IOSR Journal of Economics and Finance (IOSR-JEF)
e-ISSN: 2321-5933, p-ISSN: 2321-5925.Volume 9, Issue 6 Ver. IV (Nov. – Dec.2018), PP 67-70
www.iosrjournals.org

Securitization Performance Model in Malaysia

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Abstract: *In 1986, the Malaysian Securities Commission established Cagamas Berhad as the National Mortgage Corporation of Malaysia, based on the Fannie Mae and Freddie Mac guidelines or models in the United Stated. The objective of Cagamas Berhad is to develop the secondary mortgage market and to encourage home ownership in Malaysia. However, the growth of asset securitization in Malaysia is relatively slow because of originator hesitation, investor reluctance and the unclear position of the regulators. Thus, this study intends to fill the study gap that pertains to the performance of asset-backed securities firms in Malaysia. Most studies on the performance of securitization were done in other countries and they only focused on banks. However, no studies have been carried out on the performance of the firms, especially in Malaysia. Malaysia is currently suffering from the financial crisis and with the currency declining, not only is the performance of the securitized firms affected, the Malaysian economy is also adversely impacted.. Several studies reported that banks have high performances because of Asset-backed Securitization and the commonly used method for financial analysis is the use of profitability ratios such as net profit, Return on Asset (ROA) and Return of Equity (ROE)*

Keywords: *Islamic Securitization, Asset-Backed Securities, Subprime Mortgage, Sukuk, Malaysia*

Date of Submission: 16-12-2018 Date of Acceptance: 31-12-2018

I. Introduction

Ever since the United States introduced asset securitization in 1970, the development of securitization has continued to grow worldwide, including in the Malaysian financial markets. In the case of securitization in this region, Malaysia was recognized as the main division of the bond market in 1986 when the Securities Commission established and introduced a mortgage financing frame called Cagamas Berhad as the National Mortgage Corporation in Malaysia. The Fannie Mae and Freddie Mac guidelines from the United States were the models that Malaysia used to establish Cagamas Berhad. In 2001, after the country's Securitization Commission had established the regulatory framework for securitization, investors began investing in securitization assets and the securitization market grew.. A lot of research has been carried out on securitization performance, especially in the United States, Europe and East Asia. The results of these studies show that countries which practise securitization have managed to improve their profits and performance. However, there is a lack of research conducted in Malaysia to test a firm’s performance in the field of securitization. Due to the significant developments in securitization and the availability of supporting literature on the related theories and models, this researcher was motivated to study the strong performance of asset securitization in Malaysia by propose the research framework to fill the research gaps.

II. Review Of Literature

The first securitization was introduced in the United States (US) in 1987 and since then, it has spread around the world, to Europe and to Asian countries (Hill, 2002). The financial assets in the United States, for example, credit card receivables and mortgage were assembled and sold in the secondary market. This situation led the US government to introduce Asset-Backed Securities (ABS) to improve housing loan funding programmes in the United States. It resulted in ABS becoming one of the most effective financing tools to minimise the cost of funding for firms in the United States (Bakri et al., 2016).

Buchanan (2014) stated that the housing bubble, credit bubble, non-traditional home loan (mortgages), credit rating issues and asset securitization influenced the economic and financial institutions in the United States. This situation (a combination of liquidity risk, contagion risk, common shock, leverage and financial shock) negatively affected all firms and organisations which led to a decline in the performance of these entities. Lastly, this circumstance influenced the financial crisis in the United States in 1980 and caused the greatest financial crises. Financial institutions used securitization to comprehend the value of cash-producing assets, for example, traded receivables, mortgage loans and credit card loans.

At the end of 2004, the securitization industry in the United States had grown to USD6.6 trillion (Benmelech et al., 2010) The Basel Committee on Banking Supervision (2011) reported that securitization raised the accessibility of loans by transforming non-tradable financial assets into securitized assets that could be issued to investors. In general, half of the securitized assets in the United States, namely, Collateralized Debt Obligations ("CDOs") and Mortgage-Backed Securitization ("MBS") are sold to foreign investors. They include mortgages, farm and energy loans, commercial equipment leases, balance sheet receivables, student credits, commercial equipment leases, small business credits, credit-card loans, automobile credits, mutual-fund management fees and even the royalties paid on music.

Near the end of 2007, the United States unfortunately faced the subprime mortgage crisis and that created a nationwide banking emergency that contributed to the global fallout and impacted several countries in the world. Black (2008) stated that the subprime mortgage crisis occurred as a result of conflicts among securitization participants, transparency with regard to collateral, over-trust on rating agency risk models and deal structures. These made investors withdraw from the market and the market demand for securitization products declined.

Malaysia based its securitization model on Fannie Mae and Freddie Mac of the United States by establishing an organisation in 1986 that managed mortgages in Malaysia, known as Cagamas Berhad (Bakri et al., 2015).According to Ali (2015), securitization is the fastest growing and an innovative form of corporate and investment financing that is now widely used in every bank and several organisations. However, the growth of securitization in Malaysia is relatively slow because of the combination of originator hesitation, investor reluctance and the unclear position of the regulators.

According to the Report on Asset Securitization in Malaysia and Asian Development Bank, securitization in Malaysia started in 2001 when the country's Securitization Commission (SC) introduced the Capital Market Masterplan. This Masterplan outlines the strategic positioning and future direction of the Malaysian capital market and is the lead base for asset securitization by recommending an overview of the framework for the issuance of asset-backed securities. SC establishes the regulation framework for securitization by publishing private debt securitization ("PDS guideline") and asset-backed debt securitization ("ABS guideline"). Using this guideline, originators with an essential step-by-step guide to the regulatory approval process for securitization transactions. The Securitization Commission (SC) released its Guidelines on the Offering of ABS to pave the way for a CBO issuance by Prisma Assets Berhad (Dabas et al., 2017).

The purpose of asset securitization is as a strategy to improve the corporate bond market as a competitive source of financing. The financial crisis showed that there was a funding mismatch, mostly in the property sector where short-term debt was used to meet long-term needs. With the economic decline, many firms which had taken loans were unable to service their loan debts and that resulted in rising non-performing loans among local banks. Firms found that there was a demand for alternative long-term financing options and asset securitization was the best way to solve the problem. Firms with good capability were able to turn illiquid assets into liquid and tradable market instruments and to get low funding costs.

III. Asset backed securitization in Malaysia

Asset-backed securities (ABS) issued by separate tranches, or classes, of securitization have different risk ratings and revenues (Cerasi and Rochet, 2014). The highest credit rating is AAA, which is supported by junior tranches. An asset-backed security will usually have three tranches: class A, B and C. the class B and C tranches pay higher yields for the reason that they have a lower credit rating. The main forms of asset-backed securitization are mortgages loans, automotive loans, credit-card receivables, student loans and mobile home loans (Rahmah and Ll, 1997; Rügemer and Marr, 2008; Faltin-Traeger et al., 2010; AFME, 2013; Remsing, 2013).

Asset-backed securitization (ABS) was already accepted in the United States, Europe and Australia in 1985, but in Malaysia, the domestic market is only just being recognised in 2001 (Bakri, 2018). In the Malaysian capital market, asset-backed securities made slow growth with two issues in 2001 amounting to RM1.23 billion. Subsequently, in 2002, the value of ABS grew with four issues valued at RM1.92 billion. However, in 2003, the number of ABS issues fell to three issues but the ABS value was higher at RM3.11 billion. Next, in 2004, the number of ABS issues increased to six issues with a value of RM3.02 billion. In 2005, ABS Malaysia recorded a significant increase of 140% to RM7.0 billion although the number of issues was only eight. The growth of ABS was quite impressive; it recorded the highest number of 19 issues with a value of RM7.42 billion for seven years, marking the resurgence of asset securities in Malaysia. However, in late 2008, asset-backed securitization issues declined to RM2.34 billion.

Table 2.1: Total Amount of ABS Issuance in Malaysia for the Years 2001 to 2013

Year	Amount of ABS Issue
2001	1,235,390,000
2002	1,916,203,000
2003	3,116,500,000
2004	3,020,501,000
2005	7,006,468,750
2006	1,660,874,000
2007	7,416,000,000
2008	2,285,000,000
2009	1,287,088,000
2010	2,343,470,000
2011	1,402,500,000
2012	488,601,000
2013	517,000,000
Grand Total	**33,695,595,750**

Source: Bank Negara Malaysia.

IV. Conceptual Model

This part assesses the past research on discussions on theories or models in terms of the fundamental securitization performance. There are several models and theories related to performance. Most of these models and theories are not focused on securitized firms. Therefore, this study attempts to bring these theories into a different context of performance in respect of securitization. Among the models and theories related to performance are those by Pavel and Phillis (1987), Pennacchi (1988), Lockwood, Rutherford and Herrera, (1996), Chen *et al.*, (2005) and Sarkisyan *et al.*, (2009). The fundamental theoretical framework for this research is extension from Corporate Debt Pricing by Sarkisyan et al., (2009) because this theory suggests that securitization provides the financial institution with an opportunity to lower the cost of funding, improve credit risk management and increase profitability. The theory is very well suited to the title of this research and some authors have adopted the theory. In addition, the theory is the latest. However, this theory focuses on internal factors of firms. Thus, this research added external factors. Therefore, this study has two models (internal factors and combination of internal and external factors) in order to look at the importance of external factors to the firm. The general estimation model is specified as follows:

$\mathrm{P}it = \alpha 0i + \beta 1\mathrm{ASSET}it + \beta 2\mathrm{LQD}it + \beta 1\mathrm{LVG}it + \beta 4\mathrm{OPR}it + \beta 5\mathrm{INFit} + \varepsilon it$ (3.1)

where P is performance, ASSET is Firm Size, LQD is Liquidity, LVG is leverage, OPR is Overnight Policy Rate, INF is the Inflation, $0i$ is the constant term, while β is the slope coefficient and εit is the error term where i stands for the i th firm and t for the t th period.

MODEL 1

PERFORMANCE = f (Asset, Liquidity, Leverage,)
$\mathrm{PERFORMANCE}it = \alpha 0i + \beta 1\mathrm{ASSET}it + \beta 2\mathrm{LQD}it + \beta 3\mathrm{LVG}it + \varepsilon it$ (3.2)

The study by Zabri, Ahmad and Wah (2016) used return on assets (ROA) and return on equity (ROE) as dependent variables to measure the financial performance for banking, where ROA is net income before interest expense divided by total assets for the same period. The study indicated that the total revenue was generated from invested capital assets by shareholders and all stakeholders, in addition to the combined profits and efficiency of the firm (Chen et al., 2005).. The ROE is income before interest expense divided by the total shareholders' equity for the same period. ROE has proven to be a reliable measure of performance for corporate stakeholders. It is also suited for determining short-term and long-term performances for most investors. In conclusion, ROE shows investors how much profit the firm can make, using the money invested by the shareholders in the firm.

In any organisation, its performance is the main concern of many interested parties, such as the shareholders and the economic experts. In other words, the main focus of all the concerned parties in any organisation centres on revenue. This worry stems from the idea that the performance of profit-maximising corporations, like banks, is manifested in their profitability position and the high retention of customers (obligor). The commonly used method for financial analysis is the use of profitability ratios as key measures of a firm's overall efficiency and performance. Various studies examined different variables that may influence a firm's performance as its survival or business success mostly depends on its profitability (Niresh and Velnampy, 2014)

V. Conclusion And Recommendation

Several studies reported that banks have high performances because of Asset-backed Securitization and the commonly used method for financial analysis is the use of profitability ratios such as net profit, Return on Asset (ROA) and Return of Equity (ROE). Virtually nothing has been studied specifically on performance in securitized firms in Malaysia. Most of the previous studies on bank performance used financial analysis as the method. In light of the knowledge gap, this study seeks to provide the empirical evidence, particularly on securitized firms in Malaysia and measure the use of profitability of a firm.

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Nurayati Dabas. "Securitization Performance Model in Malaysia." IOSR Journal of Economics and Finance (IOSR-JEF) , vol. 9, no. 6, 2018, pp. 67-70.