

absalon project



Absalon Project (Absalon) is a financial services company dedicated to unique aspects of the Danish Mortgage Model. The company delivers an innovative mortgage securitization scheme that offers financial stability, access to funding and transparency to borrowers, investors and financial intermediaries.

The main objective of Absalon is to offer to clients and stakeholders an efficient and stable source of mortgage funding free of market risk. Furthermore, it can provide specific-case mortgage funding outsourcing (turn-key full operation). This would ensure that more people can have access to mortgage financing, lowering the barriers to homeownership.

This model is based upon the Danish Mortgage Model, which protects the equity invested in real estate, shields the investors from defaults and contributes to macroeconomic stabilization. This promotes the housing market, reduces risk in the financial system and improves both savings and investment flows.

Market attributes that Absalon Project aims to bring into the domestic mortgage finance market:

- Market Integrity
- Price discovery
- Transparency
- Quality Assurance
- Competition
- Standardisation
- Liquidity

Absalon is a joint venture between affiliates of VP SECURITIES A/S and Soros Fund Management LLC.

Problems stemmed from financial crisis for the mortgage markets:

- In the U.S. and developed markets securitisation “broke” the banking model of mortgage finance:
 - Lack of interest alignment
 - Weak credit culture
 - Disintermediation
 - Systematic mis-pricing or risk
 - Illiquidity
 - Opaque securitization
 - Contagion and systemic risk
 - Investor loss of confidence
- RMBS proved to be highly pro-cyclical
- Repo of RMBS were the contagion channel for inter-bank markets instability and illiquidity
- RMBS markets remain frozen aside from government guarantees
- Covered Bonds are raising encumbrance and liquidity risks
- Banks can’t normalise lending until the refinancing overhang of past securitisations is stabilised
- Falling house prices create public concern and political instability

The Danish system has proved almost immune to financial crisis due to:

Asset-Liability Management Risks

- No maturity mismatch. Prepayment risk on bondholder
- No interest rate mismatch
- No currency mismatch
- No hedging/CDO/insurance mismatch
- Tight counterparty risk controls

Principle of Balance (PoB)

- Mortgages funded by simultaneous issue of bonds for like term, rate and amount
- Tap issuance (large, liquid bond series open for 3 years)
- Pass through interest and principal repayment (no warehouse risk)

Prepayment Options

- Callable and non-callable mortgage options
- Prepayment options (partial and full)
- Prepayment at par with cash
 - / New lower rate loan financed by issuance of new bonds
- Prepayment at market price by buying the bonds in the market
 - / New, smaller mortgage comes with higher coupon financed by issuance of new bonds
 - / Highly counter-cyclical stabilizer for household and financial markets
 - / Reduces risk to homeowner equity due to changes in interest rates

Responsible Lending

- Originating Mortgage Credit Intermediary (MCI) services the loan for the term of the loan
- Originating Mortgage Credit Intermediary (MCI) carries credit risk for the term of the loan

Transparency

- Transparent price and cost structure
- Bond prices publicly available on Stock Exchange
- All information posted to the entire market in real time

Liquid Bond Series

- Assured liquidity through large, tapable bond series
- Joint bond series for smaller and new entrant MCI's (Totalcredit model – Multi-originator platform)
- Voluntary Market Maker Agreement

Bond Series Features

- Fixed rates, Adjustable Rates and Floating Rates.
- Cover pools can mix segments for funding efficiency.
- Borrower gets near-wholesale interest rates
- MCI retains service and credit risk on the borrower
- Bond investor takes interest rate risk, currency risk (if any) and prepayment risk
- Competition between MCIs is on service and rates – not credit laxity
- Borrowers have better information and make better decisions
- Even very small MCIs can finance mortgages at near wholesale rates through a multi-originator platform
- Capital is assessed dynamically to ensure continued responsiveness of MCIs to credit risk and loan quality

Balanced payment flows

Mortgage origination



Payments



- MCIs assume credit risk - which they control - and investors assume other risks - which they price
- Local banks, pension funds and insurance investors are matched to local mortgage borrowers so less dependence on foreign sourced finance and lower exposure to global imbalances
- Deep, liquid bond markets attract investors – even under stress conditions
- No state bailouts, subsidies, liquidity facilities or guarantees
- Primary and secondary market prices are the same
- Prices are transparent to investors, borrowers, banks and supervisors
- Less cost, risk and complexity from synthetic or derivative products
- Sustained investor confidence and demand
- Balanced mortgage bonds protect borrowers, banks and bondholders from instability, illiquidity and contagion risks
- Market pricing, trading and liquidity ensure liquid borrower refinancing, sustained investor appeal and bank capital asset quality in all credit cycle conditions
- Dynamic capital assessment and cover pool management promote good behaviour bias and bondholder confidence
- Mortgage bonds proven counter-cyclical stabilising capital asset class and liquid investments
- No state bailouts, special liquidity facilities or guarantees to stress state fiscal and debt balances
- Better resolution outcomes as more domestic assets available to satisfy domestic creditors
- Restructuring debt through mortgage bonds rather than bank refinancing would reduce risks and instability

Global Reviews on Danish mortgage system

Moody's: (2002)

"Moody's believes that Danish mortgage bonds are very strong and very low-risk financial instruments"

Mercer Oliver Wyman: (2003)

"The Danish mortgage credit in a European context has high efficiency, low prices and large product offers"

Bank for International Settlements (BIS): (2004)

"However, in the Danish case the institutional structure, the regulatory approach and monetary policy together have resulted in a market which, relative to the US market, has shown little or no stress in periods with significant refinancing"

International Monetary Fund (IMF): (2006)

"Through the implementation of a strict balance principle, the system has proved very effective in providing borrowers with flexible, transparent and close-to-capital markets funding conditions. Simultaneously, as pass-through securities, mortgage bonds transfer market risk from the issuing mortgage bank to bond investors. Lastly, strict property appraisal rules and credit risk management by the mortgage banks have also historically shielded mortgage bonds from default risk."

George Soros, The Financial Times (2008)

...I would recommend the system of mortgage credit used in Denmark...

These mortgages are transformed into instantly tradable bonds... house values and bond prices tend to move in unison...this arrangement reduces the danger of householders' equity falling into negative territory... The standardization of mortgages in the Danish system promotes transparency and liquidity... I pioneered the introduction of the Danish system in Mexico...

Hancock and Passmore (2009)

"We think implementing a Danish-Type system in the United States would have many benefits"

Shin: (2010)

"The Danish system of mortgage banks has attracted considerable attention as a resilient institutional framework Narrow banks would be akin to Danish mortgage banks whose liabilities match the duration of assets perfectly and whose equity provides a cushion for bond holders".

International Monetary Fund (IMF): (2011)

"Denmark has a sophisticated housing finance system with a unique arrangement of asset liability management that has helped maintain financial stability over the last two centuries"

Stakeholder's benefits

<p>BORROWER</p> <ul style="list-style-type: none"> • Near wholesale interest rates • Good range of loan types (fixed or variable rate, callable or non-callable) • Lower risk of negative equity trap • Attractive prepayment options • Easier product comparisons 	<p>INVESTOR</p> <ul style="list-style-type: none"> • AAA-rated, long duration asset class • Liquid, large bond series • Transparent price discovery and performance history • Low cost due diligence and administration • Repo asset for cash management
<p>BANK / MCI</p> <ul style="list-style-type: none"> • Stable mortgage finance • Lower capital costs • Transparent ALM • Counter-cyclical capital and repo asset class • Lower compliance cost and risk 	<p>SUPERVISOR</p> <ul style="list-style-type: none"> • Low risk for fraud, mis-pricing or mis-selling • Matched ALM for stability • Central data reporting and history • Low refinancing, contagion and systemic risk • No subsidy, guarantees or bailouts

MSP

- Low cost - low risk solution
- Proven system and support

Absalon products and services

Absalon delivers a multi-issuer, ready-to-use solution that could be implemented at a local servicing company, referred to as a Mortgage Service Provider (MSP), to manage and operate the business procedures and IT systems that will deliver the mortgage services mentioned. This utility could be owned by the market participants.

Such a solution would utilize all services and products that Absalon offers in areas as:

Business Consultancy

- Project identification and description
- Feasibility Study, including Business Model and Budget

Business Model Implementation

- Workflow implementation and training
- Business Model Execution

Systems Solutions

- FundingXpert, Mortgage Functionality for integration with existing origination system
- Absalon Turn Key Solution, ready-to-use solution delivered as Software as a Solution (SaaS) service
- Systems Development and Customization

Technical Integration and Operations

- System integration and testing
- Operation services

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