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THE DEVELOPMENT OF ASSET SECURITISATION IN MALAYSIA

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ABSTRACT

The Capital Market Masterplan released in February 2001 for the Malaysian financial market has identified asset securitization as part of the strategy to develop the corporate bond market and as a competitive source of financing for companies with good assets.

This paper will examine the current state of asset securitization in the Malaysian financial market. The focus will be on collateralized bond obligations (CBO), collateralized loan obligations (CLO) and asset backed securitizations (ABS) which are introduced in the past two years.

The paper will also examine the impediments, challenges and prospects of asset securitization in Malaysia.

Keywords : *asset securitization, CLO, CBO*

1.0 Introduction

Following the 1997 financial crisis, securitization activities have increased significantly in several Asian countries that include Korea (1997) and Singapore (1998). In Malaysia, the trend for securitization has pick up since 2001 with the introduction of the Capital Market Masterplan.

The Capital Market Masterplan outlines the recommendations in the strategic positioning and future direction of the Malaysian capital market. The Masterplan has laid the foundation for asset securitisation by recommending the introduction of a framework for the issuance of asset backed securities. The Masterplan recommends that asset securitization be part of the strategy to develop the corporate bond market as a competitive source of financing. The financial crisis has revealed that there is a funding

mismatch particularly in the property sector where short term debt are used to meet long term needs. With an economic downturn many companies that have taken loans are unable to service their loan debts resulting in rising non-performing loan among local banks. Companies find that there is a need to find alternative long term financing options.

With the ABS framework in place, companies with sound assets will be able to turn illiquid assets into liquid and tradeable market instruments. Cash strapped companies with weak credit ratings but having good cash flow generating assets will have access to a wider scope of corporate financing options and at cheaper funding costs.

The private debt securities market is not well developed as evidenced by public debt securities barely a quarter of outstanding bank loans.

2.0 Early securitisation development in Malaysia

The incorporation of Cagamas Bhd., the National Mortgage Corporation, in 1986 paved the way towards the development of securitization in Malaysia.

Cagamas's role is to promote the secondary mortgage market in Malaysia by buying housing loans from banks and finance companies. Cagamas therefore functions as a special purpose vehicle between the house mortgage lenders and investors of long term funds. The aim of Cagamas is to improve liquidity in the lending system by providing liquidity to long term mortgage loans (15 to 30 years) given out by banks and finance companies. By providing liquidity to the banks, the banks are able to provide continuous supply of mortgage funds to needy house purchasers.

However, as Cagamas Berhad retains full recourse against the financial institutions from which it purchased the housing loans, Cagamas bonds are not true asset backed securities. The types of bonds issued by Cagamas are Tier-1 and Tier-2 bonds. Tier-1 bonds are backed by the purchase of conventional housing loans including civil servant housing loans whilst Tier-2 bonds are backed by the purchase of industrial property loans. In early 1998, Cagamas extend its activities by purchasing other receivables.

To be eligible for sale to Cagamas, the housing and industrial property loans must :

- be for financing or refinancing the purchase, construction or renovation of residential and industrial properties
- be fully disbursed
- at the time of sale must not be more than three months in arrear
- for industrial properties the book balance less unearned interest not exceeding RM20 million per loan

As at end of December 2002, the total amount of outstanding housing loans purchased by Cagamas amounted to RM14.823 billion and its total debt securities outstanding amounted to RM24.97 billion.

ISSUANCE OF CAGAMAS DEBT SECURITIES BY YEAR										
Type of issue	1998		1999		2000		2001		2002	
	RM million	No.of issues								
Fixed Rate Bonds	3,250	8	4,425	14	8,403	26	6,430	25	8,925	16
Floating Rate Bonds	0	0	0	0	0	0	0	0	0	0
Notes	16,845	21	20,625	22	14,182	22	10,970	19	10,015	18
Mudharabah Bonds	70	1	0	0	144	1	0	0	610	3
Total	20,165	30	25,050	36	22,729	49	17,400	44	19,550	37

Source : (Cagamas 2003)

Apart from property mortgages being securitised by Cagamas, securitisation market for other assets has not developed fully in Malaysia.

Securitisation has not developed in a major way in the 1990s due to several issues (Low 1997) :

- (a) To control inflation, Bank Negara Malaysia does not approve of any securitization which places upward pressure on inflation particularly the securitization of consumption credit assets.
- (b) The lack of transparency due to the Banking & Financial Institutions Act 1989 which require confidentiality by banks of the identity and information of its customers.
- (c) Unfavourable taxation issues. For example the issue of stamp duty on securitization transactions which could increase the costs of securitization deals.

Apart from Cagamas, two other institutions are setup in response to the increasing non-performing loans arising from the 1997-8 financial crisis. These two bodies are Danaharta Nasional Bhd and Danamodal Nasional Bhd.

Danaharta Nasional Bhd was established in May 1998 to purchase non-performing loans from the financial sector. Danamodal Nasional Bhd is setup to finance bank recapitalization.

3.0 Recent development in securitisation

The Securities Commission is the single authority to give approvals for securitization applications effective from 1st July 2000.

With the Capital Market Masterplan launched to facilitate and develop asset backed securitization in Malaysia, the Securities Commission has issued *Guidelines on the Offering of Asset Backed Securities* on 11th April 2001. Asset backed securitisation is made possible with the issuance of the ABS Guidelines by the Securities Commission.

By late August 2003, ten securitization proposals/deals amounting to RM5.89 billion have been approved.

Table 1 : Asset securitization in Malaysia since 2001

Month announced	Company	Types of securitisation	Amount
June 2001	First Silicon	S y n t h e t i c securitization [@]	RM950m
September 2001	Prisma Assets (Arab-Malaysian Merchant Bank*)	CBO [#]	RM255m
December 2001	Pengurusan Danaharta Nasional Bhd	CLO ⁺	RM310m
2002	Commerce International Merchant Bankers Bhd*	CBO	RM385m
January 2002	Chin Foh Bhd	Asset-backed bonds Asset backed commercial papers	RM60m RM200m
April 2002	WCT Engineering Bhd	Commercial paper	RM350 m
May 2002	Sunway City Bhd	Commercial property ABS	RM891.6m
November 2002	Aegis One (Affin Bank*)	CLO	RM1 billion
July 2003	Wijaya Baru Global Bhd	Asset backed serial bonds	RM1.31 billion
August 2003	Sunway Hldgs Inc. Bhd Sunway Construction Bhd	Property ABS	RM240 million
TOTAL			RM5.89 billion

- @ Whole business securitisation
- * Lead manager and arranger
- # Collateralised bond obligations
- + Collateralised loan obligations

4.0 Securitisation transactions in Malaysia

4.1 Collateralised Bond Obligations (CBOs)

Arab-Malaysian Merchant Bank acting as underwriter, arranger and lead manager is the earliest to launch the first asset backed securitization product in Malaysia : a CBO issue of RM255 million in September 2001. The asset backed securities is issued by Prisma Assets Bhd, the special purpose vehicle involving two classes of bonds of a senior tranche of RM225 million class A bonds and a subordinated tranche of RM30 million class B bonds.

Commerce International Merchant Bankers Bhd has also launched a CBO issue involving RM126.93 million senior Class A bonds and RM385 million mezzanine Class B bonds :

Company	Issue year	Credit rating	Issue amount	Maturity	Security
Arab-Malaysian Merchant Bank	2001	AAA (Rating Agency Malaysia)	RM255m	5 years (2005)	Private debt securities/ corporate bonds
Commerce International Merchant Bankers Bhd	2002	AAA AA3 (Rating Agency Malaysia)	RM126.93m RM385m	7 years	Private debt securities of 27 companies

Chin Foh Bhd issued RM60 million asset backed bonds and RM200 million asset backed commercial papers/medium term notes in January 2002 for the purchase of stocks and raw materials and implementation of a new computer system for the group.

WCT Engineering Bhd has issued RM350 million commercial paper for the construction and completion of the Guthrie Corridor expressway.

In July 2003, Wijaya Baru Global Bhd. issued RM1.31 billion asset backed serial bonds to fund the purchase of land for property development and for the repayment to Danaharta and other outstanding loans.

4.2 Collateralised Loan Obligations (CLOs)

Pengurusan Danaharta Nasional Bhd (Danaharta)

Pengurusan Danaharta Nasional Bhd is the first to use CLO through its special purpose vehicle, Securita ABS One Bhd, which offered RM310 million. The CLO is issued on two tranches, the senior bonds worth RM310 million and the junior bonds worth RM283.96 million. The unrated junior bond which is taken up by Danaharta will act as collateral for the senior bond.

The bond has a AAA-rating by Rating Agency Malaysia (RAM). The issue will provide a yield of 4% which is 75 basis points above the four year Malaysian Government

Securities benchmark. The issue was oversubscribed by 3.5 times. The investors comprise :

(a)	Institutions	29%
(b)	Banks/Financial institutions	26%
(c)	Money managers	21%
(d)	Pension funds	16%
(e)	Insurance funds	8%

For the issued CLO, the composition of the RM570m security portfolio is comprise of :

Industries	%
Property loans	59.5
Automobile loans	11.2
Health care & pharmaceutical loans	6.2
Building material loans	3.6
Others (industrial, consumer, finance etc)	19.5
Total	100.0

The table below shows the composition of the security portfolio :

	%
Term loans	52
Revolving credit	14
Omnibus	33
Overdrafts	1
Total	100

Danaharta has used the ABS issue as part of its programme to restructure its non-performing loans. Danaharta may also use foreign denominated ABS to securitise its foreign non-performing loans amounting to US\$1billion.

Affin Bank Bhd.

In November 2002, Affin Bank Bhd, acting as the originator, advisor and lead arranger, has arranged the largest CLO deal in Malaysia amounting to RM1billion. The securitization raised new loans for a group of medium size listed companies from 16 different industries. The amount of loan borrowed by the listed companies range between RM25 million to RM50 million. The minimum credit rating of the 25 companies is BBB.

The special purpose vehicle, Aegis One Bhd, issued RM900 million AAA-rated senior bonds and RM100 million Junior bonds. The investors are banks, institutions and fund managers. The AAA-bonds carry a coupon rate of 5.2% and the Junior bonds would carry a variable coupon rate depending on credit rating.

Table 2 : An issue of a RM1 billion collateralised loan obligations by Affin Bank Berhad

MAIN BOARD (KLSE)	SECTOR	AMOUNT RAISED	TENURE	PURPOSE OF LOAN
TNTT	Trading/Services	RM50m	5 years	Expansion of container haulage and logistics business
Ireka	Construction	RM40m	5 years	
Hunza Property	Property	RM40m	5 years	For working capital purposes
SECOND BOARD (KLSE)	SECTOR	AMOUNT RAISED	TENURE	PURPOSE OF LOAN
Harrisons	Trading	RM40m	5 years	For investment & working capital
PJI Holdings	Trading/Services	RM50m	5 years	To provide additional funds for working capital and future investment opportunities
WCT	Construction	RM50m	5 years	For investment & working capital
Elba Holdings	Consumer	RM45m		For future business expansion & working capital
Malaysian Models	AE Industrial Products	RM40m		To reduce short-term borrowings and provide for sufficient working capital
Britac	Trading	RM45m		For working capital and business expansion.

4.3 Asset backed securitization

Sunway City Berhad (Suncity) has undertaken the disposals of six investment properties including plant & machinery and its lease rights and redeemable preference shares of RM892 million to ABS Real Estate Berhad (AREB), a special purpose and bankruptcy remote vehicle, under an asset backed securitization (ABS) exercise (refer Table 3). Suncity will receive a sale consideration comprising cash and Subordinated Class D Notes from AREB. The Subordinated Class D Notes will be redeemed upon the maturity of the ABS notes.

Table 3 : Details of the disposals by Sunway City Berhad

Properties & shares	Types of property/ Share	Built up area (sq. ft.)	Cash RM'000	Subordinated Class D notes RM'000	Total RM'000
Sunway College	Education College	704,529	61,600	73,400	135,000
Sunway Lagoon Resort Hotel	Hotel	1,050,463 (441 rooms)	121,464	218,536	340,000
Sunway Hotel Penang	Hotel	192,382 (240 rooms)	10,305	29,695	40,000
Sunway Hotel Seberang Jaya	Hotel	167,621 (208 rooms)	10,058	31,942	42,000
Menara Sunway	Office	654,783	52,894	72,106	125,000
Sunway Lagoon Theme Park assets & rights	Assets & rights on Resort	-	69,846	21,697	91,543
Sunway Pyramid Preference shares	Preference share	-	108,833	9,240	118,073
TOTAL			435,000	456,616	891,616

AREB issued Ringgit denominated senior ABS notes to investors in the Malaysian debt capital market to finance the purchase of the properties and shares from Suncity.

Suncity raised RM435 million under the ABS exercise. In addition, Suncity will issue commercial paper and medium term notes to raise RM250 million for the repayment of existing debts and for working purposes.

The ABS exercise is a landmark property deal as it involves the largest property and asset sale by a single corporation in Malaysia. This is also the first ABS that is backed mainly by property assets.

AREB has also undertaken a sale and leaseback arrangement by granting operating leases to Suncity to operate the investment properties for 35 years and the theme park for 10 years. Suncity will have the option to purchase back the properties the end of year 5.

The ABS issue involved the issuance of the Senior and Subordinated notes (refer Table 4). The ABS Notes is secured against the investment properties and shares, lease payments and redemption and dividends of the preference shares.

Table 4 : Types of Notes issued

Types of Notes	Coupon rate (%)	Amount
Class A	5.25	RM120 million
Class B	5.75	RM330 million
Class C1	8.00	
Class C2	7.875	
Subordinated Class D Notes	20	RM457 million
TOTAL		RM907 million

Sunway City Berhad had undertook the securitisation exercise for the following reasons :

- (a) to enable the company to obtain a fair sale price for the properties owned;
- (b) to enable the company to continue to enjoy productive use of the properties by a sale and leaseback option;
- (c) to reduce gearing of the company, enhance earnings per share and other performance ratios of the company;
- (d) to raise funds for working capital and expansion of the company's property development business at a lower cost.

In mid-August 2003, another two companies of the Sunway Group i.e. Sunway Holdings Ins. Corp. Bhd and Sunway Construction Bhd, have undertaken another real estate asset backed securitization. The securitization will involve the disposal of properties and companies owned by Sunway Holdings for RM185 million and Sunway Construction will also disposed properties for RM55 million. The Sunway Holdings disposal will be satisfied by RM108 million Subordinated Class ABS Notes and RM77 million. Sunway Construction will receive RM32 million Subordinated Class ABS Notes and RM23 million cash.

The Sunway companies have undertaken the securitization route for the following reasons :

- (a) To realize immediate cash proceeds of RM100 million to repay borrowings;
- (b) To convert non-core property assets into cash;
- (c) To fetch a reasonable price for the disposal of non-core property assets;
- (d) To achieve lower gearing and interests savings.

In addition to the real estate asset backed securitization, the exercise involved also an issuance of RM350 million five-year unsecured bonds by Sunway Holdings. The fund raised from the bond will enable Sunway Holdings to redeem its outstanding US\$ denominated bonds. The impact of the bond issue is to eliminate foreign exchange exposure and to change from short term revolving credit facilities to a five year fixed rate bond.

Table 5 : Terms of the ABS Notes by Sunway Group of Companies

Terms	Sunway City Bhd	Sunway Holdings Ins. Corp. Bhd Sunway Construction Bhd														
SPV/Issuer	ABS Real Estate Bhd. (AREB)	ABS Land & Properties Bhd (ALP)														
Arranger/Lead manager	Deutsche Bank (Malaysia) Bhd	Deutsche Bank (Malaysia) Bhd														
Mode of issue	Private placement	Private placement														
Date announced	16.5.2002	15.8.2003														
Primary subscriber	Deutsche Bank (Malaysia) Bhd	Deutsche Bank (Malaysia) Bhd														
Facility description	ABS notes issued via an asset backed securitization comprise (a) Senior Class A, B, C1 and C2 Notes and (b) Subordinated Class D Notes. Only Class A, B, C1 and C2 Notes will be distributed to investors	ABS notes issued via an asset backed securitization structure.														
Issue size	Senior Class A RM120 m Senior Class B, C1 and C2 RM330m	RM240 million														
Legal maturity date	6 years from the date of issue of the ABS notes	6 years from the date of issue of the ABS notes														
Coupon rate	<table border="0"> <tr> <td>Senior Notes</td> <td>Coupon (%)</td> </tr> <tr> <td>Class A</td> <td>5.25</td> </tr> <tr> <td>Class B</td> <td>5.75</td> </tr> <tr> <td>Class C1</td> <td>8.00</td> </tr> <tr> <td>Class C2</td> <td>7.875</td> </tr> <tr> <td>Subordinated Notes</td> <td></td> </tr> <tr> <td>Class D</td> <td>20.00</td> </tr> </table>	Senior Notes	Coupon (%)	Class A	5.25	Class B	5.75	Class C1	8.00	Class C2	7.875	Subordinated Notes		Class D	20.00	To be determined
Senior Notes	Coupon (%)															
Class A	5.25															
Class B	5.75															
Class C1	8.00															
Class C2	7.875															
Subordinated Notes																
Class D	20.00															
Coupon frequency	Semi-annual based on actual/365 days	Semi-annual based on actual/365 days														
Redemption	<p>Senior ABS Notes Mandatory redemption on legal maturity date Early redemption possible by Suncity.</p> <p>Subordinated notes Can only be redeemed after all outstanding principal and interests have been fully repaid.</p>	Up to 6 years from the date of issuance of the ABS Notes														
Status of the ABS Notes	Secured against properties, shares, lease payments on the properties and redemption and dividends of the redeemable preference share	Secured against properties, shares and rental payments on the properties														
Listing	Will not be listed on the KLSE	Will not be listed on the KLSE														

4.4 Synthetic securitization

Synthetic securitization is not strictly asset securitization as there is no true sale of assets by the company to a special purpose vehicle. Synthetic securitization may involve whole business or operating revenue securitization where the business of the company is seen as a series of cash flows. A company is able to achieve better credit ratings by credit enhancements and structuring of the cash flows.

Nomura Securities has completed a US\$250 million deal for a whole-business or operating-revenues securitization involving a high technology business in June 2001. The securitization involved the securitization of First Silicon, the first wafer foundry in Malaysia located in Kuching, Sarawak.

Initially, the plant will be funded by syndicated bank credit, and upon production it will be refinanced by securitisation. The bonds will be backed by sale revenues of the wafers.

5.0 Issues constraining growth of ABS

Various tax and accounting issues exist that prevent securitization to take off in a big way in Malaysia :

- (a) absence of tax incentives for asset securitization and lack of support from tax legislation. For example how is the income derived by the SPV will be treated by the tax authority.
- (b) Lack of clarity on accounting issues
- (c) Markets reluctance in accepting papers rated below AA
- (d) Absence of tax incentives – Without tax neutrality, securitization may lead to additional tax burdens for originators.

Among the tax issues pertinent to the originator is the transfer of assets under securitization transactions that include determining the disposal price and gain or loss on the sale or receivables (and other assets) to special purpose vehicles and the treatment of lump sum receipts from sale of future receivables (and other assets).

- (e) Excess domestic liquidity has made borrowing cheaper in the domestic market.
- (f) Financial institutions are governed by the Banking and Financial Institutions Act and comes under the purview of Bank Negara Malaysia (BNM). A new guidelines on securitization is required to be prepared by BNM for financial institutions to get involved in ABS.

6.0 Current development and future potential

The Securities Commission, Finance Ministry and the Inland Revenue Board are currently in discussions to formulate a set of tax treatments that would provide a tax neutrality framework for asset securitization transactions.

Securities Commission are also working on accounting and other regulatory issues.

The Malaysian Accounting Standards Board will study and clarify appropriate accounting treatment applicable for securitization transactions.

Bank Negara Malaysia is also looking into coming out with guidelines for financial institutions to be involved in securitization. In particular, risk management requirements, capital requirement, provision of credit enhancement and liquidity facilities.

Assets owned by the banking sector is among the biggest in Malaysia. Mortgages owned by banks amount to RM79 billion, corporate bonds RM66 billion, hire purchase RM40 billion and credit card RM7.6 billion in 2001. ABS is expected to grow once financial institutions are allowed to securitise their mortgages.

7.0 Conclusion

It is hope that with the efforts put in to remove the tax and accounting impediments, a more efficient and facilitative framework will be created to facilitate the development of securitization in Malaysia. Given time, asset securitisation will emerge as a viable and significant source of competitive financing for the corporate sector in Malaysia.

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