

# Catalyst for Islamic finance innovation

Cagamas has evolved from a national mortgage corporation to a securitization leader

The issuance of Islamic securities commenced in Malaysia in 1990 and the country's national mortgage corporation, Cagamas, has been consistently issuing *sukuk* since 2002. Starting with a modest 0.4% in 1994, *sukuk* (including Islamic residential mortgage-backed securities or RMBS) as a percentage of Cagamas' annual securities issuance grew to a staggering 82% in 2012.

Cagamas was established in 1986 to promote the secondary mortgage market in Malaysia. It has, through the years, evolved and diversified its business model from that of a national mortgage corporation supporting Malaysians with affordable housing, to becoming a leader in securitization.

It issues debt securities to finance the purchase of housing loans and other consumer receivables from both financial and non-financial institutions. The provision of liquidity at a reasonable cost to the primary lenders of housing loans encourages further financing of houses at an affordable cost.

"Over the years, Cagamas had played a strong developmental role deepening and broadening the local debt market," explains company president and CEO Chung Chee Leong. "It has been at the forefront in introducing new innovative structures that added varieties to the Malaysian debt capital market. Out of these new structures, precedents are then set for accounting, legal and regulatory treatment. In addition, Cagamas *sukuk* issuances set important precedents for Shariah acceptability and harmonization."

Since the introduction of the Islamic finance business in 1994, Cagamas had continuously been involved in the launching of innovative Islamic financial products, including the first global *sukuk mudharaba* in 1994 amounting to 30 million ringgit (US\$9.04 million) and the first rated *sukuk musyaraka* RMBS in the world in 2005 amounting to 2.05 billion ringgit.

The Islamic RMBS attracted a robust order book of 13.5 billion ringgit from a wide range of investors, of which 12.8 billion ringgit came from domestic investors and 700 million ringgit from offshore investors. Issued under the principles of *musyaraka*, the deal involved a



**Chung:** Pursuing a strict matching funding policy

partnership arrangement between various parties to raise capital towards the financing of a business venture. Profits are shared based on an agreed ratio, while losses are shared on the basis of capital contribution

Cagamas likewise arranged the largest and longest-dated corporate *sukuk* – *sukuk* commodity *murabaha* – a transaction in Malaysia amounting to 2.015 billion ringgit in 2008 and the first *sukuk al-amana li al-istithmar (ALIm)* deal amounting to one billion ringgit in 2010.

Cagamas issued the *ALIm* in an effort to meet the global Shariah requirements for tradable *sukuk*. This hybrid instrument consisted of 49% debt (commodity *murabaha*) and 51% tangible assets. They also had a unique redemption feature to meet one of the strictest Shariah requirements and, unlike the previous *sukuk* structures, there were two different trustees for *ALIm*.

The latest innovation was launched in October 2013 when Cagamas successfully concluded Malaysia's largest *sukuk* commodity *murabaha* offering amounting to 4.2 billion ringgit in two issuances. The first issuance, which was upsized from 2.5 billion ringgit to 3.8 billion ringgit due to strong demand, has tenors ranging from one year to 20 years to cater to varying investor demand.

The second issuance amounting to 400 million ringgit has maturities of one year and three years.

Cagamas' achievement in Islamic finance can also be attributed to its unique position in Malaysia's financial sector that enabled it to continuously innovate its Islamic financial products when addressing the market needs, says Chung.

The structuring of new *sukuk* products that are widely accepted and Shariah-compliant is one of Cagamas' priorities in supporting the government's objective to establish Malaysia as a global Islamic financial centre. In addition to the *sukuk*, Cagamas, for the years to come, envisages the following to further develop the Islamic finance market in Malaysia:

- Promote home ownership via extension of Islamic liquidity facilities to originators of Islamic mortgage financing
- Support human capital development in Islamic finance through sponsorship of research/authoritative textbook on Islamic financial markets
- Continue to develop and introduce globally accepted Islamic liquidity facilities and capital market products to support the primary market as well as the government's initiative to promote Malaysia as an international Islamic financial centre
- Enhance product innovation to provide effective hedging instruments and solutions to Islamic financial institutions for better capital and risk management.

– By Chito Santiago