



Case Study of Secondary Mortgage Liquidity Facilities: Cagamas Berhad

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Workshop on Housing Finance in South Asia
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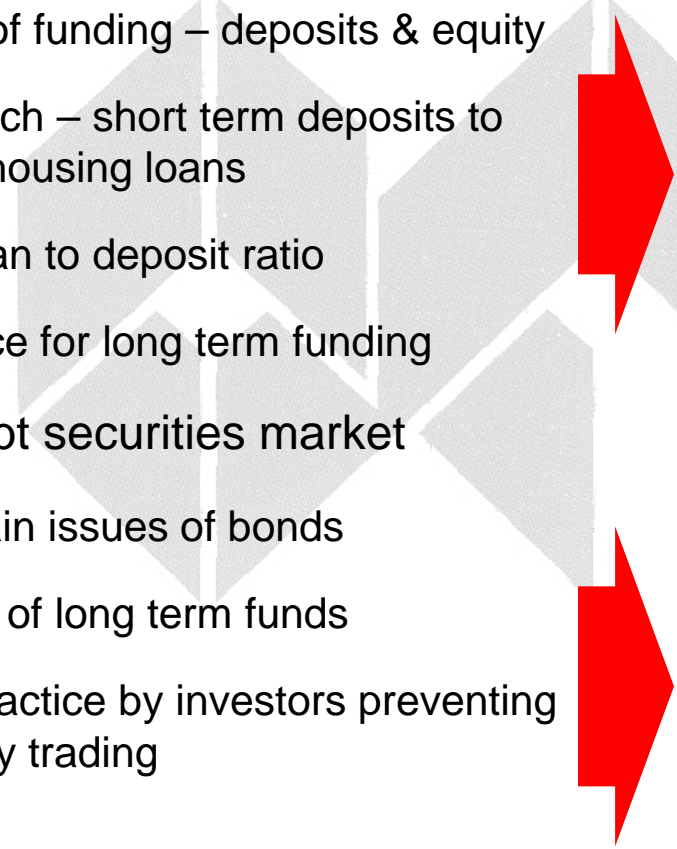
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Establishment of Cagamas

Situation in the mid 80s

- Financial Institution faced tight liquidity situation
 - ✓ Limited source of funding – deposits & equity
 - ✓ Funding mismatch – short term deposits to fund long-term housing loans
 - ✓ Deteriorating loan to deposit ratio
 - ✓ Inability to source for long term funding
- Limited private debt securities market
 - ✓ Government main issues of bonds
 - ✓ Limited sources of long term funds
 - ✓ Buy and hold practice by investors preventing active secondary trading



FIs reluctant to give out housing loans, particularly low & medium cost houses – housing loans are deemed long-term illiquid assets

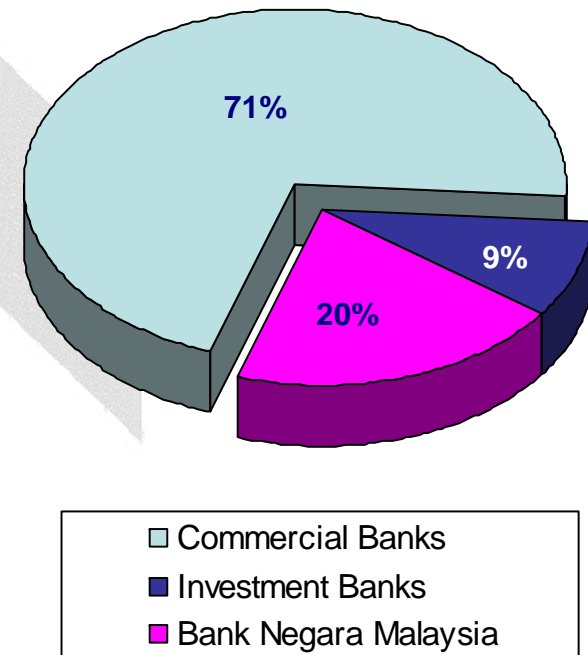
Need for private debt securities market to enable private sector to tap alternative sources of financing

Establishment of Cagamas

Establishment of a National Mortgage Corporation

- Cagamas was established in 1986
 - ✓ paid up capital of RM150m
- Shareholders comprise of Bank Negara Malaysia (20%) and commercial and investment banks in Malaysia (80%).
- Snapshot at 31 March 2009:-
 - ✓ Shareholders fund of RM1.6b
 - ✓ Assets of RM21b (excl. RMBS – RM9b)
 - ✓ Bonds issued todate RM233b

Shareholding Structure of Cagamas



Role of Cagamas

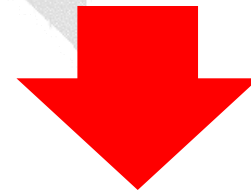
Objective of Cagamas

- Cagamas was set up with 3 main objectives:-

1. Alleviate the liquidity problem and reduce funding mismatch within the banking sector
2. Promote home ownership
3. Spearhead development of the private debt securities market



Function as intermediary between primary lenders and investors of long term funds



Take on role of credible issuer of mortgage securities

Role of Cagamas

Objective of Cagamas (Cont'd)

- The role of Cagamas in today's market has evolved to include playing an active role as a catalyst for the Governments' and Bank Negara Malaysia's initiative for the economy and financial sector. They are:-
 1. Promotion of home ownership / home accessibility and affordability in Malaysia
 - Shift from liquidity and hedging to risk management and portfolio management (PWOR)
 - Development of the RMBS market
 2. Development of the Islamic financial sector
 - Develop innovative Islamic financial instruments / structure (IRMBS, Sukuk Commodity Murabahah)
 - Support the promotion of Malaysia as an International Islamic Financial Centre
 3. Enhance and support in the stabilization of the financial sector in Malaysia
 - Removal of systematic risk in the financial system (PWOR & MGP)
 - Promote risk management (PWOR & MGP)
 - Conduit for best practices & setting up of standards
 4. Development of the Malaysian and regional capital market
 - Contribute to the depth and breath of capital market (innovative structure, longer tenor etc.)

Role of Cagamas

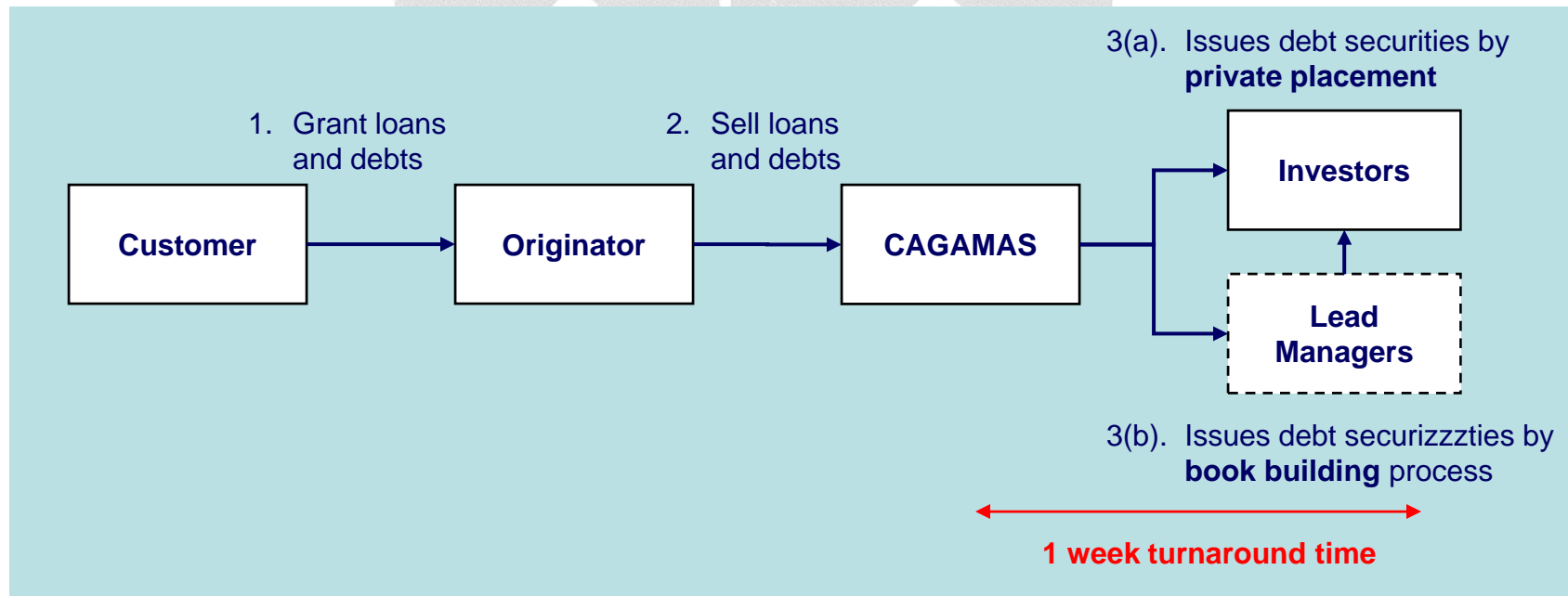
Key Success Factors

- Implicit and explicit support from Government & regulators
 - ✓ Regulatory treatment for Cagamas Bonds (Liquid asset status, low-risk asset status, 10% risk weight*, principal dealers etc.)
 - ✓ Exemptions from certain regulatory requirements (e.g. Statutory reserves & liquidity requirements, SC approvals etc.)
 - ✓ These regulatory treatments and exemptions have been gradually removed over time
- Standardised procedures and processes for purchase
 - ✓ Fast turn around time
- “AAA” rating by Rating Agency of Malaysia (RAM) and Malaysian Rating Corporation (MARC)
 - ✓ High quality issuer by investors
 - ✓ No default in over 22 years of operations

Liquidity Model: Purchase with Recourse

Background to PWR

- Cagamas started by purchasing housing loans from financial institutions on with recourse basis as it was liquidity for longer term financing that was needed then
- Cagamas purchases loans and debts with recourse to the originator whereby the latter is responsible for any loss arising from default by the borrower.



Liquidity Model: Purchase with Recourse

Types of Purchase with Recourse

- Cagamas purchases loans and financing debts under the following facilities:

1. Conventional Housing Loans Purchase Facilities

- ✓ direct purchase
- ✓ back-to-back arrangement

2. Islamic House Financing Debts (IHFD) Purchase Facilities

- ✓ purchase of Bai Bitaman Ajil house financing debts

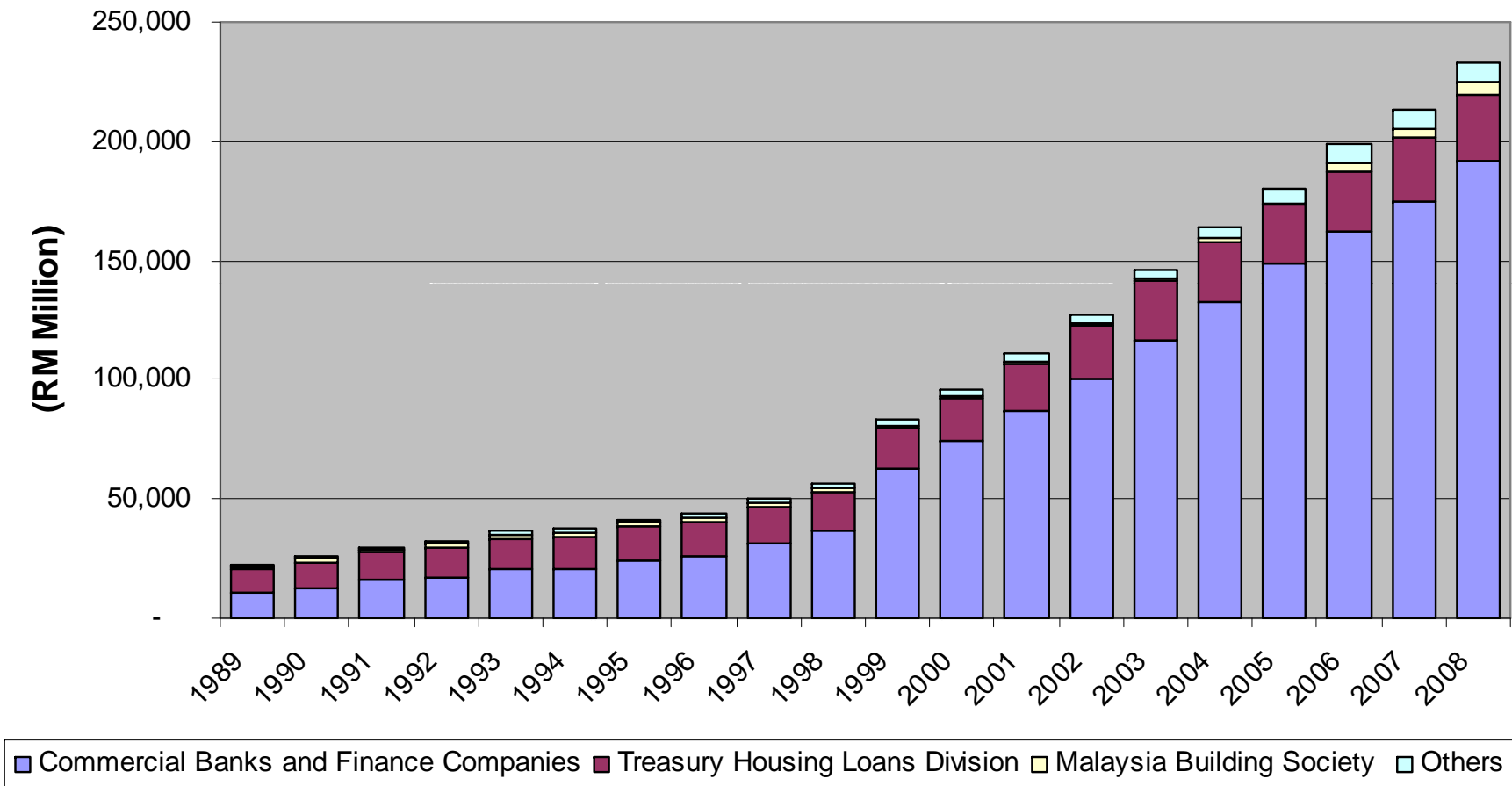
Liquidity Model: Purchase with Recourse

Key Features and Benefits

Features	Benefits
<ul style="list-style-type: none">• Structured legally as sale of debts. However, the structure does not qualify as a “true sale” under the Asset Backed Securities (“ABS”) Guidelines due to its recourse feature• Sale is subject to a Credit Limit established for each FI/IBI• Cagamas rate is based on Cost Plus Basis i.e. Bond Yield plus Cagamas’ margin• Loans sold to Cagamas are not off balance sheet	<ul style="list-style-type: none">• Hedge interest/profit rate risks• Alternative funding to grow assets• Increase Return on Equity as the income generated through the proceeds of the PWR will not be shared for Profit Distributable to Depositors• Able to price financing products competitively• Proceeds from the sale is deductible from Eligible Liability calculation

Impact of Cagamas on the Housing Market

Housing Credit Outstanding (cumulative)

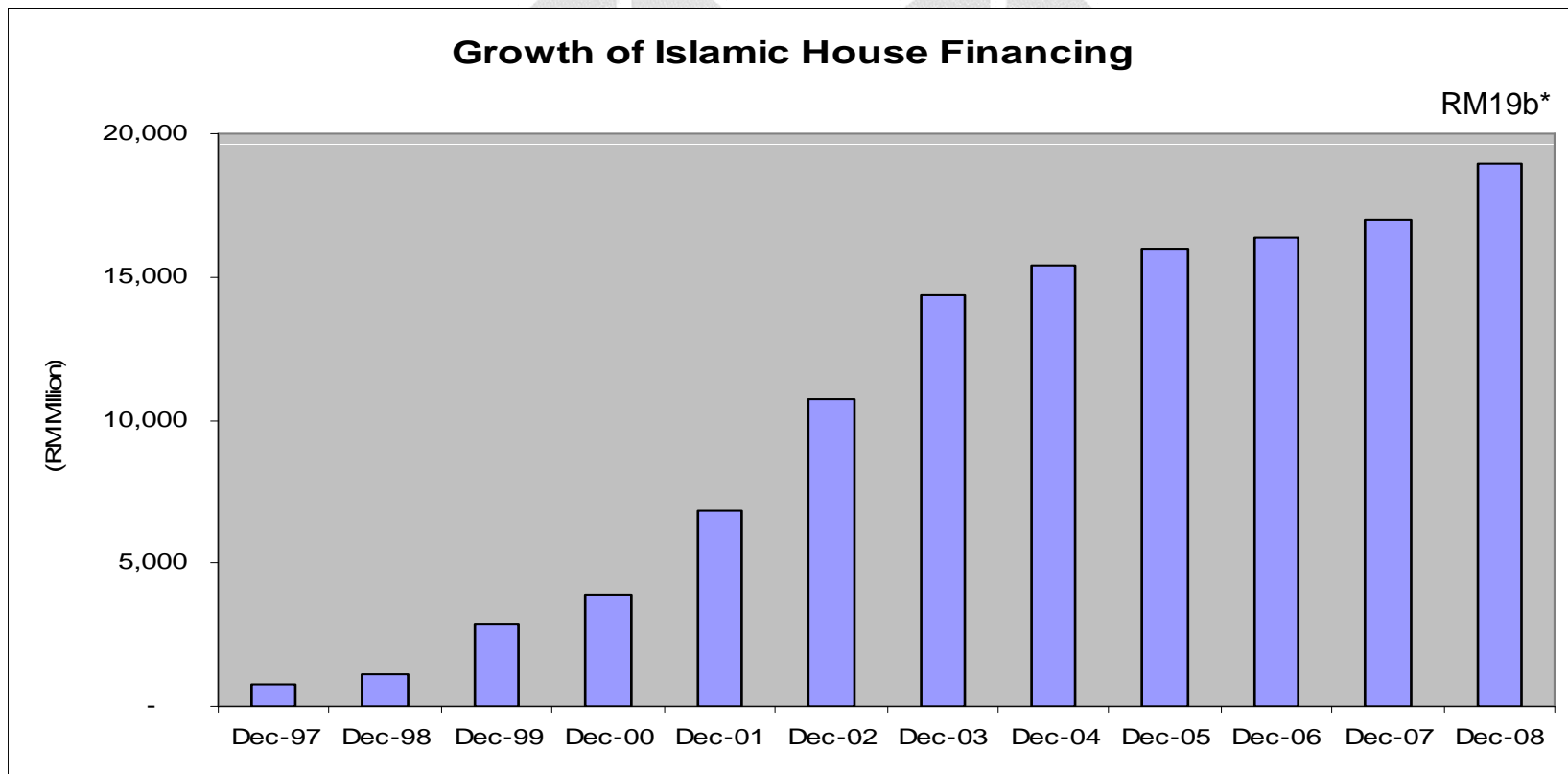


Source: BNM Annual Report, various years

Impact of Cagamas on the Housing Market

Promotes the growth of Islamic Mortgage Financing in Malaysia

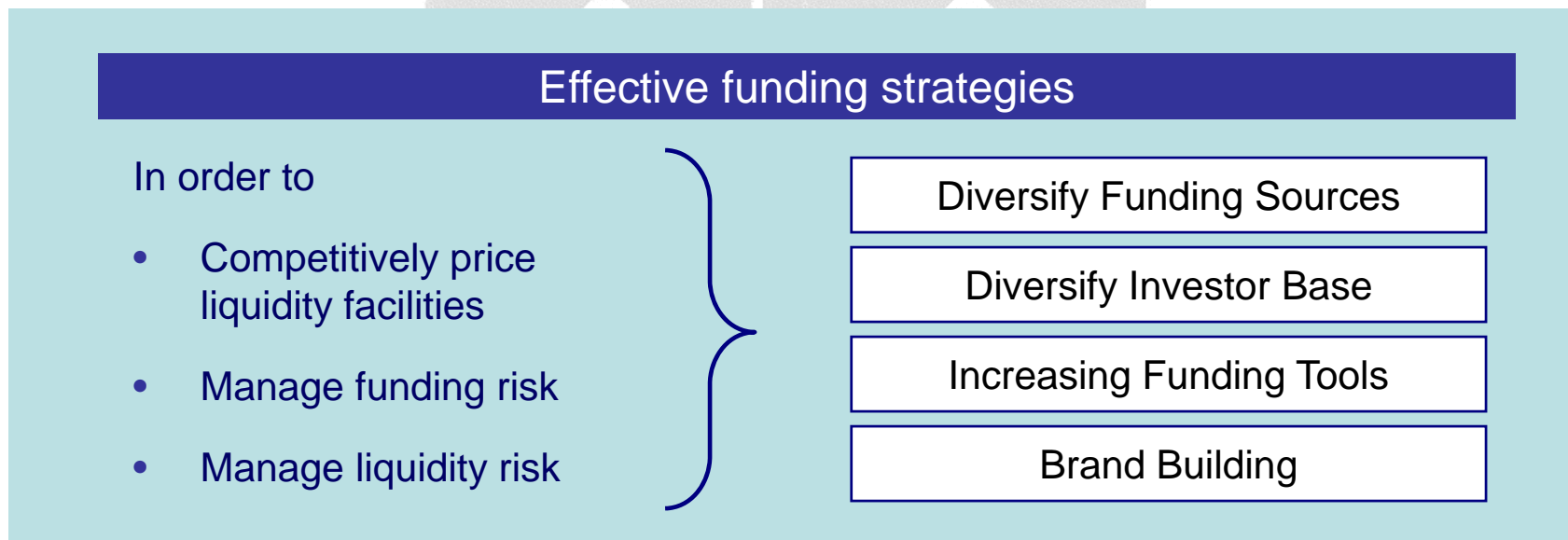
- As at 31 March 2009, Cagamas has 11% of Islamic house financing debts market



Funding Strategy

Effective funding strategy to manage risks

- Any purchase facility requires effective and adequate funding strategies in order to competitively price the products.
- At the same time, in providing funding and liquidity to its customers, the facility would also have to ensure that its own funding and liquidity risks are managed.



Funding Strategy

Matching funding with purchases

- Cagamas issues the following debt securities to finance the purchase of loans and financing debts:
 - ✓ Commercial Paper (CP)
 - ✓ Short-term Notes
 - ✓ Fixed Rate Notes / Bonds
 - ✓ Floating Rate Notes / Bonds
 - ✓ Sanadat Mudharabah Cagamas (SMC)
 - ✓ Sanadat Cagamas
 - ✓ Bithaman Ajil Islamic Securities (BAIS)
 - ✓ Residential Mortgage-Backed Securities
 - ✓ Islamic Residential Mortgage-Backed Securities

Funding Strategy

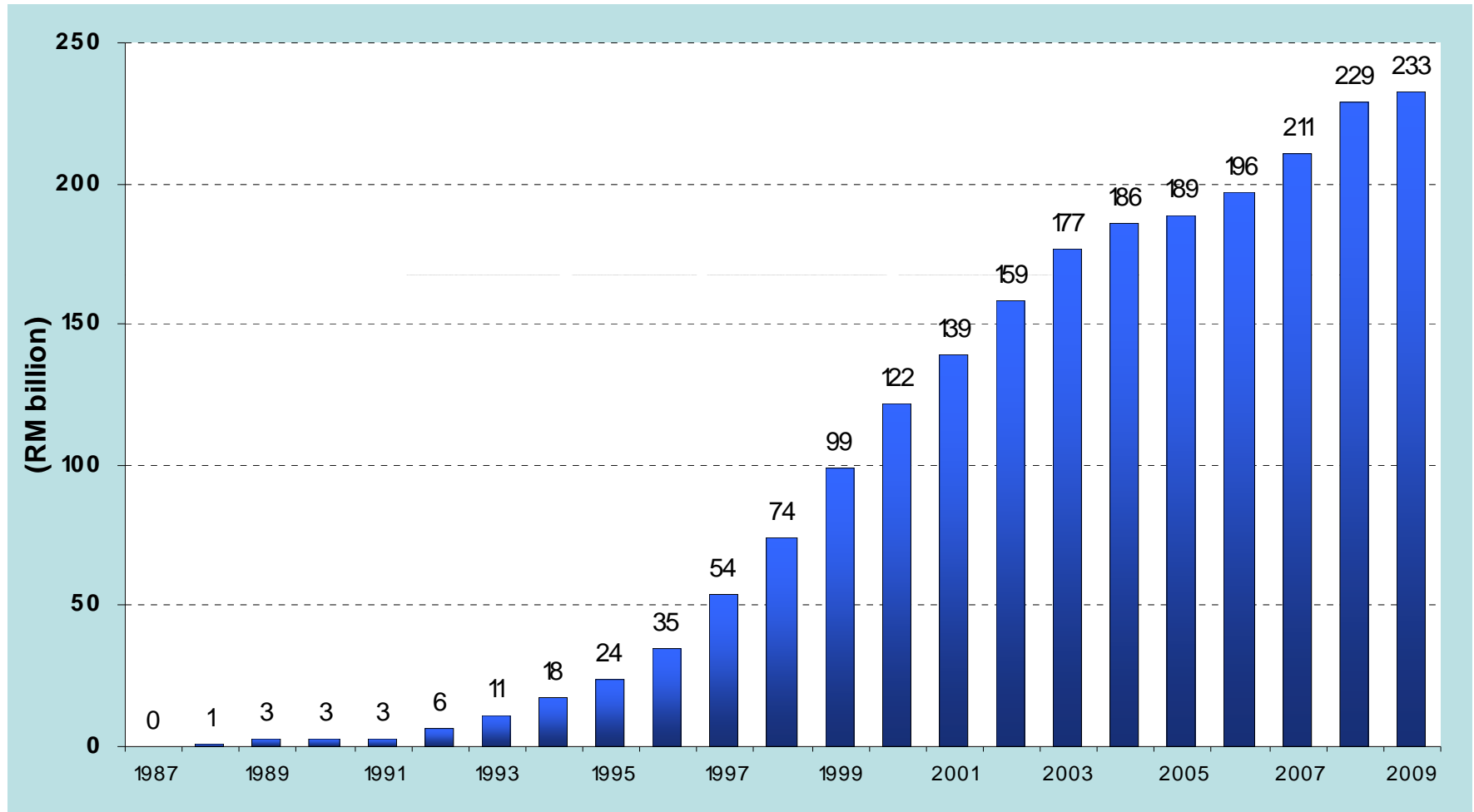
Features of Cagamas debt securities

- Classified as Class-2 liquefiable asset status under Bank Negara Malaysia's liquidity framework.
- Listed under the Bank Negara Malaysia's Scripless Securities Trading System (SSTS) and are traded in a "paperless" form.
- Holdings by insurance companies are classified as 'credit facilities' and are accorded admitted asset status.
- Holdings by banking institutions qualify for a 20% risk weight for capital adequacy purposes as compared to 100% for other corporate issuers
- Carry a yield slippage of 6% as compared to 10% for other corporate issuers under Bank Negara Malaysia's liquidity framework.
- Cagamas is the largest issuer of private debt securities (PDS) accounting for *11% of all outstanding PDS in the domestic market and the second largest issuer after the Government of Malaysia
- Rated AAA/AAA by Rating Agency of Malaysia (RAM) and Malaysian Rating Corporation (MARC) accounting for *35% of all outstanding AAA PDS in the domestic market
- Cagamas is the largest issuer of RMBS in the domestic market and outstanding issuance accounts for *47% of the total domestic Asset Backed Securities (ABS) market

*as at 31 March 2009

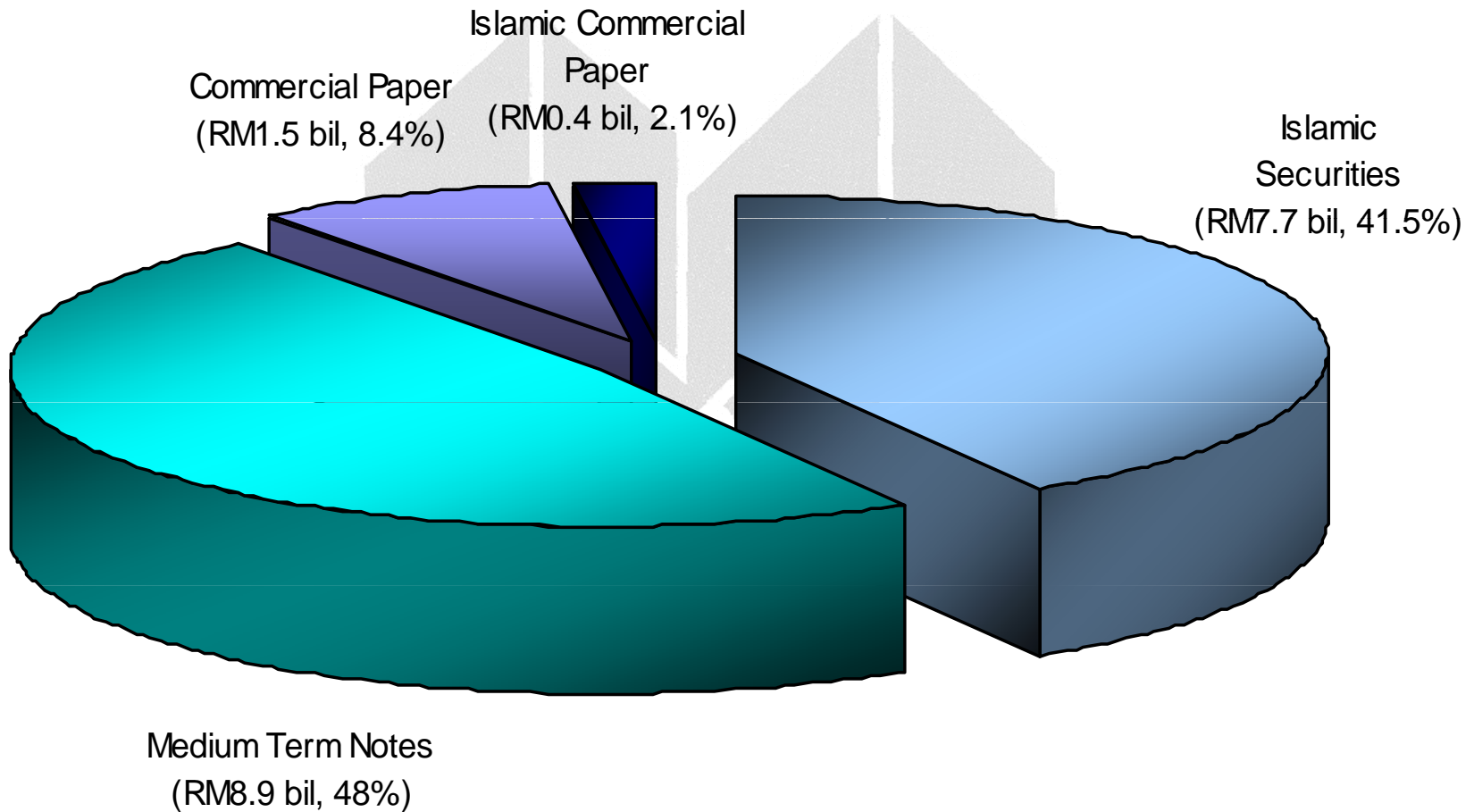
Impact of Cagamas on the Capital Market

Cumulative Cagamas issuances from 1987 to March 2009



Impact of Cagamas on the Capital Market

Breakdown of Outstanding Cagamas Unsecured Debt Securities as 31 March 2009 – RM18.5 billion

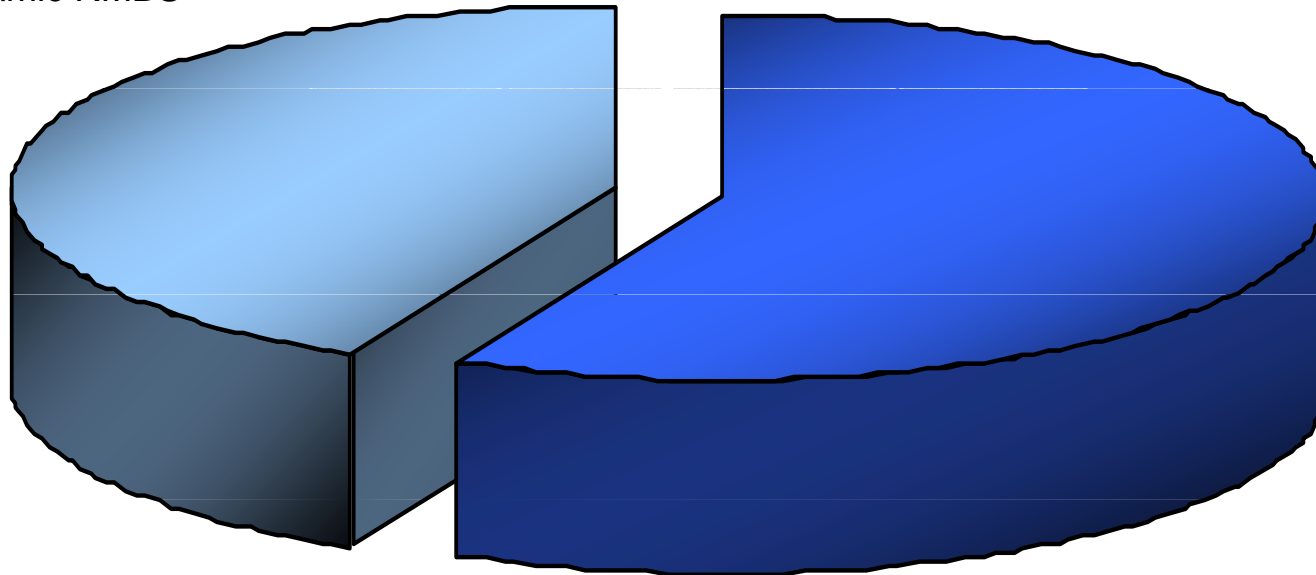


Impact of Cagamas on the Capital Market

Breakdown of Outstanding Cagamas Residential Mortgage-Backed Securities as at 31 March 2009 : RM9.13 billion

RM3.91 billion or 43%

Islamic RMBS

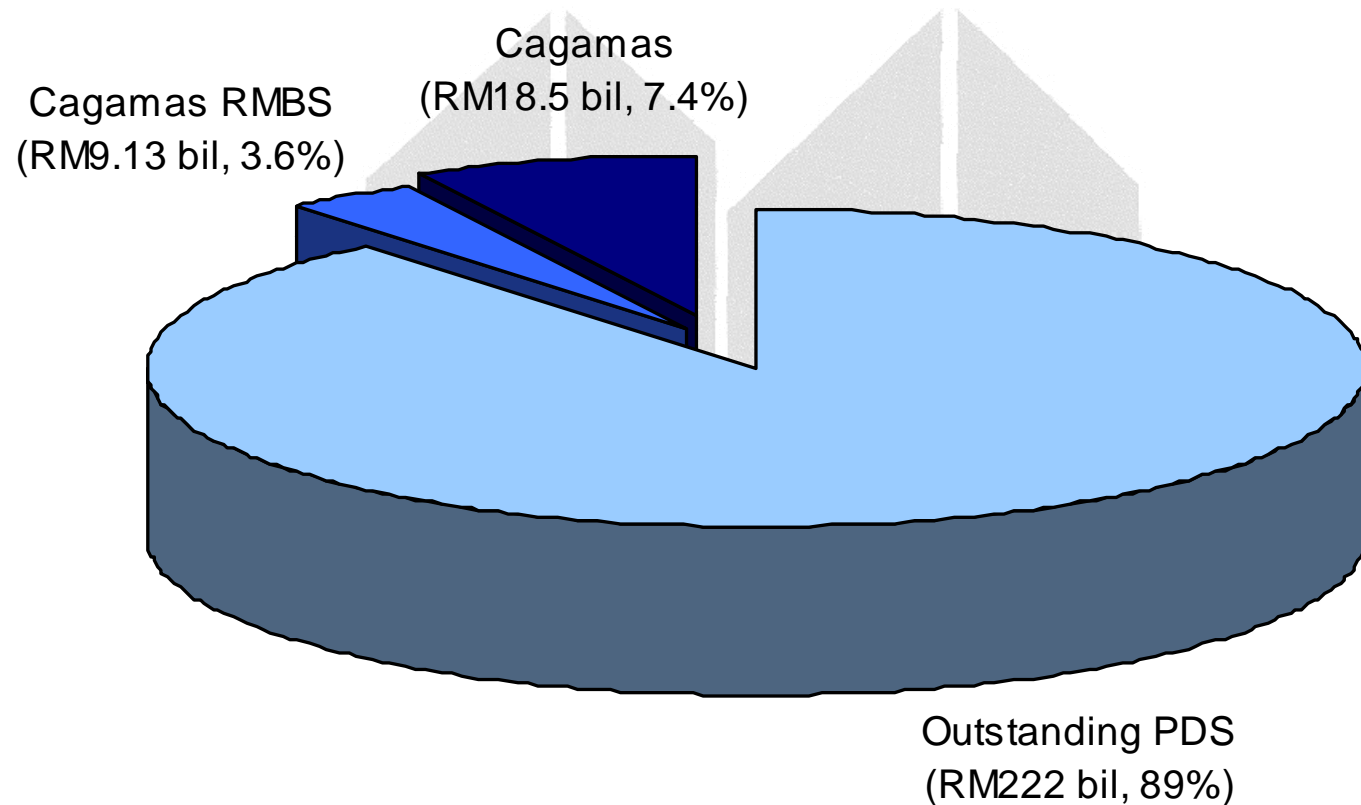


RM5.22 billion or 57%

RMBS

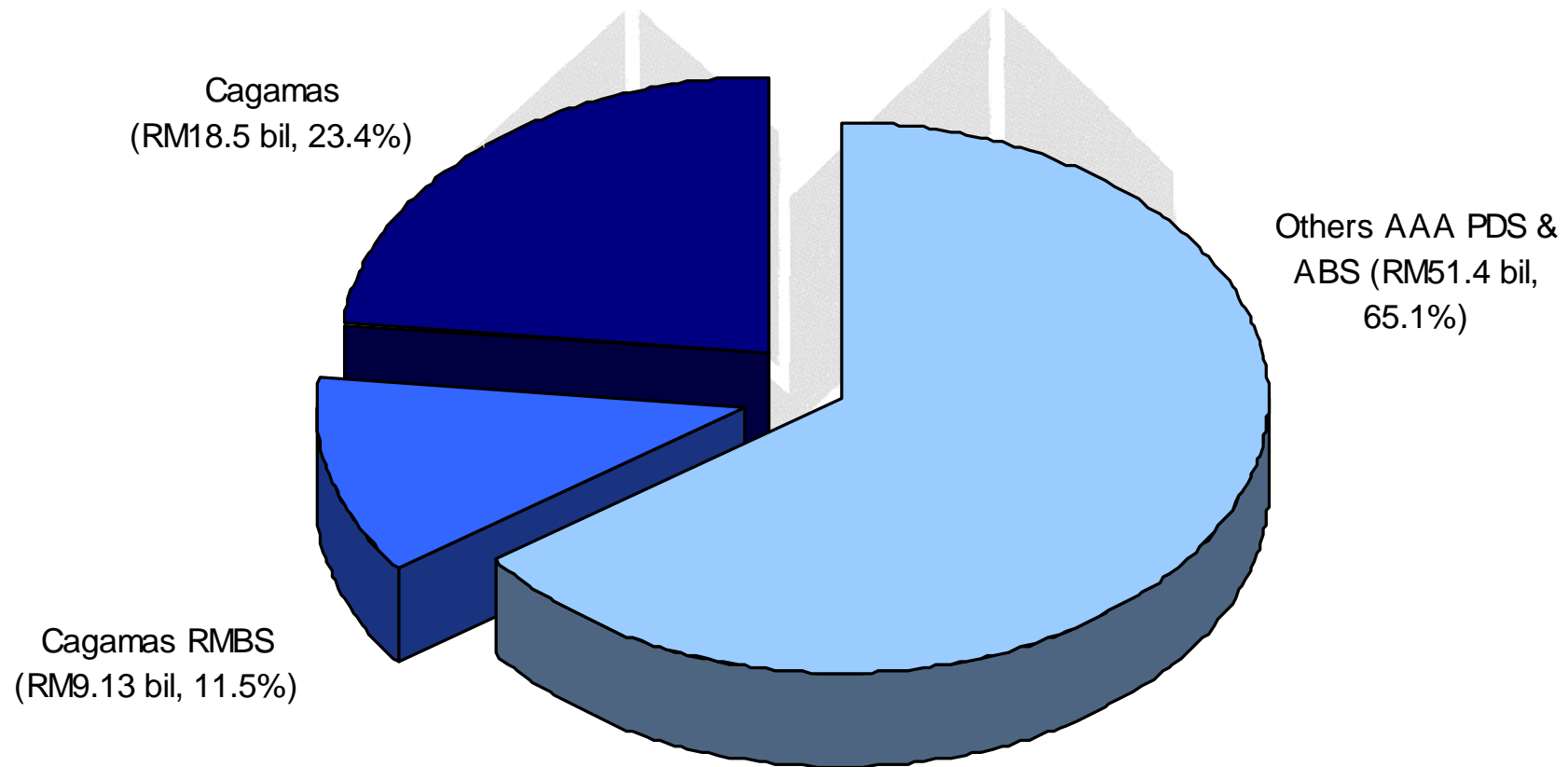
Impact of Cagamas on the Capital Market

Share of Outstanding Cagamas Debt Securities in the PDS Market as at 31 March 2009: 11%



Impact of Cagamas on the Capital Market

Share of Outstanding Cagamas Debt Securities in the AAA PDS Market as at 31 March 2009: 35%



Impact of Cagamas on the Capital Market

Investors' Profile of Cagamas Debt Securities from 2003 to 2008

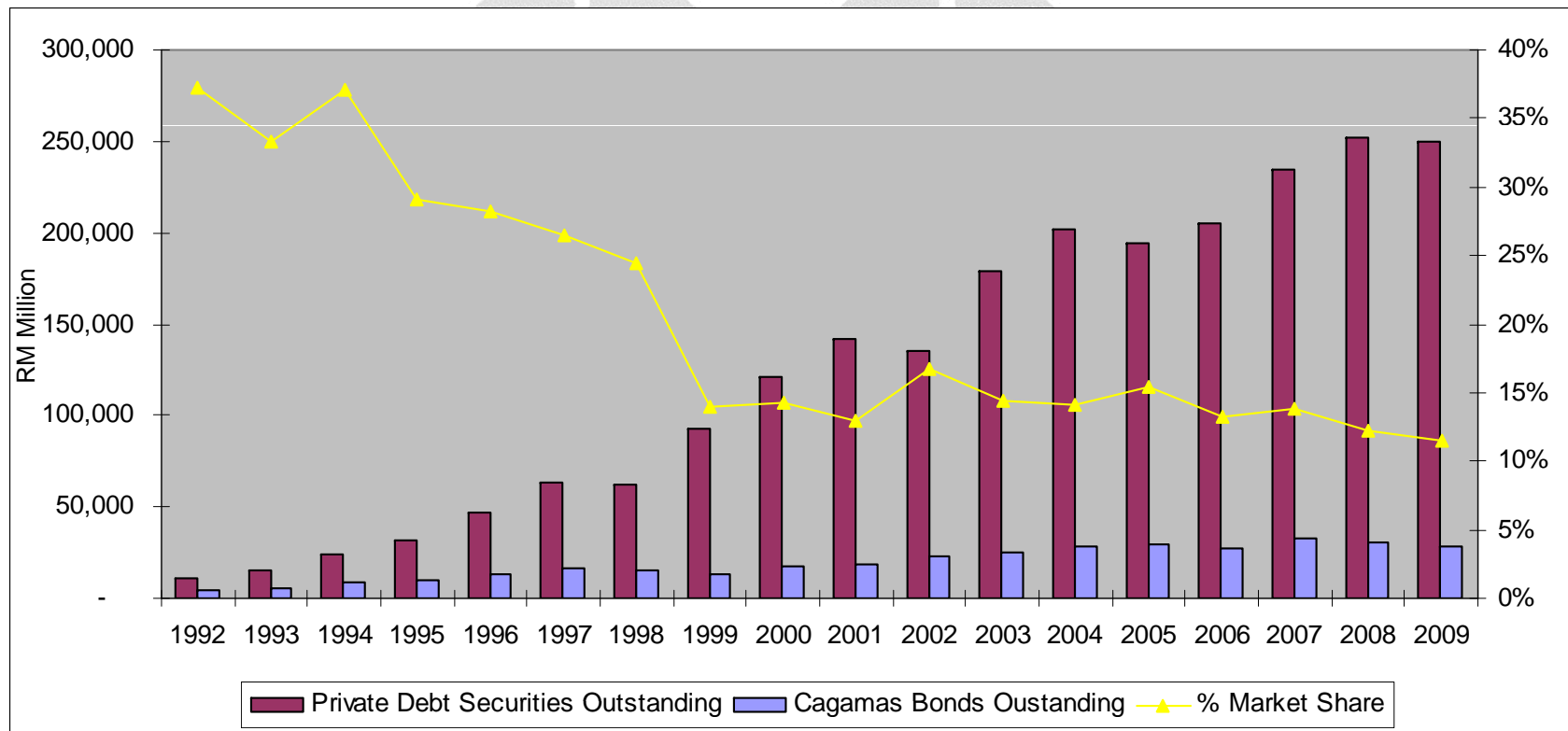
Investors	2003	2004	2005	2006	2007	2008
	%					
Banking Institutions	59.0	56.8	50.6	39.2	51.5	54.9
Insurance Companies	9.2	4.5	11.9	12.4	10.7	14.1
Provident/Pension Funds	29.1	26.6	29.3	35.5	30.9	23.9
Others*	2.7	12.1	8.2	12.9	6.9	7.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

* Corporations and Government-Linked Companies

Impact of Cagamas on the Capital Market

Cagamas' Share in the Total PDS Market*

- The reduction in Cagamas' market share of the total PDS market from 60.5% as at end-1989 to 11% as at March 09 reflects the increase in the popularity of debt issuance by others



* Total PDS outstanding include ABS and RMBS

Source: BNM Annual Report, various years

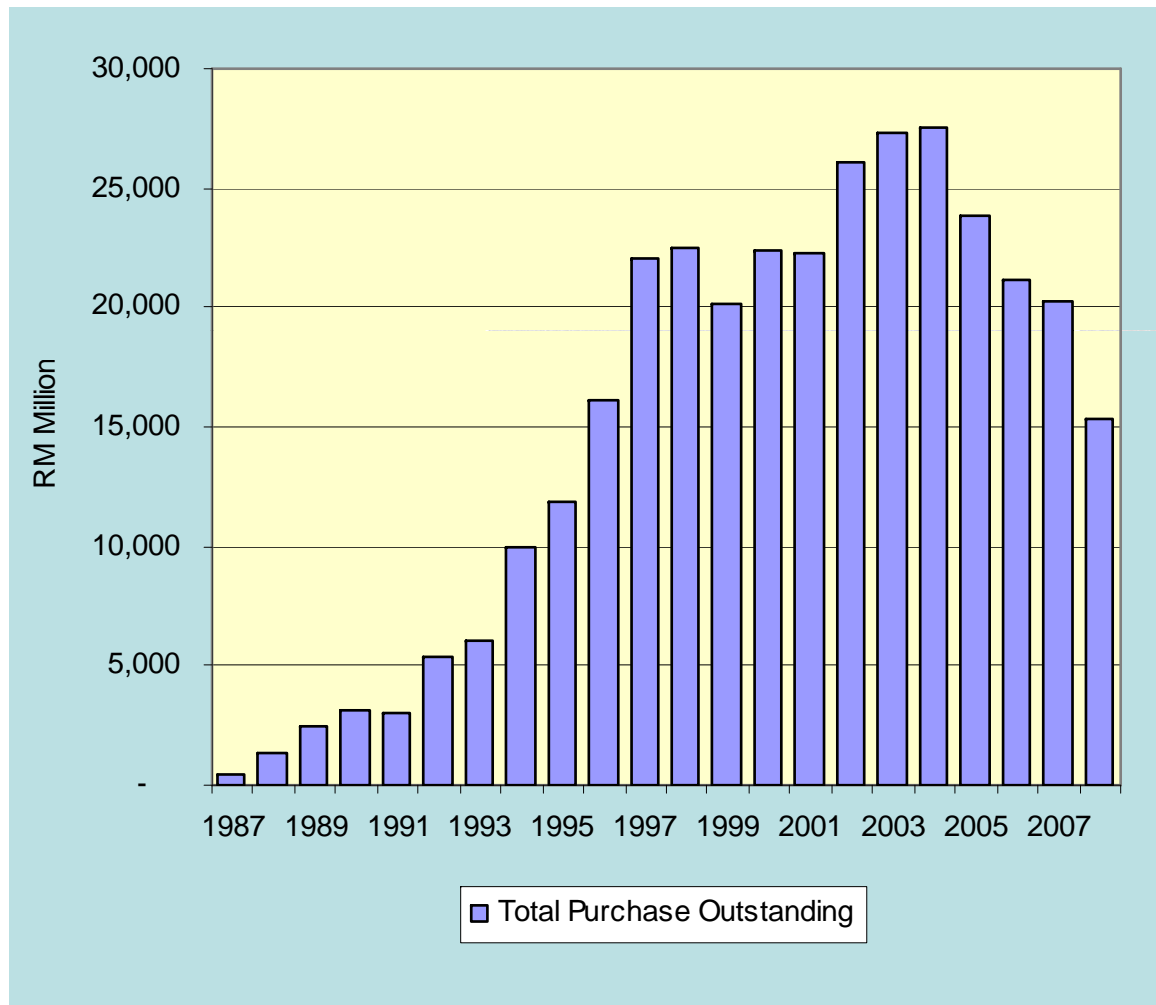
Impact of Cagamas on the Capital Market

Market Share of Islamic Securities by Cagamas

- Total outstanding Cagamas Islamic securities as at 31 March 2009 is RM8.4 billion
- Total Cagamas Islamic RMBS issued and outstanding as at 31 March 2009 is RM3.9 billion
- As at 31 March 2009, Cagamas Islamic securities and Islamic RMBS comprises 5.9% of total Islamic PDS and 9.0% of AAA Islamic PDS

Transformation of Business Model

Ample Liquidity in the Financial Sector



- Tapering largely due to diminishing need for PWR product as the market becomes flush with liquidity
- Change in market needs and requirements
- Need for Cagamas to adapt to market conditions

Transformation of Business Model

Challenges faced by Cagamas

- The introduction of the Prudential Standards on Asset-Backed Securitisation by BNM, the financial institutions can now choose to securitise their asset portfolios on their own
- The issuance of the 'Guidelines on the Offering of Asset-Backed Securities' by the Securities Commission (SC) would also encourage more parties to undertake issuance of ABS in the capital market
- The revision of regulatory treatment for Cagamas debt securities in 2004 to level the playing field to a more competitive basis, in line with the ongoing liberalisation of the financial and capital markets
- Operating in an environment that is flushed with liquidity in the banking system and low interest rates. In such an environment, the FIs have been less active in selling their loans and debts to Cagamas
- Liberalisation of the financial and capital markets and the growing sophistication among issuers and investors will encourage more innovative approaches to securitisation

Purchase without Recourse

Background to PWOR

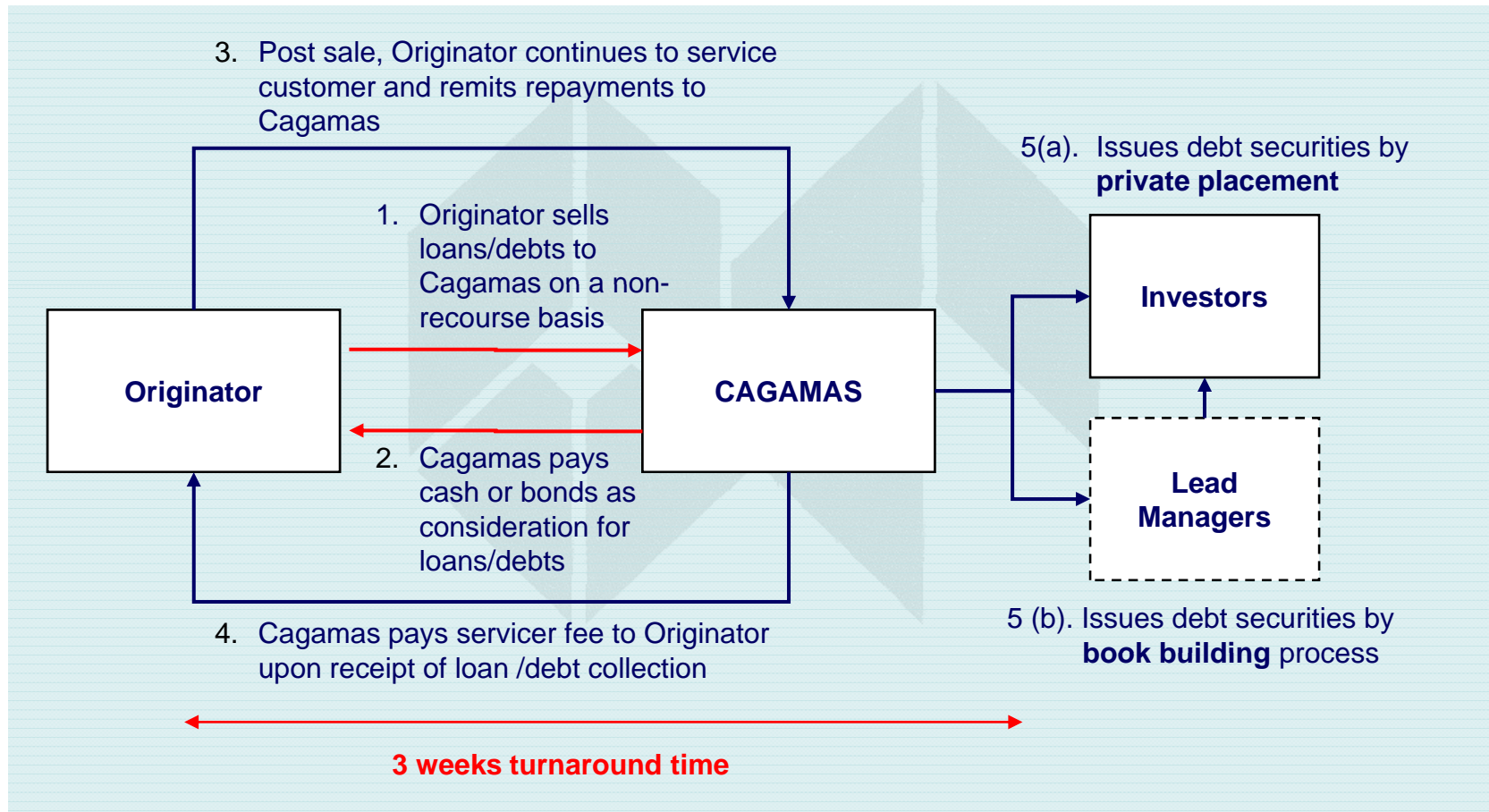
- Due to the change in market conditions, the banks no longer required a liquidity tool, so the existing PWR was not as relevant as before.
- Instead, with the advent of Basel II, the banks were looking for a different tool. So Cagamas enhanced the existing PWR product to create a risk management tool.

Purchase WithOut Recourse (PWOR)

- A contract whereby Cagamas purchases conventional and Islamic receivables **without recourse for default risk**
- Seller gets principal of the receivables up front and receives excess spread as servicer fee upon collection of loan installments

Purchase without Recourse

PWOR Mechanism



Purchase without Recourse

Key Features and Benefit

Features	Benefits
<ul style="list-style-type: none"> ▪ Outright sale to Cagamas, with no recourse for default risk ▪ Cagamas rate based on Cost Plus Basis i.e. Bond Yield plus Cagamas' margin ▪ Standardised structure and documentation ▪ Pricing from par to premium, depending on quality of assets ▪ Cash purchase or settlement by bond/Cagamas Islamic securities ▪ Excess spread paid to FI/IBI as servicer fee ▪ FI/IBI will be appointed as servicer for loans/debts sold. FI/IBI/servicer remits collections to Cagamas 	<ul style="list-style-type: none"> ▪ Transfer of credit risk ▪ Full capital relief ▪ Management of portfolio concentration risk ▪ Shift to fee based income ▪ Improve Return on Asset/Return on Risk Weighted Capital ▪ Improve earning stability ▪ Purchase at premium – locking in profits ▪ Stabilizing marketing strategy ▪ No transaction cost ▪ Fast turnaround time ▪ Flexible transaction

Adapting Facilities to Market Demand

Other Risk and Capital Management Tools

- Although the market conditions continue to change, Cagamas' role in innovating new products and continually supporting the housing finance industry has not. In the near future, Cagamas will be able to provide a complete risk and capital management solutions to the banks by introducing Mortgage Guarantee and Priority Sector Guarantee Programmes to the banking sector which serves to tackle the rise in loan-to-value ratios of mortgages over the years.

Mortgage Guarantee Programme

- Banks can transfer part of their credit risk out of their balance sheet to Cagamas for a guarantee fee, and thereby improve the risk profile on their mortgage loan portfolio. This allows banks to cap their credit exposure and yet continue to be in a position to offer their customers competitive loan-to-value ratios. It will also be attractive to banks who do not wish to reduce their asset position as it would allow them to retain the loans on their balance sheets while removing part of the credit risk.

Priority Sector Guarantee Programme

- Similar product targeted to assist banks in achieving their lending targets to the Priority Sector

Adapting Facilities to Market Demand

Relevance in today's market

- Growth of Islamic financial markets
 - ✓ Cagamas' liquidity model is proven and tested to be compatible with the requirements of Shariah compliant financing
- Source of liquidity in times of crisis
 - ✓ Financial Institution will still have access to capital markets through Cagamas
 - ✓ Cheaper source of funds in times of credit crunch
 - Credit enhancement for FIs
 - ✓ Quick source of liquidity vs. going to the capital market
- Cagamas' liquidity model suitable for developing / emerging markets
 - ✓ Concurrent development of mortgage market and capital market



Thank You