

ASSA RECOGNITION AWARD 2017

PROJECT PROPONENT:

Pag-IBIG Fund (Home Development Mutual Fund) - Philippines

CATEGORY:

Transformation Recognition Award

1. NAME OF THE PROJECT:

Pag-IBIG Fund's Pricing Framework for Housing Loans (Market Determined Interest Rate for Housing Loans)

2. OBJECTIVES OF THE PROJECT:

The project has the following objectives:

- a. To provide an objective pricing model reflective of the market
- b. To ensure that Pag-IBIG Fund covers all its costs, risks, and a reasonable spread
- c. To provide a handy tool for management for consistency and rational pricing/re-pricing
- d. To facilitate changes in pricing and its impact assessment; hence, prices can be adjusted to reflect prevailing market conditions and make pricing competitive with other lenders

3. NATURE OF THE PROJECT:

The project is the result of Pag-IBIG Fund's desire to have a competitive but sustainable housing finance. Pag-IBIG Fund rationalized its housing loan programs and at the same time adopted market-based pricing so that it can source funds from the market and be able to lend at market.

Market-based pricing was implemented using a pricing framework for all the products based on market, and using the Full Risk-Based Pricing model. The framework covers the cost of funds, cost of servicing and administering, reasonable margin, expected loss rate, and use of capital. Pricing will be determined by the term structure / re-pricing period, instead of the loan value.

Implementation of the project is in accordance with Section 3 of Rule IV of the Implementing Rules and Regulations (IRR) of Republic Act No. 9679, or the Home Development Mutual Fund Law of 2009: the Fund shall have the specific powers and functions to conduct continuing actuarial and statistical studies and valuations

to determine the financial condition of the Fund and taking into consideration such studies and valuations and the limitations provided, readjust the benefits, contributions, interest rates of the allocation or reallocation of the funds to the contingencies covered.

The Pag-IBIG Fund Board, during its 285th Regular Board Meeting, approved, among others, the Proposed Pricing Framework for Pag-IBIG Fund's Programs/Products under Board Resolution No. 2940, Series of 2012. The shift to risk-based pricing is now being applied to Pag-IBIG Fund's End-User Financing Program.

The project adopts the following:

- a. Full Risk-Based Pricing which will cover base rate (funding cost or market, whichever is higher), cost of servicing and administering, reasonable margin, expected loss, and use of capital;
- b. Pricing will be determined by the term structure / re-pricing period rather than the loan value. The minimum re-pricing period of three years is recommended to minimize operational difficulty of yearly re-pricing considering the volume of loans granted. In March 2016, Pag-IBIG Fund offered a one-year re-pricing period where loans will be subject to eligibility enhancements, or a more stringent underwriting guidelines, thus, lower risk;
- c. The **base rate** will be the funding cost or market, whichever is higher:
 - c.1. Pag-IBIG Fund funding cost is the cost of the source of Pag-IBIG Fund for the program. If not specifically identifiable, it will be the weighted cost;
 - c.2. Dividend rate to be incorporated in the funding cost will be a notional rate used by banks which is equivalent to 1Y PDST-R2 rate;
 - c.3. Market reference rates to be adopted will be the applicable PDST-R2 rates; and
 - c.4. Comparison of investment performance with benchmarks.
- d. The **cost of servicing and administering** covers cost directly associated with the program as well as other indirect cost;
- e. The **expected loss rate** is based on the target probability of default (PD) and loss given default (LGD);
- f. The **margin** may be increased depending on the risks associated with the borrowers/counterparties in accordance with the approved Credit Scoring Guidelines (i.e. Pag-IBIG Fund's Borrower Evaluation System or BES);
- g. The **use of capital** accounts for unexpected losses; and

- h. Interest rates will be set at the beginning of each semester based on prevailing market rates.

4. WHY IT SHOULD BE RECOGNIZED:

Prior to the implementation of the Pricing Framework, Pag-IBIG Fund's housing loans were on fixed terms which extend up to 30 years, with mandated interest rates based on the loan amounts rather than the loan terms. This has been the practice since the inception of its housing loan program in 1983. Sources of funds are on shorter term than Pag-IBIG Fund's housing loan programs. These bring about risks due to mismatches in loan terms and pricing.

A pricing framework for all the products based on market and using the Full Risk-Based Pricing model was formulated, the first of its kind among government housing-related agencies in the Philippines. The use of the framework facilitated pricing/re-pricing will ensure that Pag-IBIG Fund covers all its costs, risks, and spread. The new rates now depend on the fixing term rather than the loan amount, removing market interest rate risks and mismatches in loan terms and pricing. Moreover, re-pricing enables adjustments for changes in cost and associated risks in lending.

The benefits of Pag-IBIG Fund from the project are gains in market share in housing loans – borrowers that could not have been captured by Pag-IBIG Fund if its lending rates are not competitive or aligned with that of the market.

Moreover, the project provided awareness on how Pag-IBIG Fund's activities affect costs of its products, and, ultimately, the welfare of its members. It also serves as a handy tool for management for consistency and rational pricing/re-pricing. With this pricing tool, price changes can easily be made to reflect market conditions.

The project, **Pag-IBIG Fund's Pricing Framework for Housing Loans (Market Determined Interest Rate for Housing Loans)**, deserves to be recognized by the ASEAN Social Security Association because it is an activity that transformed Pag-IBIG Fund, inculcating discipline in its financial and business operations. Moreover, the Pag-IBIG Fund Pricing Framework also helped transform the lives of Pag-IBIG Fund members, specifically the housing loan borrowers who enjoyed the reduced interest rates, since homeownership is one of the top goals of Filipino workers in their dream of leading better lives.



