



# Asian Bond Market Forum

Hong Kong  
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# Introduction

- The evolution of housing finance and the development of bond markets are mutually consistent ideas.
  
- Both are good for economic development and society in general.
  - Perpetuation of private property ownership – a home.
  
  - Creation of high quality, liquid assets – bonds.





# Introduction

- Establishing a connection between housing markets and bond markets.
  
- Two basic models:
  - Securitization – complexity.
  - U.S. Home Loan Banks – simplicity.





# Securitization Model

- Inherent complexity.
- Requires massive investment in:
  - Information Systems
  - Computing Technology
  - Securities Market Infrastructure
- In short – a highly developed, sophisticated capital markets.





# Federal Home Loan Banks

- 12 Banks:
  - Independently operated cooperatives.
  - Joint debt issuance.
  - AAA/Aaa rated.
  - Global presence.
- 8080 Members.
- \$809 billion assets.
- \$2 billion annual income.
- \$710 billion debt outstanding.
- \$37 billion capital.





# Federal Home Loan Banks

- Created by U.S. Congress in 1932.
- Two fundamental assumptions:
  - Widespread property ownership is a desirable goal for society.
  - Achievement of this goal is significantly enhanced by an effective and economically efficient link between residential mortgages and the bond markets.





# Home Loan Bank Model

- Inherent simplicity.
  - Utilizes existing market participants:
    - Bond Investors
    - Home Loan Borrowers
    - Lending Institutions
    - Bond Dealer Community
- Working together  
to achieve  
societal benefits
- Benefits to society are demonstratably positive.





# Investors

- Bonds among most basic financial instruments.
  - An essential part of economic development.
  - Investors wish to commit capital for varying terms at a variety of interest rates.
  - Bonds are basic investments for institutions which are key to economic development.
    - Banks
    - Insurance Companies
    - Pension Funds
- } Demand long-dated fixed coupon securities.
- Investors tend to seek high quality bond instruments as part of their asset mix.







# Investors

- Diversified pools of residential mortgage are recognized as inherently sound credits.
- In the U.S. credit losses for pools of residential mortgages are 0.5 basis points per year.
- Creating assets underpinned by residential mortgage portfolios is low risk proposition.



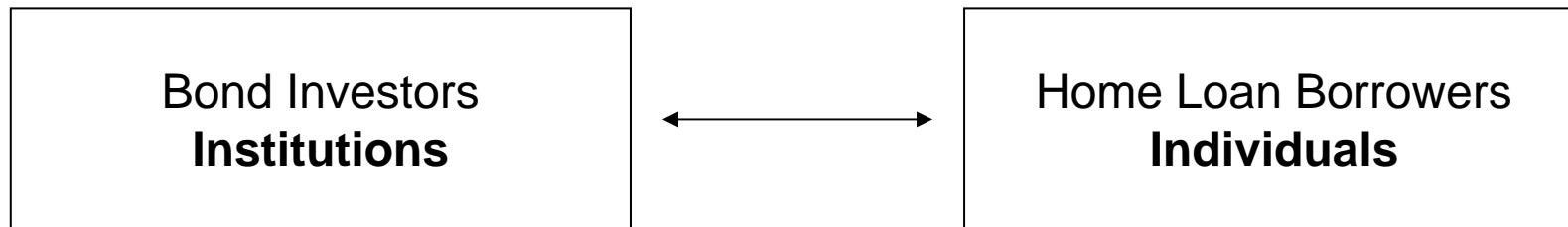


# Borrowers

- The home purchase is largest and most important financial decision ever made by most households.
- The home is an important medium for wealth creation.
- Fixed debt service over a long period, with an option to refinance, is highly desirable.
- Fully amortizing mortgage structure allows for the creation of equity and reduces likelihood of shocks due to temporary financial dislocation.
- Creates assets with inherently stable credit characteristics.



# Intermediation A Need to Connect



- A natural match:
  - Bond investor seeking bonds tied to mortgage assets.
  - Borrowers seeking funding for mortgages.
  
- Difficult to achieve without intermediation.





# Lending Institutions

- Most efficient mortgage financing will be created by private firms which must balance profit and risk
  - Innovations
  - Efficiencies
- Local level best for mortgage lending decisions – most intimate knowledge of borrower capacity to repay loan.
- Private depository institutions are demonstrably effective creators of mortgage finance.





# Lending Institutions

- Deposit liabilities must be augmented to ensure long-term success for mortgage finance.
  - Liquidity back-up.
  - Access to long-term liabilities.
  - A well functioning bond market is needed.
  
- Access to bond market – essential but difficult for local institutions.
  - Lack size.
  - Lack credit worthiness.
  - Lack financial sophistication.





# Bond Dealers

- Well suited for stimulating capital flows.
- Provide a conduct to international marketplace.
- Excellent medium for information / knowledge exchange between sellers and buyers.
- Deep and relevant research.
- Highly motivated to help bond programs succeed over the long term.



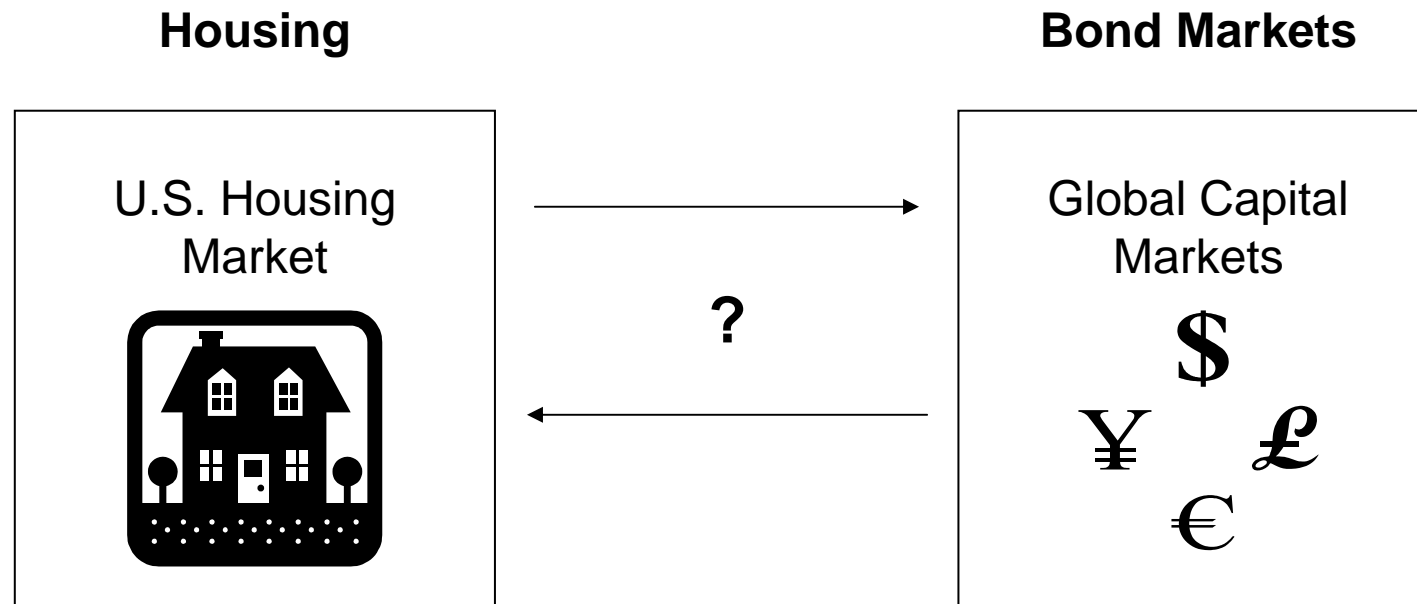


# Society

- Widespread private property ownership – embraced by many countries, as a basic public policy goal.
- For today's industrialized societies home ownership is the most logical means to achieve this goal.
- A national institutional framework is needed.



# Federal Home Loan Banks

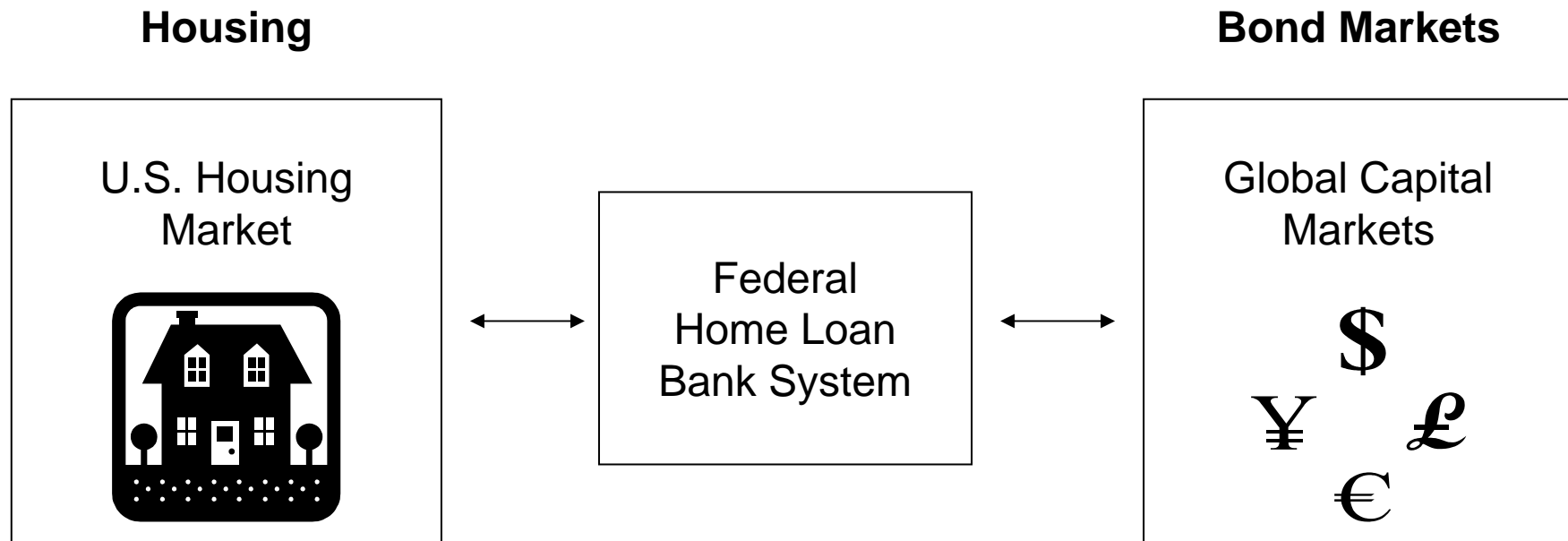


**Objective:** Promote home ownership by providing economical financing for home purchases.





# Federal Home Loan Banks

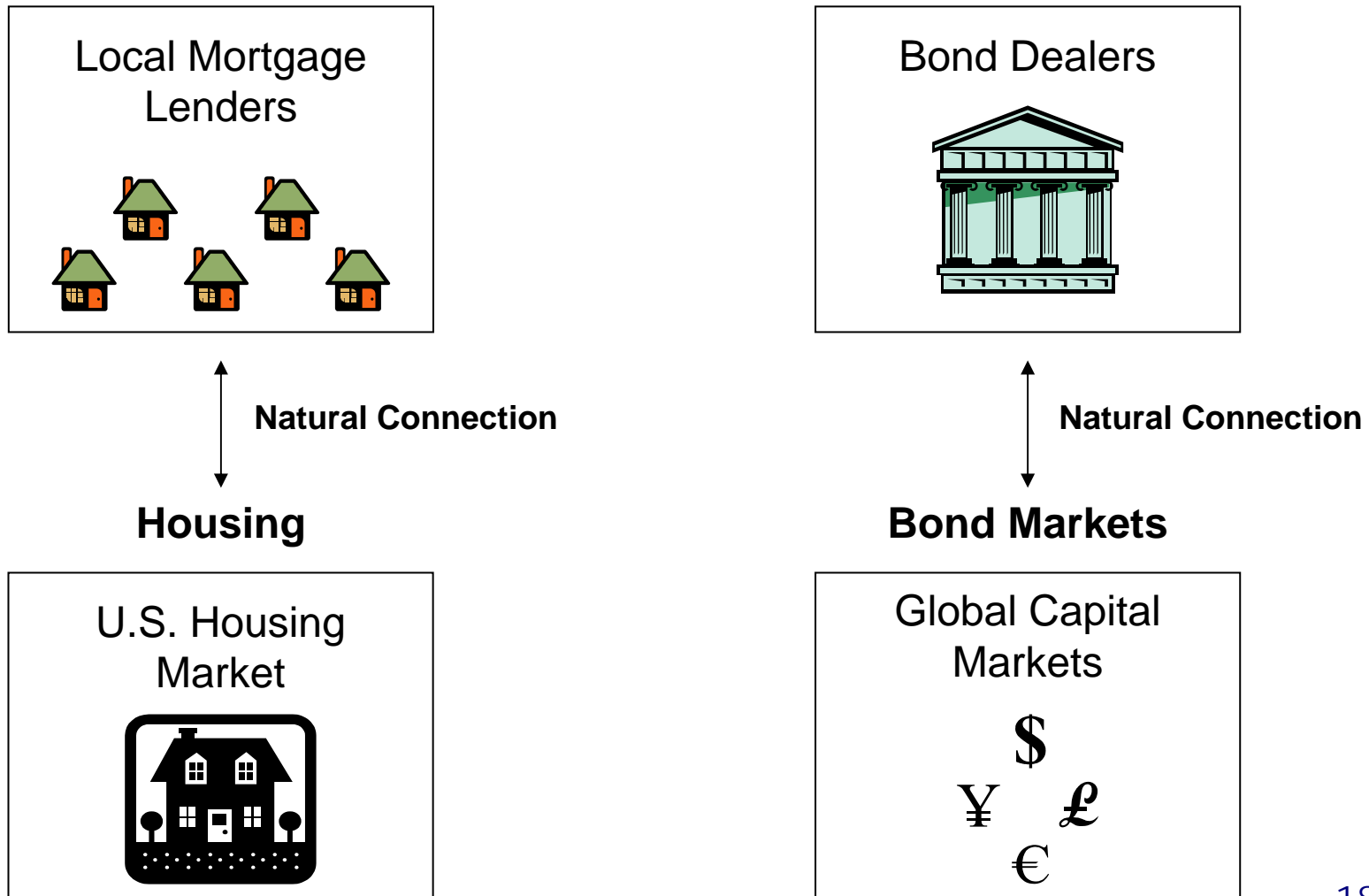


**Solution:** Create a connection between bond market and home owners, e.g. Federal Home Loan Banks.



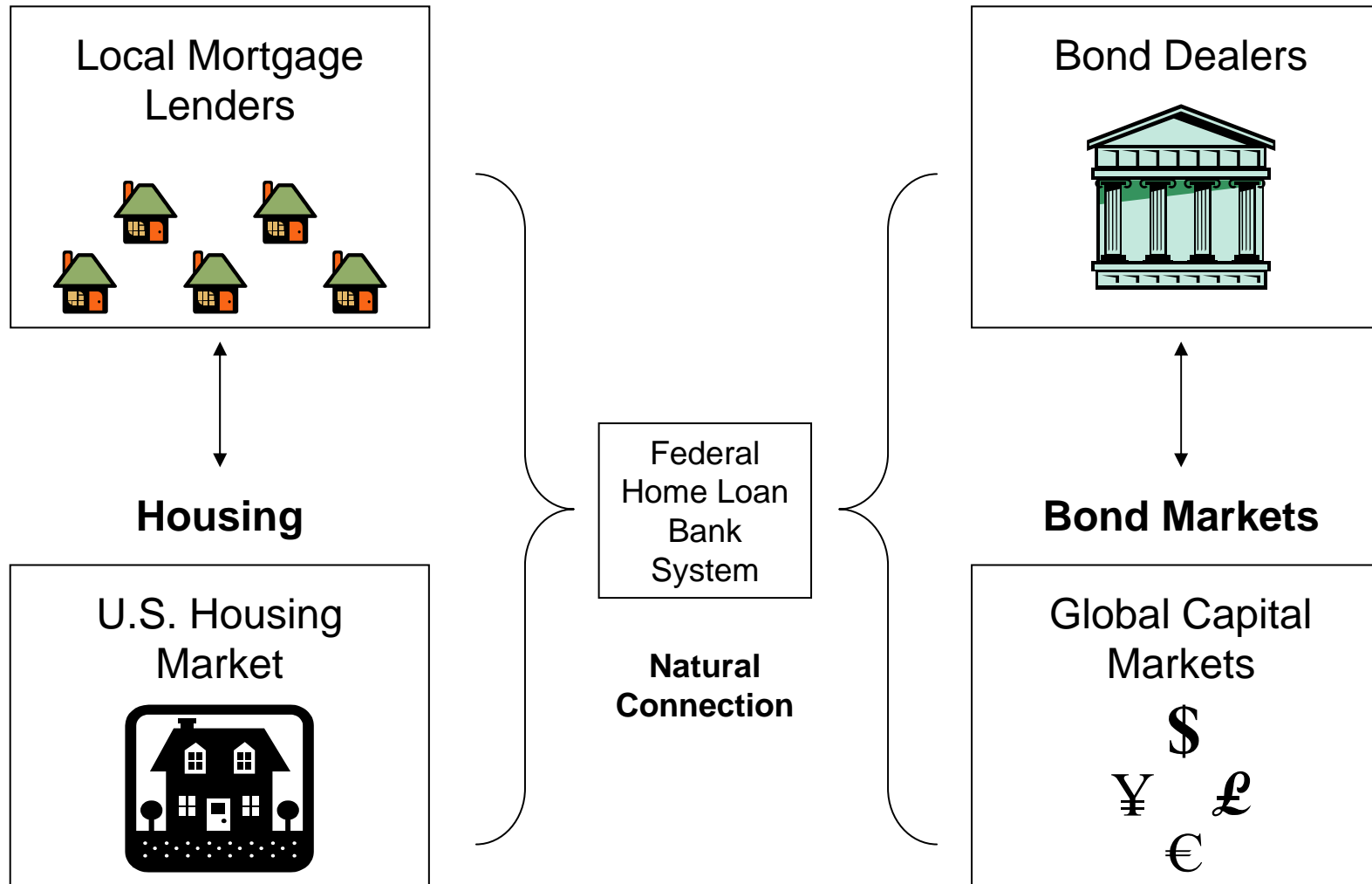


# Federal Home Loan Banks





# Federal Home Loan Banks





# Federal Home Loan Banks

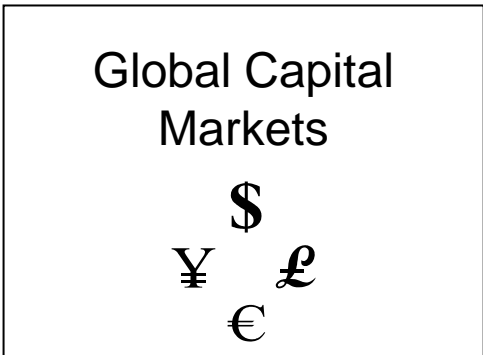


- 12 Independently Operated Banks
- 1 Federal Regulator – Federal Housing Finance Board
- 1 Bond Operations Office – Office of Finance
- Consolidated Bonds



Housing

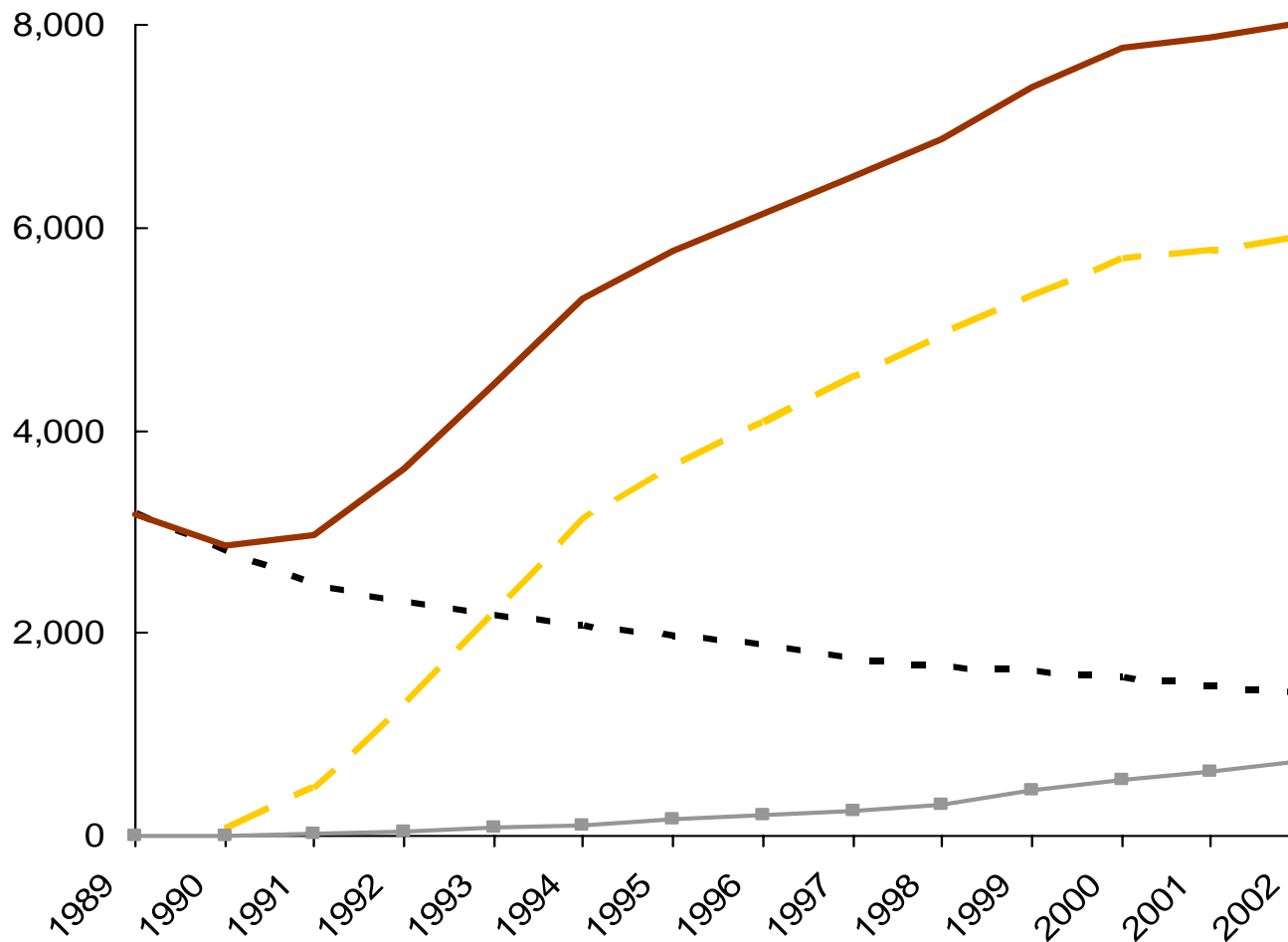
Bond Markets



**Result:** An efficient flow of funds from global debt markets to home owners.



# Federal Home Loan Banks Membership Growth



8,080 Total Members  
Assets = \$5.9 trillion

5,886 Banks  
Assets = \$4.0 trillion

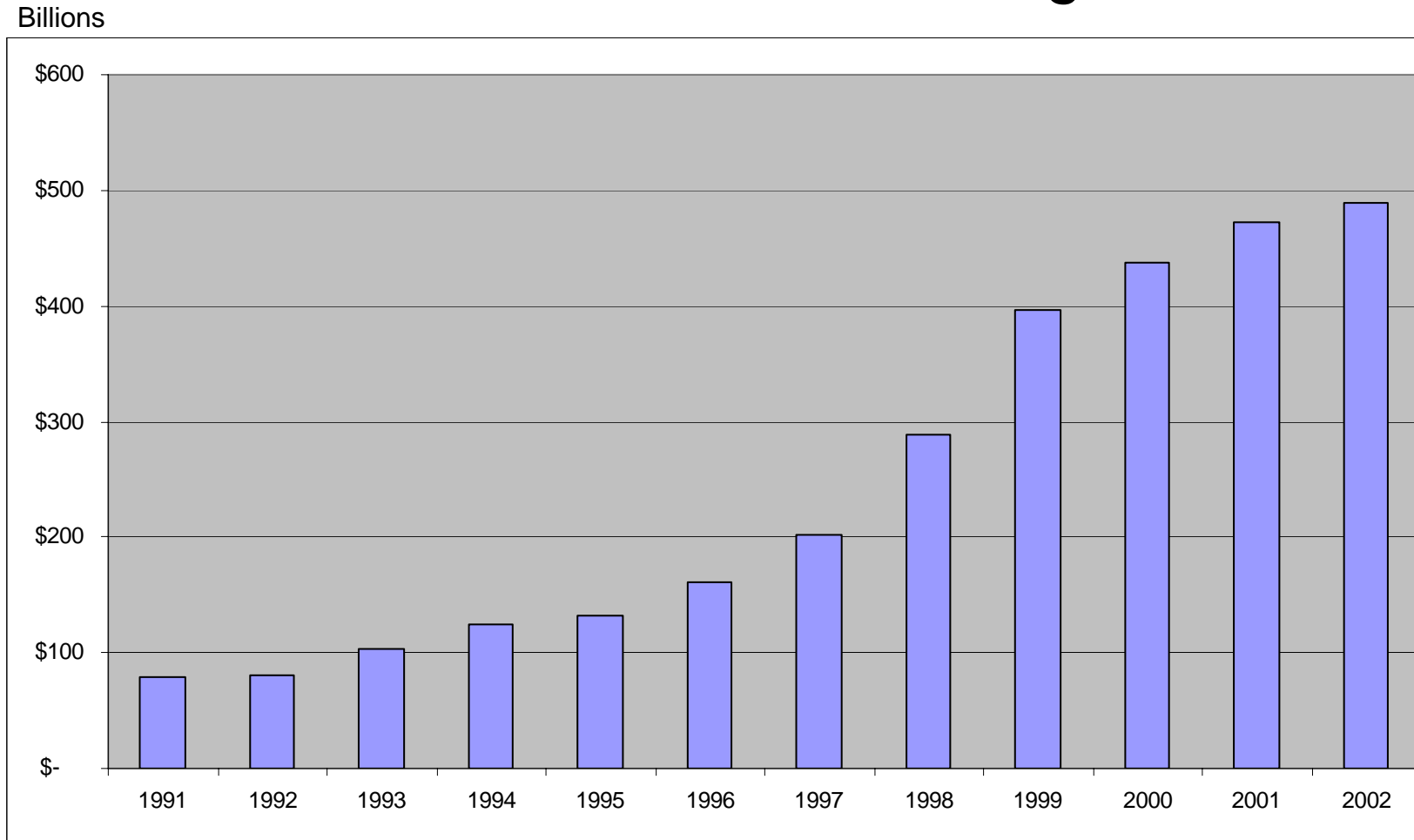
1,390 Thrifts  
Assets = \$1.4 trillion

735 Other  
Assets = \$542 billion



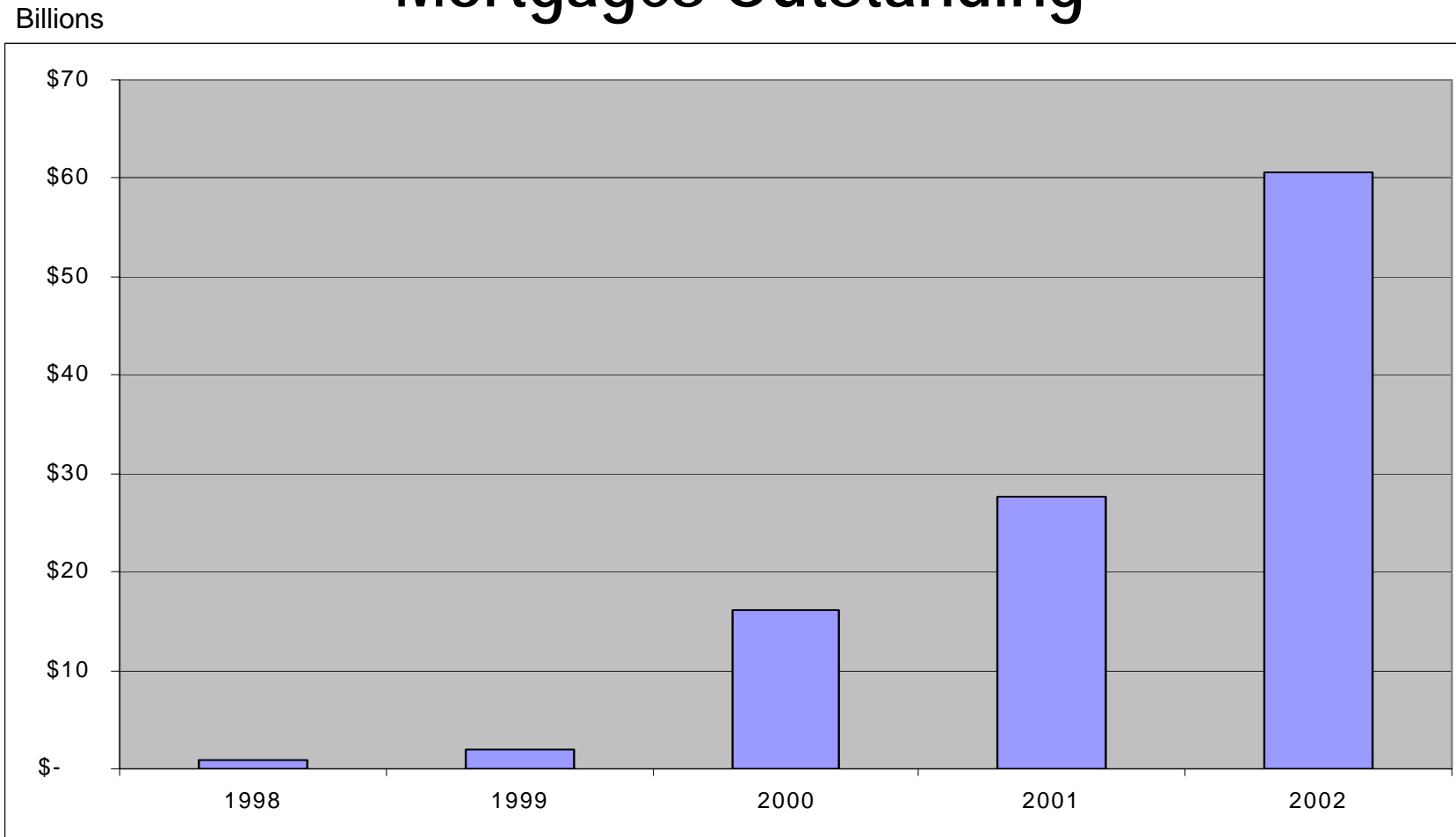


# Federal Home Loan Banks Advances Outstanding



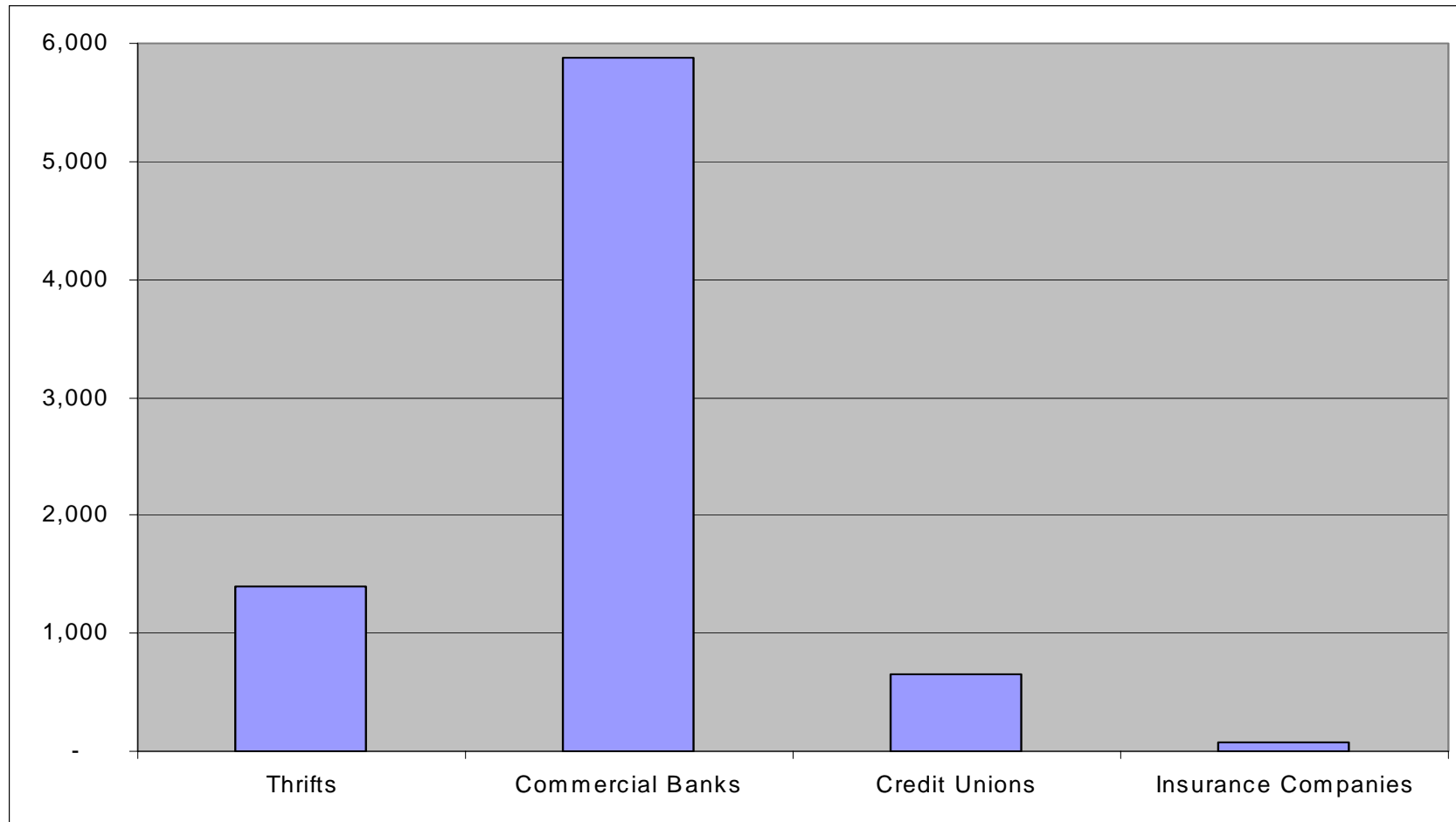


# Federal Home Loan Banks Mortgages Outstanding

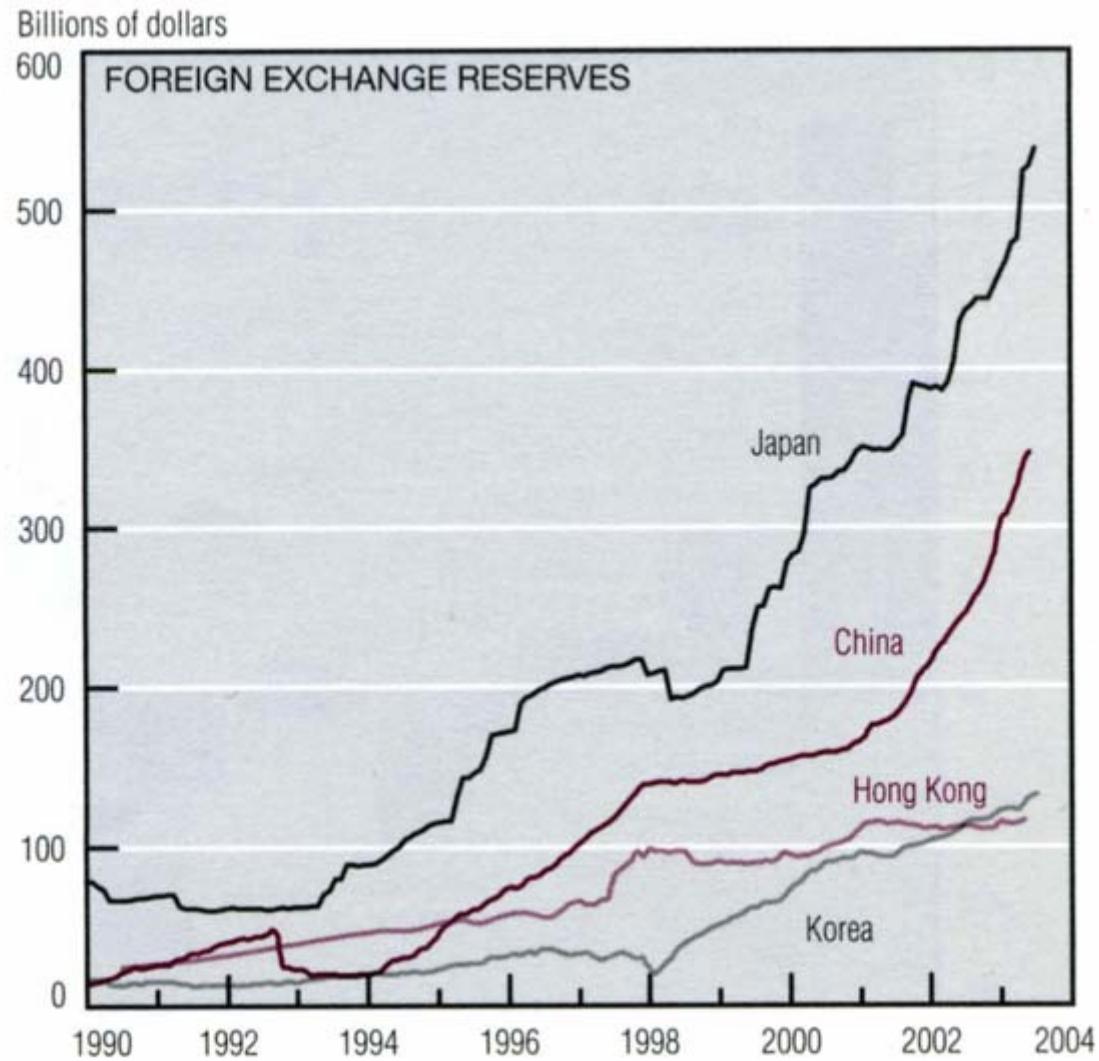


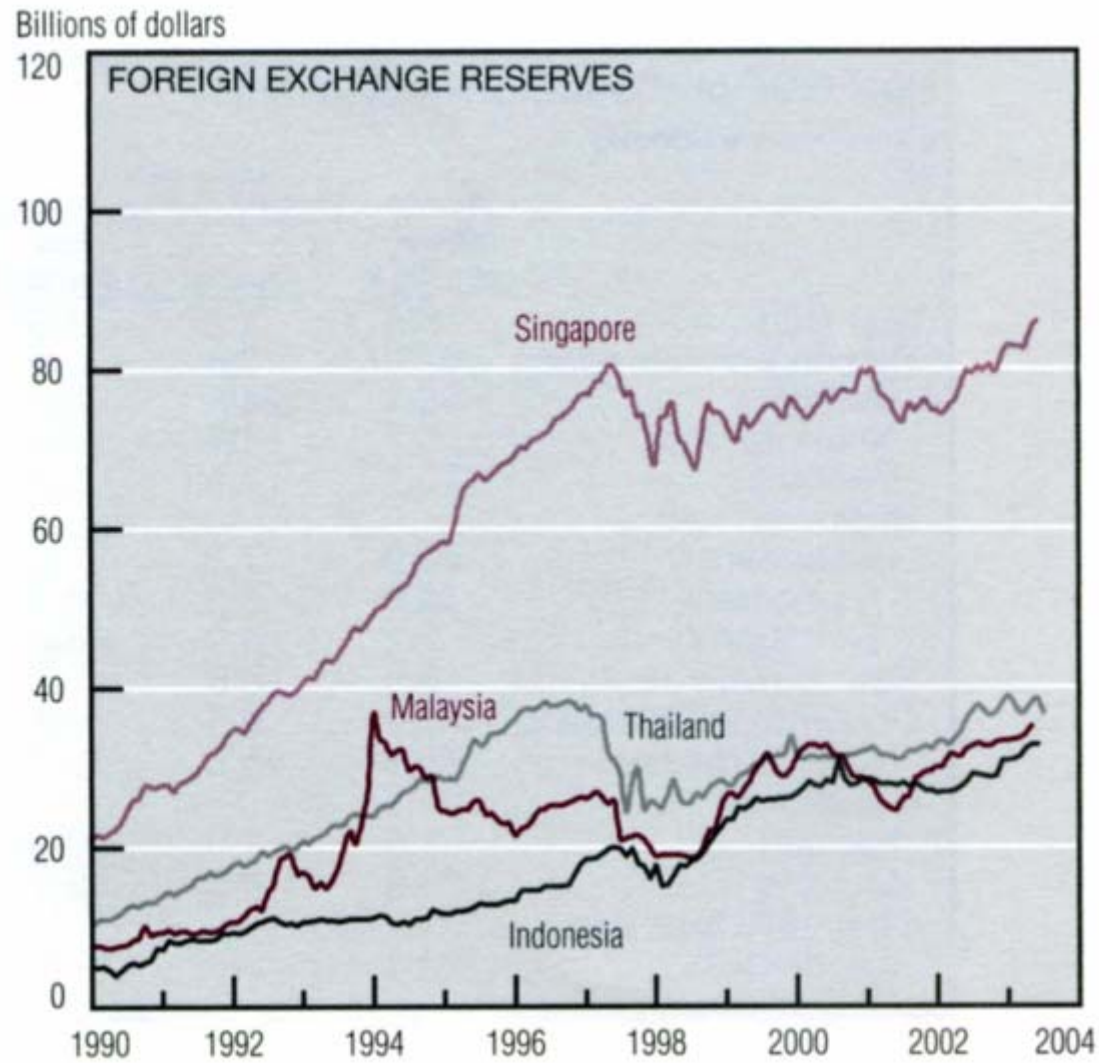


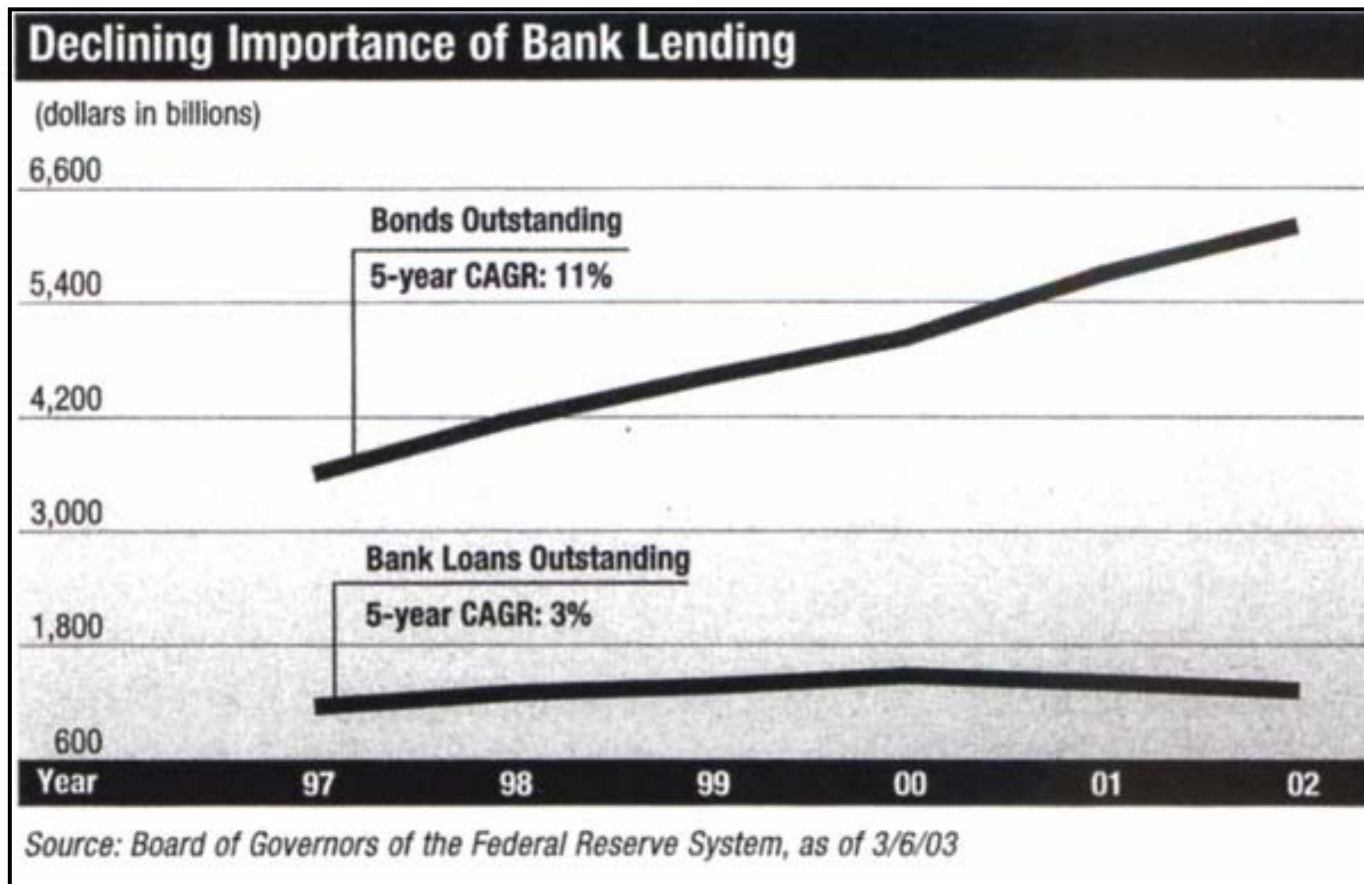
# FHLB Membership Composition - 2002













# Summary

- Residential home lending is an activity to be encouraged for economic stability and achievement of public policy goals.
- Linking the residential mortgage market to the bond market creates compelling synergies.
- The U.S. Home Loan Bank model offers an alternative to securitization as a way to stimulate both mortgage lending and bond market development.
- The success of the FHLB System suggests consideration of similar approaches is warranted.





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