The Securitization Laws in Thailand: Implications for the Housing Sector

by Ballobh Kritayanavaj

The main objective of this article is to share some initial thoughts on the development of a secondary mortgage market system through the provision of securitization laws, as well as to discuss its potential benefits, particularly regarding the housing and housing finance sector.

INTRODUCTION

Securitization as a financing technique has been established in the United States since 1970 and has expanded to many other countries in many parts of the world, such as Canada, the United Kingdom and Australia. It also has been introduced to some Asian countries, like Japan, Malaysia, the Philippines, Hong Kong and Indonesia. It is now becoming well-established in the international capital market.

Securitization techniques, particularly the issuance of mortgage-backed securities, have been proposed in Thailand since 1979 or for nearly two decades, as a supplementary funding strategy to mobilize funds for the Government Housing Bank. Circumstances, however, have not yet permitted the development of mortgage securitization. The concept has been discussed from time to time in financial and housing circles, and was gradually accepted by the authorities. It was finally incorporated in the Seventh National Economic and Social Development Plan (1992–1996) as an instrument for long-term savings and capital market development. According to this plan, the Government Housing Bank was stipulated to play a role in the securitization of mortgage assets.

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In response to the national policy of promoting securitization and a secondary mortgage market, a Working Group at the Government Housing Bank was established in 1992 to study the feasibility of the operations of a secondary mortgage market in Thailand. However, since the creation of a secondary mortgage market involves many financial institutions as well as regulatory organizations, the Minister of Finance decided to set up the Secondary Mortgage Development Committee in 1993 with the main objectives of creating and promoting the operations of a secondary mortgage market in Thailand.

Secondary Market Requirements

In establishing a secondary mortgage market in any country, many factors need to be taken into account, such as market potential, legal and regulatory frameworks, taxation issues, quality of assets to be securitized, design and pricing of securities, and types of secondary market institutions to be set up.

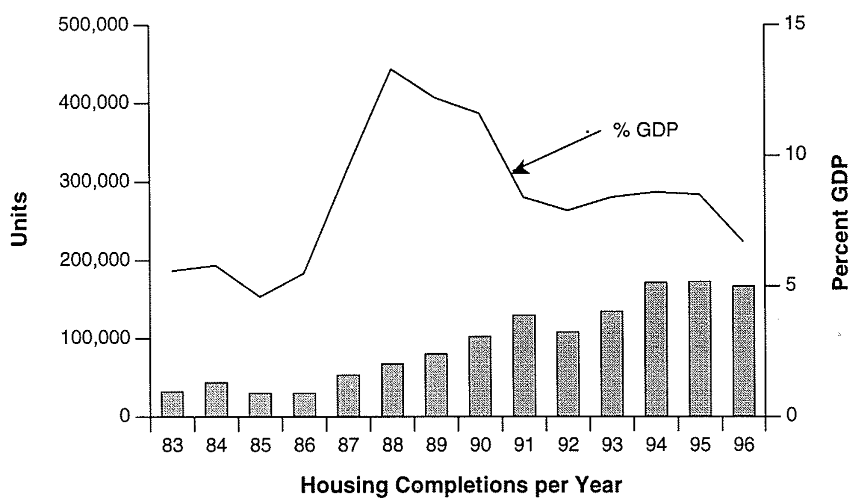
Of all of these areas, the legal framework seems to be the most critical issue and needs to be considered carefully. This is because legal matters will always determine the choice of structure and details of a transaction, and will influence the planning and execution of any successful securitization program. It is critical, therefore, for all parties involved to have a clear understanding of the legal and regulatory framework of each country.

After nearly four years of setting up the Secondary Mortgage Development Committee in Thailand, a clear legal framework has been developed in the form of two laws regarding securitization, enacted by the government on June 28, 1997. The first is the Emergency Decree on Special Purpose Vehicle for Asset Securitization; the second is the Emergency Decree on Secondary Mortgage Corporation. This presentation will not focus on the details of these two decrees but rather on highlighting the operation of the securitization business and discussing its contributions and the impact it may bring to the housing sector.

THE CURRENT PRIMARY MORTGAGE MARKET SITUATION

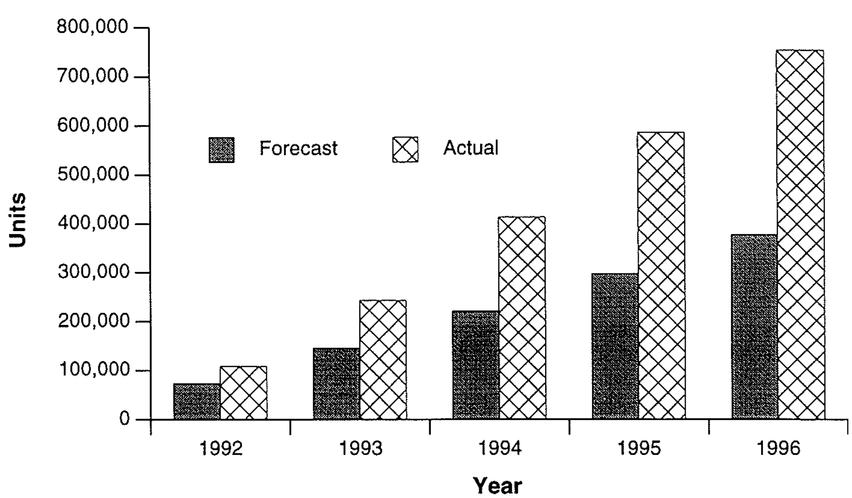
In 1996, investments in the housing industry in Thailand expanded at a slower rate than in 1995. The downward trend is likely to continue in the next few years. The present housing slump is mainly due to the severe downturn of the overall economy resulting in weak

Figure 1. Annual Housing Completions in Bangkok, 1983–1996



Source: GHB, BOT

Figure 2. Cumulative Housing Completions in Bangkok Metropolitan Region Actual vs. Forecast, 1992–1996



Source: GHB, NESDB

demand for housing. However, although newly launched housing projects noticeably decreased in the past two years, the number of housing units offered for sale in the present market is extremely high. This is due to an excessive number of new projects begun in 1993 and 1994, combined with a large portion of reselling of vacant housing units released by speculators. In the Bangkok Metropolitan Region alone, a total of about 755,000 newly built housing units were completed during 1992–1996, whereas the forecasted demands were only 376,000 units during the same period. Thus, an oversupply of housing was inevitable, as is clearly evident by hundreds of thousands of unoccupied housing units in the Bangkok Metropolitan Region.

The present housing market remains largely a buyers' market. Under the existing circumstances, housing developers have to compete aggressively to sell their houses. House prices have remained stable and tend to decline in the short term. Many developers are facing serious cash flow problems and are unable to repay debts to the mortgage lenders. This has severely affected the financial liquidity of many banks and finance companies, as well as credit foncier companies. The tight liquidity of several financial institutions, particularly finance companies, is now shaking the stability of the overall financial sector.

It is notable that home loans in the Thai financial system increased very rapidly during the past two decades (see Table 1). The total outstanding mortgage loans of all financial institutions expanded dramatically from 1985 to 1990 at a compounded annual rate of 34% and continued to grow at an average of 33% per year during 1990–1995. The growth rate declined to about 23% in 1996, with a total amount of about 700 billion baht. This accounts for about 14% of the gross domestic product. Commercial banks and the Government Housing Bank have played a leading role in the Thai home loan market, with a combined market share of about 89% (see Table 2).

Table 1. Home-Mortgage Loans Outstanding by Lender Type (as at Years Ended 1981–1996)

Institutions	*Market Share (%)*									*Annual Compound Growth Rate (%)*			
	1981	*1985*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*81–85*	*85–90*	*90–95*	*95–96*
Commercial Banks	39.79	52.78	69.04	68.86	68.15	67.74	67.13	64.48	61.42	24.16	41.20	31.20	16.80
Government Housing Bank	36.61	23.58	18.81	19.35	20.17	20.42	20.96	23.55	27.04	3.95	27.90	39.12	40.81
Finance Companies	8.35	8.59	7.27	8.07	7.38	8.37	9.16	9.44	8.89	16.86	29.44	40.12	15.53
National Housing Authority	8.80	9.24	2.00	1.32	2.27	1.95	1.46	1.24	1.24	17.46	1.50	20.90	22.61
Life Insurance Companies	3.18	3.84	1.26	1.06	.76	.52	.58	.72	.95	21.59	7.13	19.	60.56
Credit Fonciers Companies	2.72	.77	1.16	.96	1.01	.81	.53	.45	.37	-15.22	45.14	10.01	-.30
Government Savings Bank	.55	1.19	.45	.38	.26	.19	.15	.12	.10	41.06	10.30	1.76	2.19
TOTAL	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00				
Total Outstanding (million baht)	17,750	32,176	138,002	181,475	242,768	333,518	443,815	574,409	704,387	16.03	33.81	33.00	22.63

Remark: The amount of total mortgage loans outstanding of the Government Savings Bank in 1996 is estimated.

Source: GHB, BOT

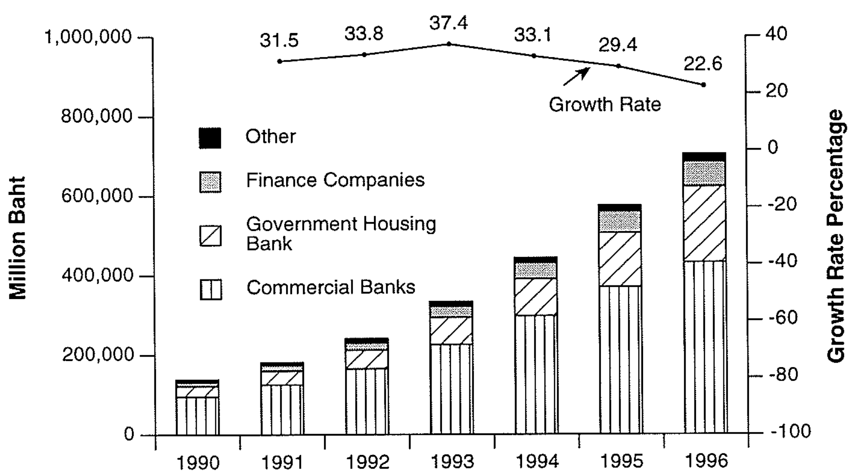
Table 2. Annual Home Mortgage Lending by Lender Type 1990–1996

Institutions	*Amount*							*Market Share (%)*							*Average Growth Rate p.a.* *Value: Million Baht*	
	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*90-95*	*95-96*
Commercial Banks	39,650	54,728	72,328	101,624	143,030	143,327	136,107	66.79	69.89	64.96	68.74	68.17	64.15	57.00	29.31%	-5.04%
Government Housing Bank	15,272	17,681	21,424	29,442	40,248	54,869	76,936	25.72	22.58	19.24	19.92	19.18	24.58	32.25	29.15%	40.22%
Finance Companies	1,414	2,210	13,412	14,205	22,228	19,718	18,445	2.38	2.82	12.05	9.61	10.59	8.83	7.73	69.39%	-6.46%
National Housing Authority	1,929	2,514	2,219	791	1,583	1,911	3,094	3.25	3.21	1.99	0.54	0.75	0.86	1.30	-0.19%	61.90%
Life Insurance Companies	612	699	502	474	1,475	2,222	3,029	1.03	0.89	0.45	0.32	0.70	0.99	1.27	29.42%	36.32%
Credit Fonciers Companies	381	376	1,397	1,179	1,069	1,117	598	0.64	0.48	1.25	0.80	0.51	0.50	0.25	24.00%	-46.46%
Government Savings Bank	110	98	64	114	178	244	335	0.19	0.13	0.06	0.08	0.08	.011	0.14	17.27%	37.30%
TOTAL	59,368	78,306	111,346	147,829	209,811	223,408	238,544	100.00	100.00	100.00	100.00	100.00	100.00	100.00	30.35%	6.78%

Remark: The amount of mortgage loans of Government Savings Banks for the years 1995 and 1996 is estimated.

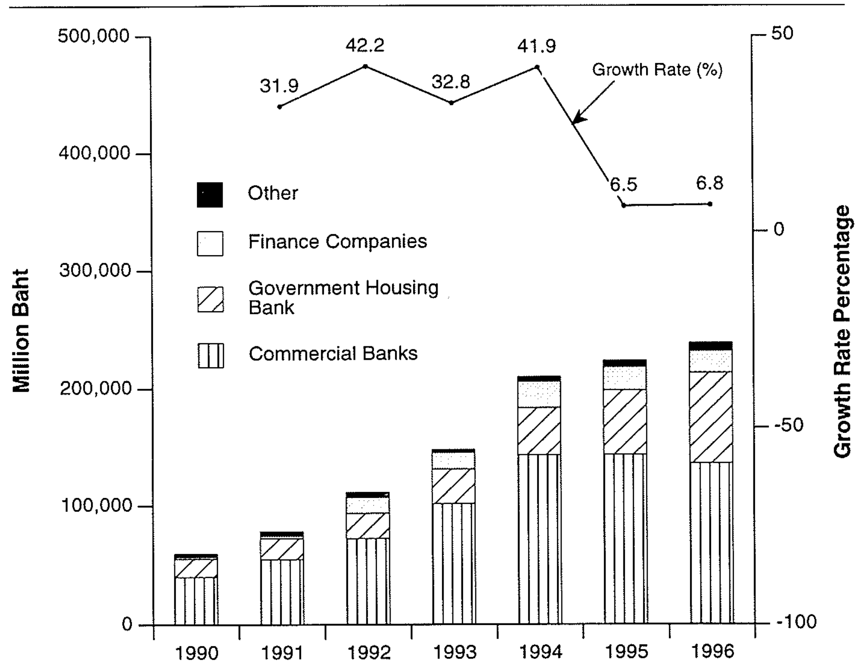
Source: GHB, BOT

Figure 3. Home Mortgage Loans Outstanding in Thailand



Source: GHB, BOT

Figure 4. Annual Home Mortgage Lending in Thailand



Source: GHB

Although mortgage interest rates in Thailand in 1997 declined from 1996, they remain relatively high compared to those of many other countries. The present mortgage lending rates of commercial banks and other financial institutions range from 12.75—15.00%, whereas those of the Government Housing Bank are between 11.25—12.75%, the lowest in the market. The current state of the housing market has been under intense debate with a wide range of arguments about whether the government should force financial institutions to reduce mortgage rates in order to encourage housing demands.

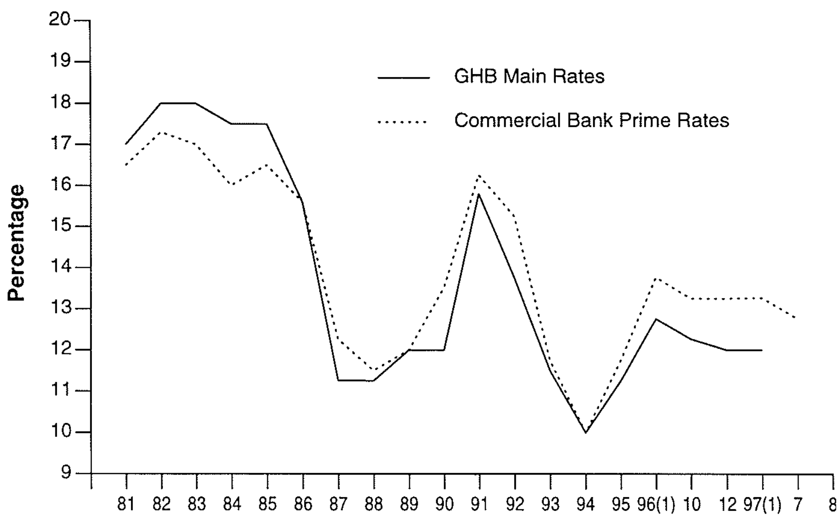
Due to the slump of the real estate market, most developers and mortgage lenders have increasingly faced severe liquidity problems. The government has recently attempted to resolve the real estate crisis by introducing several measures to cope with the problem. Some financial measures have also been introduced, such as promotion of the establishment of the private resolution property trust funds and property mutual funds; establishment of the government-run Property Loan Management Organization; establishment of the Secondary Mortgage Department at the Government Housing Bank; and the injection of 20 billion baht loans with a subsidized 9% lending rate to government employees and later on to the general public.

Accelerating enactment of the securitization laws is also one of the government measures to provide more liquidity to the mortgage lenders.

INTRODUCTION OF THE SECONDARY MORTGAGE MARKET: TWO LAWS

The prospects for securitization business in Thailand are encouraging since the two emergency decrees regarding asset securitization were enacted by the government on June 28th of this year and have already passed the Parliament. The main purposes of these two decrees are to create a more favorable securitization business environment

Figure 5. GHB Lending Rates versus Commercial Bank Prime Rates, 1981–1997



Source: BOT, GHB

and to bring stability to the residential mortgage market, as well as to increase available funds for housing loans on a continuing basis.

Emergency Decree on Special-Purpose Vehicle for Asset Securitization

According to this law, the issuer of an asset-backed security must be established as a special-purpose vehicle (SPV). The SPV will be in the form of either a company limited, a public company limited, or a mutual fund; it must be granted permission by the Office of the Securities and Exchange Commission. The SPV's sole purpose is to carry out a securitization program.

The licensed SPV will purchase financial assets or receivables from the originator and issue securities backed by these receivables to investors. The proceeds of the issue will be used by the vehicle to pay the originator the purchase price for the portfolio. The SPV will be separated from the originator and be self-supporting so as to be isolated from the risk of the originator's bankruptcy. It is noteworthy that an SPV can carry out only one securitization program (or can issue and offer for sale only one series of asset-backed securities throughout its lifetime). When the SPV has completely paid out all money, in accordance with the securities sold to investors, the SPV then shall dissolve its business and the approval granted shall be deemed terminated.

It is also notable that according to this law, the assets that can be securitized must be loan claims or any receivable rights that will generate future cash flow income over a certain period of time. Thus, the securitizable assets under this law will not be restricted to only mortgage loans but also include non-mortgage assets such as auto loans, consumer loans, vehicle and equipment leases, credit card receivables or any other obligations.

Emergency Decree on Secondary Mortgage Corporation

According to this law, the Secondary Mortgage Corporation (SMC) will be established as a government organization (or state enterprise) with initial capital of one billion baht allocated by the Bank of Thailand. Its main purpose is to run a business that promotes the secondary market facilities for residential mortgage loans.

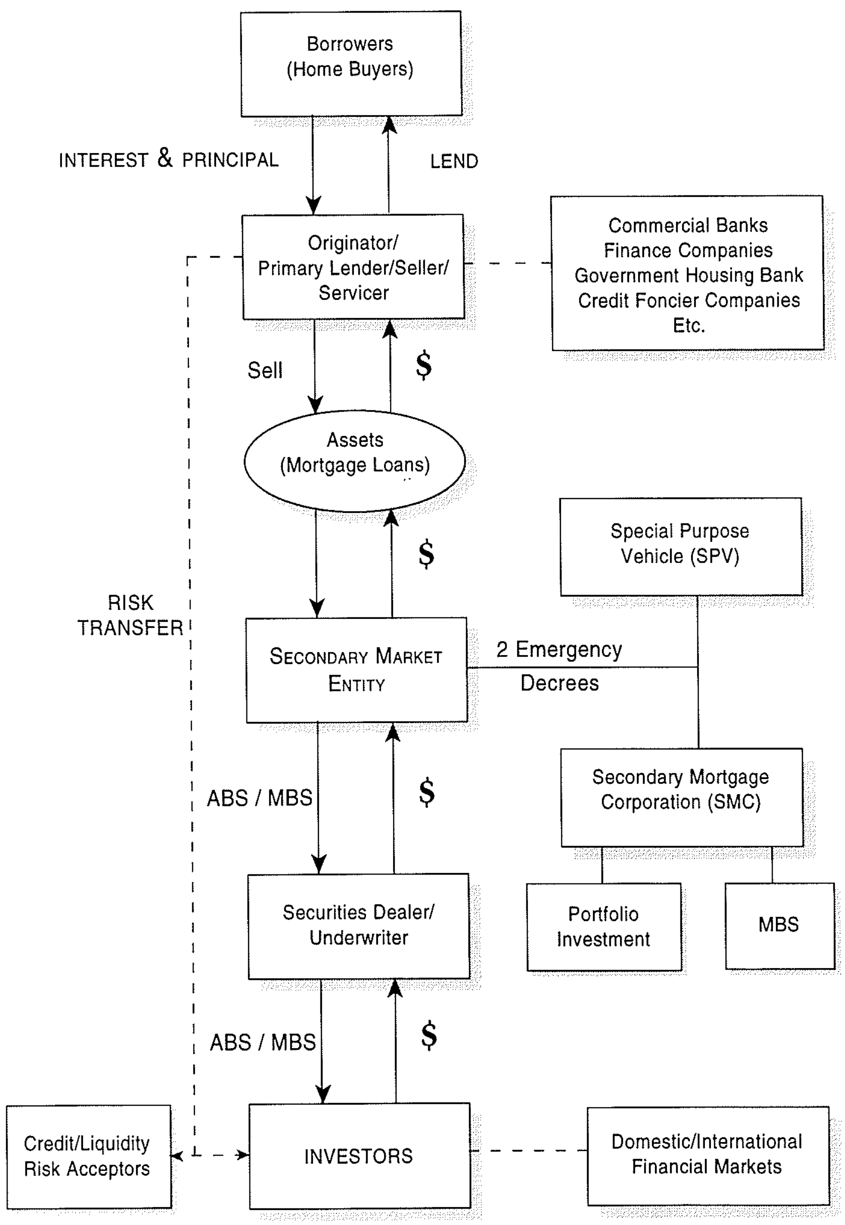
The SMC will be administered by the Board of Directors, called "The SMC Board," which will be comprised of 10 directors. Five directors will be from the public sector, i.e., Director of the Fiscal Policy Office as the chairman, Director-General of the Land Department, and representatives from the Bank of Thailand, the Government Housing Bank and the Office of Securities and Exchange Commission. The other five directors, including the managing director, will be appointed by the Minister of Finance with the consent of the Cabinet.

It is anticipated that the initial 100% government ownership of the SMC will significantly facilitate its recognition and acceptance by the market. Its legal status as a government organization also will enable the SMC to raise funds at a more favorable cost and thus enable the corporation to operate profitably under prudent principles.

The SMC will operate in a way similar to Fannie Mae or Freddie Mac in the United States or the Mortgage Corporation in Hong Kong. The SMC will carry out one or both of the following types of business:

1. **First is a secondary mortgage portfolio business.** The SMC will purchase pools of residential mortgage loans from primary market lending institutions and hold them in its own portfolio. The SMC will fund its mortgage purchases through the issue of bonds or other unsecured debt securities. The SMC will earn income from the spread between the yield earned on the purchased

Figure 6. Securitization Structure in Thailand



Source: GHB

mortgage loans and the costs of funds including administrative costs.

2. **Second is a mortgage securitization business.** The SMC will package the mortgage loans from its own portfolio or from loan originators and structure them into mortgage-backed securities (MBS) for sale to investors in the capital market. The SMC may guarantee to the investors the timely payment of principal and interest on these securities.

IMPLICATIONS OF THE SECONDARY MORTGAGE MARKET TO THAILAND HOUSING

The introduction of these two laws, which allow the operations of the SMC and SPVs, will significantly help promote the secondary mortgage market and securitization in Thailand. It will provide significant benefits to the Thai housing finance system and ultimately to the housing market in the following ways:

Contribution to Housing Finance Sector

1. **Increase flow of new funds.** The creation of the secondary mortgage market will help increase the flow of funds from the capital market to the housing finance sector. As wholesale secondary institutions, the SMC or SPVs will play crucial roles as intermediaries between the capital market and home lending institutions by channeling capital funds and long-term savings, such as pension funds, provident funds and insurance funds to the housing finance system in an efficient and safe manner, thus increasing the availability of mortgage loans to home buyers.

2. **Increase liquidity.** The secondary market institutions, either the SMC or SPVs, will provide more liquidity to primary lenders. They will ensure a constant flow of capital to mortgage lenders (such as finance companies and credit foncier companies),

particularly during the time of tight money situations, such as at present.

3. **Offer lower cost of funds to originators.** Many financial institutions in Thailand, particularly finance companies and credit foncier companies, have higher costs of funding than depository institutions like commercial banks or the Government Housing Bank and thus have to originate home loans at higher interest rates. Through the secondary mortgage market, these originators can sell their pool of mortgage loans to the SMC or SPVs as an alternative source of funding. It is likely that the cost of funding in an off-balance sheet treatment may well be less than the cost of funding in traditional ways.

4. **Improve equity capital management.** The securitization business will provide considerable relief from the pressure most financial institutions are currently facing regarding capital bases. When an originator, such as a bank or finance company, sells its mortgage loans to a secondary institution, these mortgage assets will be removed from its balance sheet. The off-balance sheet structure will achieve a reduction of capital reserves as required by the Bank of Thailand (according to the BIS capital adequacy requirements). This means that some of the capital need no longer be set aside to cover risk assets of the originator. This capital will then be freed up for further lending. As a result, the return on capital will be increased.

5. **Improve risk management for originators.** The interest-rate risk incurred by the Thai housing finance system is relatively small, due to the overwhelming majority of mortgage loans being on a floating-rate term while originators' funding is also on a floating-rate basis. However, many mortgage lenders are still facing other risks associated with mortgage lending, particularly funding risks and liquidity risks. The funding risk arises from maturity mismatches. The actual average life of a mortgage loan is much longer than the average maturity of funding, which comes mainly from customer deposits or short-term financial instruments, mostly less than a year. If funding sources become more volatile, lenders will be exposed to funding risk. This risk can be reduced if mortgage loans can be liquidated quickly by selling them to a secondary institution.

   The liquidity risk also can be reduced through expansion of funding opportunities. In addition, financial institutions will be able to manage their liquidity by a choice of holding liquid MBS instead of illiquid mortgage loans.

6. **Promote standardization for operations of primary lenders.** Up to now in Thai mortgage lending, neither documentation nor underwriting criteria are standardized; each financial institution has its own formats and procedures. However, with the establishment of the secondary mortgage market, the SMC and SPVs will work cooperatively with mortgage originators and servicers to standardize mortgage design and loan documentation. This is because the secondary institution in any country usually requires the purchased mortgage loans to be uniform in credit characteristics (e.g., fixed or floating interest rates, terms of repayment, loan-to-value ratio, etc.) This enables the secondary institution as a mortgage conduit to reduce transaction costs as well as restructuring and administration costs of the MBS.

   In addition, the securitization business will encourage the standardization of loan documentation (such as application forms, loan contracts, mortgage contracts and property appraisal reports) of any originator who would like to sell their mortgage loans. The uniform loan documentation will ultimately help improve the quality of mortgage loans in the housing finance industry.

7. **Promote sound mortgage lending criteria.** The SMC or the SPV also will help establish sound lending criteria or prudent loan origination standards, as only mortgage loans of reasonable quality will be purchased by a secondary institution. Sound lending criteria, which originators would have to follow in order to be able to sell their mortgages to the secondary institution, will eventually force loan originators to be more cautious in lending. The underwriting process will be improved, ensuring that a borrower has both the ability and willingness to repay the debt and that the property provides sufficient security for the mortgage in case of foreclosure. Sound underwriting policies of originators will eventually help decrease loan defaults and delinquency levels, and thus help improve the health of originators in particular and the stability of the banking system in general.

Impact on Housing Property Market

The advantages of the secondary mortgage market to home buyers and the housing market are foreseeable as follows:

1. **More available funds for borrowers.** Since home loan originators, such as commercial banks and finance companies, can sell their mortgage assets to the SMC or SPVs, they will have a constant source of funds to be loaned to borrowers. Thus, home seekers will never lack mortgage credits for purchasing houses.

2. **Lower lending interest rates to borrowers.** More availability of mortgage funds among mortgage lending institutions will in turn alleviate potential upward pressure on mortgage interest rates. Over the long term, a lowering of mortgage rates

Table 3. Key Features of Financial Institutions in Thailand (end 1995)

Financial Institutions	*Operation Began*	*No. of Institutions*	*No. of Branches*	*Total Assets*	*Household Savings*	*Total Credits*	*Home Loans*	*Home Loans to Total Credits (%)*
Government Housing Bank	1953	1	39	154,100	72,300	142,000	135,259	95.3
Credit Foncier Companies	1969	13	0	7,900	5,500	6,600	2,584	39.2
Life Insurance Companies	1929	13	1,210	126,200	94,100	24,600	4,159	16.9
Commercial Banks	1888	29	2,991	5,013,700	3,249,900	4,230,500	370,407	8.8
Finance Companies	1969	91	66	1,588,100	914,600	1,301,400	54,196	4.2
Government Savings Bank	1946	1	540	210,500	182,200	39,400	684	1.7
Bank for Agriculture & Agricultural Coop.	1966	1	495	160,000	82,700	125,700	0	0.0
Industrial Finance Corp. of Thailand	1959	1	15	118,100	0	76,500	0	0.0
Agricultural Cooperatives	1916	3,610	0	36,000	6,400	25,600	0	0.0
Savings Cooperatives	1946	1,160	0	194,000	51,900	165,500	0	0.0
Pawn Shops	1866	379	0	15,000	0	13,000	0	0.0
Small Industries Finance Corp.	1992	1	1	1,600	0	600	0	0.0
Export-Import Bank of Thailand	1993	1	1	28,100	0	26,700	0	0.0
TOTAL		5,301	5,358	7,653,300	4,659,500	6,178,100	567,289	9.2

Source: GHB, BOT

will be possible because of improved liquidity as well as lower costs of funds for mortgage lenders. It is noticeable that interest rates have a significant impact on housing affordability and demand. Even a 1% lowering of the interest rate will cause a 5–7% reduction of monthly installment payments on mortgage loans. This will help home buyers save substantial money over a period of 15–20 years.

3. **Enhance demand for housing.** The availability of loanable funds coupled with lower interest rates will help improve the purchasing power of potential home buyers and will therefore enhance housing demand and housing consumption. A secondary market can also improve the affordability of housing finance for borrowers through the offering of longer terms of repayment (e.g., from the typical 15 years to 20 years or even to 30 years) and alternative mortgage instruments (e.g., fixed-rate loans and graduated-payment loans). The operation of a secondary mortgage market is therefore conducive to the promotion of homeownership to the general public, particularly in the lower income groups.

CONCLUSION

The secondary mortgage market, as well as securitization, is a relatively new field of activity in Thailand. To facilitate the operations of the securitization business, it is essential that the proper legal framework be established. The two laws regarding securitization have been enacted as Emergency Decrees and already passed the Parliament since July 4, 1997. The introduction of these two complementary laws will provide a solid legal framework to facilitate the sound development and operation of the secondary mortgage market in Thailand. Thus, it will contribute to the improvement of the housing finance sector as well as the housing market.

As capital markets and financing techniques are becoming globalized, asset securitization as a funding strategy will increasingly play a crucial role in corporate financing, not only in the United States, but also in the rest of the world. Securitization will inevitably be adopted and established in Thailand. It is expected to grow in the near future, as many financial institutions increasingly look to diversify funding sources and to better allocate their scarce equity capital.