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### **"Securitisation: The Alternative Financing Mode"**

**Keynote Address**

**by**

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**at the**

**Conference on "Asset Securitisation: Malaysia's Untapped Potential"**

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**JW Marriott Hotel, Kuala Lumpur**

A very good morning to all of you.

I would like to thank the Rating Agency of Malaysia, the organiser of this Conference, for inviting me to deliver the Keynote Address on " Securitisation: The Alternative Financing Mode" .

The topic today could not have been more relevant and timely in the current economic environment with the appeal of asset-backed debt securities to investors in their relative credit quality. With ample liquidity in the financial system and the necessary infrastructure which has been put in place, asset securitisation is expected to provide further momentum to the already active domestic bond market. With the recent flight to quality among fixed income investors following a string of corporate defaults and concerns over the slowing economy, asset-backed debt securities would be even more appealing as they are generally structured as high credit quality instruments. This would certainly augur well for the success of asset-backed debt securities in this market

#### **The State of the Ringgit Corporate Bond Market**

It is indeed encouraging to note that the rapid growth of the domestic corporate bond market has continued this year. With this strong momentum and the favourable market environment, the size of the corporate bond market (excluding Cagamas debt securities) is expected to approach another milestone figure of 150 billion ringgit before the end of this year. In facilitating the development of the corporate bond market, the Securities Commission (SC) has since 1st July 2000 approved a total of 90 issues valued at 40 billion ringgit. In regard to the current level of primary market activities, in the first quarter of this year, the SC had approved a total of 22 corporate bond proposals amounting to 13.2 billion ringgit, surpassing the 11.9 billion ringgit figure for the second half of 2000. During the first seven months of this year alone, 67 corporate bond proposals involving an amount of 29.9 billion ringgit have been approved.

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As an indication of the growing maturity of the market, we observe that the average tenure of corporate bonds issued has increased steadily from 5 years in 1997 to more than 8 years in 2000. Higher credit quality papers with credit ratings of single A and above have accounted for about 93% of the total number of corporate bonds approved by the SC to-date. In terms of issue size, a large percentage of corporate bonds has been issued in an amount that is more than 250 million ringgit, as compared to the amount of less than 100 million ringgit before 1997.

Of equal importance is the fact that the resilience of the corporate bond market has been proven particularly in the current slowing economy. The defaults in payment for some corporate bonds, although quite significant in amount, have been relatively well absorbed by the diversified pool of investors. Instead, the bond market has emerged as a viable source of financing for the private sector compared to the banking sector. For example, during the period of 1998-2000, the corporate bond market has provided 39.7% of the total financing needs of the economy, as compared to 36.8% by the banking sector.

### **Ladies and Gentlemen,**

I believe asset securitisation holds an important key to the future development of the domestic corporate bond market. Accordingly, the SC had on 11 April of this year released the Guidelines on the Offering of Asset-Backed Debt Securities. Applying a disclosure-based approach, the Guidelines serve to set out clear and transparent criteria so that market participants are able to understand the SC's requirements for the offering of any asset-backed debt securities. The SC is committed to a speedy issuance process for asset-backed debt securities. As any issuance of asset-backed debt securities must comply with both the SC's Guidelines on the Offering of Private Debt Securities as well as the Guidelines on the Offering of Asset-Backed Debt Securities, the maximum approval time taken by the SC will be 28 working days in respect of both the Guidelines.

I am informed that the Guidelines have been well received with a strong level of interest from the corporate sector and that a wide variety of assets are being considered for securitisation. Based on the feedback from credit rating agencies, I understand that there are no less than 14 asset-backed debt securities proposals in the pipeline. To-date, the SC has approved two asset securitisation proposals amounting to 640 million ringgit which are originated by financial institutions using collateralised bond obligations.

### **Asset Securitisation Provides A Wide Variety Of Benefits**

From an originator's perspective, securitisation provides a vehicle for transforming relatively illiquid financial assets into liquid and tradeable capital market instruments. The originator is also able to achieve a more efficient and lower cost source of financing as asset securitisation

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structures allow for the issuance of debt securities that carry a higher rating than the long-term credit rating of the Originator. This, in turn, translates into cheaper financing costs for the originator.

The variety and flexibility of credit, maturity and payment terms made possible through securitisation structures provide investors a much broader selection of fixed income products in the Malaysian market. The establishment of liquid and efficient secondary securitisation markets would also have the effect of increasing the availability of financing options and also reduce the cost of financing in primary markets. It will encourage the efficient allocation of capital by subjecting credit granting activities to the pricing and valuation discipline of the capital markets.

Of equal importance is the fact that securitisation can serve as an effective risk management tool for corporates, particularly financial institutions, to minimise their interest rate and maturity mismatches. By securitising their loans and receivables, financial institutions would be able to offer long-term fixed-rate financing to their customers without significant exposure to the risk of interest rate and maturity mismatches. Hence, securitisation offers an ideal mechanism by which financial institutions can shift their concentrated credit, interest rate and market risks associated with their portfolio activities to the more diverse capital market, thereby reducing risks of individual institutions and systemic risks within the financial system. With increasing pressure from new competitors, I believe securitisation can become an increasingly core part of the funding activities of financial institutions. In this regard, the proposed securitisation of rehabilitated and performing loans announced by the state-sponsored debt-restructuring agency, Danaharta is certainly a positive move in the right direction.

### **The Way Forward For Asset Securitisation**

Ladies and Gentlemen,

The SC is committed to facilitate the development of a sufficient level of critical mass for securitisation transactions in the Malaysian market so as to allow for the establishment of a tried and tested template which the investor base understands. In the United States, which is the single largest and most established asset securitisation market in the world, the issuance of asset-backed debt securities is more or less a "commoditised" market in which repeat issuers can access funding in the most efficient and efficacious manner. Though we are still a far cry from that scenario, all efforts are made for the building up of a critical mass of high quality asset-backed debt securities in the market.

The release of the Guidelines on the Offering of Asset-Backed Debt Securities and provision of tax incentives in relation to real property gains tax and stamp duty for securitisation transactions are only the first few steps. We are aware of a host of legal, regulatory, tax and

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accounting issues which may impede the development of such critical mass. As such, the SC has set up the Asset Securitisation Consultative Committee comprising market participants such as lead managers, lawyers, accountants, rating agencies and the national mortgage corporation. The responsibilities of the Consultative Committee are to make recommendations to the SC and the National Bond Market Committee on a comprehensive framework dealing with legal, regulatory, tax and accounting issues that could facilitate the development of asset securitisation in Malaysia.

On the regulatory front, the SC is working closely with Bank Negara Malaysia on the specific issues relating to the involvement of financial institutions in asset securitisation transactions. I am glad to say that in support of this, Bank Negara Malaysia has agreed to introduce a facilitative regulatory framework and an expeditious approval scheme in order to promote the participation of financial institutions in the asset securitisation market. The SC has also confirmed with the Foreign Investment Committee (FIC) that the transfer of financial assets, other than the actual transfer of real property and shares, in relation to securitisation transactions would not require the approval of the FIC.

The SC is also in active discussion with the tax authorities to address the need for certainty and neutrality of tax treatment on securitisation transactions. With regard to accounting standards on securitisation, a guidance note will soon be formulated by the Malaysian Accounting Standard Board to provide clarity on issues in relation to the derecognition of assets and consolidation of accounts of a special purpose vehicle and an originator.

In the longer term, the SC will work with the relevant authorities towards reform of the bankruptcy legislation in order to provide greater certainty of the legality of transfer of assets in any securitisation transaction.

### **Responsible Innovation To Be Seen**

Ladies and Gentlemen, although the opportunities for the growth of asset-backed debt securities are only limited by the market's own initiative, there are risks, as with all new products, that need to be consciously addressed for this new product to gain acceptance in the market place. In this regard, I cannot over-emphasise the importance played by all market participants including advisers, credit rating agencies, trustees, lawyers and accountants. Whilst the SC encourages innovation, we also want to see a high level of responsibility. Market participants must exercise a higher level of due diligence and professionalism to ensure that asset securitisation takes off as a viable avenue of financing for borrowers and as an attractive investment alternative for investors. Given the complexity of documentation for asset securitisation, if need be, you should not hesitate to follow international practices and to acquire skills from other established markets in order to activate the asset-backed debt securities market here.

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To build and maintain investor confidence on asset securitisation, it will also be crucial to equip investors with relevant and accurate information for them to assess the risks and returns associated with asset-backed debt securities. The nascent stage of development of asset securitisation market would benefit greatly from the high level of transparency and disclosure that is made to investors. In this regard, investors deserve high quality information as may be appropriate in each transaction, even though that may be well over and above the minimum content requirements for information memorandum as set out in the SC's Guidelines on the Offering of Asset-Backed Debt Securities.

On this area too, I would be remiss if I do not highlight the possibility of some companies making use of asset securitisation to expropriate wealth from shareholders. This can be done through investing the proceeds of the sale of assets in negative net present value investments. Management may also, for example, avoid the disciplinary effects of poor performance by monetising valuable assets on a firm's balance sheet. Asset securitisation, like asset sales, may allow non-value maximising management to pursue poor projects by raising the funding for such investments. Alternatively, the proceeds from the issuance of the asset-backed debt securities can be used to retire existing debt, thereby lowering the company's future payouts and the likelihood that the management will have to face the discipline of the capital markets. If this motivates the originators, then there is no improvement at all to shareholder value. Hence, I call upon all market participants to be vigilant to guard against these unhealthy practices.

### **Conclusion**

To conclude, I am convinced that the asset securitisation market is here to stay and given time, it will emerge as a viable and significant source of financing for the private sector. I am hopeful that it would attain a high level of maturity over time.

On this note, I wish to take this opportunity to applaud the Rating Agency of Malaysia for its initiative in organising this timely Conference. I wish you all a fruitful and stimulating discussion in this Conference.

Thank you.

**SECURITIES COMMISSION**  
**27 August 2001**