

MARC Expands its Footprint in Islamic Finance

By Islamic Finance news

Malaysian Rating Corporation (MARC) is one of the country's two domestic credit rating agencies. It provides independent credit opinions and analyses of the financial strength of issuers, banks, insurance companies as well as ratings of corporate debt issues. These include ratings of capital market instruments and structured finance ratings.

MARC, with a present paid-up capital of RM20 million (US\$6.13 million), began operations in 1996 and quickly established itself in the Malaysian corporate bond market, particularly in the rating of Islamic debt securities. It undertakes ratings of corporates and corporate debt issues, including Islamic capital market instruments, asset-backed securities as well as the financial strength ratings of financial institutions and insurance companies. It achieved a milestone with the debut of a property-based Islamic asset backed securities (ABS) issue, the first of its kind in the Malaysian capital market.



MARC believes that the growth of financial markets depends on healthy financial institutions, a broad and deep market with active buyers and sellers, and a sound infrastructure including legal and judicial processes. Describing ratings as a useful tool in all of these areas, it says: "Financial institutions, once rated, strive continuously to improve their internal practices in order to earn higher ratings, which contributes to a reduced cost of funds. The regulatory authorities in some countries prescribe minimum rating standards for issuance of securities to the public and investors. The market aligns the cost of funding to the rating and thus forces institutions to aim for higher ratings."

Islamic Finance news recently obtained the views of MARC's senior vice president and head of business development, Roza Shahnaz Omar (pic), on the company's current performance, its direction, the Islamic bond market and its future.

How much of Islamic corporate bonds were rated by MARC over the last year? What is its market share?

There were 59 Islamic bonds issued for the whole of 2007. Of these, MARC rated 23, or 39%. Another seven Islamic bond issues or 12% of the total Islamic bond issues were dual rated, that is, rated by MARC and another credit rating agency.

In terms of value, the total Islamic bond issued for the whole of 2007 amounted to RM48.79 billion (US\$15 billion). The value of Islamic bond issues that were rated by MARC amounted to RM7.4 billion (US\$2.3 billion). A further RM2.1 billion (US\$644 million) Islamic bond issues were dual rated by MARC and another credit rating agency.

Has there been a slowdown in the issuance of Islamic corporate bonds?

For the first half of 2008, there were 31 Islamic bond issues, valued at RM12.3 billion (US\$3.7 billion). This is in contrast to the first half of 2007 when the number of Islamic bonds issued was 25 based on the value of RM6.7 billion (US\$2.1 billion).

Going into the second half of 2008, MARC expects the number and value of both the Islamic bond and conventional bond issues to drop slightly due to the more challenging macroeconomic environment as the rising bond yield environment is likely to persist in the second half of the year while moderating economic growth will result in lower financing needs.

MARC has revised its estimate of new corporate bond issuances (conventional and Islamic) for 2008 down to RM40 billion to RM45 billion (US\$12.3 billion-US\$13.8 billion) for 2008 from RM45 billion to RM50 billion (US\$13.8 billion-US\$15.3 billion). MARC's "2H 2008 Ringgit Bond Market Outlook" goes into this more comprehensively and can be read at www.marc.com.my.

What is MARC's criterion when performing a credit rating on Islamic corporate bonds? Has it changed over the years?

Islamic debt ratings are not fundamentally different from conventional ratings. The Sukuk issuances that MARC has rated to date have all been rated by applying conventional credit rating methodology. The main difference is Sukuk issuances have to be Shariah compliant.

The transaction structure of a Sukuk will have to be reviewed by authorities on Shariah matters pre-issuance and usually prior to the rating engagement. MARC has an in-house Shariah panel to provide consultation on Shariah-related matters and to offer oversight where MARC's development of rating products for Islamic financial instruments is concerned.

MARC also has a different set of rating definitions for Sukuk and non-Sukuk Islamic debt instruments. This contrasts with the approach of the global credit rating agencies which employ the same set of rating definitions for both conventional and Islamic financial instruments notwithstanding the prohibition against riba-based financing.

How well received are MARC's ratings in the Islamic finance industry?

In recent years, it has become apparent that the evolution of Islamic finance has progressed beyond a replication of conventional products to the development of real Islamic financing alternatives.

The foregoing has taken place within the context of the increasing amounts of Shariah compliant capital and accordingly, the demand for Shariah compliant financial products and services. MARC has kept pace with the evolution in Shariah compliant financial products and services and responded thereafter by introducing new rating products and rating symbols.

MARC, in providing ratings for Sukuk issuances, is the first rating agency to introduce a specific set of rating symbols and definitions for the ratings of Islamic capital market instruments. The analytical framework for rating Islamic bonds is broadly similar to that used for conventional bonds.

There are no major differences in MARC's rating approach for debt-based Islamic financing instruments. These ratings specifically assess the likelihood of full and timely payment of obligations to holders of the instrument issued under the various debt-based Islamic financing

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contract(s), which can be likened to the concept of probability of default in conventional debt ratings.

MARC assigns Islamic bond ratings on long-term and short-term rating scales that are comparable to its other credit ratings. The scale ranges from 'AAAID' to 'DID' for a long-term rating (with maturity of more than one year), and from 'MARC-1ID' to 'MARC-DID' for a short-term rating (maturity of up to one year).

Since 2001, MARC has also been assigning Sukuk ratings to fixed income Sukuk issuances. In common with MARC's conventional debt and Islamic debt rating scales, the long-term Sukuk rating scale comprises eight rating categories ranging from 'AAAIS' to 'DIS', while the short-term rating scale ranges from 'MARC-1IS' to 'MARC-DIS.'

The introduction of a different set of symbols for Sukuk obligations recognizes the fundamental difference between Sukuk and other fixed-income Islamic debt obligations. Sukuk are asset backed, Shariah compliant investment certificates, usually used in conjunction with an Ijarah (lease rental) structure or a Musharakah (profit-sharing structure).

Again, the rating focus for fixed-income Sukuk is on timely payment with added analytical emphasis on the "beneficial interest" conferred by holding a Sukuk. This "beneficial interest" represents a proportional ownership of the underlying asset as well as the income that is generated by the asset.

The analytical framework employed in rating Sukuk broadly resembles that of ABS. The first Sukuk that was rated by MARC was First Global Sukuk, a special purpose vehicle of Kumpulan Guthrie, for US\$368 million.

MARC has also appointed its own Shariah Advisory Panel to advise on Shariah aspects of Islamic financial instruments and review/endorse new or variations to Islamic rating products and rating definitions to ensure that they comply with Shariah requirements. In this regard, should MARC be the appointed rating agency for the transaction, issuers and investors also have the added validating endorsement of being Shariah compliant from MARC's own Shariah Advisory Panel.

We had in early 2008 acquired a stake in Islamic International Rating Agency (IIRA) based in Bahrain. The foray into Bahrain enables MARC to tap into the existing rating products offered by IIRA and possibly introduce them in Malaysia.

The market players are receptive to MARC's initiatives in the rating of Islamic instruments. MARC will constantly review and monitor the development in the Islamic finance and will continuously conceptualize new rating products in line with the rapid growth of Islamic finance.

How does MARC rank with other international rating agencies such as Standard & Poor's, Moody's and Fitch?

Conceptually, MARC's debt ratings are relative rankings of credit risk intended to compare credits across industries and credit types, but within the national setting. On this rating scale, AAA is defined as the lowest-risk tier of credits, which notably includes the Government of Malaysia, and 'C' as the highest-risk.

In its 12 years of operations, MARC has established a credit rating process which is robust, systematic, clear and can be applied continuously and consistently to achieve its main objective of providing credible and independent ratings. To ensure high-quality and integrity of its rating process, the detailed procedures instituted are largely governed by the company's various policies and controls system.

Under MARC's rating process, systematic procedures have been put in place which are designed to ensure that its analysts are able to reasonably identify, understand and analyze, information relevant to the issue and issuer to produce thorough and fair credit opinions. In terms of quality of rating, we conduct our rating with a high level of integrity and professionalism at par with the international rating agencies.

With the steady growth of the Takaful market, does MARC see a need to also assign ratings to the Takaful and reTakaful companies?

The Takaful business is set to further expand its role as an alternative to conventional insurance and continues to gain importance and significance. A rating on an institution which offers Takaful would provide the market with a useful means to benchmark the institution against its peers.

Importantly, such ratings could help promote high levels of disclosures and transparency as well as provide an impetus to enhance the corporate governance of an institution offering Takaful services.

Looking ahead, what does the future hold for MARC in the Islamic finance industry?

The Islamic finance industry in Malaysia, especially the Islamic bond market, has enjoyed impressive growth in the past few years. For example, the value of Islamic bonds issued in the first half of 2008 is 84% higher than the previous corresponding period.

Although MARC foresees headwinds in the issuance of new Islamic bonds in the second half of 2008, this will not derail the long-term growth potential of the Islamic bond market. The Islamic finance industry will form one of the main pillars in Malaysia's financial market.

MARC, as one of two credit rating agencies in Malaysia, is well positioned to enhance its participation in this growing market. ☺

Next Forum Question

The lack of demand for Islamic hedge funds is primarily a Shariah concern. Some say it is a complex structure which lacks investor attraction, while others believe it has great potential in the Islamic finance industry. What are your views?

If you would like to air your views on the next Islamic Finance Forum Question, please email your response of between 50 and 300 words to Christina Morgan, Forum Editor, at: Christina.Morgan@REDmoneygroup.com before Wednesday, 6th August 2008.