

Malaysian Bond Market Challenges and Opportunities

This chapter discusses some of the real or perceived challenges facing the Malaysian bond market and its participants, and describes potential mitigating factors and market developments that could address these challenges in an appropriate manner.

A. Challenges in the Malaysian Bond Market

1. Concentration of Investor Base

Public domain reports often cite the concentration of investors in the Malaysian bond market as a challenge to be addressed by policy bodies and regulatory authorities. Reference was made in Chapter III.M to the significant investments of pension funds and other statutory entities in MGS based on their appetite for safe instruments. In addition, bonds, notes, and *sukuk* are often traded and held within a small group of major institutional investors other than pension funds. At the same time, retail investors lack deep knowledge or understanding of the bond market, and are easily content with commercial bank deposits rather than with other products for investment.

2. Issuance by Large Companies Only

The lack of lower-rated, medium-sized companies in the bond market appears to be the result of a high degree of investor risk aversion. Bonds issued by government-linked companies and infrastructure issuers backed by government-linked contracts represented a significant portion of the market. While investors are more likely to be risk takers in their equity investments, they will tend to compensate by taking a very conservative approach in their fixed-income portfolios. There is concentration in the high-grade segment—possibly as well due to default experience following the 1997/98 Asian financial crisis and the recent global financial crisis—such that they demand very high yield from lower-grade issuers or second-tier companies.⁵⁸

3. Hedging No Longer a Challenge

Regulators have significantly eased both access to the market and enabled many investment activities, particularly for foreign investors. Hedging of exposure to the Malaysian bond market is available with licensed onshore banks.

⁵⁸ World Bank. 2013. Malaysia—Bond Market Development: Technical Note. Financial Sector Assessment Program. Washington, DC. <http://documents.worldbank.org/curated/en/2013/01/18639187/malaysia-bond-market-development-technical-note>

BM Derivatives trades 3-year and 5-year MGS futures as well as a contract based on the KLIBOR benchmark interest rate. Details on BM Derivatives and its offerings are available in Chapter IV.

4. Malaysian Financial Reporting Standards

Research by ABMF indicates that issuers, intermediaries, and listing places in ASEAN+3 are spending considerable energy mapping and understanding financial reporting standards in each other's jurisdictions in anticipation of an increase in cross-border bond issuance and investment activities in the region. ABMF research has also proved that the treatment and disclosure of relevant information is often the same or very similar across markets, particularly with respect to bond, note, or *sukuk* issuance.

At the same time, however, it was found that the financial reporting standards in some markets have not yet fully adopted the International Financial Reporting Standards (IFRS).⁵⁹ This may result, for example, in issuers seeking to list or profile list their bonds, notes, or *sukuk* in specific listing places needing to convert their financial reporting information into a format acceptable to such listing place if their domestic financial reporting standard does not converge with IFRS.

In November 2011, the Malaysian Accounting Standards Board⁶⁰ issued the Malaysian Financial Reporting Standards (MFRS) Framework, which became effective on 1 January 2012 and is word-for-word in agreement with all IFRS provisions.⁶¹ The Malaysian Accounting Standards Board's plan is to maintain the identity of MFRS and IFRS by adopting all new or amended IFRS. Hence, there should be no challenge stemming from financial reporting standards for either Malaysian issuers seeking a listing outside Malaysia, or foreign issuers seeking a profile listing on BMS.

At the same time, foreign issuers have, for their ringgit issuances, been able to elect whether to submit and report financial and disclosure information according to MFRS-IFRS or United States Generally Accepted Accounting Principles.

B. Opportunities in the Malaysian Bond Market

1. General Regulatory Environment

Since the global financial crisis, regulators across the globe have been strengthening laws and regulations in many areas of the capital and financial markets. Of particular interest have been banking regulations and risk-weighted capital. The outcome for the financial markets include a limitation of what banks can or are willing to lend, to whom, and under what circumstances. A number of these regulatory initiatives may, in consequence, lead to a rebalancing of funding options for the corporate sector from bank loans to the capital market.

⁵⁹ ABMF published its Phase 2 Report in April 2014, *Proposal on ASEAN+3 Multi-Currency Bond Issuance Framework*, which included an overview of financial reporting standards in ASEAN+3 in relation to IFRS. The report is available at <http://www.adb.org/publications/proposal-asean3-multi-currency-bond-issuance-framework-ambif>

⁶⁰ See <http://www.masb.org.my>

⁶¹ The IFRS application profile for Malaysia is available at <http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Malaysia-IFRS-Profile.pdf>

While not unique to Malaysia, this development might just positively influence the interest of potential domestic issuers to consider raising funds via bond, note, or *sukuk* issuance, and to diversify their debt portfolio. This increased interest, coupled with a broader and deeper investor base (see below), might also have a beneficial impact on funding costs.

2. Specific Regulatory Developments Drive the Market

A number of specific policy and regulatory initiatives have added clarity and flexibility to the Malaysian bond market and its participants in recent years. BNM is encouraging investors to utilize their long-term holdings with BNM to unlock liquidity. The SC will no longer stipulate a mandatory credit rating for professional issuances (conditions apply) beginning in 2017, and has introduced a Lodge and Launch approach, instead of a required approval, for bond, note, and *sukuk* issuances aimed at Sophisticated Investors. BMS introduced ETBS and offers an Exempt Regime for the profile listing of debt instruments and *sukuk*, without trading, to achieve higher visibility to investor groups and the market at large.

3. ASEAN+3 Multi-Currency Bond Issuance Framework

The implementation of the AMBIF is expected to benefit not only AMBIF issuances but also the Malaysian bond market at large. The ASEAN Bond Market Initiative and Malaysian policy bodies and regulatory authorities focus on a suitable balance between bank loan and capital market funding opportunities for corporates. AMBIF has been created to provide an additional bond, note, or *sukuk* issuance avenue for corporates. AMBIF in Malaysia focuses on the issuance of private placements to Sophisticated Investors, which was further supported by the introduction by the SC of concessions for professional issuance under the Lodge and Launch Framework in June 2015.

At the same time, Malaysia as a market generates some of the strongest interest from potential AMBIF bond, note, and *sukuk* issuers who may already have substantial commercial operations in the country, and would like to issue bonds, notes, and *sukuk* to use ringgit proceeds, diversify Malaysian ringgit funding options, eliminate foreign exchange risk, or more effectively manage their debt portfolio. The nature of AMBIF and its specific limitation to professional investors is likely to attract the attention and opportunity to invest in AMBIF bonds, notes, and *sukuk* from new institutional (professional) investor types in Malaysia and from other regional markets.