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Malaysian homeownership

Cagamas - Housing the nation

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Finance Asia Malaysia Chung Chee Leong Cagamas Housing

Mr. Chung Chee Leong, President/Chief Executive Officer spoke to The Worldfolio and discussed his vision of increasing ways of delivering affordable housing financing to Malaysia's people.

I was looking at a general view of the Asean Economic integration and what it would mean from a macroeconomic point of view. But in terms of what it would mean for the housing finance market, one of your core objectives is obviously to deepen the amount financing that's available for the housing sector. Do you see the integration as an opportunity for even more financing to become available, for foreign financing to come in and help drive the housing sector?

It could to some extent especially in terms of property development for example in the Iskandar area where we've seen strong interest and demand from foreign parties. We could perhaps see more of these flows with the integration, although it's too early to quantify the contribution to housing sector.

Maybe less on the housing-financing and more on the housing-construction. Maybe the availability of cheaper materials.

With housing-financing sometimes you have an issue when you're financing property overseas with legal provisions of the law that are different. But in terms of Malaysian banks, they've actually expanded regionally and could actually obtain funding and provide home financing directly from their overseas branches for example in Singapore, Indonesia, Philippines or Thailand instead of relying on funding from Malaysia.

What we wanted to try and do was to take our readers through the story of Cagamas. If you could tell us a little bit about the role that you've played in the housing sector, Cagamas' origins and obviously your progression to what you are today.

Cagamas, the national mortgage corporation of Malaysia, was established in 1986 and had its first transaction in 1987. The main mandate or first objective of Cagamas is to promote home ownership among Malaysians, and that is basically done through the provision of cheaper funding. That means we go to the capital market, get funding through issuance of debt securities and because of our domestic AAA rating, we get cheaper funds. We then pass on those cheaper funds to the banks so that they can lend to the borrowers at a lower cost. This business model would also reduce the maturity mismatches of the loan originators because they can now obtain long term funding for their long term assets such as housing loans. The second objective of Cagamas is to spearhead and contribute to the development of the debt capital market in Malaysia. Over the last twenty-seven years we have issued a total of RM280 billion bonds and sukuk, which would also translate into financing of approximately 1.8 million houses. So in terms of contribution, that's where we're coming from, basically we're buying home loans and financing and issuing bonds to finance them. That has spurred the markets as the financial institutions are now keen to lend to home buyers, and today 86% the main financier of home loans and financing are the commercial and Islamic banks. Approximately 10% comes from the Government as it funds civil servants home loans and financing whilst the balance is from the developmental financial institutions and building societies. Hence the bulk comes from the banking industry and the banks find that the housing loan portfolio is the safest in their books.

When you look at the mechanism that is Cagamas, basically people will ask about the sustainability. You're basically taking risk for the banks. When you designed that model, how did you view its sustainability, and how do you control the risks?

Firstly, in terms of risk, Cagamas works on a model that is very prudent—the match-funded model, which means that when we purchase one billion worth of housing loans, we will be issuing an equal amount of bonds in terms of amount, tenor and duration, and the cash flow that we receive from the assets will match as closely as possible the cash flow of the bonds that we are paying out. So we mitigate the interest rate risk, alleviate the liquidity risk and reduce the refinancing risk. Even in the foreign currency issuance we hedge our foreign exchange risk. We also fund it one time, meaning that we purchase RM1 billion in assets and issue RM1 billion in bonds; we don't leverage or issue multiple times the bond issuance. So in that sense we reduce the risk as far as Cagamas is concerned. Look at our track record over the past 27 years and even at the peak of the financial crisis when the GDP growth was negative, Cagamas has consistently continued to make a profit. Sustainability maybe an issue in the case that banks become stronger and they have more liquidity in the market, and the questions arises on why Cagamas is still needed. The sustainability issue is on how to position ourselves and stay relevant to the financial market. For example as you see today, with the introduction of Basel III, capital and liquidity requirements for the banking sector will become more stringent and Cagamas is one of the institutions that is able to provide solutions for the banks to comply with those requirements. In terms of sustainability, we're looking at replicating what we've done in the housing market in other sectors like SMEs and infrastructure as well.

How are you advancing in that area?

We are looking into the SMEs and privately funded infrastructure project loans as new asset classes but we have not purchased anything as yet. We maintain stringent eligibility criteria and the banks may sell us if they meet those criteria. We are continuing to engage with the banks on these loans but housing loans remains our main area of focus. Last year we had quite a good number of purchases at RM5.9 billion and expect around RM6 billion of purchases this year. Over the past 27 years, there have been two significant upward spikes in our bond issuance, one was during the East Asian financial crisis in 1997-8 and the other was during the global financial crisis in 2008-9. This demonstrates that even in times of crisis and despite the banks' liquidity issues, Cagamas was able to sell a much higher amount of bonds to the market up to as much as RM25 billion and the market was still buying Cagamas papers. It was a classic flight to quality situation where investors were moving out from the other papers to Cagamas papers. The other point to note is that during the East Asian financial crisis, when some banks were downgraded whilst Cagamas maintained its AAA rating locally.

Do you think that that ownership model ever created a conflict of interest in the sense that your customer is also your owner? Did that ever become an issue?

Currently in the existing corporate structure, the holding company i.e. Cagamas Holdings Berhad's board of directors comprises amongst others, the CEOs of selected the banks. At the holding company level, discussions focus on broader issues such as the strategic direction and formulation of policies. The board of the operating entity, Cagamas Berhad, comprises experienced former bankers and market practitioners hence there is a removal of the conflict. Cagamas undertakes arm's length transactions with all institutions, with pricing being determined by the market. Although the board members may sit at the holding company level, there is no compromise to our eligibility criteria in undertaking a transaction with the asset side of the bank. We have received positive responses on the Company structure from international investors. Their feedback was that it is a good model as there is adequate check and balance between the public sector and the private sector to amplify the point that neither the public nor private sectors bear influence on Cagamas' operations.

In terms of the rest of the world, we didn't do very well when all the mortgage backed securities and subprime lending crisis came out. Do you think that Cagamas played a role in preventing that here? Did it act as a sort of in-place watchdog? You talked about flight to quality; do you think that Cagamas helped Malaysia not to get stuck with bad papers?

Cagamas' purchases adhere to strict eligibility criteria i.e. meaning that we only buy good loans—not subprime and others and unlike others, we do not provide any guarantee on our own debt papers. Nonetheless over the last 27 years we have issued around RM280 billion bonds and successfully redeemed RM250 billion without any delay or default while the balance will be maturing over the next few years. This shows our strong track record as a high quality frequent bond issuer to the market. We are the largest PDS-issuer in Malaysia and the second-largest bond issuer after the Government of Malaysia. We don't leverage and we issue concurrently at the time we purchase the same amount of loans. As a result, our business model has been recognized by the World Bank and the Asian Development Bank, as one of the best models for secondary mortgage market in the world. In terms of funding using mortgage-backed securities (MBS), Cagamas issued its MBS between 2004 and 2007. After the global financial crisis the interest in the MBS structure somewhat diminished and the yield on MBS bonds increased as a consequence. However Cagamas continues to purchase loans and match fund through issuance of unsecured senior debts which in effect are backed by its mortgage portfolio. This is akin to a big covered bond. Moreover our shareholders fund of about RM2.6 billion is invested in good quality liquid papers which provide the additional buffer for any interim liquidity needs.

Growth seems to be coming in a big way from the Islamic finance side of your business. Could you tell us about this aspect of your financing, and how you're looking to push that forward?

Cagamas has over the years contributed in a number of ways in the evolution of Islamic finance especially in Malaysia. Cagamas has introduced innovative Islamic finance tools that include Islamic Residential Mortgage-Backed Securitisation, Islamic liquidity solutions and sukuk products since it venture into the Islamic financial market in 1994.

The many firsts and groundbreaking innovations introduced by Cagamas together with its active participation in the Islamic capital market had facilitated growth of Malaysia's Islamic capital market and helped to address the Islamic financial institutions' liquidity concerns. Cagamas' Islamic financial solutions are well received in the industry especially in view of the lack of alternative Islamic hedging instruments and this is expected to grow further with the introduction of the USD2.5 billion Multi-currency Sukuk program.

Going forward, Cagamas plan to capitalize on its Islamic financial capabilities to introduce more innovative Shariah-based products to meet the needs of discerning investors and to cater for the growing demand for highly rated sukuk by investors including in MENA and East Asia. At the same time, Cagamas continues to strengthen its existing Islamic products offering in line with market development. Cagamas is also exploring to establish relationship with potential partners in those regions to expand its Islamic finance franchise.

Obviously when you try to enter into areas like Islamic finance, you really test your human capital. A bank can come to you and show you anything, it's your human capital who have the ability to see the investments that are good from the ones that have higher risk than you're used to accepting. How have you managed to source and develop your human capital?

This is a challenging question. As you know, we are a very small entity. We continue to be challenged in the sense that when you become a renowned brand name in the market, there is a tendency for staff to be poached. We need to have strong second-liners in place who can continue to operate and develop innovative products. Malaysia has put various learning institutions in place so we rely on them, including institutions like INCEIF, to come up with human capital that we can tap on. As we are a lean organization, we do not have a training school or center, but we continue to send our people for training to upgrade their skills and knowledge.

At Cagamas, we design interventions targeting each of the human capital pillars, to enhance the ability of the Organizations to develop and deploy talent. Among them include:

(i) Education: creating self-learning environment, learning and training and investing on technical certifications
(ii) Skills & Experience: e- learning, mentoring & coaching, developing through talent collaborations with other organizations and increasing mobility within the organization to develop talent and close talent gaps

What would you say are the main challenges you're facing at Cagamas at the moment?

One of the greatest challenges is human capital. It is always necessary to move with the market. We have to ensure that our people are continually happy to work at Cagamas and that they have the required skills to meet with the ever-changing environment. There are times when we require change - new blood to bring in new ideas and innovation. However, we work to provide enhancement and upgrading of skills for the current management to be able to face today's challenges. The needs of the industry are different than they were 20 years ago. Back then, the focus was more on liquidity needs. Today however, the focus is more about innovative products that Cagamas can develop so the banks can hedge their risks in the market. It is no longer about looking at simple solutions, but more complex ones too. I believe there is a need for human capital that is able to address these requirements.

How would you describe Cagamas' position within the financial sector? Why is Cagamas so important to this system?

Cagamas functions as liquidity provider to the market. As an example, should a bank run into liquidity problems, they can come to Cagamas to sell off some of their good loans that meet our eligibility criteria, before they go to the Central Bank as a last resort lender. This actually helps stabilize the market and the institutions, as Cagamas is an option that forms part of the normal course of business in the banking industry. When liquidity was tight in the market during the East Asian Financial crisis that was when banks needed to come to institutions like Cagamas for funding assistance. We would not compromise on our eligibility criteria—that is to say, our loan standards—they had to pay whatever the market expected at that point, but they still had an avenue. The other point is that Cagamas, as a regular bond issuer which issues across various tenures is in the ideal position to provide the benchmark pricing for other private debt issuers in the market. We are trying to replicate this in the international markets as well. We have now since September last year, three foreign currency issuances - in offshore Renminbi, Hong Kong dollars and US Dollars. We aspire to become a regular issuer in the foreign currency market as well and are hopeful to provide the yield curve for other Malaysian issuers to benchmark against.

In terms of raising foreign currency, can you explain to me the importance of raising the reserves in the country?

Basically it is not raising the reserves in the country. However as you can see from the last 27 years since Cagamas began its operations, we have only been issuing in Ringgit - RM280 billion. In 2013 Cagamas was assigned an A3 (with positive outlook) with international rating from Moody's, which are in line with Malaysian sovereign ratings. In 2014 we put in place two EMTN programs—US$2.5 billion for conventional and another US$2.5 billion for Islamic financing. One of the reasons for putting these program in place was to widen and increase our investor base. Secondly, we aim to reduce over reliance on a single benchmark for pricing of our cost of funds, which relies solely on the Malaysian Government's Securities (MGS) - if we were limited to only Ringgit funding. When there's excessive price volatility in the underlying benchmark, Cagamas bonds will be priced to buffer against the volatility which is not the accurate reflection of Cagamas' credit quality. In 2013 when the former Feds Chairman was talking about tapering, the MGS' volatility went up to 35% from the normal 5%. As a result, Cagamas bonds were also priced based on that volatility instead of our own credit standing. We are also looking to diversify our funding sources in order to obtain the best price in terms of funding. One of our new strategies is to complement the Malaysian banks that are operating in the region overseas. A foreign currency program will provide us with the first step into purchasing home financing in the region.

We'd like to look at the history of the leaders of the institutions. Could you tell us about your profile, your different positions in the institutions?

It has been three years since I joined Cagamas back in April 2012. Prior to that, I was with Bank Negara Malaysia (Central Bank of Malaysia) and has served as Head of Banking Supervision and Head of Risk Management. So essentially my profile is more of a Central Banker and my focus was more on the financial stability side looking at the financial systems stability as well as banking supervision. Other than that, I have done assignments for the International Monetary Fund and the Islamic Financial Services Board. Of course I was also the first project manager for the establishment of the deposit insurance system which we have now very successfully put in place for the last seven years.

What would you say is the most enjoyable aspect of your job at Cagamas?

Well the most interesting part of my job is that I've turned into a market player from being a market regulator. It's a different perspective; you can actually see how people on the other side look at the supervisors. Some of my ex-supervisees are now my shareholders and board members.

What message would you give to investors who are looking to purchase products from Cagamas issuances?

Cagamas debt securities offer a very strong value proposition to investors with our match funding business model, strong shareholding structure, robust asset quality, stable profitability plus our commendable 27 years of track record as bond issuer. Judging from my previous role as a bank supervisor, I would admit that Cagamas works on a very prudent business model. Against a Government securities paper, you would probably be able to obtain a fair yield pick-up depending on tenure. You would be getting less compared to other AAA, because the market perceives us as safer in terms of other AAA papers. So we are a good investment option.