

## CHAPTER 1

### THE RINGGIT MALAYSIAN BOND MARKET

#### 1. INTRODUCTION

The bond market in Malaysia refers to the market in longer-term financial assets.

## CHAPTER 2 THE RINGGIT MALAYSIAN BOND MARKET

The bond market can be divided into 3 basic sectors: public debt issues, Corporate Notes and Bonds, and corporate debt or PDS. Public debt issues include Ministerial Government Securities (MGS), Khazanah<sup>1</sup> bonds, issued by the government's asset management agency, the issues of various other government agencies like Pengurusan Pembiayaan Nasional Berhad<sup>2</sup> and "Kementerian Awam dan Berhad"<sup>3</sup>, and the Bank Negara bills.

<sup>1</sup> Cagamas Berhad (Cagamas), the national mortgage corporation, was incorporated on 2 December 1996. Its original aim was to purchase housing loans from financial institutions, helping their customers by buying fixed and floating rate bonds.

Austrian Nasional Berhad (ANB) is a wholly-owned company of the Ministry of Finance and the investment arm of the Malaysian Government. The role of ANB is to manage the assets held by the Government and to undertake strategic investments particularly in technology projects.

Established in 1998, Pengurusan Pembiayaan Nasional Berhad is the government asset management company set up to purchase non-performing loans from the financial system.

Debt Model Nasional Berhad is a special purpose vehicle owned by the BNM set up for the purpose of recapitalising the banking system.

## CHAPTER 2

### THE RINGGIT MALAYSIAN BOND MARKET

#### 2.1 INTRODUCTION

The bond market in Malaysia refers to the market in longer-term financial assets, comprising public and private debt instruments with maturities exceeding one year. The main purpose of the bond market is to assist the process of economic development by mobilising medium and long-term funds from a wide section of the population to finance public development programs and to fund private investments as well as to assist the banking system in securitising their assets.

The bond market can be divided into 3 basic sectors: public debt issues, Cagamas<sup>6</sup> Notes and Bonds, and corporate debt or PDS. Public debt issues include Malaysian Government Securities (MGS); Khazanah<sup>7</sup> bonds, issued by the government's asset management agency; the issues of various other government agencies like Pengurusan Danaharta Nasional Berhad<sup>8</sup> and Danamodal Nasional Berhad<sup>9</sup>; and the Bank Negara Bills.

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<sup>6</sup> Cagamas Berhad (Cagamas), the national mortgage corporation, was incorporated on 2 December 1986. Its principal aim was to purchase housing loans from financial institutions, funding these purchases by issuing fixed and floating rate bonds.

<sup>7</sup> Khazanah Nasional Berhad (Khazanah) is a wholly-owned company of the Ministry of Finance (MOF) and the investment arm of the Malaysian Government. The role of Khazanah is to manage the assets held by the Government and to undertake strategic investments particularly in high technology projects.

<sup>8</sup> Established in 1998, Pengurusan Danaharta Nasional Berhad is the government asset management company set up to purchase non-performing loans from the financial system.

<sup>9</sup> Danamodal Nasional Berhad is a special purpose vehicle owned by the BNM set up for the purpose of recapitalising the banking system.

The government issued the first government bond in 1960, a year after the establishment of the central bank, Bank Negara Malaysia (BNM). The initial issuance took place strictly for the purpose of meeting the investment requirements of the government Employees Provident Fund (EPF). Government bond issuance increased throughout the 1970's and the 1980's, as a result of the fiscal deficits run during that period. The improved state of the government's finances in recent years had reduced the dominance of MGS issues but the current weak economic growth environment could lead to increased issuance.

The corporate bond market also has a long history. Tracing back to 1982, it really only emerged in 1990, encouraged by the introduction of several government initiatives listed in *Table 1*. By 1992, the combined issuance of Cagamas and PDS surpassed government issuance. Unlike some other markets in Asia, where a corporate bond market is developed in reaction to the crisis, Malaysia actually had a healthy primary market for corporate bonds going into the crisis.

## **2.2 CURRENT SNAPSHOT**

According to the BNM's Annual Report 2000, the domestic debt securities amount to RM241.7 billion or 71.2 per cent of the GDP (*Figure 1*). Debt securities have grown to about 37.6 per cent of total domestic credit, and expected to grow over the next few years, particularly in the corporate sector. PDS<sup>10</sup> represented 58 per cent of the total amount, compared with outstanding

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<sup>10</sup> Private debt securities refer Cagamas bonds, Danamodal bonds, Danaharta bonds and other PDS.

MGS<sup>11</sup> of 42 percent (*Figure 2*). Total outstanding debt as of the end of 2001 stood at RM188.6 billion.

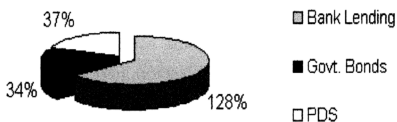
Gross fund raised in the PDS market was higher in 2000, amounting to RM31.1 billion (1999: RM26.6 billion). The higher issuance of PDS was due to several factors, such as the low interest rate environment and the ample liquidity conditions for corporates to raise funds, as well as the increased long-term capital financing. The growth of the PDS market was also attributed to investors' demand for alternative forms of investment, which would yield higher returns than bank deposits.

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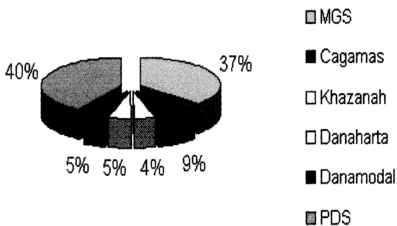
<sup>11</sup> Public debt securities refer to Malaysian Government Securities, Government Investment issues, Khazanah bonds and Malaysia Savings Bonds.



**Figure 1**  
**Total Domestic Debt Securities as at end 2000 (% of GDP)**



**Figure 2**  
**Outstanding Issuance as at the end of 2000**



2.3 DEVELOPMENT OF THE BOND MARKET

The development of the bond market has been driven by changes in the regulatory environment, infrastructural improvements, and financial incentives. The market now features well developed trading and settlement infrastructure, interest rate risk hedging capability via Malaysian Derivative Exchange (MDEX), liberalised corporate bond issuance procedures including a shelf registration program similar to Medium Term Notes (MTN) programs in other markets, and two local credit ratings agencies. The timeline below provides a historical perspective by highlighting the major milestones in the development of the market.

**Table 1**  
**Milestones in Bond Market Development**

Year	Development Initiatives
1989	<ul style="list-style-type: none"><li>• Introduction of issuance guidelines for corporate debt.</li><li>• Establishment of a Principal Dealers System.<sup>12</sup></li><li>• Waiver of stamp duty for corporate debt issuance and transfer.</li></ul>
1990	<ul style="list-style-type: none"><li>• Automated settlement of cash and securities through the scripless book-entry system (SPEEDS).</li><li>• Establishment of the first credit ratings agency, Rating Agency Malaysia Berhad (RAM).</li></ul>

<sup>12</sup> Principal dealers (PDs) are appointed to act as intermediaries between BNM and the institutions or individuals who wish to purchase government bonds and Cagamas bonds.

<b>1990</b>	<ul style="list-style-type: none"> <li>• Basic market rules established in the Code of Conduct and Market Practice.</li> </ul>
<b>1992</b>	<ul style="list-style-type: none"> <li>• Mandatory rating requirement for domestic debt securities</li> </ul>
<b>1993</b>	<ul style="list-style-type: none"> <li>• Establishment of the Securities Commission (SC) as the main debt market regulator.</li> </ul>
<b>1994</b>	<ul style="list-style-type: none"> <li>• Withholding tax for foreigners reduced from 20 per cent to 15 per cent.</li> </ul>
<b>1995</b>	<ul style="list-style-type: none"> <li>• Established the second credit ratings agency, Malaysian Rating Corporation Berhad (MARC).</li> </ul>
<b>1996</b>	<ul style="list-style-type: none"> <li>• Corporate debt begins settling through SPEEDS.</li> <li>• Establishment of Peniaga Bon Malaysia (Malaysian Institute of Bond Dealers).</li> <li>• Fully Automated System for Tendering (FAST), for government securities is implemented.</li> </ul>
<b>1997</b>	<ul style="list-style-type: none"> <li>• Issuance of the first Khazanah bond establishes the government benchmark rate.</li> <li>• FAST is upgraded to include Commercial Papers (CP).</li> <li>• The Bond Information and Dissemination System (BIDS) is set up to improve the access to, and transparency of, information on the Ringgit bond market.</li> </ul>

<p><b>1999</b></p>	<ul style="list-style-type: none"> <li>• SPEEDS is replaced with the real-time gross settlement system (RENTAS) to reduce settlement risk.</li> <li>• Code of conduct for RENTAS trading introduced to facilitate transferal of trading from SPEEDS.</li> </ul>
<p><b>2000</b></p>	<ul style="list-style-type: none"> <li>• Further development of a benchmark curve with the announcement of a regular auction schedule.</li> <li>• The SC is made the sole regulator of the PDS market to improve regulatory efficiency.</li> <li>• Improved efficiency of straight-bond issuance in the PDS market – implemented shelf registration.</li> </ul>
<p><b>2001</b></p>	<ul style="list-style-type: none"> <li>• The Capital Market Masterplan, which contained comprehensive recommendations to further promote the Malaysian bond market, was launched.</li> </ul>

## **2.4 FUTURE DEVELOPMENT – THE CAPITAL MARKET MASTERPLAN**

In February 2000, the Finance Minister launched the Capital Market Masterplan laying out 24 strategic initiatives including 152 specific recommendations. Although these are only recommendations, the majority are expected to be implemented pragmatically, in three phases over a 10-year period. The plan's six overall objectives are the following:

1. To establish the capital market as the preferred fund raising center for Malaysian companies.
2. To promote an efficient investment management industry and a more friendly environment for investors.
3. To enhance the competitive position and efficiency of market institutions.
4. To develop a strong and competitive environment for intermediation services.
5. To ensure a stronger and more facilitative regulatory regime.
6. To establish Malaysia as an international Islamic capital market center.

In addition to these broad objectives, the specific recommendations give an indication of the direction of bond market development in the near future. For the bond market, several interesting proposals were put forward:

- ✓ Allowance of regulated short selling (RSS) and securities borrowing and lending (SBL) only for bond issues (which has been banned since August 1987).
- ✓ Removal of mandatory ratings requirements.
- ✓ Tax incentives for asset-backed securities and other bond issuance.
- ✓ Encouragement of multinationals or international financial institutions to issue Ringgit bonds.

- ✓ Loosening of EPF investment requirements forcing them to invest at least 15 per cent of funds per year in the MGS market.
- ✓ Establishing a liquid benchmark curve.

## **2.5 ISSUES AND CHALLENGES**

Despite the encouraging growth of the bond market, several issues still had to be addressed for the bond market to really develop into a viable investment option. One was the lack of benchmarks in pricing bonds. In-between the years 1993 to 1995, the supply of new government papers in Malaysia's bond market had dwindled. This decline was in line with the government's mid-1980s decision to downsize its operations to give way to privatisation – a decision that was made easier by the government's healthy financial position as it had been running on a budget surplus. The shortage of MGS and its captive market lead to inefficient pricing of bond issues.

In order to enhance liquidity, both the supply (issuer base) and demand (investor base) had to be broadened. Firstly, the former called for a constant supply of primary issues to deepen the market; ideally a huge volume of issues with a range of maturities that could cater to investors' different needs. Secondly, regulatory obstacles had to be removed to shorten the issuing and approval process of bonds – a most tedious task – and hence pare down the costs.

Another obstacle was the stringent requirements imposed on prospectus, which were mandatory for public offerings of PDS, unless they were issued to exempted investors (banks, insurance companies, statutory bodies, pension funds and foreign corporations among others). Discouraged by the prospectus' cost and preparatory time, many issuers resorted to issuing their bonds by way of private placements to the exempted investors. Such private issues resulted in an

illiquid secondary market as they confined themselves to a smaller network of institutional investors who locked in the bonds until maturity, thus giving the public limited access to invest.

The investor base in Malaysia was already narrow enough, made up of the predominant pension and provident funds, the insurance companies, banking institutions, unit trust, asset management companies and foreign institutional investors. With most of them tending to pursue a buy and hold strategy, it was not surprising that trading remained thin in the secondary market. Hence, the other basic issue of enlarging the pool of bond investors beyond the small numbers was important.

Another inhibiting factor was the minimum investment grades that bonds had to attain before they could be issued – a RAM rating of at least 'BBB' for bonds of more than one year's maturity and 'P3' for short-term papers. While such a ruling instilled investor confidence in a fledgling PDS market, however, it was disadvantageous to high-growth, high-risk companies and impeded the participation of investors with diverse risk appetites.

The bond market should also tap the savings of individuals aside from just institutional investors. Presently, there are limited issues available to individuals and there is no distribution system to sell papers to individuals, other than through bond funds. The existing banking network could be one of the avenues to tap individual funds. With the increasing sophistication of Malaysian investors, banking institutions should be in a position to provide investors with a savings plan comprising of different instruments ranging from bank deposits to more complex bond investments.

On this vein, the investment culture of individuals will have to be reoriented through education program from merely bank deposits and stock market to more sophisticated bond investments. As part of the education program for individuals, the availability of up-to-date information (like price, coupon, yield, outstanding issues, ratings, and other relevant information) would encourage potential investors. The regulatory authorities and the financial institutions will have to play their role to educate the public on the investment and trading mechanics of bonds.