

Independent opinion needed on pricing

THE old assumption that pricing is best left to the experts may not hold true anymore.

In this case, it is the pricing of bonds, which is often considered a dry subject and the realm of big boys with big money to invest.

With vast amounts of personal and taxpayers' money invested in bonds, it becomes important for the ordinary man to find out if these bonds are properly priced.

He might want to know if they could have been sold cheaper to him as a result of better pricing.

"Hence, there should be an independent opinion on pricing," said Bond Pricing Agency (BPAM) CEO Meor Amri Meor Ayob. "Both issuers and arrangers can sit down and there is a point of negotiation."

The price of a bond reflects credit and market risks, as well as the interest rate environment.

Sometimes, corporates can be desperate for funding to fulfil certain project timelines and may just give in to any rate quoted. To their surprise, they find out later from the secondary market there could have been a cheaper rate.

For the larger companies, there is already a growing awareness of this need; BPAM has received good response to its reference pricing service.

Bonds is all about time value of money (how much a future sum of money may be worth today) and there is a maturity date.

So even if there is no trade, the price will move. As the bond gets closer to maturity, it will trade at par. However, the majority of bonds in Malaysia is not traded.

"We are trying to bridge the gap of the 99% (untraded) based on the movement of that 1% (which is traded)," said Meor Amri.

Companies in Malaysia have a strong credit and rating culture, which stands them in good stead when it comes to bond pricing. Other factors such as liquidity are also considered as relative pricing

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Price will only be good with willing buyer and seller

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(to certain benchmarks), realignments and valuations are being conducted on a daily basis.

BPAM's prices are used by banks and unit trusts. They are mandatory for bond funds as a reference point. Out of its client base, 24 fall under the mandatory regime while a good chunk is voluntary.

Bond funds' net asset value reflects the fair valuation prices generated by BPAM on a daily basis. Every day, the bond fund managers will download the prices from BPAM and calculate

accordingly.

Other institutional investors such as banks, insurance companies as well as pension funds subscribing to BPAM's services use their pricing for risk-management purposes as well as in their calculation of profit and loss.

"We come up with a fair valuation pricing which, in turn, is compared with any trade done in the market. In the process of fixing the price, we try to centre all valuations on market movements," said Simon Ng, head of pricing at BPAM.

"We are not saying this is the

price as it is only the market that can dictate the price. Price will only be good if there is a willing buyer and seller."

One misconception, said Meor Amri, was that BPAM created volatility in the bond market.

"It is because of comprehensive valuation," he said emphatically. "We price using relative pricing, which causes pricing to be more dynamic."

Previously, there wasn't any independent source with the sole objective of tracking prices and generating fair valuation on untraded bonds on

daily basis. Since the bond price is a function of time and interest, even if all else remains equal, the prices will continue to move every day.

"Without having a dedicated entity with the responsibility of ensuring that prices are correctly set, market players could easily misinterpret the market to be stable.

"(This can be misleading) when the 'stability' could be due to some proportion of the reference prices not properly updated," he said.

Actually, BPAM was only reflecting the true volatility in the bond market, he said.