

RAM



ACCA CEO
Breakfast Presentation

Asian Business Strategies

*Growth Through
Bond Market*

Lessons for Sri Lanka

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Outline

I

- Contribution to Financial Deepening and Corporate Growth

II

- Benefits of Ratings and Bond Market Financing

III

- RAM's Credit Rating Principles, Practices and Methodology

IV

- Leveraging on RAM's Expertise and Experience



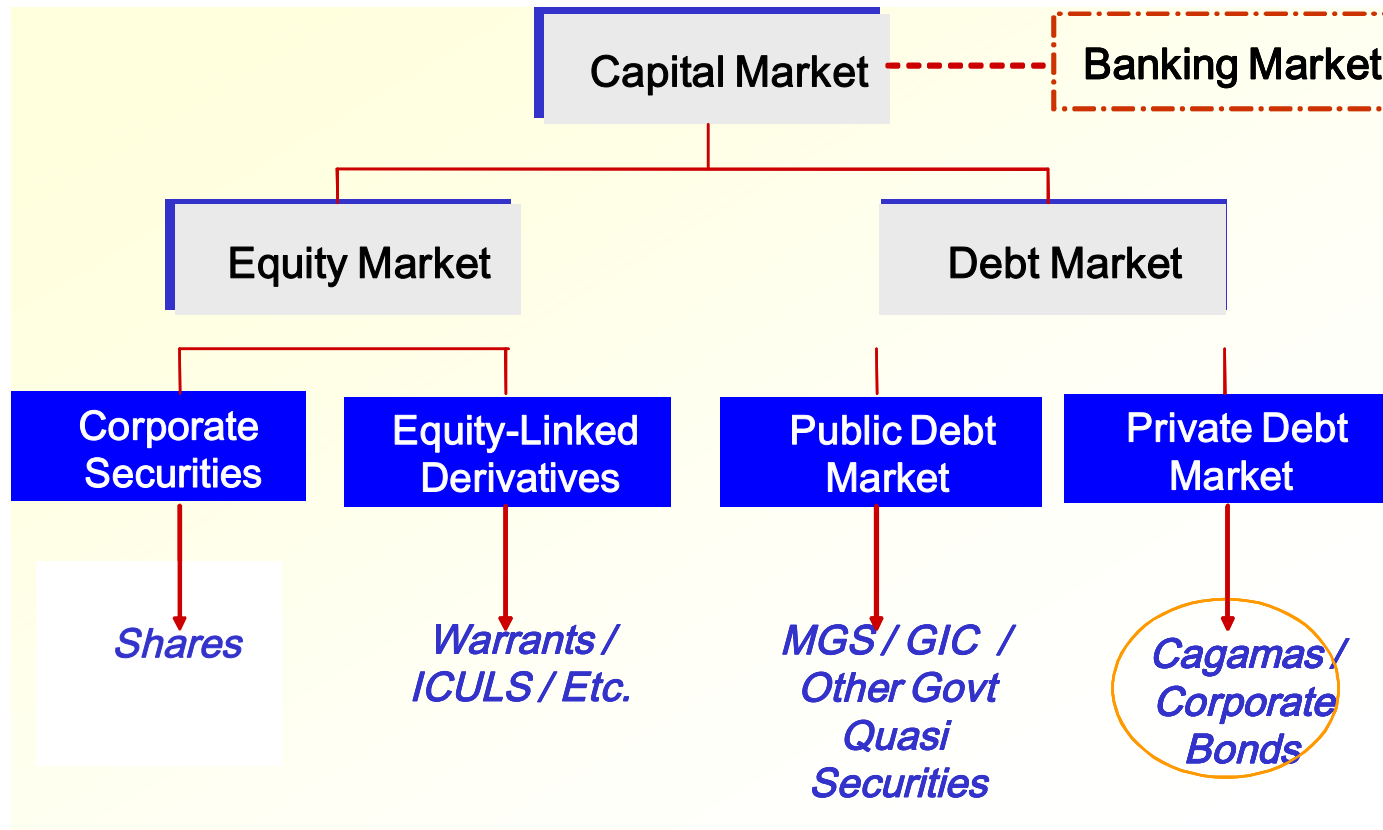
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PART I

Contribution to Financial Deepening and Corporate Growth

Bond Market in the Overall Financial and Capital Market System

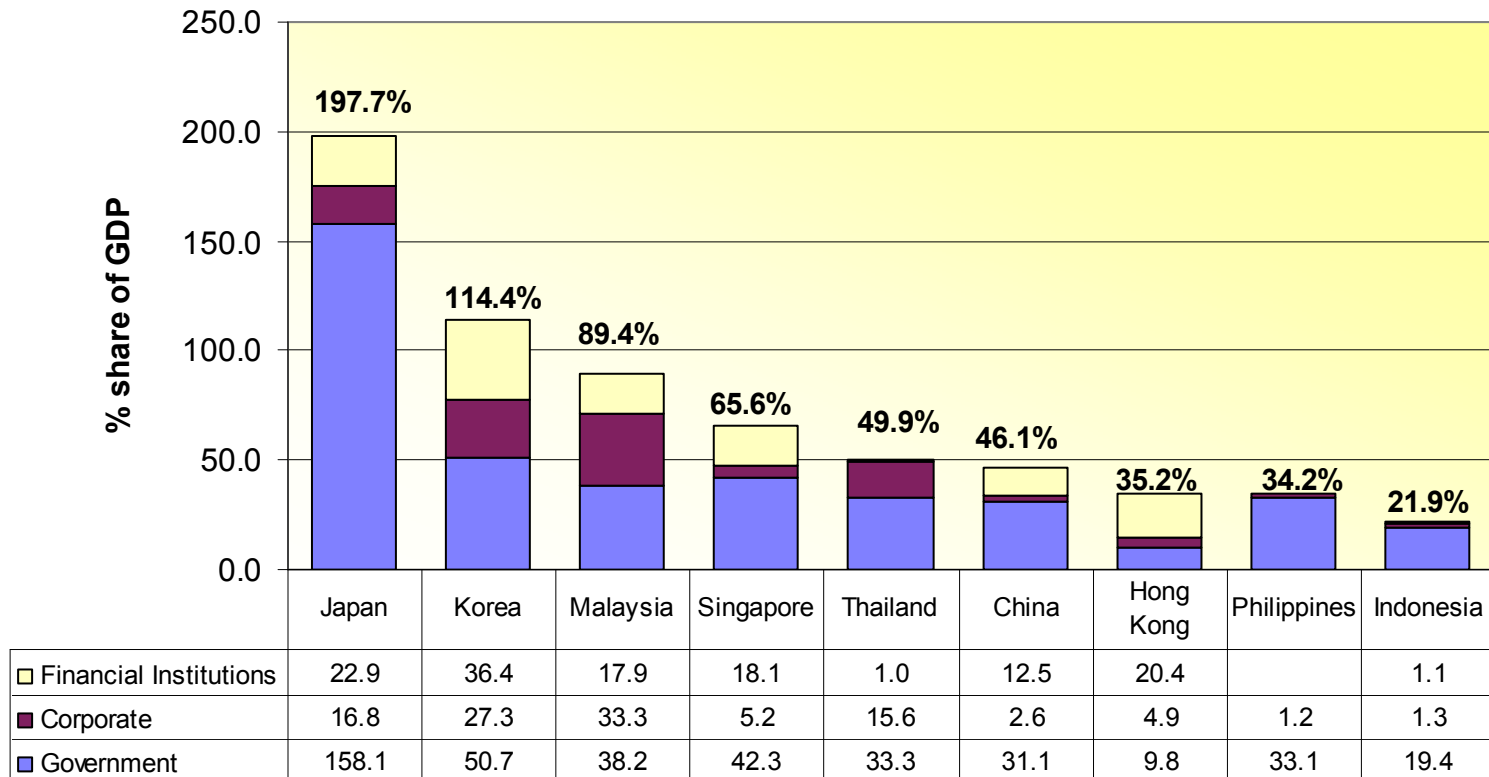
- Debt capital market consists of public (or government) debt market and private debt securities (PDS) market, more commonly known as the corporate bond market in other countries.



Bond Market Size relative to GDP

➔ As a share to GDP, Malaysia has the third largest bond market amongst the East Asian countries, including Japan.

Size of Local Currency Bond Markets
Share to GDP (%) as at end Jun-07



Source: ADB AsianBondsOnline



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I. Contribution to Financial Deepening and Corporate Growth

Benefits of Bond Market

Wider Access to Credit and Stable Source of Long Term Funding for the Corporate Sector

- Allow corporations to have wider access to credit to finance viable projects but facing funding mismatch
- Reduce over-dependence on the banking sector for corporate debt financing
- Reduce funding mismatch: promote use of long term bonds (> 5 years) in place of short term facilities



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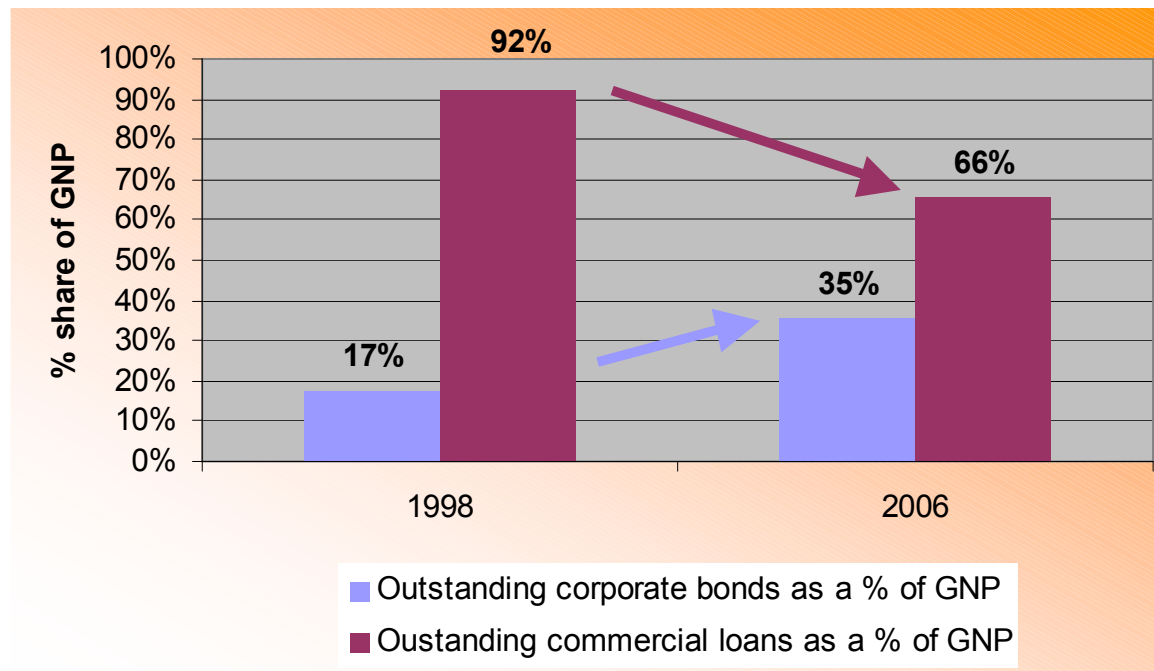
I. Contribution to Financial Deepening and Corporate Growth

Benefits of Bond Market (cont'd)

I. What's Different? Malaysian Economy Pre and Post-Asian Financial Crisis

Financial Disintermediation

Better distribution of credit risks as evidenced by the significant shift in corporate financing to the bond market, marked by lengthening of bond tenures to more than 10 years for large, long term issues



Benefits of Bond Market (cont'd)

-
- ➔ **Problems associated with over-reliance on banking system**
 - ✓ Concentration of credit allocation decisions; tendency to 'force' lending by easing of credit terms
 - ✓ 'Moral hazard' problems arising from bankers taking excessive risk due to perceived guarantee of government 'bail out'; bad loans kept from being written down for long periods; higher risk of 'crony capitalism'
 - ✓ Banks more highly leveraged than typical bond investor, leading to higher systemic risk for the country
 - ➔ **Key advantages of bond markets**
 - ✓ Greater market forces at work – functions of credit rating agencies and market intermediaries, greater transparency and information disclosure
 - ✓ Reduced currency and maturity mismatches
 - ✓ Financing of large scale, long term infrastructure projects
 - ✓ Enhance economic welfare due to range of liquid financial debt instruments of different maturities and default risks



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PART II

Benefits of Ratings and Bond Market Financing



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II. Benefits of Ratings and Bond Market Financing

Benefits of Ratings

- Provide a common yardstick to measure credit risk and to signal to the market changes in credit quality of bonds (i.e. the ability and willingness of the issuers to repay the debt obligations).
- Bridge information gap between borrowers and lenders, issuers and investors – reduce *asymmetric information* and *moral hazard* problems in financial and capital markets.
- Enhance financial disclosure and information efficiency.
- Economic role of rating agencies - lower cost of information gathering and analysis through specialization in credit evaluation and economies of scale in conducting ratings.
- Facilitate financial product innovations as ratings expedite market acceptance of rated new products.



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II. Benefits of Ratings and Bond Market Financing

Key Factors Driving Bond Market Growth

- Privatization of infrastructure projects and public utilities.
- Rise in private financing activities especially in long term, capital intensive infrastructure projects.
- Funding constraints in the banking sector (single customer limit; concentration risk; asset-liability mismatch (short term deposits [liability] versus long term loans [asset])).
- Reduction of currency, maturity and funding mismatches in project financing.
- Disintermediation – lower cost due to direct funding by investors; cost-competitive alternative to bank borrowings.
- Government support – legal and regulatory framework; network of intermediaries, development of bond market infrastructure; fiscal and financial incentives; removal of market and policy impediments.



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II. Benefits of Ratings and Bond Market Financing

Role of Domestic Credit Rating Agencies

- ➔ Domestic CRAs play **important roles** in:
 - Developing nascent local bond market.
 - Innovating new products for local market.
 - Having local perspectives and good local knowledge.
 - Ability to serve SMEs and smaller issuers.
 - Ability to charge relatively lower rating fees compared to Global CRAs.

- ➔ Among new **opportunities**:
 - Domestic bond markets in Asia poised for strong organic growth.
 - New avenues for growth under new capital framework for banks under BIS II and Asian regional bond market initiatives.



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II. Benefits of Ratings and Bond Market Financing

Bond Market Provides an Additional Option for Corporate Debt Restructuring

Malaysia's experience in facing the 1998 Asian Financial Crisis... rescheduled and conversion into bonds constituted the bulk of the restructured debts in line with the nature of financial distress which is predominantly illiquidity.

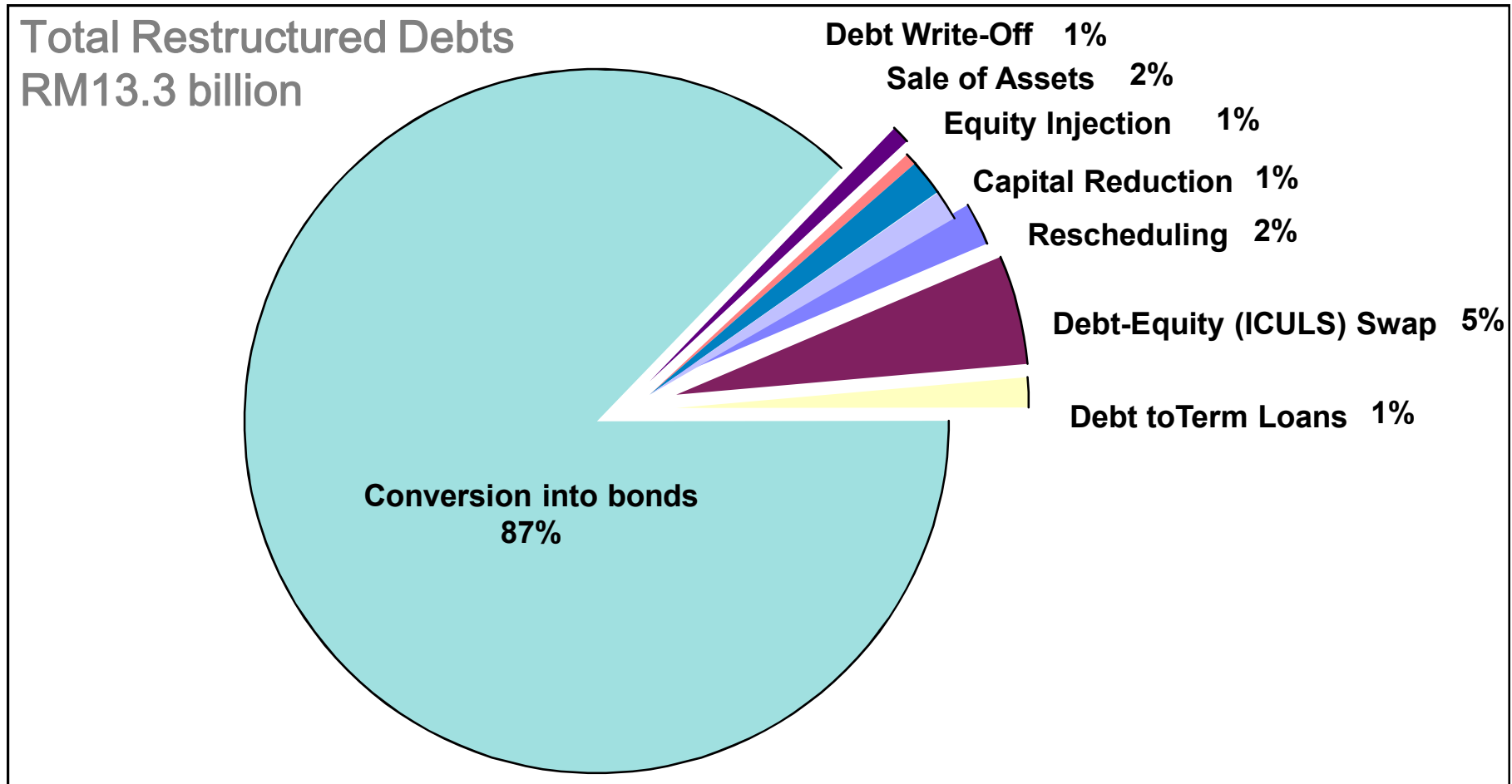
Method	Value (RM million)	% of total
Rescheduling	277	2.1%
Debt-equity (ICUL) swap	661	5.0%
Conversion into term loans	185	1.4%
Conversion into bonds	11,632	87.3%
Equity injection	110	0.8%
Debt write-off	71	0.5%
Sale of assets	211	1.6%
Capital reduction	183	1.4%
Total	13,330	100.0%



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II. Benefits of Ratings and Bond Market Financing

Distribution of Restructured Corporate Debts after the Asian Financial Crisis



Positive Economic and Financial Implications

- ➔ Immense short term economic benefits in terms of reduction in systemic risk to the banking system and stabilisation of employment, income and product markets.
- ➔ Relatively insignificant financing costs in terms of capital injection, write-offs and loan losses.
- ➔ Relatively 'painless' by virtue of the voluntary nature of corporate debt restructuring process ("London approach").
- ➔ Consistent with 'illiquidity' rather than 'insolvency' distress.
- ➔ Industry-wide restructuring a more important concern than individual company survival.



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PART III

RAM's Credit Rating Principles, Practices and Methodology

Types of Ratings

- Rating of issuer/obligor versus issue
- Local currency versus foreign currency ratings
- Sovereign versus corporate ratings
- Types of corporate ratings
 - Corporate ratings (private limited and public limited companies)
 - Financial institutions (banks)
 - Claims-paying ability (insurance companies)
 - Senior debt rating
- Ratings by types of instruments
 - Corporate bonds/PDS
 - Islamic bonds
 - Asset-backed securities

Types of Ratings (cont'd)

'Issuer' versus 'Issue' Ratings

➤ Issuer rating:

- An opinion of the general creditworthiness of an obligor; addresses the issuer's overall capacity to meet its financial obligations on a timely basis
- Commonly referred to as Corporate Credit Rating (CCR)

➤ Issue-specific rating:

- An opinion of the creditworthiness of an obligor with respect to a specific financial obligation

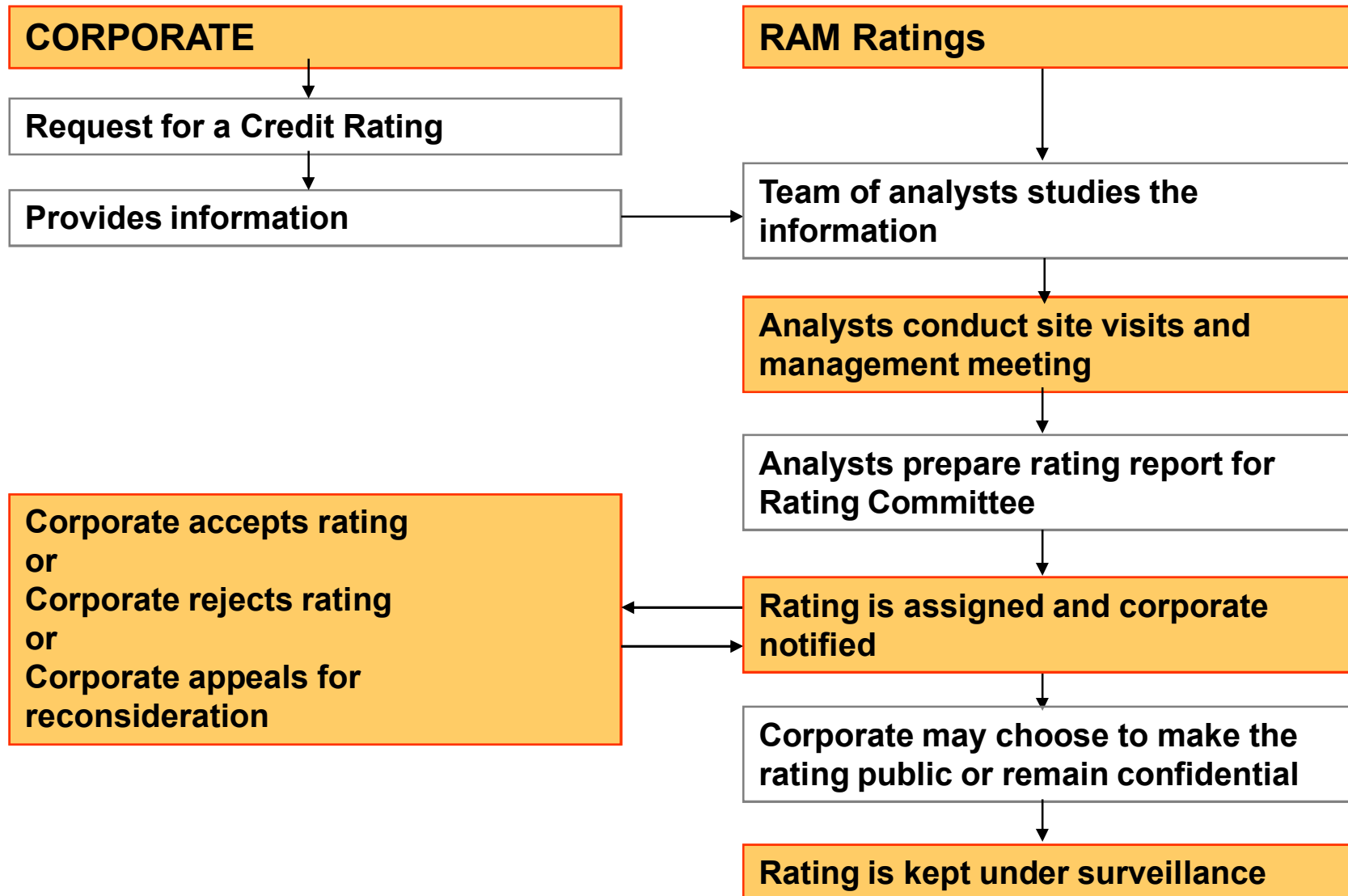
Not all debt issues of a company will be rated the same.



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III. RAM's Credit Rating Principles, Practices and Methodology

Overview of Rating Process



Ensuring Quality & Integrity of Rating Process

- ➔ Use of consistent & rigorous rating methodologies
- ➔ Large & experienced analysts pool, backed by experienced economics team
- ➔ Rating specialisation – 7 core ratings group
- ➔ Tiered decision making process: 2-level committee-based; rating decisions are not made by an individual
- ➔ Transparency & disclosure of rating criteria
- ➔ Detailed rating rationales, supported by data & comparative analysis

Corporate Rating Framework

Key Risk Factors

Industry Analysis

- Growth potential
- Industry vulnerability
- Barriers to entry/exit
- Threats of substitutes
- Level of competition

Financial Analysis

- Profitability
- Financial leverage
- Interest coverage & liquidity
- Cash flow analysis
- Financial flexibility

Business Analysis

- Market position
- Product diversity
- Operating efficiency
- Cost structure

Management Analysis

- Track record
- Capacity to overcome adversity
- Risk appetite
- Succession plans
- Goals, philosophy & strategies

Surveillance and Monitoring

What happens after a rating has been assigned?

❏ Provision of Timely & Meaningful Credit Reviews

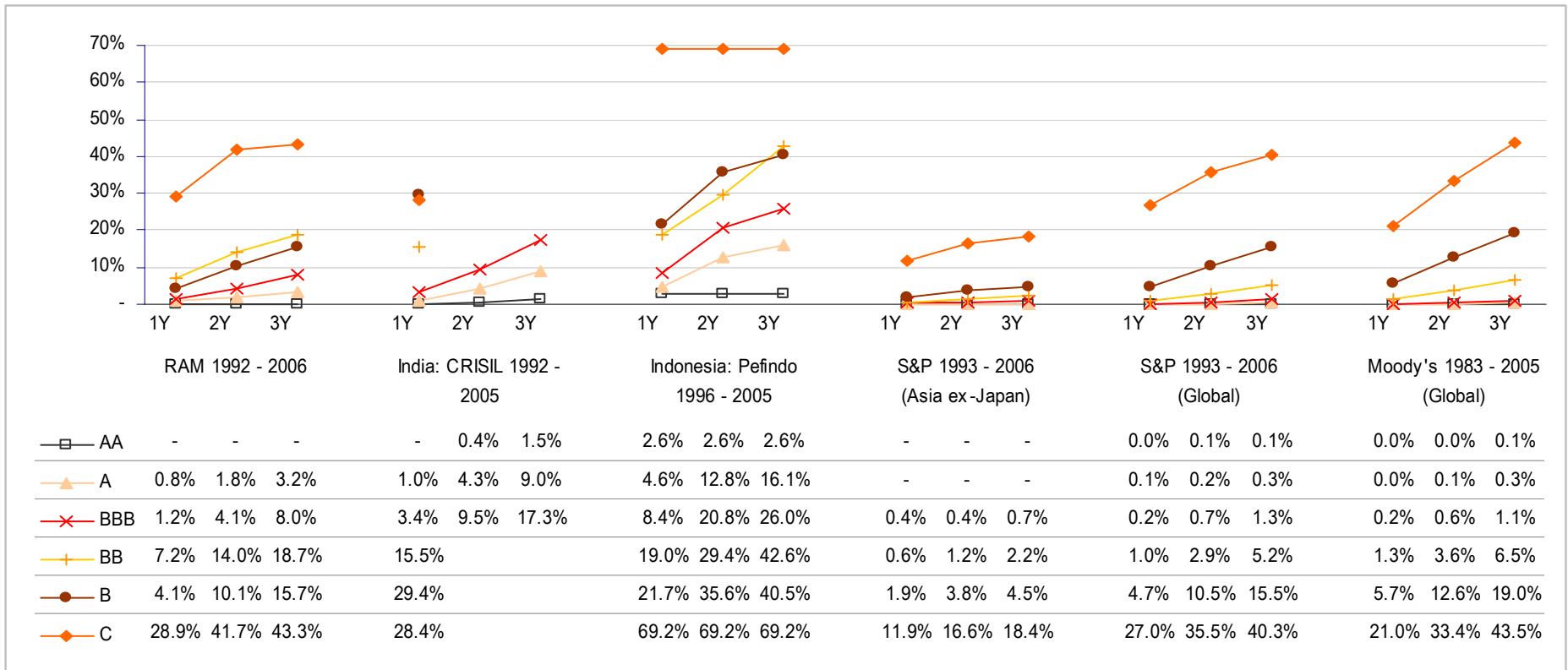
- Annual surveillance
- Quarterly updates / Commentaries
- E-mail alerts
- Annual Default Study - *which allows investors continuous opportunity to appraise rating agencies' capacities and capabilities*
- Rating Watch
- Rating Outlook - *enhancing ratings' predictive value*



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III. RAM's Credit Rating Principles, Practices and Methodology

Comparison of Default Profiles



* Due to rating scale truncation, we caution that the default ratios are not directly comparable although the general observations of the default trends can

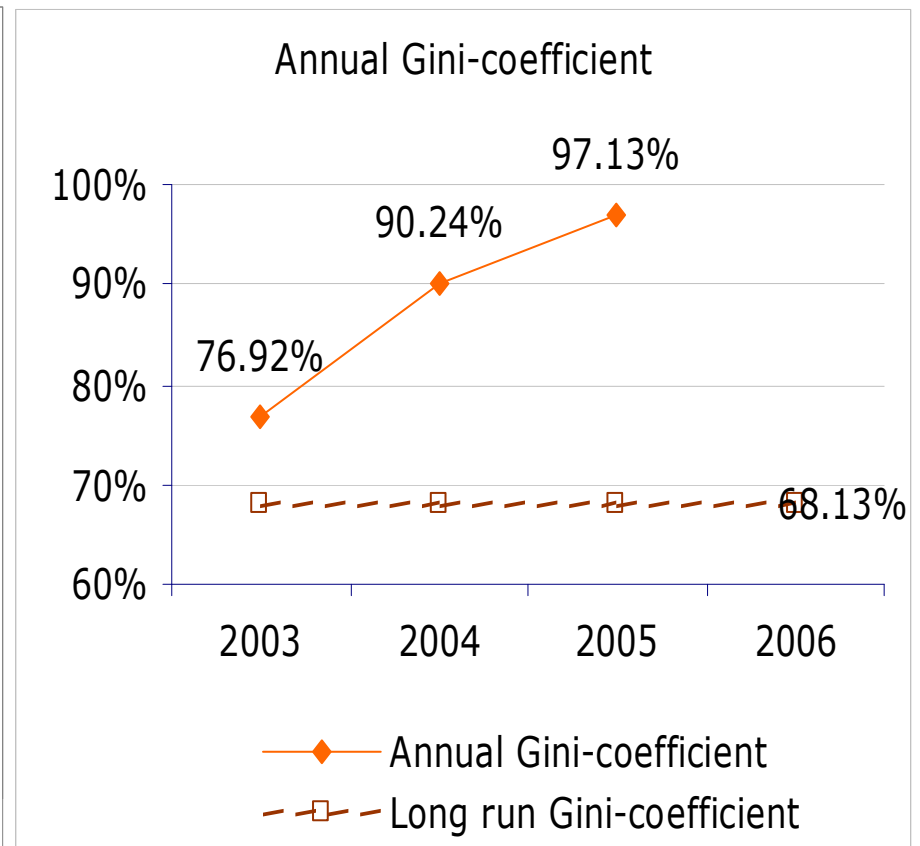
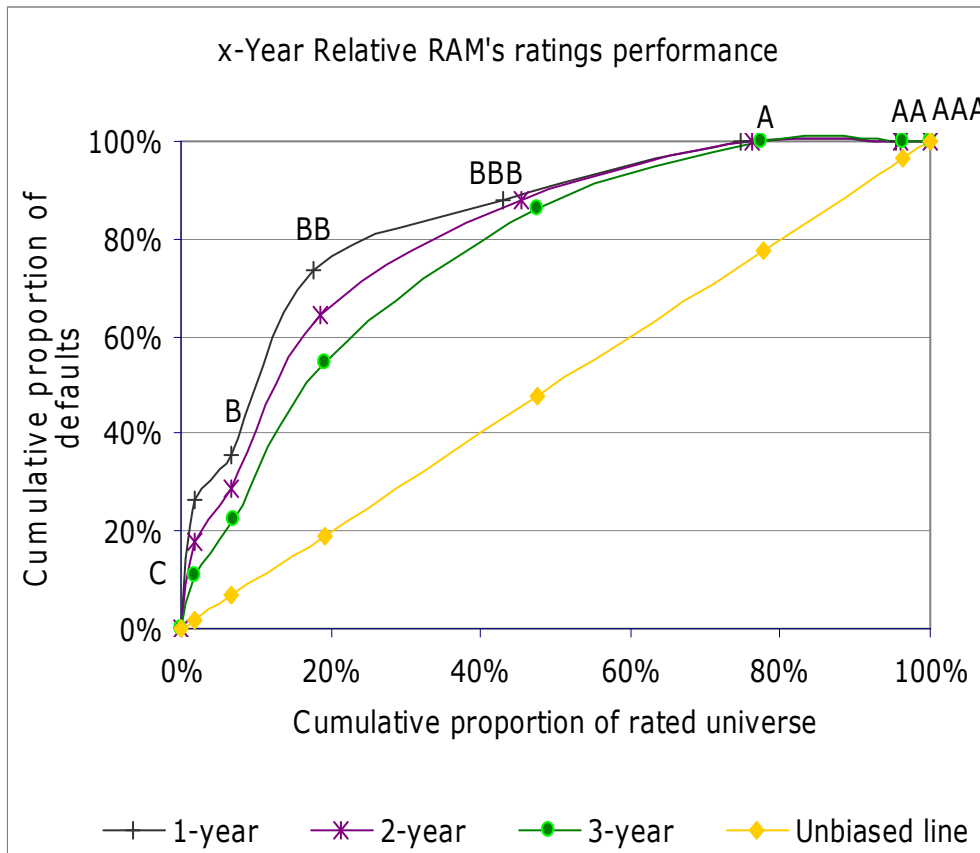
- Negative correlation between ratings and probability of default – consistent with results of other rating agencies
- RAM's experience reflects the 1997/98 crisis but are comparable – if not better – than those observed in region



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III. RAM's Credit Rating Principles, Practices and Methodology

RAM's Rating Accuracy



- Gini-coefficient (quantitative measure of historical ability to predict defaults) on an improving trend
- 1992-2006: 68.1% versus pre-crisis period (1992-1999): 58.8%



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III. RAM's Credit Rating Principles, Practices and Methodology

Domestic versus International Ratings

Why international ratings are not suitable for domestic bond market:

- International rating scale introduces a high degree of **'rating or risk compression'** for corporations operating in the domestic economy.
- Risk pricing will not be adequately defined across the spectrum of local corporations.



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PART IV

Leveraging on RAM's Expertise and Experience



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IV. Leveraging on RAM's Expertise and Experience

Key Lessons from Malaysia

- ➔ **Malaysia's early development of the corporate bond market** beginning in the late eighties helped to mitigate the effects of the Asian Financial Crisis on the Malaysian corporate sector especially for those which were able to fund large infrastructure projects with local currency-denominated bonds at fixed rates.
- ➔ **Subsequent corporate restructuring efforts** have reduced significantly financial distress and averted a spillover into the real economy.
- ➔ **2009 global financial crisis did not cause a liquidity or credit crunch** in the Malaysian bond market due to strong market integrity and soundness as reflected by the predominance of bonds with high credit ratings.



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IV. Leveraging on RAM's Expertise and Experience

Key Lessons from Malaysia

- **Rapid growth and expansion of local currency bond markets in Asia**
 - ✓ Local bond markets outgrowing other financing sources
 - ✓ Issuance of corporate bonds has overtaken sovereigns in Malaysia and other countries in the region (Philippines, Hong Kong and Singapore)
 - Budget surplus in some countries; reduced deficits in others
 - Increased private financing activities
- **More balanced financial structure with bond market shouldering more credit risks**
 - ✓ Improved resource allocation
 - ✓ Reduced maturity and currency mismatches



Thank you....

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