

Information, the new gold dinar

KNOWLEDGE IS POWER: Transparency and credibility can help build trust and reduce risk to investors

IRECENTLY had the opportunity to sit down with one of the leading experts in Malaysia on bond/sukuk valuations, Meor Amri Meor Ayob, chief executive officer of Bond Pricing Agency Malaysia (BPAM) Sdn Bhd.

He articulates some extremely important takeaways on the role and impact of information, from availability to transparency to credibility, on capital market development for both Islamic finance and Muslim countries.

We often hear about exporting Malaysia's Islamic finance model to jurisdictions wanting to be a complete financial hub. Malaysia may want to start with its flagship that measures the health and pulse of the fixed income market, BPA of Malaysia.

It's an interesting story that deserves an information spotlight.

In the Beginning

The history of the world or humanity can be defined by distinct period of advancements. To name a few as example, The Stone Age, the Agricultural Revolution, the Islamic Golden Age, the European Renaissance, the Age of Enlightenment and the Industrial Revolution are all characterised by a common singular cause: the explosion of information.

The development of Malaysia's bond and sukuk markets were also precipitated similarly. Introduction of various regulatory guidelines on the issuance process, as well as key market infrastructures such as credit rating agencies, automated systems for tendering, issuance and transfers of funds (FAST and RENTAS) and a trading dissemination system have contributed immensely to the growth in supply and demand.

Sustaining such a growth requires a very good legal as well as price discovery mechanism to enable market participants to be well informed of valuation levels and their rights. In this regard, Malaysia has in placed a very good legal framework which has shown its impartiality as well as fairness.

However, the issue of valuation remains a very grey area. This factor is very important as only with a strong valuation regime in place could one confidently assess the performance of Malaysia's bond and sukuk markets.

In the Beginning

A relatively recent piece to the jigsaw is the introduction of the Bond Pricing Agency concept in Malaysia. Since Bond Pricing Agency Malaysia Sdn Bhd (or BPA Malaysia) was established in 2004, the company has provided daily valuation for every bonds and sukuk traded in Malaysia.

For the first time, market players

have a valuation source that was established with the stated objective of being independent and conforming to the rules and regulations spelt out by the Securities Commission under the Bond Pricing Agency Guidelines 2006.

Despite having a regulatory based price discovery mechanism for market players, adoption of such a system requires a level of trust in the quality of output. For market players to be confident in the product, the highest level of excellence is a prerequisite for the service provider.

A formal feedback procedure must be made available to subscribers to query. The provider should also provide technical briefings as well as publish research papers to market players. These reactive and proactive measures can provide an invaluable insight into the valuation process.

The level of transparency helps build trust and confidence in the valuation system. This symbiotic relationship also helps the service provider to ensure its output is market relevant.

With eight years of data, there is now a treasure trove of information in BPA Malaysia. The company is now able to present data series as well as design sets of indicators that

could effectively show the performance and risk levels of any portfolio of bonds and sukuk. Coupled with growing acceptance by more market players for the service, the bond and sukuk markets have forged forward with additional momentum.

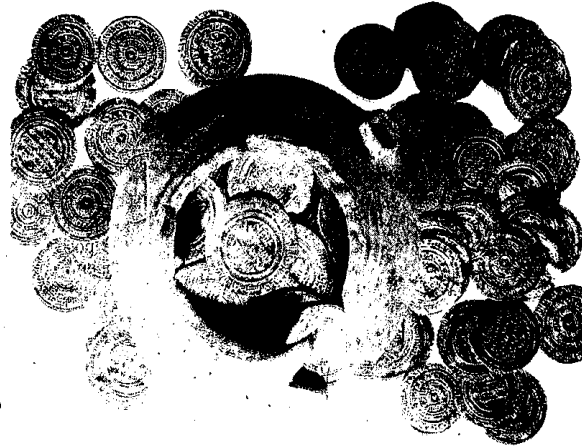
Information is Golden

Revitalising trading in the secondary market has been a goal for all market players. Published evaluated prices (or commonly known as "mark-to-market" prices) from a bond pricing agency acts as a price discovery system, enabling traders to assess the feasibility of initiating a transaction.

This same price discovery system can also help revitalise the primary market for bonds and sukuk.

From an origination and underwriting perspective, primary level pricing becomes challenging especially for lower credits. Mark-to-market pricing on previously issued corporate bonds and sukuk can promote new issues by functioning as benchmarks for primary level pricing.

The clarity of price discovery and engagement between market players, promotes the depth and breadth of new product development. The availability of data and the buildup of market professionals will spur the evolution of the bond and sukuk markets. When advanced pricing methodologies are established, it will encourage more bond offerings and more active trading of these prod-



Bond Pricing Agency Malaysia

Meor Amri Meor Ayob is the chief executive of Bond Pricing Agency Malaysia Sdn Bhd (BPA Malaysia). Over the last 6 years, Meor has progressively developed BPA Malaysia's core business to become the principal source of valuation and data reference on the Malaysian Sukuk and Bond market.

He continues to reinforce BPA Malaysia's position as a specialist in valuation and to expand its reach with its stable of innovative products, providing world class data in keeping with Malaysia's leading position in the global sukuk market.

He has a Masters of Business Administration with specialisation in Finance from the International Islamic University, Malaysia. He also has a Bachelor of Science degree in Actuarial Science from the University of Kent in Canterbury, in the United Kingdom.

ucts in the secondary market.

The effect of such advancement also supports the work done in accounting as well as financial institution space. The availability of mark-to-market prices for bonds and sukuk from an independent bond pricing agency easily satisfies the requirements set by the accounting standards to value these particular financial assets on balance sheet.

The availability of market based credit curves now allow risk based capital requirements to be implemented for financial institutions.

All of this brings together the necessary conditions for a scientific way to approach the bond and sukuk markets.

Solving the "Valuation Dilemma" is one of the "Holy Grail" in the fixed income world. Lack of transparency perpetuates the problems of information asymmetry and discourage existing players to do more as well as becoming a substantial barrier to entry to new players.

Firms that are incapable of attaining unbiased, transparent and independent valuation of their portfolios would consequently face problems in managing risk and effectively the whole business.

Risk, return and valuation are interrelated. Valuation provides a holistic solution to counter the risk challenges of dealing with illiquidity and increasing complexity of the

market. In addition, it promotes better capital return efficiency.

Quality versus Quantity of Information

History has shown the importance of quality valuation. The last decade alone, a number of financial crises in some regions of the world have shown the importance of fully understanding the ramifications of the pricing and valuation function. These events give a clear lesson not only why valuation is needed but more importantly, the quality of such services, if available, should not be taken for granted.

A laissez-faire attitude towards information can also create questions of accuracy and credibility. The onus of responsibility must be inculcated into each provider. Failure to conform to certain set standards can be costly for the market.

Unfettered right for anyone to provide data without the necessary safeguards could invite potential systemic risk for everyone.

BPA Malaysia is cognisant to this fact. The company has been working diligently for the last eight years to introduce new products and services to help market participants get the best relevant information for their fixed income and sukuk needs.

Credibility and capacity building are two focus areas for the company. Continuous open channel between

the company and the market has allowed BPA Malaysia to continuously evolve its existing products and services to conform to current market needs.

For example, the coming together of Thomson Reuters and BPA Malaysia to co-brand an existing index product in late 2011, confirms our belief that the company's products are of global standards.

This arrangement for the Thomson Reuters & Bond Pricing Agency Malaysia Sukuk and Bond Indices will provide a new global window to Malaysia's sukuk and bond market. From a global perspective, BPA Malaysia is contributing to Malaysia's aspiration to be a global financial centre especially in Islamic finance.

Conclusion

There are a number of important lessons that could be useful for other jurisdictions interested to replicate the Malaysian bond and sukuk growth story.

Capacity building in terms of regulatory framework and key market infrastructure is paramount. Using sports as an example, to play any game, understanding the rules and having the correct equipment allows players to compete fairly.

In a similar vein, such an environment must be made possible to encourage participations by market players as well as entice new players into the industry.

Every jurisdiction will have their own different level of economic, legal and market maturity. However, fundamentally, ingredients for growth remain similar regardless of development stage.

Availability, transparency and credibility of information; responsible stakeholders; clear rules of conduct; and strong investor protection regime makes potent growth drivers.

There is no secret ingredient for success. By making available the right conditions market forces will take over and make full use of it. This facilitate decision making as no market can progress or even operate effectively without having the availability, transparency and credibility of information.

The value of information in any markets has become higher than capital infrastructure and people. In current times, as evident from countless financial markets' boom and bust events, it is perhaps high time for everyone to recognise information as the most important and valuable commodity not just for financial markets but the entire economy for any country.

When something as intangible as information can move markets, its value becomes immeasurable, but BPA Malaysia has done a commendable job!

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