

INDUSTRY CONSULTATIVE PAPER – PROPOSED REVISION TO THE PDS AND ABS GUIDELINES

Background

The Securities Commission (SC) announced a whole new regulatory framework for PDS issuance in July 2000 which resulted in the release of the SC's Guidelines on the Offering of Private Debt Securities ("PDS Guidelines"). Subsequently in April 2001 the SC released its Guidelines on the Offering of Asset Backed Debt Securities ("ABS Guidelines"). Since these guidelines were operationalised, the SC has received feedback from regular consultation with industry practitioners as to areas which could be further improved.

Purpose

The purpose of this paper is to propose further improvements to the PDS and ABS Guidelines in order to make the issuance process more cost effective and practical for issuers. In this regard, the SC would like to seek industry feedback on these draft proposals, particularly, to consider the following:

- The nature of the proposed reforms considering the current stage of Ringgit corporate bond market development; and
- Market practices in other jurisdictions which may be applied in the local corporate bond market scene.

AREAS OF REVIEW AND NEW POLICY PROPOSALS

A. PDS GUIDELINES

1. To clarify circumstances in which Issue/Offer Guidelines will apply

The existing PDS Guidelines are silent as to what the requirements would be if an issue of PDS would result in a significant change in the business direction or policy of a listed public company. Currently, if an issue of shares results in similar consequences, it would be subject to the Back-door Listings (BDL) and Reverse take-overs (RTO) requirements under the Guidelines on Issue/Offer of Securities (Issue/Offer Guidelines).

Proposal

- To ensure regulatory parity between the equity and debt market, it is proposed that a new provision be included in the PDS Guidelines to clarify that any issuance of PDS that falls under section 32(2)(g) of the SCA, i.e. that would result in a significant change in the business direction or policy of a listed public company, would be subject to the requirements of both the PDS Guidelines as well as the Issue/Offer Guidelines.
- Given that such transactions would involve merit assessment on a case-by-case basis, the 14-day approval period would not be applicable.

2. **Partial Underwriting and Minimum Level of Subscription**

The present PDS Guidelines have removed the mandatory underwriting requirement imposed in the guidelines that were issued prior to 1 July 2000. Paragraph 24 of the PDS Guidelines that were issued on 1 July 2000 nonetheless require that where there is no underwriting commitment, issuers must state a minimum level of subscription necessary to achieve their funding objectives. This requirement was imposed so as to ensure that actual funds raised from a PDS issuance are sufficient to finance the intended purpose i.e. for working capital, capital expenditure etc. If the amount of funds raised is insufficient, the proposed issuance should be aborted for investor protection reasons.

As the existing PDS Guidelines do not specify what the minimum level of underwriting must be for an offer, the SC has received queries from industry as to whether PDS issuances can be partially underwritten and if it is necessary at all to disclose the minimum level of subscription in such instances.

Proposal

- The SC is of the view that the issue of underwriting is separate from that of minimum level of subscription. Issuers should therefore be free to decide the extent to which the proposed issue is to be underwritten.
- Regardless of the level of underwriting, the disclosure of the minimum subscription level is generally important as it states the minimum amount that the issuer would require to fund the intended purpose. Thus, it is proposed that the PDS Guidelines be clarified to require issuers to disclose the minimum level of subscription based on the total size of the PDS issue, if the intended level of underwriting is lower than the minimum level of subscription required.

3. **Requirement to disclose 'Mode of issue' (bought deal/book building/private placement/competitive tender) and disclosure of 'indicative' information**

Presently, the SC requires the issuer to state upfront the specific mode for issuance. However, industry practitioners have highlighted to the SC that it is difficult to determine upfront the actual mode of issuance of PDS and that such decisions should be left to be determined commercially by the arranger/issuer prior to actual issuance date. Further, it was explained that except for instances where the chosen mode for issuance was on a 'bought deal' basis, most information which is 'indicative' due to market/price sensitivity and disclosed in the Term Sheet are conditional upon the deciding an alternative mode of issuance.

Proposal

- Except for instances of 'bought deal' transactions, it is proposed that issuers/ arrangers be allowed the flexibility of determining a suitable mode of issuance at any time prior to the actual issuance of the PDS.
- However, issuers/advisers will be required to furnish the SC, prior to the actual date of issuance, details of the chosen mode of issuance and the relevant 'indicative' or market/price sensitive information dependent thereon.
- Industry feedback is also sought on the type of information that should be deemed as 'indicative' or market/price sensitive.

4. Review of requirements for Commercial Paper (CP) and Medium Term Note (MTN) Programmes

• Decoupling CPs from MTNs

The SC has received feedback from industry practitioners that the existing CP/MTN programme should be decoupled to ensure the more effective use of the programme as an option for fund raising. CPs, which carry a tenure between 1 month to a maximum of 12 months are largely used for working capital purposes while MTNs are used to fund longer term project financing needs. A mixed programme of CPs and MTNs allow issuers greater flexibility. However, the present structure and requirements also possibly perpetuates the tenure mismatch between funding and use of funds. This is exacerbated by the fact that such programmes are difficult to monitor given that they are not cleared and settled through RENTAS.

Proposal

- To encourage more efficient matching between the tenures of sources and uses of funds, the SC proposes to decouple CP from MTN and that different criteria be applied for CP programmes and MTN programmes respectively given the different nature of the instruments.
- **Liberalisation of 7-year tenure restriction for MTN programmes without rollovers**

Following proposals to decouple CPs from MTNs, industry practitioners have suggested that the current 7-year rule imposed on the MTN programme be revised. The suggestion is for a tenure requirement to remain for CP-programmes (to ensure CPs are not used recklessly to fund longer term needs) but to remove the maximum tenure requirement for MTN programmes. Again, this is to ensure more flexibility and effectiveness in the use of the programmes to fund specific needs of the issuer, thus avoiding a mismatch. Following the above, MTN programmes can be issued to match the intended purpose of fund raising without the need for having an option to roll over.

Proposal

- As such, it is proposed that the 7-year tenure restriction for MTN programmes be fully liberalised but rollovers on the same will not be allowed.
 - Industry feedback is also sought on the recommendation to tighten the existing tenure restriction for CP programmes from 7 years to 2 years.
 - Where there is any material change, CP programme issuers would have to update information to holders prior to it being rolled over for another term.
- **Extension of 6 month implementation period for both CP and MTN programme**

The SC has also received feedback from industry practitioners to extend the maximum period for implementation of bond issuances beyond the existing 6 months from the date of SC's approval for CP/MTN programmes. It was further highlighted that this existing requirement, while reasonable to be imposed on straight bond issuances, was not practical with regard to CP/MTN programmes given the nature of such programmes. In order to give full effect to the inbuilt flexibility of the programme, it was recommended that an extended duration beyond the 6 month period be allowed for such approved programmes to ensure that issuers need only go to the market to raise funds when required. This approach is analogous to that imposed under the Shelf Registration Scheme for Debentures.

Proposal

- Therefore, it is proposed that this maximum period for the implementation of any CP or MTN programme be extended to 2 years from the existing 6 month requirement provided that:
 - an Information Memorandum (IM) is issued to investors of such instruments; and
 - a supplementary IM reflecting material changes is made available to investors prior to any issuance of notes under the programme subsequently.
- **Removal of 'Minimum Subscription Levels'**

Industry participants have highlighted that the fixing of a minimum subscription level for a CP/MTN programme upfront is impractical, often resulting in issuers quoting an arbitrary percentage for mere compliance sake. When programmes extend over a period of 7 years, it is difficult to predict upfront the minimum levels of subscriptions for each and every possible tranche in the future. The impracticality or irrelevance of the requirement is particularly acute in the case of:

- (a) CPs with a dedicated standby credit facility where the credit facility fully matches the amount and tenure of the CPs to be raised; or
- (b) when the utilisation of proceeds from the issuance of CPs is for working capital.

Proposal

- It is proposed that the existing requirement to stipulate a minimum subscription level be waived for CP programmes that are accompanied by dedicated standby credit facility that fully matches the amount and tenure of the CPs to be raised or for CP issuances for the purpose of funding working capital needs.
 - However, for instances where the intended standby credit facility is lower than the required subscription level, a minimum level of subscription must be disclosed.
- **Requirement for MTN programmes to be scripless and cleared/settled on RENTAS**

Presently, CP/MTNs are tendered through the FAST system and is reflected on the BIDS system. The RENTAS system on the other hand is not favoured by issuers/advisers as a mode for clearing/settlement as it is currently operating on a gross basis. Gross settlement was said to be a concern particularly for large issuances where the Lead Arranger would inevitably have to fund a balancing amount between the redemption amount and the funds raised from investors, in a case of a rollover. Effectively, the Lead Arranger would be assuming the credit risk of the issuer and would have to incur a funding cost for amounts forwarded in advance to BNM.

Proposal

- Following the proposal to decouple CPs from MTNs and to prohibit MTNs issued from being rolled over, it is proposed that MTN programmes be made scripless and that they be cleared and settled through RENTAS in order to capture sufficient information on such instruments. *(In preliminary discussions with BNM, they had informed that the RENTAS system would still require testing on the creation of new stock codes for MTNs.)*
- CPs will continue to be settled outside the system as the gross settlement system would still hinder effective rollovers for CPs.

5. Streamlining information in the Term Sheet

Currently, the information in the Term Sheet that issuers are required to submit to the SC include the principal terms and conditions intended to be issued to investors in relation to a PDS issue. In this regard, some of the information that the SC receives in the Term Sheet is replicated in the principal terms and conditions.

Proposal

- It is proposed that the relevant requirements in the Term Sheet be streamlined with the information in the principal terms and conditions. It is believed that the streamlining of such information would reduce administrative costs to issuers. Industry feedback is thus sought on the proposed streamlined Term Sheet, as given in the Appendix.

B. ABS GUIDELINES

The SC released the ABS Guidelines on 11 April 2001. Since then, it has approved 7 securitisation transactions valued at approximately RM5.415 billion (as at September 2002). Considering the novelty of asset securitisation in Malaysia, advisers have been required to make a presentation on the details of the proposed transaction to the SC prior to making a final submission. Among others, advisers would state the extent to which the relevant requirements of the ABS Guidelines have been complied with and the necessary waivers required. Through this process and regular consultation with relevant industry bodies, the SC has received feedback on areas with respect to the guidelines that could be further improved.

6. Redefining 'credit enhancement'

Credit enhancement is currently defined as 'any arrangement which requires its provider to compensate a special purpose vehicle for a pre-determined amount of loss incurred as a means of insuring against the credit risks of the assets'. This definition has been found to be problematic for the market as it is not practically possible to ascertain the amount of loss incurred upfront. In addition, credit enhancement is not necessarily compensatory in its objectives. The term 'credit enhancement' is used in the guidelines to reflect that a Special Purpose Vehicle (SPV) must have no recourse to an originator for losses arising from those assets save for any credit enhancement provided by the originator at the outset of the securitisation transaction under paragraph 6.4 of the guidelines.

Proposal

- Following the above, it is proposed that the definition be amended as follows:

'Credit enhancement' refers to provisions or arrangements made for the purposes of reducing the credit risk of a securitisation transaction.

7. Segregation of funds in the hands of the originator

Often, the originator is appointed as the servicer for the SPV in relation to the cash flow streams flowing from the pool of assets. The existing provision under paragraph 5.6 of the ABS Guidelines serves to ensure that such funds are 'separated and ring-fenced as soon as they are received by the originator as far as possible'. It is felt that the current wording of the requirement does

not make sufficiently explicit the need for such moneys to be in a separate account from that of an originator immediately upon its receipt. Given that these cash flows are critical to holders of ABS, it is necessary to impose stringent requirements on the management of such funds particularly by persons other than the SPV.

Proposal

- It is proposed that the relevant paragraph in the ABS Guidelines be amended to require funds to be 'ring-fenced in a separate trust account, distinct from the cash flows and assets of the Originator as soon as they are received by the originator'.

8. Clarifying circumstances in which the Originator may purchase assets

Paragraph 6.7 outlines two circumstances in which the Originator may during the life of the ABS repurchase assets of the SPV while still achieving true sale. However, paragraph 6.7 (i) has been interpreted by the market as confining such purchases by the Originator only in circumstances where the ABS is fully repaid or settled. This would therefore not give effect to the true purpose of paragraph 6.7(i) as outlined above.

Proposal

- Under the circumstances, it is proposed that the phrase 'fully performing' and 'on upon full repayment or settlement of the ABS' be deleted to allow the originator to exercise its first right of refusal to repurchase **any** assets from the SPV even **prior** to the settlement of the ABS outstanding where such assets have declined to a level that renders the asset securitisation transaction uneconomical to carry on.

9. Protection of ABS holders

Paragraph 7.6(ii) of the ABS guidelines allows for the dissolution of the SPV when more than seventy percent of the ABS holders entitled to vote have resolved to do so. However, this can be possibly be interpreted as seventy percent of a class of debenture holders only which could affect the rights of other classes of debenture holders.

Proposed

- It is therefore proposed that the wording of this paragraph be amended to ensure that the decision to dissolve the SPV takes into consideration the rights of senior ABS holders, as follows:

'... in aggregate, more than seventy percent of all classes of ABS holders, excluding subordinated debt holders, entitled to vote have resolved, in accordance with the terms and conditions agreed by all the relevant parties in a securitisation transaction that the SPV shall be dissolved and the SC has been notified of this resolution.'

10. Revision of the disclosure requirements on rating summary

One of the current disclosure requirements is that the IM should include a summary of the rating report. However, industry as well as the rating agencies have highlighted that the requirement lends uncertainty as to whether the responsibility of the summary should rest with the issuer/arranger or the rating agency and what the summary should contain or not.

Proposal

- To solve this uncertainty it is proposed that the requirement be replaced by a requirement that a preliminary credit rating and a description of the corresponding risk factors associated with the rating be disclosed instead. Further, to enhance the existing disclosure requirements in the IM, it is suggested that the profile of directors of the SPV and the latest audited accounts of the originator be disclosed as well.

It would be appreciated if all comments, views and concerns are submitted by e-mail or by fax to the SC on or before 5 November 2002. Responses should be addressed to:

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APPENDIX

Term sheet of the Proposal (Proposed Revision)

BACKGROUND INFORMATION

1. Issuer
 - Name
 - Address
 - Business Registration No.
 - Date/Place of Incorporation
 - Date of Listing (in case of a public listed company)
 - Status (resident/non-resident controlled company)
 - Principal Activities
 - Board of Directors
 - Structure of shareholdings and names of shareholders or, in the case of a public company, names of all major shareholders
 - Authorised and paid-up capital

PRINCIPAL TERMS AND CONDITIONS

2. Names and addresses of parties involved in the proposed transaction, (where applicable)
 - (i) Adviser/Lead Arranger
 - (ii) Joint-advisor/co-arranger
 - (iii) Valuers
 - (iv) Solicitors
 - (v) Financial Adviser
 - (vi) Technical Adviser
 - (vii) Guarantor
 - (viii) Trustee
 - (ix) Facility Agent
 - (x) Issuing Agent
 - (xi) Names of Primary Subscriber(s) and Amount subscribed (where applicable)
 - (xii) Names of Underwriter(s) and amount underwritten
 - (xiii) Name of Syariah Adviser (applicable to Islamic PDS)
 - (xiv) Central Depository
 - (xv) Paying Agent
 - (xvi) Others (please specify)
3. Types of instruments [e.g. CP/MTN, Bonds, Loan Stocks/Notes]
4. Principal
[e.g. Conventional/Islamic]
5. Facility Description
[e.g. Murabahah Notes Issuance Facility, fixed rate bonds, etc.]
6. Issue Size
[Nominal value in RM million]
7. Issue Price [At par/discounted/ premium]
8. Tenure of the facility/issue
9. Interest/Coupon/Profit or equivalent rate

10. Interest/Coupon/Profit Payment frequency & basis
[Annually, semi annually, etc]
[Actual days basis or Malaysian Government Securities formula]
11. Security/Collateral (if any)
12. Details on utilisation of proceeds
13. Sinking fund (if any)
14. Rating
Credit Rating Assigned [Please specify if this is an indicative rating]
Name of Rating Agency
15. Form and Denomination
16. Mode of Issue
[tender and/or non- tender]
[if non tender please specify e.g. private placement or bought deal]
Tender criteria:
 - Yield for discounted securities
 - Yield for fixed rate securities (i.e. coupon not pre-determined)
 - Price/100 for floating or coupon rate if known
 - Purchase price for all Islamic PDS
17. Selling Restriction
18. Listing Status
19. Minimum Level of Subscription
20. Other regulatory approvals required in relation to the issue, offer or invitation and whether or not obtained [please specify]
21. Additional information for Islamic PDS:
 - Islamic principle [BBA, Murabahah, Ijarah etc.]
 - Identified assets
Purchase and selling price/rental (where applicable)
 - Details on primary and secondary bonds
[Ratio/detachability]
22. Events of Default
23. Conditions Precedent
24. Representations and Warranties