IOSR Journal of Business and Management (IOSR-JBM)
e-ISSN: 2278-487X, p-ISSN: 2319-7668. Volume 20, Issue 12. Ver. V (December. 2018), PP 40-44
www.iosrjournals.org

Islamic Securitization Conceptual Framework in Malaysia

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Abstract: *Asset securitization began in 1970 when the Government National Mortgage Association (Ginnie Mae) of the United States introduced planned funding of mortgage pools. This situation affected the financial market for matured and successful securitization loans to control the mortgage market in the United States. Asset securitization is now a highly important factor for both consumers and businesses. In the United States, Europe, Japan and East Asia, asset securitization is growing significantly and attracting many investors to explore the asset securitization market for a diversity of asset investments and increased profitability.*
It has subsequent to the credit disaster where investors are yet anxious with elevated danger delightful and unbalanced asset cost that loses appetite in conservative economics, accordingly rendering the development of Islamic economics in worldwide incident. Due to this fact, its excellent development has been energized by rolling demand for shariah acquiescent merchandises from bankers in the Middle East and other Muslim regions. Based on a review of the literature, this research proposed a conceptual framework of Islamic securitization in Malaysia.
Keywords: *Islamic Securitization, Asset-Backed Securities, Subprime Mortgage, Sukuk, Malaysia*

Date of Submission: 17-12-2018 Date of acceptance: 01-01-2019

I. Introduction

In the case of Malaysia, the Malaysian Market Cagamas, was formed in 1986 based on Fannie Mae and Freddie Mac of USA (Gangwani, 1998)[1]. Therefore, Cagamas utilities as a Special Purpose Vehicle (SPV) between investor of long term funds and house mortgage lenders, is the major imperative matter of securities tools in Malaysia by far. Securitization market in Malaysia was only estimated at RM45.5 billion at the end of 1996 and this is due to the fact that the other parts of asset, instead of Cagamas, have not been very strong. Near the end of 2007, the United States (U.S.) faced a subprime mortgage crisis and that created a nationwide banking emergency which contributed to a global fallout and affected several countries in the world by the end of 2007. Bakri et al. (2014) [2] stated that Malaysia was blessed for having been protected from the high-impact repercussions of the American subprime mortgage crisis. However, this situation was not felt in Malaysia until the last quarter of 2008 when Asset-Backed Securities (ABS) stalled and then began to fall because investors had become more cautious in investing their money. This research gives a brief synopsis of the Islamic securitization framework in the Malaysian financial market.

II. Review Of Literature

The main purpose of the SPV is to ease the assets securitization and to guarantee that the SPV is recognized for bankruptcy goals as a lawful entity divided from the seller. Blum and DiAngelo (1997) [3] in addition to Choudhry and Fabozzi (2004) [4] state that the assets marketplace where these securities are traded and made compromises three major categories: mortgage-backed securities (MBS), asset-backed securities (ABS) and collateralized debt obligations (CDO). Securitization issues are reversed by debt obligations, named CDO and securitization issues are reversed by mortgages named MBS (Fitch Ratings, 2004 and Nomura, (2004) [5]. Securitization issues reversed by customer-reversed merchandises including consumer loans, car loans and credit cards which are named ABS (Moody's Investors Service, 2002). [6]

Normally, the asset securitization marketplace is poised of ABS, MBS and CDO. Due to the dissimilarities in the assets connected to the securities, the pertinent pricing issues for these securities must be different, as well. As argued before, securitization is the increasing of money during a procedure of issuing ABS from revenue making asset that makes prospect cash flows (Fan, Sing, Ong and Sirmans, 2004) [7] . Asset securitization, however, is different from customary asset-oriented lending and collateralized debt where the loans or supplementary monetary claims are allocated or sold to a third party, characteristically a SPV or a trust. Based on the Giddy (2000) [8] , principal payments and interest are reliant on the cash flows impending as of the fundamental assets where SPV makes single or additional debt tools, ABS.

The financial disaster that started a slump in US housing marketplaces as a rising quantity of hedge and banks funds created considerable losses on MBS and subprime mortgages. The disaster has gradually structured as the primary months of 2007. For example, at the end of 2007 February, the Federal Home Loan Mortgage Corporation (Freddie Mac) promoted that it will no more purchase the riskiest subprime mortgages. It means that a great piece of the securitization and origination process of subprime MBS will force to be transferred to the private section. Standard and Poor and Moody's Investor Services that demoted over 100 bonds, it was reversed by second-line subprime mortgages in June 2007. However, a main pace in the direction of a spiraling disaster was highlighted by Fitch Ratings' choice in August 2007 to demote one of the main companies particularly in intermediation of mortgage in the subprime division, Countrywide Financial Co. consequently, Countrywide was enforced to use the whole $11.5 billion obtainable in its credit lines through additional banks. It was a tender proof that the disaster was intended to increase from the finance marketplace to the monetary mediators reversing its operators (Guidolin and Tam, 2013) [9].

Nonetheless, it is attractive to mention that the 2007-2010 periods, the Malaysian securitization marketplace has been quite downcast. With regard to RAM (2011), [10] despite the fact that the Malaysian securitized assets performance has been mostly resistant from the 2008 US finance disaster it has undergone from the spill-over impacts that curbed domestic craving to prepare business merchandises counting Islamic bonds.

To mirror the international praise disaster, the Islamic bond marketplace was devoid of exemption when its issuances in 2008 went down to US$7.3 billion or 54% refuse of US$15.7 billion in 2007. It creates a brawny reply in 2010 with an enormous worth of US$51.5 billion, showing an excellent increase of 54% in comparison to 2009. Similarly, it is attractive to mention that Malaysia is yet considered as the primary issuer for Islamic global bond by controlling about 54% in 2008, 60% in 2009 and excellently at 78% in 2010 with an enormous worth of US$40 billion as discussed by[11] (Zawya, 2011). From now on, the subsequent part will explain Islamic securitization.

III. Islamic Securitization

Islamic economics has worn the marketplace self-assurance in the direction of conservative economics. It has subsequent to the credit disaster where investors are yet anxious with elevated danger delightful and unbalanced asset cost that loses appetite in conservative economics, accordingly rendering the development of Islamic economics in worldwide incident [12] (Hesse, Heiko, Andreas and Juan, 2008). Due to this fact, its excellent development has been energized by rolling demand for shariah acquiescent merchandises from bankers in the Middle East and other Muslim regions. The major famous appearance of securitized praise economics in Islamic Finance is sukuk. It compromises a broad variety of shariah acquiescent finance tools that can be extremely illustrated as a contribution credential from real asset possession. This has resulted in the investor's revisit with regard to profitable speculation. Securitization ilustrates a simple capital marketplace in the shape of Islamic Finance since it is asset reversing, commercial speculation, and exact credit contribution in distinguishing commerce danger measured to be a basic standard to any Islamic transaction.

Fascinatingly, covered bond or ABS is likewise prepared to sukuk bonds where they can have considerably dissimilar fundamental provisions and structures. Most prominently, sukuk bonds are require to fulfill with the shariah that certified come back or interest from speculation are forbidden as the payment and receipt of interest stipulate that profits must be extracted from a fundamental genuine business danger or real asset. A conservative pass-through expense arrangement appears to be nearer to the severe understanding of Islamic values, which needs the move of the smallest amount of possession to guarantee straight investor contribution in the business danger linked to the dedicated collateral pool performance of securitized assets.

In the meantime, Islamic securitisation has been slow to take off. In contrast to the broader corporate bond market where sukuk accounts for almost 90% of annual issuance, only a third of the structured finance market constitutes sukuk issues. One of the commonly quoted reasons for the slow growth of structured sukuk in the securitisation market is related to the time taken to ensure the appropriateness of the nature of the pooled assets and the Islamic principles applied. At the same time, there has been little incentive for banks to pursue securitisation as a means of funding. With healthy capitalisation ratios of at least 13%, banks prime candidates for securitisation given their underlying loan portfolios do not prioritise securitisation given their strong capitalisation level. However, there is a strong argument for Islamic securitisation as the next engine of growth for the structured finance market, given that Islamic finance tends to relate to asset financing. So long as these assets are structured in accordance with Islamic principles, asset-backed securitisation appears to be convincing as the right financing product for Islamic institutions.

Even in the face of such challenges, the domestic structured finance market has grown tremendously in terms of structural innovations and maturity. Despite the idiosyncrasies of the Malaysian structured finance market, it has achieved a number of milestones in its relatively short history, including a number of global firsts: the first sukuk to be backed by plantation assets and the first Islamic RMBS.

The 3-year period between 2004 and 2007 had witnessed rapid development and progression; the first RMBS (Cagamas MBS, CMBS 2004-1) was issued in 2004 while the first equity-based Islamic Sukuk (by PG Municipal Asset Berhad) was issued in 2005, as was the first plantation-backed CMBS (by Golden Crop Returns Berhad). Although not rated, the first NPL securitisation came to the market in 2007, via 2 offerings (from Neptune ABS One Berhad and Neptune ABS Two Berhad). Since the introduction of the SCs Guidelines on REITs in January 2005, six REITs have sought funding through the capital market, with a total rated value of RM1.1 billion. The issuance of Cagamas SMEs Credit-linked Notes in 2007 also led to several achievements, including the first synthetic securitisation. Until then, most of the securitised financial assets had been limited to consumer loans such as vehicle loans, consumer loans and residential mortgage loans.

The following section presents a snapshot of some of the noteworthy deals rated by RAM Ratings in recent years, which offer a distinct structure or have notched up notable milestones. Cagamas SME's Credit-Linked Notes, issued in October 2007, lay claim to many firsts: it had been the first synthetic transaction, the first transaction involving the use of credit-default swaps, the first involving loans provided to small and medium-sized enterprises (SME), and the first rated issuance approved under the SCs Guidelines for the Offering of Structured Products. Given the government focus on SME growth, funding through the capital market provides some degree of disintermediation, and reduces the overall lending dependency on the banking sector. [13]

In early 2008, Menara ABS Berhad issued its RM1.0 billion sukuk Ijarah – the largest-ever issuance of property-backed securities – originated by TM, and backed by a portfolio of 4 office buildings. Similar to the transaction issued by ABS Real Estate Berhad (AREB) which was the first CMBS transaction to hit the market in 2004. Menara ABS transaction is a hybrid between a CRE-backed structure and a credit-tenant lease; the ratings of its Tranche B Sukuk reflected TMs debt-servicing ability. Unlike AREB, however, this transaction did not feature any buy-back options commonly seen in other CMBS transactions. Apart from the underlying Islamic contract to facilitate the sale and leaseback agreements, it also enabled the equity note holders to actively participate in the transaction structure. At the same time, the subordinated Tranche C sukuk holders had the option of providing funding support to the transaction and remedying trigger events. This offers another good example of how structured securities can be used to cater for the specific demands and requirements of varied investors.

Al-Aqar Capital Sdn Bhd RM300 million Sukuk Ijarah Programme, issued in February 2008, is the first CMBS backed by specialised assets. The originator is Al-Aqar KPJ REIT, a healthcare-based REIT; the collateral consists of 11 hospitals valued at RM660 million. Due to the unique nature of the securitised properties, this transaction features unconventional lease terms that are tied to the market value of the properties. It had also necessitated a different approach when assessing the sustainable value because of these assets specialised nature [14]

IV. Conceptual Framework

The proposed framework for this research in terms of shariah values, all Islamic securitizations need the formation of debt throughout the sale-and-lease based modes of financing to the subsequent conditions:

i) The asset which is being sold or rented should be real, not fantasy or theoretical;
ii) The lessor or seller have to own or have the merchandises to be leased or sold;
ii) The deal has to be a real trade deal with complete purpose of taking and giving delivery
iv) The debt cannot be sold and consequently, the risk connected with it should be borne by the lender himself.

These evaluations comprise the attendance of the asset or confidence over its performance, deliverability or accessibility at a prospect date that the asset can be delivered free from encumbrances. In addition that the asset is halal (lawful) with regard to the shariah and that the underlying subject matter can be sufficiently distinguished, categorized or distinguished without any ambiguity. Further, the asset is helpful to the Muslim Ummah and that the seller has possession over the asset.

The rent-based securitization initiates with the recognition of an appropriate fundamental asset. To be appropriate, the asset should be competent of both rental and sales. In terms of the contractual flow, the procedure generally commences with the originator selling the recognized asset to the SPV. The SPV will subsequently go into a rent agreement with the originator. The rent agreement makes a stream of profits in the shape of leasing expenditure in favour of the SPV. The SPV subsequently makes the sukuk that is invented to characterize a complete impartial possession over the rented asset.

V. Conclusion And Recommendation

Habitually, the fundamental asset in the Malaysian Islamic asset-backed transaction should not have any components that are not based on the shariah. The non-interest bearing assets were mere pooling only and does not routinely make an Islamic securitization system. It should be noted that every facet of the Islamic securitization agenda requires tobe Shariah acquiescent (Engku, 2006) [15] For example, separating the removal of the interest issue, the fundamental asset will also require to completely convince the supplementary conditions.

From the Islamic perspective, the sukuk purchaser efficiently purchases a piece of the rented asset, and therefore, turns it out to be the asset's co-owners. As owners, the sukuk-holders are the lessors to the originator, and are consequently allowed to the rental payments stream. Lastly, at the conclusion of the rent era (showing the development of the sukuk), the originator will cash the sukuk from the holders, efficiently purchasing back the fundamental asset from them.

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Nurayati Dabas. "Islamic Securitization Conceptual Framework in Malaysia." IOSR Journal of Business and Management (IOSR-JBM), Vol. 20, No. 12, 2018, pp. -.40-44.