kshs 29.3 bn as recorded in the third quarter of 2021. This was also a major drop from Kshs 10.9 bn surplus recorded in the second quarter of 2022. The deterioration in the Balance of Payment performance indicates that the country is paying more than it is receiving as indicated by the widening current account deficit by 5.5% to Kshs 193.4 bn in quarter three in ’2022 from Kshs 183.4 bn in the same period in 2021.

Central Bank of Kenya (CBK) data, indicates that the net financial accounts inflows dropped by 34 percent ($345 million) to $660 million in the first quarter of 2023, compared with net inflows of $1 billion in 2022. This means that the capital market is shrinking, less inflow of foreign capital portfolio investments. This could also mean the country has a net financial outflow resulting in less liquidity in the country. In March civil servants’ salaries were delayed signaling a liquidity strain facing the government because of financial obligations –not to default on its debts.

According to the World Bank report in April 2017 on Kenya’s housing demand, the units targeted by the government were 200,000 units of housing annually for all levels of income. However, the building of housing units is presently at 50,000 units per year, which is below the targeted, number, adding up to a housing deficit of more than 2 million units. High interest rates have reduced the demand for mortgages, exacerbating the housing deficit.

The United Nations 2030 Agenda for Sustainable Development Goals (SDGs) that were unanimously adopted by the 193 countries in September 2015 Kenya inclusive have created an ambitious development agenda of reducing poverty by 2030, which requires an equally ambitious agenda to finance them. Kenya is ranked position 118 with a 60.96 percent of SDGs achievement. (Sustainable Development Report 2022) Gideon Mailu reported that “the challenge to the implementation of SDGs in Kenya is financing, https://www.tuko.co.ke/278353-sdgs-kenya-challenges.html

For Kenya to achieve highly sustainable and significant economic growth, its vision 2030 targets, which the new government has coiled on its bottom-up economic model that prioritizes agriculture, healthcare, housing, and manufacturing. Which aligns with the country's long-term development agenda of Vision 2030, which aims to transform Kenya into a competitive and prosperous country with a high quality of life, there is a need to have more capital that will fuel the bottom-up economic growth, achieve Kenyan’s country's long-term development agenda of vision 2030, the sustainable development goals (SDGs) and achieve Africa strategic plan 2063.

The deficient of finances in the country given that currently, the country’s economy is not doing well, the Kenya Revenue Authority has not met its financial target for the last three months ending December 2022, the lack of confidence in debt markets, and the little aid for development, it will be difficult to raise a substantial amount of capital for development as per the World Bank. This means that inadequate capital will jeopardize the short-term and long-term economic growth for the country’s Vision 2030, the realization of the bottom-up economic model, attaining the sustainable development goals, and Africa’s Vision 2063.

Kenya has entered signed the Kyoto Protocol or Paris Agreement and the United Nations Framework Convention on Climate Change (UNFCCC). This requires Kenya to have some plans and strategies to minimize the negative impacts of climate change and also adapt to

Conference of the Parties (COP) decisions. This means that the government has to look for funds to actualize the demands of the treaties entered into and also implement COP decisions

According to the Central Bank of Kenya (CBK), diaspora remittances remittance inflows remained strong in June 2021, amounting to USD 305.9 million compared to USD 288.5 million in June 2020 and USD 315.8 million in May 2021. The report also showed that the cumulative inflows in the 12 months to June 2021 totalled USD 3,383 million compared to USD 2,809 million in the same period in 2020, a 20.4 percent increase. The World Bank reports that Kenya's diaspora remittances stood at shillings 285.5 billion in 2019, which went up 13.6 billion in 2018. By the end of, 2021 the diaspora remittances stood at USD 3,718 million.

According to Dilip Ratha, (Migration and Remittances; Head, KNOMAD – World Bank), remittances are a large and stable source of external financing in sub-Sahara Africa. Remittance flows to sub-Sahara Africa were recorded as dollars 48 billion in 2019, larger than foreign direct investments (FDI) and comparable in size to official development assistance (ODA).

Bonds that are indexed to economic growth could be issued by Kenya encouraging the diaspora to invest in their country. The Central Bank of Kenya and Nairobi Securities Exchange can deduce Diaspora remittance if well harnessed can be a good source of funds for economic development. Innovative financing mechanisms such as the issuance of diaspora bonds and securitization of future remittance flows can help finance big-ticket projects, such as climate conservation, railways, roads, power plants, and institutions of higher learning, stadiums step by step, that will help to transform Africa. Bonds that are indexed to economic growth could be issued. This will improve liquidity and reduce liquidity risk in the government also defaulting on its debt.

For Kenya to reduce its debt burden, and realize its development agenda, given the constraints, it will need to have solutions that will help raise more capital. Treasury, central bank, and capital markets can innovate some market-based financing mechanisms, and create instruments, that could see it borrow from the diaspora communities by securitizing future cash inflows. The government can securitize its predictable stream of current and future cash flows by selling or pledging its future income streams to investors in exchange for immediate cash. This will provide the government with a new source of financing. Inflows to be securitized will include payments from HELB - students' loans, loans or mortgages, hustler fund, youth fund, Sacco-based Hustler, women Enterprise Fund uwezo fund, credit card receivables, auto loans and leases, mortgages, equipment loans, and any other government enterprise receivables.

Securitization, through the development of robust financial markets and innovation financing, will aid in reducing the debt burden and raising funds and will be the way that bring about economic growth. This will improve liquidity and reduce liquidity risk in the government also defaulting on its debt. Securitization helps to reduce risk and increase liquidity in the financial markets. Securitization will be key in promoting financial inclusion in Kenya, by widening the scope of assets that can be used as security or collateral. It is a way to raise finance when other forms of finance are unavailable. For example in a recession banks are often unwilling to lend - and during a boom, banks often cannot keep up with the demand for funds.

Benefits of Securitization in Kenya

The economic product of securitization is based on the ability to provide liquidity -Gyntelberg & Remolona (2006). Outlining the benefits of asset securitization as non-monetary assets can be converted into reasonable instruments that can be cashed in and instruments of high credit score can be made out of debt of low credit score, minimizing risk. Affinito & Tagliaferri (2010) suggest that asset securitization is among the main instruments of transferring credit risk from the originators' annual assets and liabilities, by making a special purpose vehicle, as relayed by Lemmon et al. (2010), asset securitization consists of the transfer of assets from the balance sheet to a bankruptcy remote SPE/V. This makes the property and valuables untouchable for creditors.

Asset securitization will offer a more efficient lower-cost financing source compared to bank or capital markets financing alternatives, according to the European Securitization Forum (ESF). Since securitization normally requires less capital to support it than traditional on-balance sheet funding. Asset securitization will bring more efficient economic risk sharing and allow funding of new assets through the capital market. That way, financial distress costs will be reduced.

Asset securitization will be extremely beneficial for companies that have no problem originating loans but have funding problems. Thomas (1999) argues that asset securitization allows financial institutions to specialize in activities where they have a comparative advantage. Banks take deposits and originate loans, and investment banks through the process of securitization provide the funding. The process of asset securitization can segregate some functions performed by financial institutions that were inseparable now, before this financial innovation. In the traditional banking model, the funding and the origination function always go together. By separating the origination, servicing, and funding functions, financial institutions focus on those activities where they excel.

Asset securitization enhances liquidity Bannier & Hänsel (2008). The underlying assets are efficaciously removed from the originator's balance and instead, cash is injected into the originator's balance sheet. The cost of obtaining these funds is independent of the originator's credit rating. Also, illiquid assets can be turned into reasonably liquid instruments and instruments of high credit quality can be created out of the debt of low credit quality Gyntelberg & Remolona (2006)

Asset securitization will offer improved access to funds, (IMF, 2009, p. 78). Moreover, originators will benefit much more from the market-based valuation of securitized assets and from improved asset-liability management. Originators can perfectly match the cash flows from the securitized assets to the cash flows paid to investors in the Asset-Backed securities (ABSs.) To match-fund certain classes of assets - mortgage assets are technically 25-year assets, a proportion of which should be funded with long-term finance. Securitization will offer the ability to raise finance with longer maturity than is available in other funding markets.

Securitization will be the main instrument that will transfer credit risk away from the originators' balance sheet, Affinito & Tagliaferri (2010). It will help achieve a regulatory (Central Bank of Kenya) advantage since securitization will remove certain risks that can cause the regulators (CBK and CMA) some concern, there will be a benefit in terms of the availability of certain forms of finance for example, the minimum required capital ratio, if the risk in terms of lending increases. Securitization will be a means of managing the restriction on their wholesale funding abilities.

Kenya will benefit from being credit assessed because it will expect foreign investors to purchase its debt, and these investors rely heavily on the credit ratings given by the credit agencies. Also, Kenya will be able to access funds from outside the country and attract other forms of financing for the country in the form of foreign direct investments.

The European Securitization Forum (ESF), proposes that asset securitization allows for diversification of the financing sources. Securitization will offer expanded borrowing capacity and that way the corporate entities and Parastatals can pursue additional positive NPV projects. The proceeds from the securitization issue can be used to retire existing debt, thereby reducing interest expense, and increasing earnings for government, corporates, and shareholder equity.

The asset pool is untouchable for creditors. This is because, asset securitization involves the transfer of assets from the balance sheet to a bankruptcy remote Special purpose vehicle, Lemmon et al. (2010). In case the originator files for bankruptcy, the underlying asset pool is not considered part of the bankruptcy estate and creditors cannot reach the assets in the pool. The assets in the pool are used only for the benefit of the investors in the Asset-Backed Securities (ABSs).

Securitization will reduce information asymmetry, DeMarzo (2005). Securitization will allow, Kenyan banks and investment banks to avoid the “lemon” price of their assets, by pooling and selling assets at their true price.

Theories Explaining the Mechanism of Securitization

The theories and concepts are to help illustrate and understands the various economic, financial, and regulatory factors that drive and influence the practice of securitization. They will help in understanding the motivations behind securitization, its economic implications, and its role in shaping financial markets. The application and relevance of these theories will depend on the specific context and the type of assets being securitized. Regulatory changes and market dynamics can influence the theories and practices of securitization over time.

Funding and Capital Efficiency

The theory informs securitization by emphasizing the optimization of capital and funding allocation. Securitization allows financial institutions to free up capital that was previously tied up in illiquid assets. This capital can then be redeployed into more productive uses, such as making new loans or investments. By doing so, financial institutions can optimize their capital allocation, putting it to work where it generates the highest returns. Originators can use the proceeds from the sale of securitized assets to fund new loans or investments, which can be more profitable than holding a portfolio of loans on their books. This approach can improve the return on equity and overall profitability of the originator.

Regulatory Capital Arbitrage

The regulatory capital arbitrage theory informs securitization on how financial institutions can seek ways to optimize their capital usage within the bounds of existing regulations. They use securitization to optimize their regulatory capital requirements. By securitizing assets, they free up capital that would otherwise be tied up on their balance sheets. Financial institutions are subject to regulatory capital requirements that dictate how much capital they must hold in reserve to cover potential losses. By securitizing their assets and selling them to other investors, banks transfer some of the credit risk associated with those assets to those investors. This reduces the amount of capital that the bank is required to hold against those assets, providing capital relief. The way that regulators classify and assign risk weights to different types of assets can create opportunities for regulatory capital arbitrage. By securitizing assets, banks can potentially benefit from more favourable regulatory treatment or lower risk weights for the resulting securities. This can reduce the capital required to be set aside. Regulatory authorities have since introduced reforms to make capital regulations more stringent and to improve the transparency and quality of securitization practices.

Market Microstructure

Market microstructure theory examines the processes and mechanisms by which securities are traded and how these activities affect market outcomes. It focuses on the detailed aspects of trading, order execution, and price formation. Market. The theory primarily deals with the structure and operation of financial markets, but it can inform securitization .It examines how securitization affects the microstructure of financial markets, including trading practices, pricing mechanisms and price discovery, and market liquidity. The theory provides a framework for understanding the inner workings of financial markets, including securitization markets. By applying this theory, securitization practitioners can make more informed decisions related to the design, pricing, and execution of securitization transactions, ultimately leading to more efficient and effective securitization processes. The theory will inform securitization practitioners and investors with a better understanding of liquidity characteristics of securitized assets. It will provide insights into how liquidity can vary based on the type of security, market conditions, and the trading mechanisms used in securitization markets. This knowledge can inform decisions about the design of securitization structures and the pricing of securitized assets.

The Profit-Maximizing Theory

According to Marshall (1976), the profit-maximizing theory is based on the notion that business organizations' main objective is to maximize long-term profit and develop sustainable competitive advantage in the marketplace. The theory argues that profit maximization is the major and may be the only objective available for turning around companies in order to survive.

Profitable enterprises maximize shareholder value as the main goal of securitization. By removing assets like loans from balance sheets, enterprises can increase their return on assets (ROA) and return on equity (ROE) (Jacobsson & Nordstrom, 2009, p. 16; Fabozzi & Kothari, 2007). Financial institutions profit from asset securitization by obtaining an alternative source of funding, one that costs less than standard borrowing, and with better terms. Originators can use the proceeds from the sale of securitized assets to fund new loans or investments, which can be more profitable than holding a portfolio of loans on their books. This will improve the return on equity and overall profitability of the originator. The originator reduces its exposure to potential loan defaults, which can be costly. This risk transfer leads to lower capital requirements, freeing up capital for other profit-generating activities.

This theory will be integral in supporting the importance of securitization by financial institutions in Kenya, to increase liquidity and maximize shareholder's wealth. It will explain the need for a company to create wealth and do so in the most efficient way possible.

Theory of Innovation

This theory was brought about by Schumpeter in 1943. According to Schumpeter (1943), profit can be attributed to dynamic changes resulting from an innovation. Financial innovation theory posits that the creation of new financial instruments and markets can stimulate economic growth. Securitization has the potential to develop new markets for various asset classes, promoting economic activity and creating opportunities for investors. Securitization has been a driver of financial innovation, as it involves the creation of complex financial products and structures. The innovation theory will drive the development of securitization products that focus on green finance or socially responsible investments. These innovations can improve the allocation of risk and capital in the financial system. Innovations in regulatory frameworks can help ensure the stability and integrity of securitization markets. Which will involve the creation of rules and standards for emerging asset classes or finance technology assets. The Theory encourages the use of technology and data to provide investors with more detailed and real-time information about the underlying assets in a securitization.By embracing innovation, securitization can continue to evolve and better serve the needs of both issuers and investors while addressing emerging challenges and opportunities in financial markets.

Securitization will increase the liquidity of financial markets because tradable securities backed by underlying assets will be created. Financial innovation theory suggests that improved liquidity can reduce the cost of capital and make it easier for borrowers to access. Once loans are securitized and sold as securities, they can be traded in secondary markets. Increased liquidity leads to higher demand for the securities, potentially driving up their prices and benefiting investors. This will be beneficial in markets where certain assets are traditionally illiquid. This theory emphasizes how securitization contributes to the creation of secondary markets for previously illiquid assets.

Modern Portfolio Theory

Harry Markowitz emphasized on concept of diversification to reduce risk. Securitization enables the creation of diverse portfolios of loans. When a large number of loans are pooled together, the risk associated with individual loans is spread across a broader set of assets. This diversification can help reduce the overall risk of the investment, making it more attractive to a wider range of investors. Investors diversify their portfolios by investing in a wide range of loans and credit instruments, as the performance of individual loans may not be correlated.

Through securitization, banks and other originators of loans can convert illiquid assets, like mortgages or auto loans into marketable securities that can be sold to investors. This process helps spread risk among a broader group of investors, reducing the concentration of risk on the balance sheets of individual institutions.

The theory of diversification contributes to securitization by helping issuers reduce risk, attract a broader investor base, enhance credit ratings, mitigate concentration risk, tailor risk profiles, and comply with regulatory standards. Diversification will make the investment more attractive to a wider range of investors and improve the overall risk management of financial institutions.

Agency Theory

In securitization, there are often multiple parties involved, including originators, servicers, trustees, and investors. This calls for separation between the originator of the assets and the investors. The agency theory addresses the potential conflicts of interest among these parties. For example, the servicer may prioritize its fees over the interests of investors. Effective agency management is crucial to ensure that the interests of all parties are aligned. Agency theory emphasizes the importance of aligning the interests of different parties to mitigate conflicts. The theory supports securitization by emphasizing the benefits of risk transfer, by securitizing assets, originators can transfer the credit risk associated with those assets to investors, which can reduce the moral hazard problem of originators taking excessive risks. Agency theory supports the idea that transparent reporting and disclosure requirements in securitization will enable investors to monitor the performance of the assets and the agents responsible for managing them. This transparency can reduce information asymmetry and enhance trust between principals and agents.

Securitization in Kenya

If Kenya starts it will take up great lessons from the South African case and be the first in the East Africa community to securitize assets.Securitization offers a potential alternative to the traditional primary systems and is clearly a paradigm that ought to be seriously considered locally if Kenya is to meet its soaring growth, liquidity needs, capital needs, and increase of wealth of shareholders. By adopting this innovative method, the government, and institutional investors with continuing assets are a possible viable source of funding for loans more expedient than depository institutions that are short-funded. Asset securities will bring about investments that will result in increased wealth, a better stream of funds to the financial and real estate sectors, and a more appealing placement of the risk found in finance.

Kenya can begin by issuing asset-backed securities, it is easier to start with mortgage-backed securities because we have a mortgage refinancing company that could aid in the process. South African Home Loans Ltd had issued its first mortgage-backed security in 2001. According to the National Treasury of South Africa, as of 2019, there were approximately 40 publicly listed residential mortgage-backed securities in South Africa with a total issuance of around ZAR 120 billion (equivalent to approximately USD 8 billion). This has impacted the provision of affordable housing to South Africans.

The Capital Markets Authority (CMA) issued initial regulations for ABSs in the year 2007. In order to open up the market and regulate the issuance of asset-backed securities. However, amendment provisions to the Capital Markets Act were introduced in 2013 and these have since been inconsistent with the 2007 regulations. To address this lapse in the legal framework, the CMA initiated the process of finalizing a Policy Guidance Note (PGN) to clarify and offer guidance for asset-backed securitization. The regulation and the policy guidance were intended to facilitate security innovation which will create room for the development of new financial instruments. Since the introduction of regulation, there has been no financial institution creating securitized assets. The Kenya commercial bank group, in 2014 had plans to issue mortgage back securities on the Nairobi securities exchange (NSE), but is yet to actualize its ambition. Regulation on the securitization of government receivables will also need to be placed, together with the regulation on other forms of securitization, for example, the collateralized mortgage obligation and collateralized debt obligations.

The Central Bank of Kenya (CBK) data indicate that 26,993 active mortgage loan accounts worth sh.239.7 billion in 2019, 26,971 active mortgage loans accounts valued at sh.232.7 billion in 2020 and in2021 dropped to 26,723 active accounts. The drop is attributed to the effects of covid -19. Kenya has potential through Mortgage Refinancing Company (KMRC) Housing finance corporation (HFCK), Nairobi Securities Exchange, (NSE) and investment banks, to set up a secondary mortgage market where lenders will sell home loans, as mortgage-backed securities to long-term investors institution investors like the pension funds, insurers and individual investors. These investors will gain by earning monthly mortgage repayments from home buyers.

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Mortgages in many bank balance sheets add to the list of assets that can be securitized. It is revealed 40% of the financial institutions hold mortgage loans of over Kenya shilling one billion, Kenya commercial bank had a mortgage portfolio of around Sh76.3 billion in 2022 by June, KCB has more than the capability of originating mortgage loans for securitization and has three-quarter of the market share for Mortgages.

According to the World Bank report in April 2017 on Kenya's housing demand, the units targeted by the government were 200,000 units of housing annually for all levels of income. However, the building of housing units is presently at less than 50,000 units per year, which is below the targeted number, adding up to a housing deficit of more than 2 million units. The National Housing Corporation and The Kenya Mortgage Refinancing Company (KMRC) can re-package their loans, securitize them and get more finances immediately, which will enable them to build more houses for citizens. This means another phase of housing begins, then the proceeds of loans are securitized for another phase, more cash is raised and money raised is used to start another phase, as the selling of built houses is going on, whose proceeds may be used to pay interest to investors of securitized securities, without waiting for more funds from government or donors or until all the houses are fully sold or a considerable amount of loans are repaid to start the next housing project. This will reduce the burden on the government and also reduce reliance on government funding.

More than 75 % of financial institutions in Kenya have always raised additional funds to finance their expansion plans indicating the need for additional funds, which would be sourced from securitization. The regulatory framework for asset-backed securities is adequate however lack of enough credit rating agencies. Special-purpose vehicles will be created when the process begins.

Implementation of mortgage-backed securities is necessary in order to improve financial literacy, financial inclusion, and capital deepening in the capital market and attract foreign investments, Karimi, Peter M University of Nairobi Publishers 2019, as well as foreign direct investments.As at 2021 Kenya's mortgage debt stood at 2.48 percent of the GDP, better than that of its East African neighbours Tanzania and Uganda which are 0.2 and one percent respectively. The gap indicates a need for financial innovative products that meet market needs that will aid in the construction of lower-priced houses that are accessible by lower-income earners and hence more buyers. The housing finance, together with Kenya Mortgage Refinance Company (KMRC) can take up all these mortgages off the financial institutions balance sheets and use them to introduce Mortgage-backed securities which will transform and revolutionize the financial market in terms of mortgage-backed Security and Asset-backed security industry just like was the case in Malaysia with the Cagamas Berhad. It can adapt the structure of the Ginnie Mae, Fannie Mae and Freddie Mae of the United States of America. Researchers have found that the security in the securitization of residential mortgages has lowered rates paid by those who borrow, Sirmans and Benjamin (1990), Hendershott and Shilling (1989), Jameson, Dewan, and Sirmans (1992).

Diaspora bonds are cheap and stable income to the economy, and more so during times when the country cannot meet its revenue targets, it can supplement by issuing diaspora bonds and securitization of future remittances. Kenya can consider raising funds from the diaspora community and securitizing them. According to Suhas Ketkar and Dilip .The governments of India and Israel have raised about $40 billion often, during liquidity crises, by tapping into the wealth of their diaspora communities to support the balance of payments needs and finance infrastructure, housing, health, and education projects (Suhas Ketkar and Dilip Ratha world bank2013).

In developing countries, particularly in Latin America, some borrowers have raised financing by securitizing future flow receivables in hard currency.Suhas Ketkar and Dilip Ratha 2001 indicate that, during financial crises, developing countries cannot obtain low-cost, long-term loans. The Government can further its development objective by securitization, for example, it can issue to investors both asset-backed securities and collateralized debt obligations, by securitizing loans extended by Sacco-based Hustler, hustler fund Youth Enterprise Development Fund, Women Enterprise Development Fund, joint business loan board scheme, and Uwezo fund, and utilize the cash profits from securities to create more financial advancements to other small and midsize enterprises as loans. This will assist small businesses that are starved for cash. Under this plan, small firms get access to capital, borrowing up to a certain limit without putting up collateral.

The various ministries can also securitize by repackaging various streams of income from the standard railway gauge, the oil mining in Trukan, wind power in the same area, and securities issued to raise funds to expand operations of the standard railway gauge to other profitable routes without relying on external loans. Funds raised by streams of securitization of oil mining can also be used for the refinement of oil, this means Kenya will have its own oil and not import and also fund infrastructure.

The stream of incomes flowing to by Kenya Ferry Services as charges on vehicles and ferry cruises that cross Likoni channel can be securitized. Funds raised from securitization can be used to modernize and expand ferry services. In 2018, Kenya Ferry earned Sh1.9 million daily from vehicle tolls paid in cash. The Auditor General's Report for the year ending June 2020 showed that Kenya Ferry Services got an annual income of Sh1.3 billion, out of which Sh497 million is in respect to the income from its operations. The funds from the asset backed securities can be used to buy and modernize ferries . This will enable Kenya ports to have cruises between the ports of Mombasa, Lamu, Shimoni, Zanzibar and Pemba. This means an increase of tourist visit, hence increase in economic growth.The government can structure bonds by securitizing income received from Kilindini Harbor,Dongo Kundu Port, Kisumu port, lamu part and the shimoni port. This will help develop the ports and leave some income for government. Alternatively it can also securitize lease payments by private investors in the ports.

The Higher Education Loans Board (Helb) has a good pool of student loans, especially the ones issued to salaried employees, offered at a much higher rate can be securitized and money raised can be used to create more loans especially for needy students to provide more loans to students. The high education loans that are offered at a lower rate, than the central bank lending rate will be financially reengineered to enable securitization. The United Kingdom managed to raise 1.7 billion sterling pounds from more than 400,000 student loans in December 2017.

Securitization of future flow receivables will enable investment-grade public and private sector entities in Kenya to obtain credit ratings higher than those of the governments and raise funds in international capital markets.

The Process of Asset Securitization

Securitization involves the conversion of a pool of assets with a regular and predictable cash income, such as mortgage repayments, credit card receivables other receivables like leases, into a security or marketable instrument which allows the institution to transact a large number of its assets, which would otherwise not be attractive as an individual asset.

It is the financial exercise of pooling various types of contractual debt such as residential mortgages, commercial mortgages, auto loans, credit card debt obligations, or other non-debt assets which generate receivables and selling their related cash flows to third-party investors as securities, which may be described as bonds, pass-through securities, or collateralized debt obligations (CDOs). Investors of these securities are paid from the principal and interest cash flows collected from the underlying debt and redistributed through the capital structure of the new financing. Securities backed by mortgage receivables are called mortgage-backed securities (MBS), while those backed by other types of receivables are asset-backed securities (ABS), backed by debt are called collateralized debt obligations and the ones with different risk profiles to the investors are called collateralized mortgage obligations(CMOs). The securitization process begins with the origination and subsequent pooling of assets, which are transferred to a balance sheet that is legally separate from that of the originator's balance sheet.The originator or financial institution or even government enterprises, then creates a legal entity known as a Special Purpose Vehicle (SPV). The special purpose vehicle may be in the form of Limited Liability Company, a trust, a partnership or even a subsidiary of the Originator. These selected receivables are then transferred to the special purpose vehicle who then becomes the owner of these receivables.

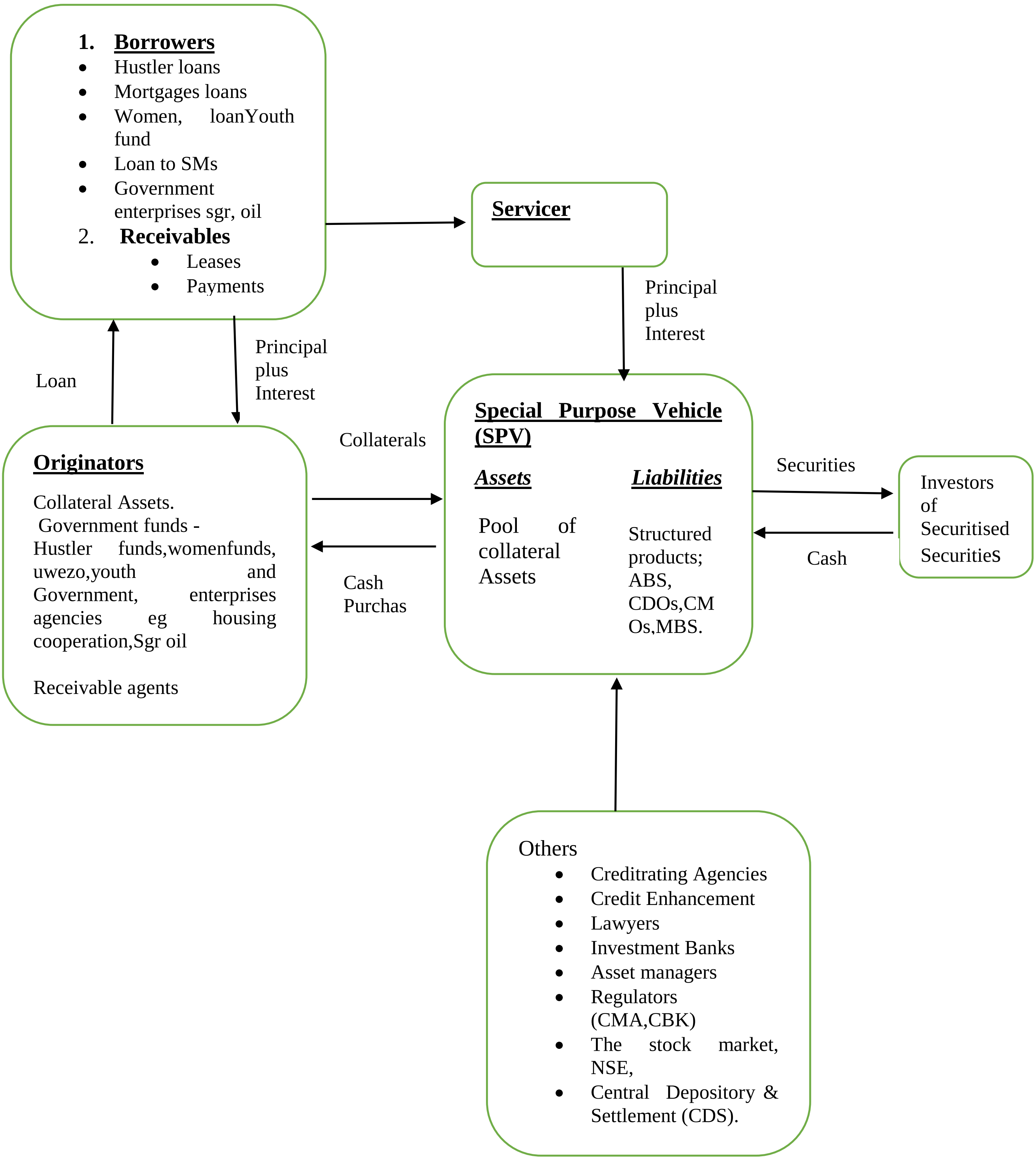

Figure 1: Conceptual Framework (By the author)

Originator

The originator (Fund, Financial institution, Non-financial institution, Government Enterprises, or a Company) is the entity that creates a pool of assets of financial assets, such as loans.

Special Purpose Vehicle (SPV)

A special purpose vehicle (SPV), is also known as a special purpose entity (SPE). It is a legal entity created specifically for a particular financial transaction, such as securitization. It is a separate legal entity that is established to hold the assets that are being securitized.

Borrowers of Funds

In a securitization process, the borrowers of funds are the original owners of the underlying assets that are being securitized. These assets can include a wide range of financial instruments, such as loans, Sacco loans, mortgages, auto loans, credit card receivables, and student loans.

Servicer

The servicer is a company or an entity that is responsible for managing the day-to-day operations of the assets that have been securitized. The servicer is responsible for collecting payments from the borrowers, maintaining records, and ensuring compliance with the terms of the underlying loans or other assets.

Investment Bank

An investment bank acts as an intermediary between the issuer of the securities and the investors who purchase the securities. The investment bank will facilitate the process of converting illiquid assets, such as loans or receivables, into tradable securities that can be sold to investors. And ensures that the process runs smoothly from start to finish.

Asset Managers

Asset managers play a critical role in the securitization process. They are responsible for, identifying and selecting the underlying assets, pooling them together and managing the assets being securitized, designing and managing the structures that make securitization transactions, perform due diligence and establish investor relationship and servicing the assets after issuance.

Credit Rating Agencies

Credit Rating Agencies (CRAs) play a critical role of assessing the creditworthiness of the securities being issued. They provide an independent assessment of the creditworthiness of the securities being issued.

Credit Enhancement

These are the various measures that are taken to reduce credit risk in securitization transactions. They enhance the credit quality of securitized assets, making them more attractive to investors and enabling issuers to raise funds at lower costs.

Lawyers

Lawyers ensure that securitization transactions are structured, documented, and executed in a way that meets legal and regulatory requirements and protects the interests of all parties involved.

The Stock Market – Nairobi Securities Exchange (NSE)

The NSE will facilitate securitization by providing a marketplace for issuers to list their securities and a platform to trade securities, as well as providing liquidity to the market. NSE will facilitate the pricing of the securities based on supply and demand.

Capital Market Authority (CMA)

The Capital Markets Authority (CMA) is responsible for regulating and supervising the capital markets in Kenya, which include the issuance and trading of securities. It will be responsible for ensuring that the issuance and trading of securitized securities are done in a transparent and fair manner and that investors are protected from fraudulent practices.

The Central Bank and Banking Act

The Central Bank of Kenya Act and the Banking Act have provisions that govern securitization, particularly with respect to the role of banks in securitization transactions.

Central Depository & Settlement Corporation

The CDSC through its CDS will provide the infrastructure for the issuance, settlement, and trading of the securities that are created through securitization. CDSC services are absolutely necessary for the efficient functioning of the securitization market in the country.

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