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MORTGAGE LIQUIDITY FACILITIES

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1. Introduction

This note brings together some of the policy lessons learnt in the creation of mortgage liquidity facilities around the world. It looks at the main benefits which can be derived from the creation of a mortgage liquidity facility and the conditions under which they can operate most effectively. The note details some of the pre-conditions necessary for the creation of a liquidity facility. There is summary of some of the key techniques used in obtaining security over the mortgage collateral. Lastly two important aspects which are crucial to building confidence in mortgage liquidity facilities are how they are regulated and their corporate governance. The note brings in relevant examples from liquidity facilities which have been set up as far back as 1987 (Malaysia), from developed countries (France) and from facilities still under discussion (West Africa). Overall the note points to the valuable developmental role that mortgage liquidity facilities can play in nascent mortgage markets as an intermediary between capital markets in the primary mortgage markets. This is especially the case in markets where the mortgage lending infra-structure and environment have not developed sufficiently to allow for other more sophisticated alternatives such as securitization or covered bonds.

2. Main function and purpose

A Mortgage Liquidity Facility (MLF) is a financial institution designed to support long tem lending activities by Primary Mortgage Lenders (PML). The core function of a MLF is to act as an intermediary between PMLs and the bond market, with the objective of providing long term funds at better rates and under better terms and conditions than PMLs might be able to obtain if acting alone. In addition, a MLF can provide temporary liquidity support to lenders through collateralized short term operations such as repurchase agreements.

The need for such an institution arises because of the maturity mismatch between the liabilities and assets of PMLs. Capital market funding is an important way to overcome such mismatches and in some cases it can be the only route for institutions with small or no deposit bases (non-bank specialized lenders, small banks).

Instruments to raise funds directly from the capital markets are not always available, or might be too costly or complex given the stage of market development. For instance mortgage securitization requires a detailed legal and accounting framework, as well as a

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substantial mortgage portfolio in order to make the operation economically viable. In addition investors will require detailed portfolio information on the valuation of the

credits and on pre-payment risks. This requires large portfolios to obtain meaningful data, otherwise the issuer would have to pay a premium to the market where there is insufficient information.

Large commercial banks may not need an external source of cash, but they still have to be able to manage their liquidity if they extend long term loans using their deposits. Holding marketable bonds or being able to pledge loan portfolios for short term advances are ways to address this requirement.

3. Why create a Mortgage Liquidity Facility?

The impact of MLFs can be critical for the development of mortgage lending. In situations where lenders are reluctant to engage in large scale maturity transformation – because of macro-economics instability or fear of deposit runs for instance-, or if the limits set for such transformation have been reached[2] , these institutions can have a significant catalytic effect on the growth of mortgage lending. This was for instance clearly the case in Malaysia or in Jordan.

Overall the key benefits of MLFs can be summarized as:

- The provision of secure long term funding at attractive rates. Lowering the cost of funds, which can lead to a lowering of mortgage rates, thereby improving affordability and extending the range of potential borrowers.

- In emerging markets where interest rates and inflation can still be relatively volatile and dampen confidence in the markets, the availability of long term fixed rates can help provide a degree of certainty which can help the markets develop with confidence.

- Allows for greater competition in the mortgage market. The introduction of a MLF means new institutions to enter the market which was previously restricted to those with either a good credit rating or to those who had invested in a branch network and had significant deposit collection capabilities. MLFs therefore enable a more diversified set of lenders to develop than just large commercial banks, and can be a driving force for competition on the primary market, another factor promoting efficiency and affordability.

[2] Such limits can stem from regulatory provisions – as was the case in Pakistan recently with the capping of banks' mortgage portfolios – or from internal policy

- Leveraging of existing funding sources. Typically a PML will also be a deposit taker, often carrying a large supply of short term liabilities. Whether it is for regulatory reasons, economic instability, inflationary environment or general risk averseness, the short term liabilities are not always easily converted into longer term assets. A MLF provides a back up and allows for better management of the balance sheet. The short term deposits can therefore be used for long term lending, safe in the knowledge that the MLF will be there as a lender of last resort[3].

- By acting as a central refinancing platform, they are able to act as a force for standardization in the market, pushing PMLs to adhere to best practice. The MLF is able to set criteria for the types of loans it will refinance, including standardized documentation, processes, risk characteristics, etc. Standardizing market practices allows for greater transparency, allows the creation of market information systems, which in turn can lead to better risk management better market and consumer regulations and an overall lowering of the risks associated with mortgage lending.

- Acts as an intermediate step on the path to a full secondary mortgage market. Whether it is the lack of adequate legislation, the absence of credit bureaus or the absence of rating agencies, many countries are not able to directly make the leap from funding mortgages through short term deposits to refinancing them on secondary mortgage markets using covered bonds or securitization. MLFs provide an interim step which connects capital markets to the mortgage markets but with limited complexity or transfers of risks. It provides

Box 1 – Catalyst for Market Development

Jordan Mortgage Refinancing Company (JMRC)

JMRC played a significant role in the development of the Jordan's mortgage market. It was established in 1996 with the help of a World Bank loan. It was set up at a time when the state housing bank had withdrawn from mortgage lending to focus exclusively on commercial banking. It has 16 shareholders from both the public and private sector. In a few years, the number of lenders active in mortgage lending increased from two to ten, and the stock of mortgage loans increased from JD 100 million in 1997 to JD 336 million at end 2001 (USD 470 million), reaching 7% of bank advances overall. Down payments required from borrowers declined steadily (as low as 20% or 10% compared to 50% or more before), while loan maturities more than doubled and are now generally between 12 and 15 years, with some lenders offering up to 20 years. JMRC's impact has been substantial with the total of refinanced loan amounted to $215 million by end of 2005.

[3] This is dependent on the loans having been originated meeting certain eligibility criteria for refinancing. Riskier loans are therefore less easily refinanced and present greater liquidity risks.

the long term funds necessary for the market to grow and evolve, and allows time for the growth of the infra-structure necessary for risk transfers to take place.

- Act to deepen the financial market more generally by providing a long term investment to institutions with long term liabilities. Institutions such as pension funds, social security funds or insurance companies which have long dated liabilities are not always able to match these adequately solely using public debt issuance. So often they engage directly in the mortgage market or real estate markets (both commercial and residential) often with poor results. The MLF acts as an efficient way of connecting long term investors with the institutions generating long term assets.

- MLFs can be used as tool for delivering policy objectives such as the promotion of affordable housing or the promotion of local currency lending. If managed carefully a MLF can be used to pursue affordable housing objectives without necessarily distorting the objectives of market based pricing. The MLF may be able to set specific criteria for the refinancing of loans to particular groups of society such as low income groups or slum dwellers. Balancing these objectives in a way that does not cause market distortion and that does not require large fiscal resources can be very challenging however.

Box 2 – MLF force for innovation

Cagamas Berhad (Malaysia)

Cagamas is one of the earliest and most successful examples of a MLF, it was created in 1987 as a public/private partnership in which the Central Bank of Malaysia has a 20% stake, and financial institutions, its potential users, 80%. The objectives for the new entity were : a) to promote home ownership by providing liquidity to the financial institutions, to enable them to give out more housing loans, particularly to low and middle income groups; and b), to develop the local bond market.

One of the key features of Cagamas has been its willingness to change, adapt and innovate as the market has grown. For a long time, Cagamas offered only one product: the purchase of floating rate mortgages with recourse against the sellers. Starting in 1994 it diversified its services, to include the refinancing of leasing agreements, fixed rate loans and Shariah compliant instruments like Bai Bithaman[4] Ajil or Ijara[5]. It funds itself through the issuance of unsecured bonds, among them Mudharabah and Bithman Ajil bonds. More recently, in 2004, Cagamas entered the securitization market for the first time.

[4] Deferred Payment Sale, with single bullet payment made at maturity which is calculated using a discount rate to build in a profit margin.
[5] Leasing product which can be structured in different ways to allow for hire-purchase agreements.

Cagamas had a clear impact on the development of Malaysia's mortgage market. Mortgage loans outstanding grew from RM 20 Billion to RM 183 Billion (about $51bn) between 1987 and 2005, and the Malaysian market experienced the 1997-1998 South Asia liquidity crisis to a much lesser degree than neighboring countries. Cagamas' market share, which peaked at 41% in 1997, progressively decreased afterwards. Its balance sheet amounted to RM 24Billion in 2005 (about $7bn), half of which is leasing finance.

This relative decline in its market share is a testimony to the role it has played in building the market. Its role now is mostly a back up function, which was clearly evidenced by its activity surge during the Asian financial crisis.

4. When to create a MLF?

The two main pre-conditions for the creation of a MLF are that effective mortgage legislation is in place which allows for repossession of a property on a defaulted loan and secondly that a fixed income market exists even if in its initial phase.

Ideally the mortgage market would already benefit from the presence of a credit bureau, efficient mortgage and land registration systems, efficient judiciary, appraisal industry and the other institutions which help lower transactions costs and lower risk. However the reality is that many of these market features only develop once mortgage lending is underway. The MLF therefore fulfills a critical catalytic role of providing the long term funds which allows loans to be made which in turn acts as an inducement for the creation of the risk management infrastructure.

A MLF will invariably rely on the issuance of bonds as its source of long term funds. It therefore requires a minimum infrastructure in place covering securities regulation, settlement systems and pricing. The larger and more liquid the market the lower the spreads on the bonds. In addition, the longer the maturity that can be issued the easier it will be for the MLF to fulfill its Asset Liability Management obligations. However, the government debt market can sometimes be under-developed or very short term. In particular unless there is regular issuance of key benchmark bonds of different maturities, it is very difficult to build a yield curve and when pricing new issuances a higher spread is likely to be required.

It is worth noting that MLFs are not necessarily constrained by the size of the market or the need for specific enabling legislation. Unlike securitization or covered bonds which require a reasonably active market which has reached a critical mass, mortgage liquidity facility can serve a useful purpose in markets which are just developing. This is because the bonds issued by the facility are not directly linked to the mortgages, which means that a bond issuance can go ahead at any time without the need for a warehoused portfolio of

mortgages ready to be funded. This does entail the management of liquidity and interest rate risk on the part of the MLF.[6]

5. How do MLFs operate?

On the asset side, MLFs normally do not engage in any other activities besides providing funds to primary lenders, which is done in such a way as to minimize any possible risks in order to achieve the lowest spread to Government bonds as possible. Being seen as a secure low risk institution is a crucial in gaining a good rating for the bonds which they issue.

(a) Taking loans as security

First, they take the underlying mortgage portfolios as security. This is done either (i) by extending wholesale loans to the mortgage lenders collateralized by the lenders' mortgage portfolios – e.g. Jordan, Algeria -, or (ii) by directly buying mortgage portfolios "with recourse" from the originator. This means that the originator is bound to replace any loans which go into default with performing credits (Cagamas system)[7]. Therefore MLF's primary exposure is to the mortgage lenders themselves, and it is only in the case of the mortgage lenders default that the loan portfolio would be required as an additional security.

Second, MLFs typically have strict lending requirements: (i) for the refinanced originators, that must meet safety and soundness criteria to be eligible to the facility, and are subject to concentration limits; (ii) for the quality of underlying assets – typically mortgage rank, Loan-to-Value ratio, credit scores, residential purposes etc. It is worth noting that MLF's can be customized to the profile of Islamic Housing Finance Products, as demonstrated by Cagamas. These lending requirements imply a series of due diligence checks, reporting obligations and portfolio audits on both the mortgage originators and on the underlying mortgage portfolio –generally done through samples.

Box 3 – Achieving Operational Efficiency

Caisse de Refinancement de l'Habitat (France)

CRH was created in 1985 following the passing of a law which aimed to facilitate the refinancing of loans through the use of bonds. CRH is entirely owned by the institutions which make use of the facility, which currently number 18. CRH's refinanced portfolio amounts to around $25bn (2005) equivalent to around 4% of the French market.

The business model of CRH is a simple one based on minimizing financial risks. This is achieved in a number of ways:

[6] MLF may require market standing or a rating. Since rating agencies are often not present in the markets where MLFs are developing, some government backing (e.g. central bank shareholder participation) in the initial phase can be necessary to get bond issues off the ground.

[7] These sales are therefore not "true sale" in the securitization sense

i) The assets and liabilities are matched as closely as possible on a marked to market basis. CRH issues bonds matching the composition of its assets.

ii) Pre-payment risk is eliminated through a requirement that the pass-through of pre-payments be done at their market value

iii) Repossession is facilitated by the 1985 law which gives CRH a privileged security interest in the underlying housing loan

iv) Over-collateralization is set at a minimum of 25%. There is no requirement to remove bad loans but the over-collateralization is monitored on an ongoing basis and cannot drop below 25% level.

v) Each of the members of the facility are committed to providing CRH with liquidity support within certain limits should it be required

Given the simple model and its low risk profile CRH is able to operate with very low overheads, the organization counts just 9 staff, and is able to run its business model without charging a margin to its borrowers. Its profits stem solely from the return it makes on its capital which is then paid out as dividends to its members.

CRH represents a good example of efficient intermediation between lenders and the capital markets. The bonds it issues are highly liquid and benefit from a favorable risk weighting of just 10%.

The MLF can obtain security over the mortgage collateral in a number of ways, the easiest and cheapest is for the assets to be pledged or listed. This is effectively a promise by the primary mortgage lender that it has wholly allocated certain assets as collateral against the loan advances form the MLF. This method does carry some risk: in the case of bankruptcy it may not be clear who would have the rights to the mortgage assets. Therefore, earmarking and ringfencing underlying mortgages is preferable. Also, a full pledge is safer than a preferred lien in case of insolvency. In the French system, a higher degree of security is conferred to CRH by law. The mortgages are assigned to the CRH liquidity facility using promissory notes which automatically transfer ownership rights of the mortgages to the MLF in case of the originator's default. This system is completely immune to third party claims on the assigned assets.

The delivery method - purchasing the mortgage loans- is typically the most secure. As the legal owner of the mortgages the MLF would have the rights to dispose of them if necessary. In the case of disposal it is usual, however, to give the originating institution the right of first refusal to repurchase the assets, which in any case it would still be servicing. Full recourse means that, if the mortgages used as collateral go bad, the primary mortgage lender has to replace them with an equivalent asset, if this proves difficult it may be able to use a substitution asset with an appropriate discount.

In addition, MLFs must be protected against a fall in the value of the collateral. This can happen either because of market fluctuations, or because the replacement of defaulting

loans in the cover pool does not happen continuously. MLFs address this issue by requiring the over-collateralization of refinance loans by underlying mortgages. Typical over-collateralization levels would be of the order of around 120% of the level of advances

(b) Issuance of bonds

On the liability side, MLFs only have one activity: issuing general debt obligations, typically on the bond market. Because of the entities' extreme specialization, their bonds need not be collateralized. Typically when they are rated, the bonds would receive the highest grade available. This reflects the low risk nature of the MLF, which benefits from a number of safeguards to protect it against the main risks it faces. The two key risks for an MLF being a default by the refinancing institution and secondly a deterioration of the portfolio of loans it is holding as collateral against its loan to the primary mortgage lenders (PML). The safeguards take the form of over-collateralization, ability to call for more capital on its shareholders, recourse requirements on the collateral it receives and in some cases government backing in the form of guarantees for the MLF itself or its bond issuance.

Unlike covered bonds or securitization, they do not need a specific legal and tax framework –like exemptions to the general bankruptcy law for the former, or design of a true sale mechanism for the second. Furthermore, contrarily to securitization, they do not require a large volume of seasoned loans, which is a necessary requirement to value the risks (default, prepayment) which are transferred to investors. Nor do MLFs require the credit enhancement structures which can be expensive, or the equally expensive transaction and deal structuring costs which are characteristic of securitization. Assessing the credit risk of the mortgage portfolio is a major function of MLFs, which can focus on it better than non-specialized investors. MLFs can therefore be seen as ideally suited to the relatively early stages of market development[8]. Later on, they can help the market achieve a higher level of sophistication and be used to promote mortgage securitization once the proper conditions are fulfilled. The two instruments can however co-exist, leaving users and investors free to choose between different combinations of features, risks and prices. Cagamas has started doing just this in 2004.

(c) Balance Sheet Management

Another critical operational feature of an MLF is the way assets and liabilities are matched. Generally, in emerging markets, the duration of the bonds is shorter than the mortgages they refinance. A frequent approach (Jordan, Palestine, Malaysia) is for the MLF to turnover its debt by extending medium term refinance loans. In this case, the PMLs would typically reset the interest rates on their mortgages in line with the new funding rate following each change. This means PMLs do not incur interest risks in this

[8] However, the infrastructure for mortgage lending must meet some basic requirements in terms of property and security rights administration, and efficiency of mortgage collaterals. Obviously, a functioning bond market must also exist.

situation. They would only face a minimal liquidity risk in the case of the MLF being unable to refinance the loans if it was unable to roll over its debt. In Malaysia, the rate resetting on the mortgage loans is disconnected from the refinancing, which creates at the minimum a basis risk for the lenders. But the gap between bonds – generally with a bullet repayment profile - and mortgage loans – amortizable on long periods- can stay open. This results in balance sheet mismatches for the lenders or the MLF, and a need to manage the mismatches, in particular the interest rate risk. Therefore, this situation is only viable in mature markets where hedging instruments are available. The two possible solutions are to either keep the mismatch at the originators' level – this is the case of the French CRH[9]-, or to transfer it onto the MLF's balance sheet. This is the option used by the US Federal Home Loan Bank system, the two oldest examples of such facilities. Finally, an important concern can be the "pipeline" risk stemming from the time discrepancy between bond issues and the disbursement of advances. MLFs must be reactive issuers, and need to have access to the bond markets on tap.

(d) Pricing

The intermediation role carries a price which varies from one country to another, depending on the size of the balance sheet, the risks transferred to the MLF, and its corporate structure. In the case of the CRH in France, a small organization based on the principles of mutuality, which manages large assets and does not incur financial risks, there is no fee on the loans, so the banks receive the funds at the same rate that the bonds are issued at. The only profit it makes is from the investment income derived from its capital, to which users must subscribe. Younger facilities without large scale benefits charge up to 1% over their cost of fund. In between, American Federal Home Loan Banks' interest spreads amount to 25 basis points on average, and Cagamas' intermediation cost is about 70bps.

6. Governance and Public Support

The "public good" function of MLFs translates in two frequent components of their ownership structure: a cooperative approach, and government participation.

(a) Cooperative Approach

The joint ownership, spreading of risk and stronger capitalization allow MLFs to attract more favorable credit rating than individual PML lenders could attain on a standalone basis. This enables small lenders to tap into funding sources at rates not otherwise accessible to them.

[9] The CRH provides refinance loans that mirror its debt on a marked-to-market basis. Mortgage prepayments can be passed on to the Facility advances, but also on a marked-to-market basis – for instance by buying CRH's bonds in the market and delivering them as in-kind payments.

Box 4 – Giving smaller lenders access to the capital markets

Federal Home Loans Banks

The FHLBs were created in 1932 by Congress in an effort to fill a dire need for long term funding for mortgage loans. The Great depression had undermined the existing banking system and with it the possibility of buying a home. The mission of the FHLB is to provide cost-effective funding to members for use in housing, community and economic development; to provide regional affordable housing programs, which create opportunities for low and moderate – income families.

One of the key characteristics of the FHLB is the way it allows even relatively small savings banks access to the capital markets on terms which are close to those available to much larger institutions. Membership is open to a broad range of institutions including commercial banks, savings institutions, credit unions and insurance companies. The only requirement is that they purchase a capital stake in the FHLB which is proportional in value to the size of their assets and mortgage portfolios. In return, they may borrow, on a secured basis, at generally attractive rates from its FHLB. Beside long term advances, FHLBs provide short term loans secured by mortgage portfolios.

In fulfilling this mission, the FHLBs' primary business is to make advances to their members. Members – more than 8,000 overall- are savings institutions and, since l989, a growing number of commercial banks. Other financial institutions that are eligible to membership include credit unions and insurance companies, but few of these have chosen to join. Mortgage banks are not eligible for membership. The twelve exisiting FHLBs refinance around $1,000bn or 11% of the US residential mortgage market, however given the small average size of their members, they in fact cover approximately 80% of the US' financial institutions.

In many cases, given the extensive state involvement in the creation of a MLF, and the initial start up risk, the main equity holder in the initial phase of a MLF is often the State or a State related institution. This can change over time with users taking greater private equity participation, as the market grows and the refinancing needs of the sector require equity injections into the MLF. Although the government could continue supporting it, once the operation is underway, private equity provides greater flexibility. A good level of capitalization is especially important in order to maintain a good credit rating.

Box 5 – Using MLFs as a tool for achieving policy objectives

Example 1: Federal Home Loans Banks – Promoting affordable housing

The FHLB banks deliver on their commitment to promote community development through two housing programs: the Affordable Housing Program (AHP[10]) and the Community Investment Program (CIP[11]).

Since their inception in 1989, AHP has provided over $2.9 billion dollars in grants to help create 575,000 housing units, and there have been over $47 billion of CIP-funded loans, which have financed nearly 600,000 housing units and thousands of economic development projects.

Each year, the FHLB's must pay 20% of their profits to REFCORP which is the Resolution Funding Corp, an entity established to contribute funds for support of the savings and loan deposit insurance fund. An additional 10% is then paid to support the AHP program. This represents an implied tax on the cost of the funds, but it is in part compensated for by exemption from income tax. However to maintain low rates and good levels of return for shareholders, the FHLBs are much more engaged in investment activities in MBS which also increases their risk profile.

Example 2 State Mortgage Institution – Promoting local currency lending

Ukraine's State Mortgage Institution (SMI) was created in 2004 with the dual aims of providing long term funds, and to promote local currency lending.

As with many other transition economies, mortgage lending in Ukraine is dominated by foreign exchange loans, notably dollar lending. This carries a high risk for lenders but also for the borrowers who open themselves up to foreign exchange risk. The SMI therefore will provide PMLs with an affordable source of long term funds in local currency which will offer competitive rates compared to the dollar ones. This needs to be supplemented by regulation to effectively put a price on the foreign exchange risk to level the playing field between the loans. At present almost 95% of mortgage lending in Ukraine is denominated in foreign currency, so there is a clear need for such an institution. Its role will not only be to provide long term funds, but through its issuance of bonds, provide a long term Hryvnia asset which pension funds, banks and insurance companies can invest in. Through its bond issuance it will also provide greater long term liquidity which will allow for the extension of pricing points on the Hryvnia yield curve.

2007 marked the start of SMI's refinancing operations, together with its first bond issuance. Its operations are expected to scale up during 2008 and beyond.

[10] AHP provides subsidies for low income owner occupied or rental housing for individuals or families with income at or below 80% of the median income in that area.

[11] CIP provides funds at below market rates for lending to low and medium income families whose income should be at or below 115% of median in that area. Loans can be sued for purchase, renovation or development of units to benefit low and medium income groups.

(b) Government Support

Even when it does not participate as a shareholder, the government usually takes a lead role in the creation of the MLF. The objectives that a government might have in setting up a MLF would usually aim to complement its overall housing policy. Typical objectives might include: improving affordability through lowering of mortgage interest rates; increasing the level of home-ownership, with all of the associated externalities; and implementing of social agenda for housing, which may include special conditions for refinancing of subsidized loans or loans to specific population segments. Therefore, generally government provides support at least during a ramp-up phase of MLFs independently of holding a stake in their capital. A typical enhancement provided by government during the initial phase of a MLF is to guarantee the bond issuance of the MLF. This provides added security for the bond investors and allows the MLF to begin operations and have some initial working funds which it can lend out. In some cases, MLFs enjoy special regulatory or tax treatments.

It is important that the initial support ceases once the facility has reached a level of self-sufficiency. Making special privileges a permanent feature will generally result in market distortions, but additionally it is the market which generally requires the MLF to be viable on a long term stand-alone basis which creates confidence in its bond issuances. Therefore, special status should only be used during the initial 'setting-up' phase of a MLF, and the removal of any State backing should be planned from the outset through the inclusion of a "sunset" clause when creating the MLF. In France, the law that established CRH provided for a government guarantee, but stipulated that it would apply only for the first 3 years of the company. In Malaysia, Cagamas' most significant tax and prudential advantages were abolished in 2004.

(c) Corporate Governance

MLF's often fall in the slightly ambiguous position of being quasi-governmental institutions but with a clear market objective to fulfill. The State, as the largest shareholder and equity provider can be tempted to assume control of the management of the MLF. A further difficulty facing MLFs, is the fact that its customers are also often its main shareholder which can create conflicts with competition rules and business confidentiality requirements.

Good governance rules must therefore be cautiously designed to ensure the efficiency of a MLF. MLFs must be seen as entities that address a gap in the mortgage and bond market or correct a 'market failure', rather than as government tools exerting undue influence corporate decisions which may distort an MLF's mandate[12]. The risks are more limited if the public sector is represented by the Central Bank – as is the case for

[12] A counter example is provided by the Ukrainian MLF, whose Board comprises mainly representatives of ministries, of the National Bank and the Financial Services regulator, with just one representative from the industry in the form of the President of the Ukrainian Mortgage Association (UNIA).

Cagamas and JMRC in Jordan, which have both their national Central Banks as significant shareholders. This may however generate conflict of interests with the supervision function. The best solution is typically for the MLF to be treated as a temporary Public-Private partnerships with a commercial mandate, and to limit the control that the public sector can exercise. This can be achieved (i) by capping its voting power , and (ii) use a two tier management system, with a strategic/supervisory board with government officials, and an operational board to run the company.

7. Regulation of Liquidity Facilities

Transparent and effective regulation of MLF is key to building confidence in the bonds they issue. A strong regulator is important in instilling the confidence in the MLF which is required by investors. However, given the unique nature of the institution it is often difficult to decide by whom and how the MLF should be regulated. Given that it is not a depositary institution (FHLB is an exception) or a banking institution as such, the general banking regulatory framework may be inappropriate. Nevertheless strong capital ratios are necessary in maintaining investor confidence. The role of the regulator would include powers to review financial information, monitor capital adequacy, to review risk management procedures, to assess the quality of management. Even if regulated by the Capital Market Authorities, MLFs should be subject to capital adequacy standards: whilst not depositary institutions they do carry an important level of systemic risk and moreover they should not present opportunities for regulatory arbitrage.