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Keynote Speech

by

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"Sustaining Growth and Development of the Malaysian Bond and Sukuk Markets"

Development of bond and sukuk markets

1. It is well documented that one of the key lessons learnt from the Asian financial crisis is the need for a broad, deep and well-developed bond market that would provide a more stable source of long-term financing. For Malaysia, the release of the National Economic Recovery Plan in 1998 served as a blueprint for developing the domestic bond market. To accelerate this development, the regulation of the corporate bond market was centralised with the Securities Commission Malaysia (SC) on 1 July 2000.

2. Within just 15 years, our corporate bond market has tripled in size while the overall bond market size has quadrupled from RM264 billion (USD84 billion[1]) in 2000 to RM1.08 trillion (USD342 billion) as of end-August 2014, making it the third largest in Asia relative to GDP. The sukuk market has also grown by 14 times over this period to be of equal size to the conventional bond market. The importance placed on developing the sukuk market has in fact propelled Malaysia to become the global leader in sukuk[2]. Malaysia today stands out as the only sukuk market in the world with a size exceeding USD100 billion as of end-2013[3].

[1] All US dollar amounts are based on the exchange rate of USD1:RM3.157 as of end-August 2014.
[2] Global outstanding sukuk amounted to USD269 billion, of which 59% is from Malaysia.
[3] Malaysia International Islamic Financial Centre, Insights: Global Sukuk Begins 2014 with Momentum, 29 January 2014.

3. The significant growth of the overall bond market can be attributed to the detailed strategic framework set out in the SC's Capital Market Masterplan 1 (CMP1) to steer the development in phases from 2001 through to 2010. An early priority identified in CMP1 was the need for more streamlined regulation of the corporate bond issuance process. The SC thus introduced an approval framework based on disclosures to facilitate the issuance process for corporate bonds. Under this approach, corporations that meet the disclosure requirements under the *Guidelines on the Offering of Private Debt Securities* (PDS Guidelines) can issue bonds and sukuk with an approval timeframe of 14 working days which substantially reduced time-to-market.

4. This emphasis on disclosure invigorated the bond market as it allowed us to liberalise the utilisation of bond proceeds and do away with minimum credit rating requirements. Additionally, the underwriting requirement on a bond issuance was removed allowing greater flexibility for issuers.

5. The SC guidelines have been revised over the years to refine existing requirements and broaden participation as envisioned under CMP1. Specific provisions to facilitate the entry of foreign issuers, particularly supranationals, were introduced thereby creating a new segment of high quality issuances that can appeal to a wider investor base. The presence of foreign issuers have also provided greater exposure to international standards of offering documentations and international best practices while elevating Malaysia's profile among investors internationally.

6. Efforts to improve price transparency and liquidity in the secondary market led to the creation of a centralised electronic trading platform (ETP) to disseminate both pre and post-trade information on a real-time basis, facilitating an efficient price discovery process. Together with active market surveillance conducted by the SC, these measures safeguard investors of bonds and sukuk from unethical and manipulative trading practices.

7. Similar efforts were taken to drive further development of the sukuk market which resulted in the formulation of a dedicated regulatory framework for sukuk issuance as set out in the *Guidelines on the Offering of Islamic Securities* (Sukuk Guidelines).

Recent regulatory developments

8. Having built a strong foundation for the bond and sukuk markets, strategies to bring these markets to the next level of growth are outlined in the Capital Market Masterplan 2 (CMP2) which covers the decade from 2011 to 2020. One of the key focus areas is to deepen and broaden the Malaysian fixed income market to meet retail investors' demand for access to a wider range of investment products. This led to the SC introducing the retail bonds and sukuk framework in September 2012.

9. The framework has been launched in phases to gradually introduce investors to issuers of different risk profiles by providing them time to gain the necessary understanding and familiarity with investing and trading in bonds and sukuk. Therefore, when the framework was initially launched, only the Malaysian Government and any company whose issuances are guaranteed by the Malaysian Government were eligible to issue bonds and sukuk to retail investors. With the issuance of the revised PDS Guidelines and Sukuk Guidelines in January 2013, the list of eligible issuers have been expanded to include public listed companies, financial institutions and Cagamas Berhad, to name a few.

10. The first retail sukuk offering was issued on 8 January 2013 by DanaInfra Nasional Berhad (DanaInfra) to partly fund the Klang Valley mass rapid transit project, giving investors an opportunity to invest in the development of the nation. Subsequently, DanaInfra has issued another two tranches as part of their funding programme.

11. To facilitate the financing of sustainable and responsible investment initiatives, the SC last month announced the sustainable and responsible investment (SRI) sukuk framework. This is in line with the CMP2 initiatives to promote socially responsible financing and investment. With the shift in investor demographics, there are growing concerns over the environmental and social impact of business and greater demand for governance and ethics. The SRI sukuk framework is intended to position the Malaysian capital market to capitalise on these changing trends.

Infrastructure financing through bond and sukuk markets

12. The Malaysian bond and sukuk markets have become the largest source of capital market financing domestically, having facilitated capital raising amounting to approximately RM630 billion (USD200 billion) over the past decade, with as much as one third being used to finance the infrastructure and utilities sectors. The domestic bond and sukuk markets have also seen a lengthening of maturity profiles for corporate issues rendering it a suitable platform for the provision of

necessary funding for infrastructure development with inherently long gestation periods.

13. In fact Malaysia is recognised as one of the most successful jurisdictions in emerging Asia to facilitate local currency infrastructure bond financing due to the deep and liquid onshore market[4]. The bullet issuance of RM15 billion (USD4.8 billion) Binariang GSM sukuk in 2008 was a watershed for Malaysia in testing the depth of its corporate bond market. Although it was the first time that the market saw such a massive request for funding, investors responded positively with an over-subscription rate of 2 times. In 2012, the local currency sukuk market saw the landmark issuance by Projek Lebuhraya Usahasama Berhad (PLUS), the major highway concessionaire in Malaysia, totalling RM30.6 billion (USD10 billion) which still holds the record as the world's largest ever corporate sukuk issuance.

14. The potential for the Malaysian bond and sukuk markets to continue to play an important role in funding infrastructure development domestically and regionally is substantial given the massive projected infrastructure needs within ASEAN. Based on estimates from the Asian Development Bank (ADB), Asia will need to invest approximately USD8 trillion in overall national infrastructure between 2010 to 2020, out of which infrastructure financing needs for the ASEAN region alone accounts for over USD60 billion per year[5].

15. With these staggering amounts of funding required to build high-quality physical infrastructure, ASEAN governments may face challenges in fully fulfilling construction costs given fiscal and budgetary constraints. As such, private sector participation becomes imperative to supplement government financing. Against this backdrop, the ASEAN Infrastructure Fund (AIF) was created in September 2011 as an innovative regional co-operation and integration initiative to finance infrastructure projects in ASEAN. While the initial funding is from equities, the bulk of AIF's funding will eventually come from bond markets, further illustrating the key role that bond markets can play in facilitating infrastructure development.

16. Going forward, the development of local currency bond markets can be taken at a regional level through the ASEAN+3 Asian Bond Markets Initiative (ABMI) for example. With the objective of strengthening the resilience of the financial system to mitigate currency and maturity mismatches in financing, ABMI is

[4] See for example the July 2014 joint publication by Reserve Bank of Australia, Productivity Commission and Lowy Institute for International Policy which recorded the proceedings of a conference "Financial Flows and Infrastructure Financing" held in March 2014. Based on this publication, emerging Asia includes China, Hong Kong, Indonesia, India, Malaysia, the Philippines, Singapore, Thailand and Taiwan.

[5] ADB and ADB Institute, Infrastructure for a Seamless Asia, 2009.

focused on encouraging and enabling better utilisation of Asian savings for Asian investments.

17. Greater cross-border transactions are also being advanced through the ASEAN Capital Markets Forum (ACMF) initiatives such as the implementation of harmonised ASEAN Disclosure Standards to ease the primary offering of plain debt securities across borders and the establishment of the ASEAN Trading Link to enhance market access and liquidity among participating ASEAN exchanges.

18. These are achievements that the ASEAN community can certainly take pride in. Clearly, the needs of ASEAN can be further served through greater collaboration and coordination among the various regional agencies to achieve seamless financial integration within the region.

Moving forward

Accelerating time-to-market

19. The regulatory framework governing the Malaysian bond and sukuk markets has undergone gradual but significant changes corresponding to the stage of market development. Although the SC has significantly reduced the approval timeframe to 14 days for regular approvals and even provide for an expedited 1-day deemed approval process for eligible issuers, it is our view that the domestic markets have reached a new phase of maturity, and investors have attained a level of sophistication with a strong ability to protect their own interests. In this regard, the SC is currently looking at developing a new framework to accelerate time-to-market for wholesale offerings, where bonds or sukuk can be issued as soon as the requisite documents are lodged with the SC.

Removal of mandatory credit rating

20. The increased sophistication among market participants has also led the SC to conduct a holistic review on the continuing need for mandatory credit rating. The prevalent use of credit ratings over the years has ingrained the credit assessment culture in the industry leading to stronger internal credit assessment capabilities. In tandem with this was the global call to reduce reliance on external credit ratings. Collectively, this provided the basis for the removal of the mandatory credit rating requirement in the wholesale bond and sukuk markets which will come into effect on 1 January 2017 to enable the market to transition towards a more market-driven environment.

Securitisation

21. Securitisation markets around the world almost ground to a halt having been blamed as being the principal cause of the global financial crisis, and suffered extensive negative publicity subsequently. This has invariably generated a general increase in risk aversion among investors towards securitised products leading to its relatively underdeveloped state now.

22. However, securitisation transactions embedded with the necessary safeguards have the potential to be a valuable financing tool as the essence of securitisation is to enable businesses to realise the value of their cash producing and best quality assets, transforming illiquid assets into liquid and tradable capital market instruments. Through the ring-fencing and segregation of underlying assets in a securitisation structure, the issuer may be able to attract a comparatively higher rating for the securitised instrument as opposed to the originating company issuing a bond based on its credit standing, thereby reducing the overall funding cost.

23. Securitisation offers a viable funding option for smaller companies that are limited in their access to bond markets as well as borrowings. Similarly, securitisation structures provide investors a much broader selection of fixed income products made possible through the variety and flexibility of credit, maturity and payment terms. In view of the benefits of securitisation, there is a strong value proposition for the revival of this market that is of particular relevance to smaller companies and investors.

Conclusion

24. Since the year 2000, tremendous efforts have been expended to grow the Malaysian bond and sukuk markets into deep and liquid markets which now serve as a key source of long-term infrastructure financing. Notwithstanding, the SC continues to pursue greater development of the bond and sukuk markets to ensure relevance and attractiveness to both issuers and investors.

25. Regional efforts to encourage increased cross-border issuances and investments are also well underway and stakeholder involvement from across the capital market value chain must continue to ensure seamless connectivity and recognition of ASEAN as a single asset class.

26. The ASEAN Fixed Income Summit (AFIS) today is therefore timely in focusing on addressing cross-border issues and challenges to promote liquidity and market transparency in ASEAN as the region moves towards financial integration.

27. On that note, I would like to thank Cagamas Berhad for the invitation to deliver this keynote speech and I wish all of you a productive session ahead.

Thank you.