



Session 4: Balanced Funding and Mortgage Securities

The Evolving Role of Secondary Market Institutions and Securitisation: Experience of Cagamas Berhad

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Views expressed in this paper are that of the author and does not represent the views of Cagamas Berhad

Home Ownership and the Establishment of the National Mortgage Corporation



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Home Ownership: Government's Policy

- Objective of housing policy
 - to increase accessibility to adequate, affordable and quality houses
- Actively promote home ownership since the 1970s
 - especially among the lower- and middle-income groups



The Mortgage Market

- Characteristics of housing loans in Malaysia
 - granted on floating rate basis
 - have maturities ranging from 15-25 years
 - have low default rates and foreclosure losses are minimal



The Mortgage Market

- Ready access to credit facilities would only be available if:
 - there are willing lenders
 - the lenders are able to secure funds at low mortgage rates
 - the primary lenders are able to sell some of their existing housing loans
 - the lenders are able to raise funds to finance new housing loans on a revolving basis



The Financial Institutions

- In the early 1980s, the financial institutions faced tight liquidity situation
- They were subject to liquidity risk arising from the mismatch of maturities of the funds (short term) and the housing loans (long term)
- Therefore, the financial institutions would only be able to provide ready access to housing loans at favourable rates if they can secure cheap funds and reduce maturity mismatch



Technical Committee (1980)

- A Committee set up by Bank Negara Malaysia (BNM) recommended the establishment of a secondary mortgage market
- The proposal was not implemented since the conditions then were not conducive to introduce such a market



Technical Committee (February 1986)

- A new Technical Committee was set up to:
 - explore the feasibility of a secondary mortgage market
 - propose viable instruments for such a market
 - determine the requirements for setting up of an institution to act as an intermediary between primary lenders and investors
- Recommendation
 - that a national mortgage corporation be established as a matter of priority in view of the prevailing recessionary conditions
 - Cagamas was intended to be used as one of the measures to overcome the recession



Cagamas Berhad, the National Mortgage Corporation

- Incorporated in December 1986 as a public limited company; to operate as a private sector enterprise
- Commenced business in October 1987
- Shareholders
 - single largest shareholder is BNM (20%)
 - financial institutions (80%)
- Cagamas' specific role
 - to encourage home ownership and develop the private debt securities (PDS) market in Malaysia



Cagamas' Role: Encouraging Home Ownership

- Provides financial resources to enable primary lenders to grant more loans
- Provides liquidity by narrowing the gap between the maturity structure of the housing loans and the source of funds

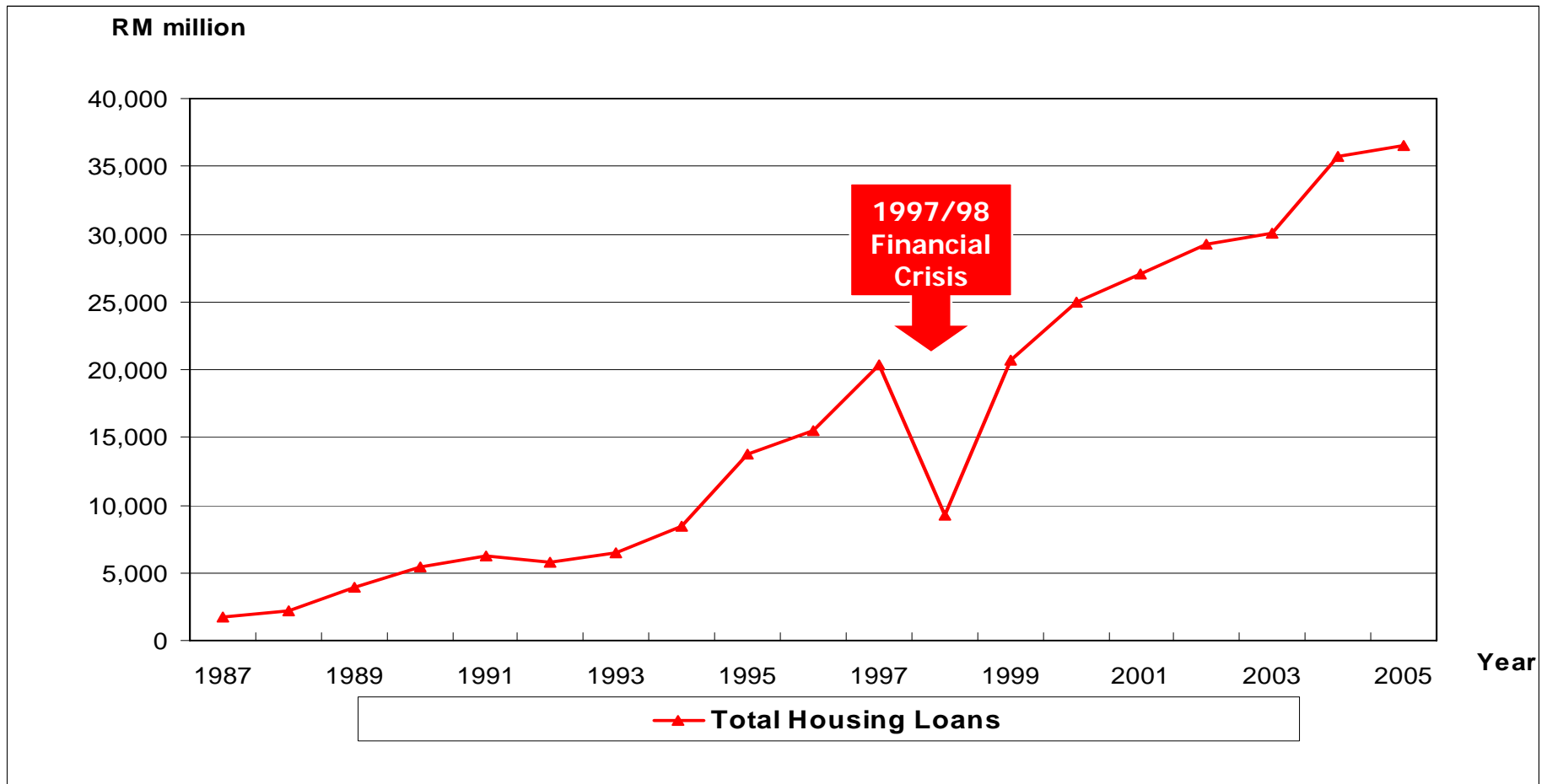


Encouraging Home Ownership: Benefits

House Buyers	Sellers	Govt. and the Economy
<ul style="list-style-type: none"> • Obtain easy access to housing loans at reasonable cost • Obtain attractive and affordable housing loan packages characterised by low interest rates for the initial years 	<ul style="list-style-type: none"> • Hedge interest rate risks • Obtain liquidity at a competitive cost to originate more housing loans and enhance lending operations • Price loan products competitively • Improve CAR if they sell on without recourse basis 	<ul style="list-style-type: none"> • Helps to achieve its policy of encouraging home ownership • Makes housing loans more affordable to the lower income group without any interest subsidy being incurred by the authorities • Encourages property development and related spin-off effects



Approved Housing Loans: Banking Sector





Housing Credit Outstanding¹

Primary Lenders	As at end	1988		1998		2004	
		RM mil	%	RM mil	%	RM mil	%
Banking System ²		10,045	47.7	50,684	72.0	109,644	77.3
Treasury Housing Loans Division		8,968	42.6	15,794	22.4	25,930	18.3
Malaysia Building Society		1,285	6.1	1,436	2.0	1,753	1.2
Borneo Housing Mortgage Finance		466	2.2	533	0.8	705	0.5
Sabah Credit Corporation		162	0.8	269	0.4	238	0.2
Bank Rakyat		129	0.6	717	1.0	2,508	1.8
Bank Simpanan Nasional		-	0.0	1,006	1.4	1,059	0.7
Total		21,055	100	70,439	100	141,837	100

¹ Includes loans sold to Cagamas

² Includes commercial banks and finance companies



Cagamas' Role: Developing the PDS Market

- The PDS market was virtually absent until the creation of Cagamas
- The fledgling capital market began to grow more rapidly after Cagamas was established
- Other corporations started to issue PDS as an alternative to borrowing from the financial institutions



Developing the PDS Market: Benefits

Capital Market

- Provides additional instruments for investing surplus funds
- Provides an opportunity for bond dealers to undertake transactions in PDS on a large scale
- Paves the way for other corporations to raise funds in the domestic market

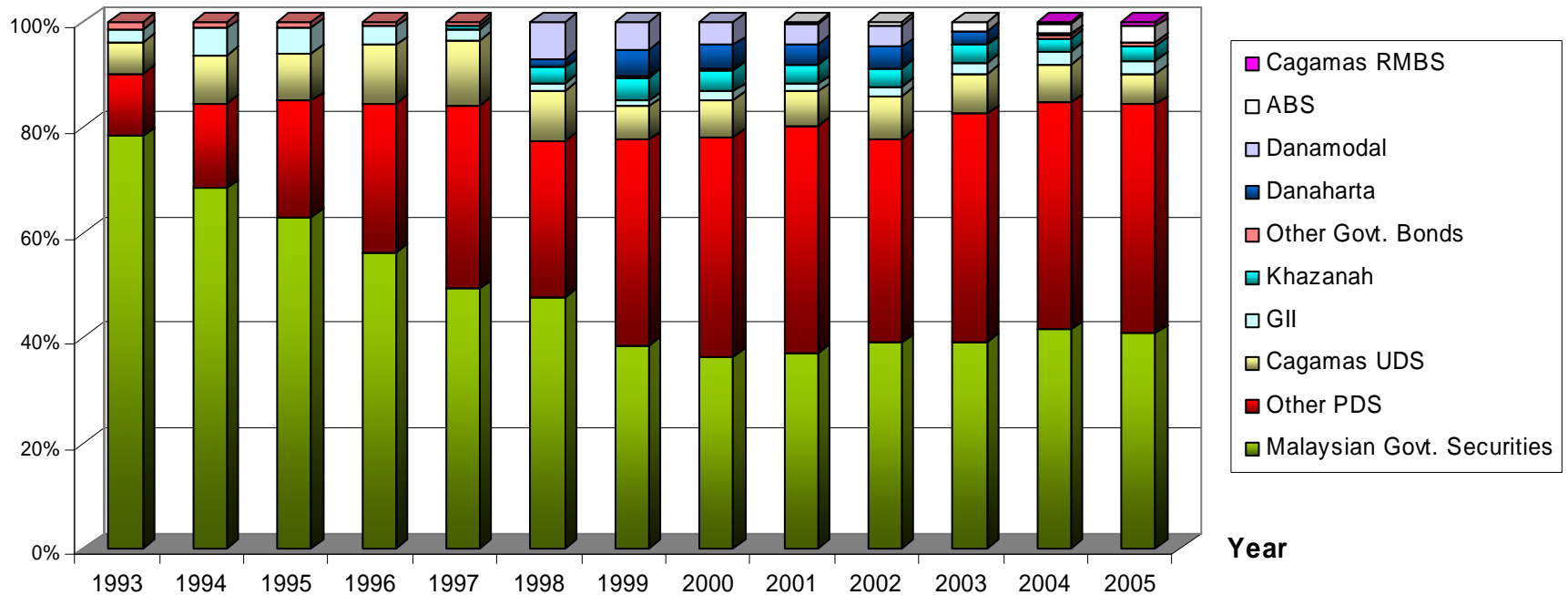
Investors

- High quality papers to investors
- Attractive channel for investment by pension funds, insurance companies and banks with large surplus long-term funds seeking long-term investment assets



Capital Market Debt Securities

Percentage





Cagamas' Share of PDS Market

As at end	Other Private Debt Securities		Cagamas Unsecured Bonds		Total	
	RM mil	%	RM mil	%	RM mil	%
1993	10,081.0	66.8	5,015.0	33.2	15,096.0	100.0
1994	15,131.2	62.9	8,925.0	37.1	24,056.2	100.0
1995	22,700.9	70.9	9,312.0	29.1	32,012.9	100.0
1996	33,527.5	71.7	13,227.0	28.3	46,754.5	100.0
1997	46,594.4	73.6	16,756.0	26.4	63,350.4	100.0
1998	46,745.0	75.6	15,064.0	24.4	61,809.0	100.0
1999	79,313.0	85.9	13,019.0	14.1	92,332.0	100.0
2000	102,220.0	85.5	17,312.0	14.5	119,532.0	100.0
2001	120,584.0	86.7	18,427.0	13.3	139,011.0	100.0
2002	108,416.0	82.8	22,595.0	17.2	131,011.0	100.0
2003	144,595.0	84.9	25,628.0	15.1	170,223.0	100.0
2004	160,057.0	85.7	26,752.0	14.3	186,809.0	100.0
2005	177,541.3	88.0	24,107.0	12.0	201,648.3	100.0

Source: Bank Negara Malaysia Annual Report - various years



Cagamas' Share of Capital Market

As at end	Cagamas Unsecured Bonds		Cagamas RMBS		Total Capital Market	
	RM mil	%	RM mil	%	RM mil	%
	1993	5,015	5.9			84,387
1994	8,925	9.4			95,003	100.0
1995	9,312	9.0			102,913	100.0
1996	13,227	11.1			118,907	100.0
1997	16,756	12.5			134,281	100.0
1998	15,064	9.6			157,276	100.0
1999	13,019	6.4			203,371	100.0
2000	17,312	7.1			245,081	100.0
2001	18,427	6.6			279,551	100.0
2002	22,595	8.1			280,565	100.0
2003	25,628	7.7			333,985	100.0
2004	26,752	7.2	1,555.0	0.4	371,868	100.0
2005	24,107	5.9	5,665.0	1.4	408,614	100.0

Source: BNM Annual Reports and Monthly Statistical Bulletins



UDS: Regulatory Treatment

- The initial regulatory treatment accorded to Cagamas debt securities acted as a catalyst to kick start the development of private debt securities market
- Cagamas has successfully established itself as a primary player in the capital market and grown from strength to strength over the past 17 years
- The domestic PDS market has displayed exemplary growth and has been underscored by a series of notable highlights
 - regulatory consolidation
 - unveiling of the Capital Market Masterplan
 - the advent of asset securitisation



UDS: Revision of the Regulatory Treatment

- To further enhance the efficient functioning of the bond market, BNM had on 3 September 2004 revised the regulatory treatment for Cagamas unsecured debt securities
- Reflects BNM's recognition of Cagamas' maturity and confidence in its ability to continue to play a pivotal role in the development of the capital market on a more competitive basis, in line with the ongoing liberalisation of the financial and capital market



UDS: Revision of the Regulatory Treatment

	Issuance before 4 September 2004	Issuance after 4 September 2004
Risk weight under the Risk Weighted Capital Ratio framework	10%	20%
Liquefiable assets status under the liquidity framework	Class-1 liquefiable	Class-2 liquefiable
Yield slippage under the liquidity framework	4%	6%
Mode of Primary Issuance	Through Principal Dealers' network	Not through Principal Dealers' network
Holdings by insurance companies	Accorded low risk asset status	Accorded credit facilities status

Evolving Role of Cagamas



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Cagamas' Evolving Role

1987-1991

Start-up Phase

1992-1997

Take-off and Growth Phase

1998-2003

Diversification Phase

2004 to date

Securitisation Phase



1987-1991: Start-up Phase

- The newness of its operations and its limited product line contributed to its slow progress in the early stage
- Client base:
 - Financial institutions (1987)
 - Government (1988)
- Initially, only one product - buying on fixed rate for 5 years with recourse



- 1 Nov 1989, introduced 7-year Cagamas Rate
 - to increase the Company's range of products offered to the market
 - to satisfy the market's demand for such longer term facilities
- On 24 August 1990, introduced 3-year Cagamas Rate
 - to cater to the demand for sale of housing loans for a period shorter than the standard 5 years
- With the new facility, primary lenders can sell their housing loans to Cagamas for a period that may range from 3 to 7 years



- First five years - low volumes of housing loans purchased
 - unfamiliarity with Cagamas' operations and the advantages of selling housing loans to Cagamas
 - interest rates were declining rapidly
- Outstanding loans held by Cagamas (1987-91)

As at end	Housing Loans (RM million)
1987	407
1988	1,396
1989	2,490
1990	3,082
1991	3,060



1992-1997: Take-off and Growth Phase

- From 1992 - active marketing and introduction of new products
- Widening of client base to include selected corporations
- Extended its range of products on with recourse basis
 - Floating rate housing loans (1992)
 - Convertible rate housing loans (1993)
 - Islamic house financing debts (1994)
 - Industrial property loans (1996)



- Outstanding loans and debts held by Cagamas (1992-97)

As at end	Housing Loans		Islamic House Financing Debts		Industrial Property Loans		Total	
	RM million	%	RM million	%	RM million	%	RM million	%
1992	5,345	100.0					5,345	100.0
1993	6,076	100.0					6,076	100.0
1994	9,915	99.7	29	0.3			9,944	100.0
1995	11,854	99.8	28	0.2			11,882	100.0
1996	16,086	99.7	56	0.3			16,142	100.0
1997	21,317	96.7	85	0.4	643	2.9	22,045	100.0



1998-2003: Diversification Phase

Purchase With Recourse

- **Hire purchase and leasing debts (1998)**
 - serves as a hedging mechanism for such debts which are granted on a fixed rate basis
- **Islamic hire purchase debts (2002)**
 - provides Islamic institutions with an avenue to raise fixed rate funds at low cost to hedge their fixed rate assets
- **Credit card receivables (2003)**
 - allows the sellers to diversify their funding resources



- Diversification into non-mortgage products has prevented the Company's balance sheet from decreasing
- Outstanding loans and debts held by Cagamas (1998-2003)

As at end	Housing Loans		Islamic House Financing Debts		Industrial Property Loans		Hire Purchase and Leasing Debts		Islamic Hire Purchase Debts		Total	
	RM million	%	RM million	%	RM million	%	RM million	%	RM million	%	RM million	%
1998	21,363	95.1	150	0.7	762	3.4	200	0.9			22,475	100.0
1999	17,493	86.9	120	0.6	868	4.3	1,659	8.2			20,140	100.0
2000	17,803	79.4	213	1.0	550	2.5	3,844	17.2			22,410	100.0
2001	15,309	68.8	143	0.6	377	1.7	6,437	28.9			22,266	100.0
2002	14,579	56.0	244	0.9	238	0.9	10,513	40.4	459.0	1.8	26,033	100.0
2003	15,140	55.4	345	1.3	55	0.2	11,236	41.1	563.0	2.1	27,339	100.0



2004 to date: Securitisation Phase

- Purchase of housing loans on without recourse basis
 - introduced in March 1999 in tandem with the thrust towards asset-backed securitisation
- However, there was no urgency for the financial institutions to securitise their housing loans
 - housing loans are good quality assets
 - excess liquidity in the banking system
 - high risk-weighted capital adequacy ratio of the banking system [12.5% (1999), 13.1% (2005)]
 - housing loans are deemed to be high quality assets since their default rates are very low and foreclosure losses are negligible



- The breakthrough for the scheme came in April 2004 when the Government of Malaysia mandated Cagamas as the vehicle to undertake the securitisation of the Government's staff housing loans (GSHL) on a scheduled basis and over a period of time
- Cagamas is also looking into the securitisation of other asset classes (including those based on Islamic principles)

Securitisation of the GSHL



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Objectives

- To promote ABS as a new tool for raising funds from the capital market
- To create a yield curve for MBS that serves as a benchmark for other ABS issuers to gauge the potential pricing levels for their assets
- To further increase the depth and efficiency of the domestic capital market

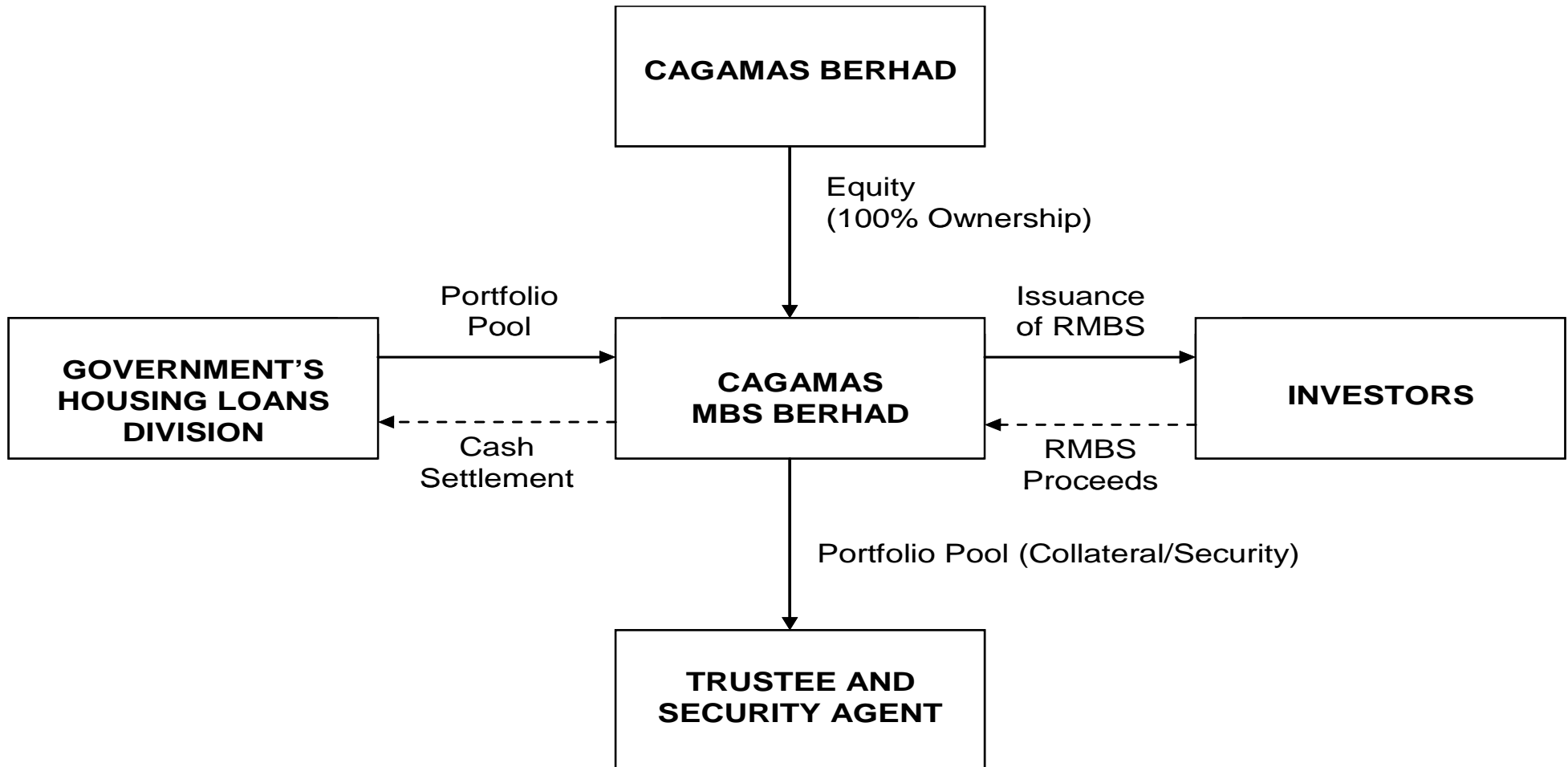


Cagamas MBS

- Cagamas incorporated a wholly-owned subsidiary, Cagamas MBS Berhad (CMBS), as a limited-purpose entity to solely:
 - purchase the Government's staff housing loans; and
 - issue RMBS
- CMBS has certain features of a bankruptcy-remote entity
 - restrictions place upon it in M&A and Trust Deed
 - cross-collateralisation of security is not expected for any of its issues



Securitisation Structure of GSHL



The Way Forward



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- Cagamas' Role

- Cagamas is now at the crossroads of having to operate in a competitive level playing field while retaining its important social objective of encouraging home ownership
- Cagamas will therefore continue to develop innovative and more diverse financial products to meet the requirements of sellers and investors
- in line with the Cagamas' mission to promote home ownership, the Company on its part, will continually refine, modify and introduce new products, including Islamic products, to meet the challenges of ensuring easy accessibility to housing loans at an affordable cost



- **Asset-Backed Securities**
 - the issuance of ABS is set to grow with support from the securitisation of the GSHL
 - other asset classes that may be securitised include HP&L debts, credit card receivables, and SME loans

Thank You



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