

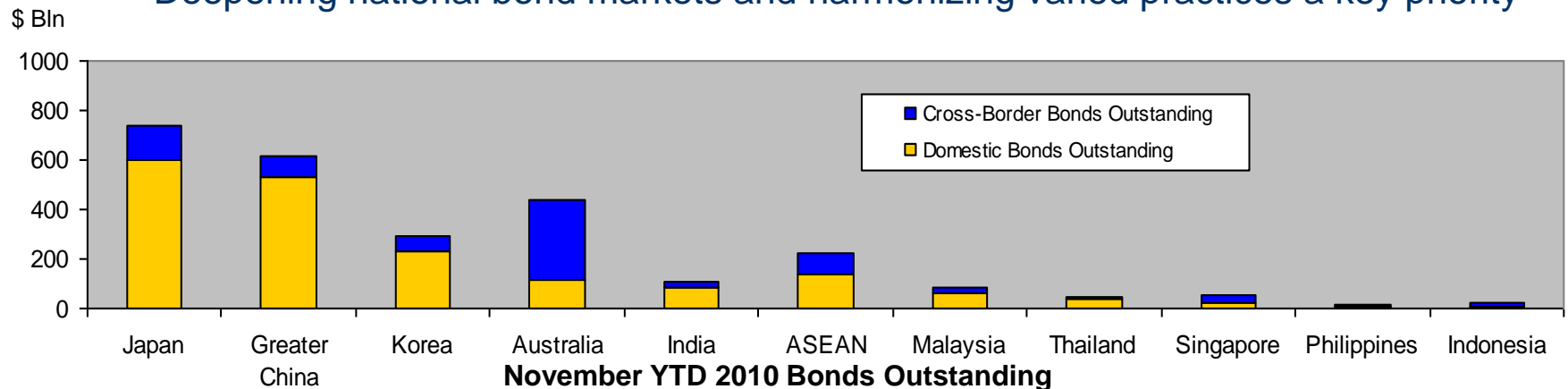
ASEAN's Bond Markets Supporting ASEAN's Revival

Surinder Kathpalia, Managing Director

April 26, 2011

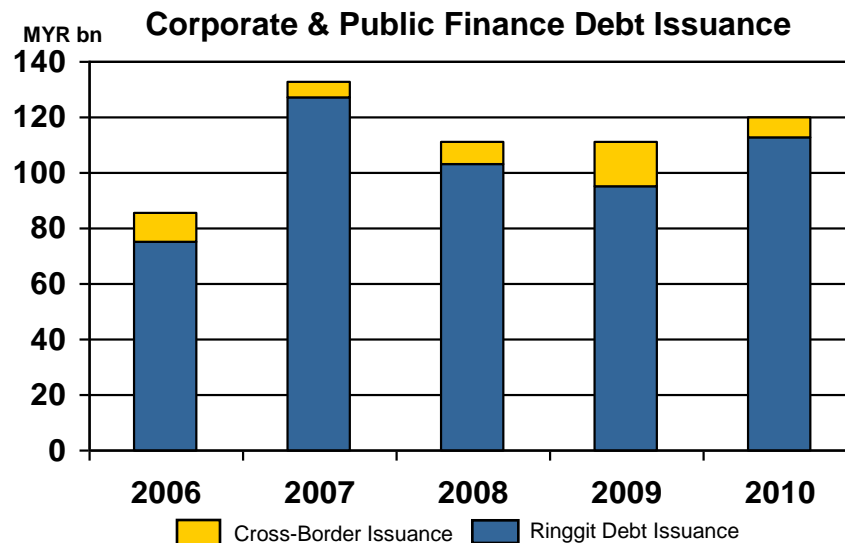
Regional Market Trends and Key Priorities

- **Growing need for capital markets to meet vast funding needs**
 - Over \$40 trillion credit needed to refinance Asian debt and fund new projects
 - Banking sector unlikely to be able to shoulder funding need
 - Stronger market mechanisms required to allocate capital productively
 - Infrastructure finance needs – over \$750 billion annually – are another huge opportunity for deepening capital markets
- **Internationalization of local currency markets**
 - Foreign issuers increasingly active in select ASEAN markets; driven by liquidity, attractive pricing and funding needs
 - Global investors increasing holdings in local currency bonds; driven by higher bond yields, potential currency appreciation and strong growth prospects
 - Deepening national bond markets and harmonizing varied practices a key priority



Permission to reprint or distribute any content from this presentation requires the prior written approval of Standard & Poor's.

Malaysia's Debt Capital Markets



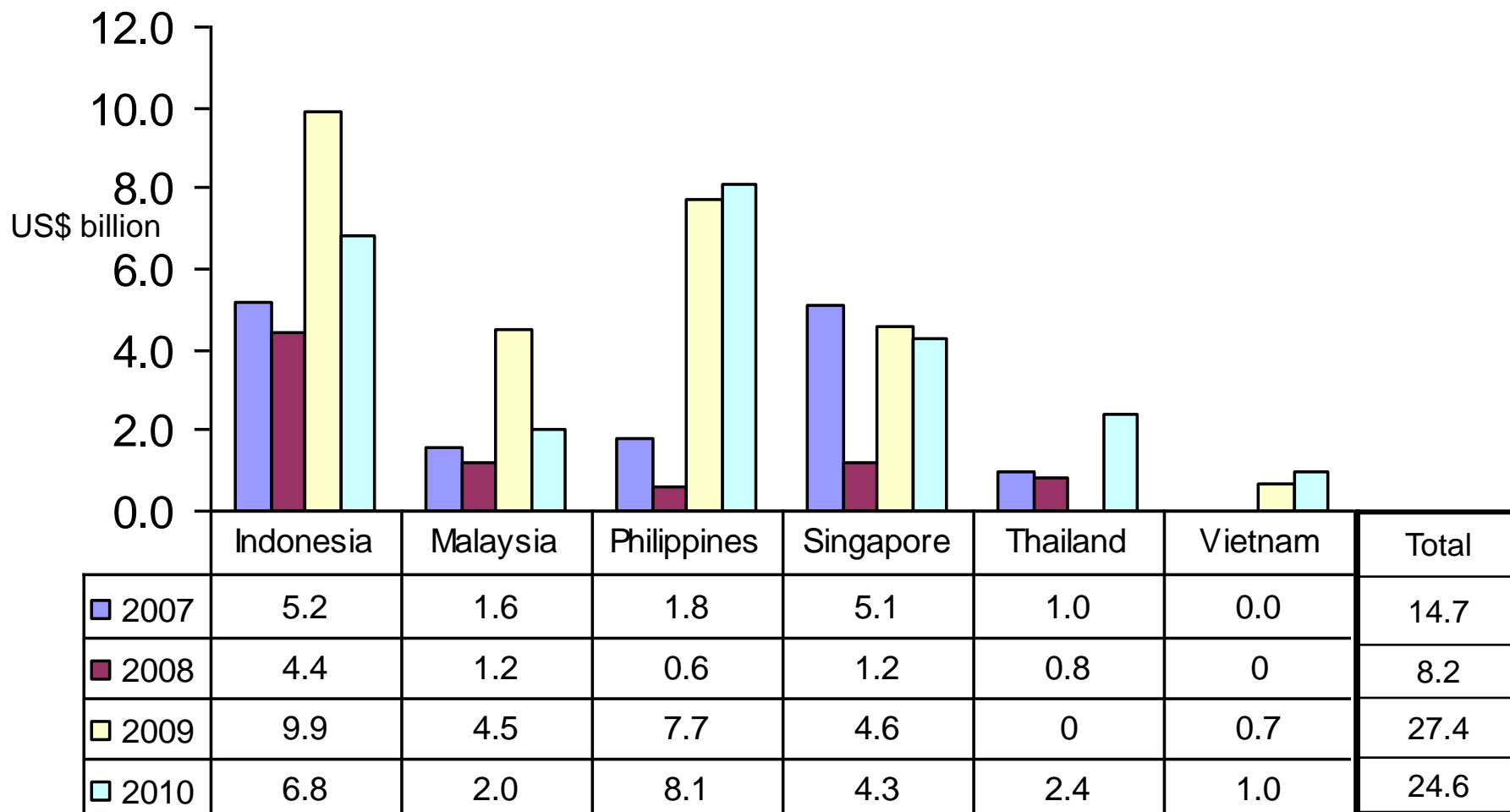
Market Trends

- **Strong GDP growth over the past decade**
- **Liquidity, cost-effective financing and unpredictable G3 markets driving growth of domestic bond market**
- **2010 total bonds outstanding in Malaysia domestic market aggregated \$247B; corporate bonds were \$101B**
 - Top 20 Malaysian issuers accounted for 46% of total debt outstanding at the end of 2010
 - Dominant issuers largely in infrastructure
 - Recently, the Malaysian Prime Minister announced a budget that includes large infrastructure spend which should increase issuance in 2011 and beyond
- **Malaysian domestic issuance is over 10x cross border issuance**
 - Withholding taxes on cross border issues discourage Malaysian issuers borrowing offshore
 - Foreign issuers are attracted by lower funding costs and liquidity
- **Malaysia is becoming the main Islamic finance centre in Asia**
 - Islamic debt issuance accounts for approximately 70% of Malaysia's domestic debt issuance, making it the largest Islamic bond market globally with over 60% of global sukuk issuance

Malaysia's Credit & Information Market

- The bond market's growth is supported by a strong market infrastructure:
 - transparent and predictable regulatory environment
 - existence of "risk-free" bonds of various tenors, possibility of repos
 - augmented by the introduction of a bond pricing service (the second Asian market beside Korea to have a bond pricing service),
 - bond guaranty organization (Danajamin) and
 - a credit bureau for corporates, SMEs and individuals.
- Higher returns, expected currency appreciation, limited cross border issuance from Malaysia, growth in regional savings and higher asset allocations to Asia have led to growing interest in Malaysia's domestic bond market. Foreign holdings in Malaysian domestic bonds grew steadily since 2005 to currently approx. 10%.
- Ratings are mandatory for all debt issues. RAM and MARC have been operational for more than 15 years
- Credit culture developing; providing support to innovation and market sophistication

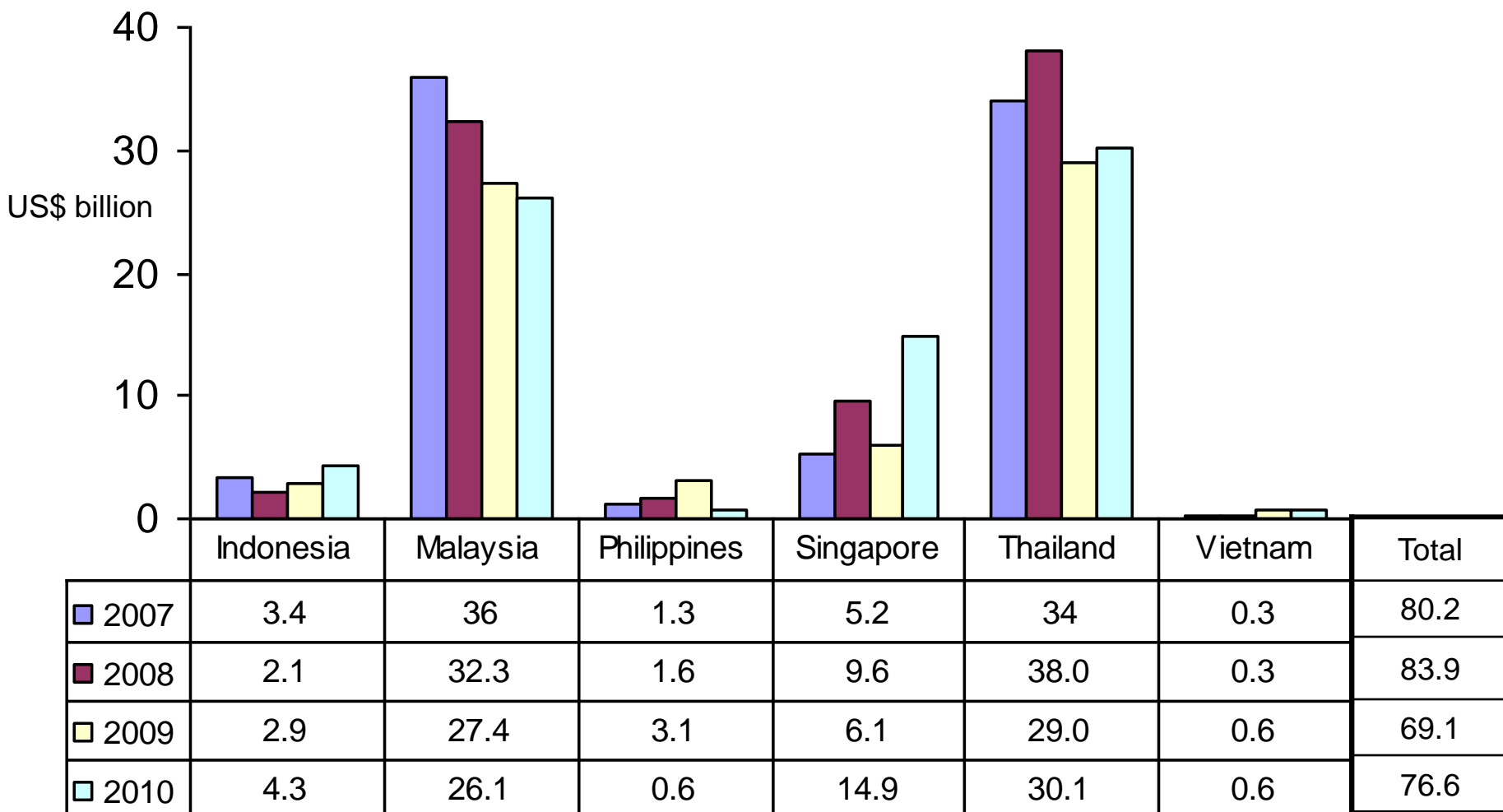
ASEAN Debt Issuance – G3 Issues (US\$, Euro, Yen)



Source: Asian Bonds Online

G3 markets for high yield choked over the summer of 2010 following market volatility. Gradually coming back for sub-region's high yield issuers

ASEAN Debt Issuance – Local currency issues



Source: Asian Bonds Online

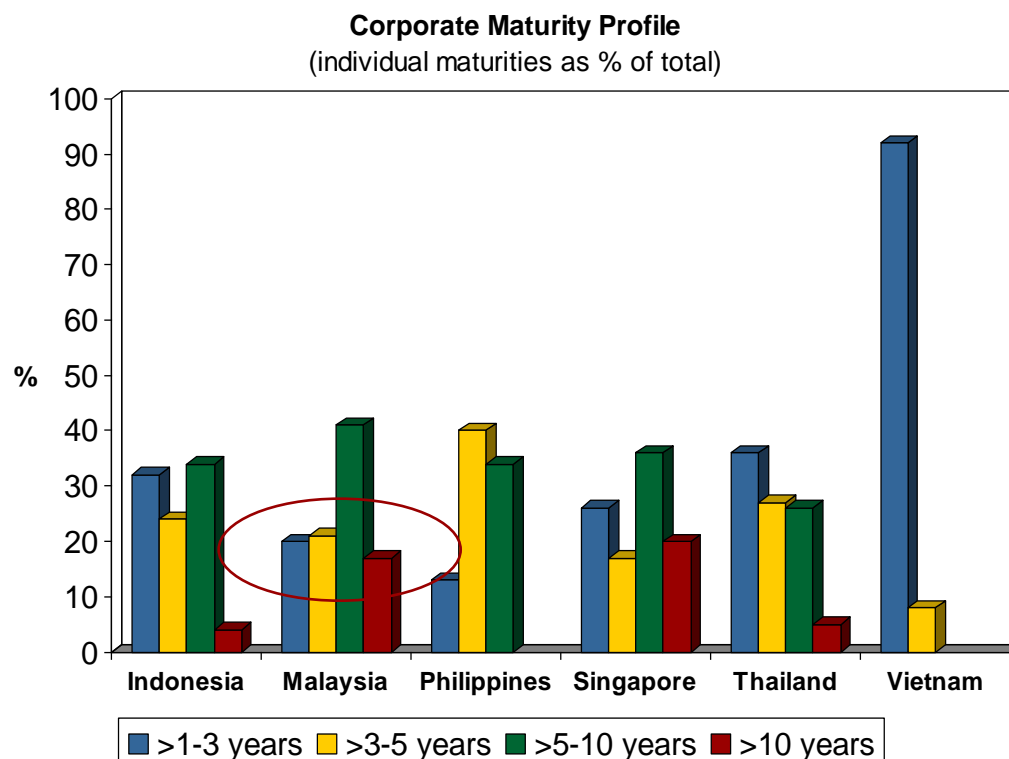
Efforts by ASEAN governments to develop local currency bond markets have succeeded in shifting issuers away from G3 markets to their local markets.

Issuer Concentration & Maturities Create Bottlenecks

Investors' risk diversification and investment choices constrained by issuer concentration

Short term tenors dominate markets creating challenges for infrastructure finance and issuers seeking long term funding

	Issuers	% of Total
Indonesia	Top 30	79%
Malaysia	Top 20	46%
Philippines	Top 20	80%
Singapore	Top 30	41%
Thailand	Top 30	75%
Vietnam	Top 10	91%



Source: Asian Bonds Online

Foreign Issuers and Investors Bring Benefits Despite Challenges

Foreign Issuers:

- Provide wider pool of issuers for investors and risk diversification
- Help build yield curve and pricing benchmarks
- Push local corporates to embrace international best practices, including transparency and governance

Offshore Investors:

- Increase diversity of participants and lead to improved liquidity
- Enhance transparency and build credit culture
- Reduce funding costs for issuers and increase availability of finance

but pose challenges:

- National markets lack depth for large issues
- Issues in long tenors rare
- Onshore investors have no appetite for lower rated issuers
- Crowding out local issuers and reducing liquidity

but face challenges:

- Withholding taxes
- Concentration of issuers
- Issues generally short to medium term
- Liquidity due to small issue sizes
- Regulatory restrictions on investors
- Enforceability of creditors' rights

Risk needs to be measured and priced objectively

What is a Credit Culture?

- Credit culture is the system of behavior, beliefs, philosophy, thought, style, and expression relating to the management of the credit function.
- A credit culture is made up of principles that need to be communicated.
- A credit culture is rooted in corporate attitudes, philosophies, traditions, and standards that require administrative underpinnings.
- The role of a credit culture is to create a risk management climate that will foster vibrant capital markets

Key elements of a Robust Credit Culture

- **Transparency**
 - disclosure, reporting standards and corporate governance
- **Independent objective analysis**
 - availability of credible high quality credit research
- **Risk based pricing**
 - investors compensated for risk assumed
- **Creditors' rights**
 - bankruptcy laws and enforceable legal system
- **Arm's length relationships**
 - between issuers and investors, governments and banking systems

Overview of Credit Culture in Key Asian Markets

China	Still developing corporate governance standards, legal processes and risk management practices
Hong Kong	One of the most mature credit cultures in Asia
India	Mostly sound but improving in some areas such as creditor's rights
Korea	Developing though some corporate governance practices yet to be fully embedded
Malaysia	Developing with sound market structure but with improvement needed for corporate governance
Singapore	Strong credit culture but constrained by relationship lending practices and over-banked environment
Taiwan	Developing with strong independent analysis but still developing corporate governance standards and some inefficient risk pricing
Thailand	Developing with improving market structure but still weak enforcement of its corporate governance code

Malaysia

Credit Culture:

- Sound, transparent regulatory and market structures
- Independent objective credit analysis
- Corporate governance standards moderate
- Enforcement of governance practices needs to be improved
- Limited shareholder activism and frequent corporate scandals

Bond Market Development:

- Poster child for bond market development
- 3rd largest bond market after China and Korea
- World's largest sukuk bond market
- Solid market infrastructure framework

Investors' perspective:

- Increasingly attractive for international investors
- Liquidity a concern given small issue sizes
- Protracted process for enforcement of legal claims

Standard & Poor's Initiatives to Connect ASEAN's Bond Markets

- Deepen partnership with S&P's affiliates in ASEAN to offer suite of rating scales and services for local, regional and global comparability
- Build capabilities for Infrastructure Finance and provide issuers, investors and regulators a better appreciation of relevant risk factors
- Build on strong progress of ASEAN Scale rollout
 - Over 70 issuer ratings published; over 150 ASEAN Scale ratings assigned
 - Discussions in progress with ASEAN's central banks and Securities Commissions on recognition of scale
 - Investor and issuer outreach; over 500 meetings completed with market participants as part of market education
 - Road shows planned for key ASEAN cities for education of broader market participants

Summary

- Capital markets are critical for financing growth and region's ambitions; bond markets are a key component of that imperative
- ASEAN rating scale
 - supports the development of an ASEAN fixed income asset class, attracting regional and foreign investors
 - facilitates integration of region's financial markets
- It will not happen overnight
- Once in place it will bring vibrancy and much needed sophistication

Appendices

Background to creation of ASEAN Regional Rating Scale

Imperatives for ASEAN's Capital Markets

Retain more of the regional savings within ASEAN

- Gross national savings for ASEAN countries approximate 30% of GDP
- Gross savings exceeds domestic investments by at least 10% of GDP
- Credit/deposits ratios at ASEAN banks low : 76% vs. 90% in Europe

Attract more global investments to ASEAN as an asset class

- ASEAN as an asset class has the potential to attract substantially larger funds than the aggregation of each constituent

Promote Intra-ASEAN investments

- Foreign shareholdings approximate 30-35% of equities in the region. However intra-ASEAN investment holdings are negligible

S&P ASEAN Regional Credit Rating Scale – What Is It?

- Provides an opinion on relative creditworthiness within ASEAN context
- Has been developed on a bottom up approach
- Issuers have the option of getting rated on the regional or global scale
- Uses the prefix “ax” to differentiate it from global scale
- Is based on the same rigorous criteria and methodology as Standard & Poor’s global scale
- Complements existing global rating scales offering finer credit risk differentiation within a regional context
- Features both long-term and short-term ratings

Mapping of ASEAN Scale to Global Scale Local Currency Ratings

ASEAN Regional Scale		Global Scale
Short-term Rating	Long-term Rating	Long-term Rating
axA-1+	axAAA	A and above
axA-1	axAA+	A- to A
	axAA	A-
	axAA-	BBB+ to A-
	axA+	BBB to BBB+
axA-1 to axA-2	axA	BBB
axA-2	axA-	BBB- to BBB
	axBBB+	BB+ to BBB-
axA-2 to axA-3	axBBB	BB to BB+
axA-3	axBBB-	BB
axB	axBB+	BB- to BB
	axBB	B+ to BB-
	axBB-	B to B+
	axB+	B- to B
	axB	B-
	axB-	
axC	axCCC+	CCC+
	axCCC	CCC
	axCCC-	CCC-
	axCC	CC
	axC	C
SD	SD	SD
D	D	D

Market Feedback on ASEAN Rating Scale

Issuers

- Access to wider group of investors: regional, local and global
- Potentially lower cost of funding
- Greater financial flexibility
 - *Choice of markets*: local, regional and global
 - *Choice of currencies*: national, regional and global
- More meaningful comparisons with peer group

Investors

- Finer distinctions of credit quality to support investment decisions
- Greater comparability of issuers across region
- Access to a wider and deeper pool of issuers
- Investment choices in regional currencies to match investment needs
- Can be mapped to global scale and probability of default

Impact of ASEAN Scale on the Market

- Could potentially lead to the creation of an ASEAN Fixed Income Asset Class

Global investors could follow the ASEAN scale ratings in addition to global scale ratings and national scale ratings to get a finer distinction of credit quality on a much wider list of companies, banks, insurance companies and government owned entities

- Large institutional investors (pension funds, provident funds, insurance companies and sovereign wealth funds) could develop an ASEAN bonds portfolio using ASEAN scale ratings
- These drivers could be harnessed in promoting pan ASEAN investments and could represent an important step in the ASEAN integration agenda

Singapore

Credit Culture

- World class market infrastructure and regulatory framework
- High standards of financial reporting and governance
- Widespread use of credit research
- Relationship based lending practices and over-banked environment

Bond Market Development

- Asean's most open bond market for global investors and issuers
- Cash rich companies and abundant banks constrain market growth
- Benchmarks for pricing across entire spectrum

Investors' Perspective

- Largest hub for fixed income asset management
- Wealth management centre supports investment hub
- Confidence in sound legal framework and investor rights protection

Thailand

Credit Culture

- Pricing benchmarks, bond exchange and credit research have driven market growth
- Corporate governance standards modest in an uncertain political climate
- Enforcement of corporate governance code is weak
- Reporting standards below international best practices

Bond Market Development

- 2nd largest bond market in ASEAN
- Top 10 issuers account for half of bond market
- Larger frequent issuers often have to borrow offshore
- Open to foreign issuers and investors

Investors' Perspective

- Improvement in legal framework is slow
- Modest protection of investors' rights
- Protracted process for legal claims
- Political uncertainty a key concern

STANDARD
& POOR'S

www.standardandpoors.com
