Colloquium on "Malaysian Corporate Bond Market"

Opening address by Yang Berbahagia Dato' Othman Rijal, Secretary General of Treasury

Good morning Tan Sri – Tan Sri, Dato' – Dato', distinguished guests, ladies and gentleman

First of all, let me, on behalf of the National Bond Market Committee (NBMC), thank you all for attending this morning's colloquium on the "Malaysian Corporate Bond Market". I have no doubt that your active participation in today's colloquium and continuing involvement in the discussions of the numerous and complex issues that affect the development the corporate bond market will help us realize our vision for the establishment of an efficient, viable and liquid corporate bond market in Malaysia.

Ladies and Gentleman,

The three principal means employed in the funding of economic enterprises are equity instruments, bonds and bank lending. Over the years, much attention has focused on the optimal ratio of debt to equity. In contrast, the "optimal" or best balance between bond financing and longer term bank financing has scarcely been addressed. And as was shown by the 1997 financial crisis, such neglect can have far reaching effects on the economy, especially on systemic risks.

It is conventional wisdom now that the presence of a well-developed corporate bond market has a strong positive effect on the economy. In the absence of a sufficiently large corporate bond market, an overly large burden of corporate lending is taken on by the banking system. In such an environment, the over-sized banking system can become fertile ground for lax lending criteria and relaxed investment standards by companies. Eventually, the resulting excessive borrowing leads to excess productive capacity, which in turn lowers the return on invested capital, causing many of the loans to go bad.

The Government recognises the importance of developing the domestic corporate bond market, the need for which has been critically underlined in the present economic recovery. This is because a well developed corporate bond market would have been able to efficiently allocate the nation's large pool of savings in two ways-

- borrowers would have an alternative source of finance and not solely depend on the discretion of bankers and equity financing; and

- it might have provided a market initiated signal that assets were being overpriced.

More so now, a strong domestic bond market is required for the following reasons:-

- massive amounts of resources are needed to finance the recovery as companies invest in manufacturing, infrastructure and services;
- structural changes in the economy from labour-intensive to capital-intensive industries will require long term debt financing that cannot be adequately be met by the banking sector or equity market;
- viability of banks to meet long term capital funding needs (especially for infrastructure projects) due to constraints such as maturity mismatch between assets and liabilities, single customer limit and capital adequacy requirements; and
- increased demand for long term fixed-income instruments by long term institutional investors for portfolio diversification and asset-liability management purposes.

The question before us today is what would the optimal or best balance between bond financing and longer term – bank financing for the Malaysian economy?

Successful creation of a corporate bond market requires the establishment of a range of specialist institutions, instruments and infrastructure. Of equal importance is the policy framework and financial system within which the market operates. If these are not condusive to bond issuance and trading, market developments will be impeded no matter how good the infrastructure and institutions are.

It is for these reasons that one of the initial tasks of the NBMC is to see to the full rationalisation of the regulatory framework for the corporate bond market. Proposed amendments to the Companies Act 1965, the Securities Commission Act 1993 and the Banking and Financial Institutions Act 1989 are being finalised to effect the Government's decision for all approvals for debt issuance to be centralised at the SC. In addition, the framework within which corporate bond issuance is regulated would be facilitative, efficient and cost effective. These amendments are expected to be completed and come into effect in the second half of the year 2000. We believe that clarity in roles, responsibilities and objectives of regulatory authorities is essential for maintaining transparency and public confidence in the regulatory framework. Clear legal definitions, and enhanced cooperation and coordination between the regulatory bodies is, therefore, essential to avoid regulatory gaps and duplications.

In addition to the proposed amendments, the SC intends to accelerate its planned transition towards a disclosure-based regime via the bond market. The accelerated transition in this case is justified because of the extra protections that are inherent in the legal structure of bonds compared to the legal structure of equities. Hence, a shelf-registration system for corporate bonds will be introduced once the proposed legislative amendments come into force. Under such a scheme, a proposal may be made by an eligible corporation to make multiple issues of debt securities within a particular time frame. Once this proposal has been approved, a corporation will be permitted to make multiple issues of securities within this time period without securing the further approvals in relation to each issue in the series, subject to guidelines which will be issued by the Commission. I am informed that the shelf registration system will help cut down the costs and time involved in obtaining regulatory approvals for bond issuance.

Another short term impediment to the development of the corporate bond market is the lack of a benchmark yield curve. A potential investor in a corporate bond issue must assess the attractiveness of the securities being offered in terms of the price compared to the risk. Or from the issuer side, the issuer must price the securities to be attractive to investors compared to other securities, taking into account the risk profile of a particular bond issue. Identifying and pricing the various components of the risk profile are key steps for both issuer and investor. To ensure that the benchmark provides an effective basis on which pricing is calculated, there must be sufficient incentives for active secondary market trading. All these issues would need to be addressed in identifying the appropriate debt issuance programme that would create a meaningful benchmark yield curve. The NBMC is studying and evaluating various possibilities in creating a meaningful benchmark yield curve and would invite a very open discussion on this issue at today's colloquium.

In addition to the regulatory framework, the NBMC would also be looking at appropriate market structures, including institutional arrangements that promote and attract active primary and secondary market activities. Such measures would involve widening the issuer and investor base, improving liquidity in the secondary market and facilitating the introduction of risk management instruments.

These impediments would need to be addressed within a longer term timeframe. In particular, secondary market liquidity is constrained by a lack of a diverse and active group of institutional investors with incentives to maximise returns on their portfolio. But alleviating the problem of lack of institutional investors will require a more thorough review of the structure of the pension and insurance sectors to make a larger portion of the assets held subject to performance incentives that would encourage active portfolio management and, therefore, a more active trading of bonds in the secondary market.

Ladies and gentleman, I believe that our markets are our national treasure that should never be taken for granted or squandered by short-sighted thinking. Let us be ruthless in our examination of every aspect of the work we need to do for the development of the corporate bond market in Malaysia and in the way we allocate resources. There are so many issues and complexities that surround our developmental efforts today and I do recognise that it is easy to get lost in the details that envelop them and allow entrenched interests to stonewall market developmental initiatives. But we must not lose sight of the underlying essence of what we want to achieve – deeper, longer maturity, more stable and more transparent debt market that would support national economic needs. Let us not look back at this time as an opportunity not seized, a challenge not taken or a frontier not explored. I call on all of you today to work closely with the NMBC in realising our vision for the establishment of a viable, efficient and liquid corporate bond market in Malaysia.

Thank you very much.