

By Chris Wright

Local currency funding has been growing in importance in Asia's mainstream debt markets for some time. Now, asset-backed markets are following suit. A string of home-currency deals shows the region's securitization markets are still breathing.

# Asia goes local

International bankers will tell you that Asia's securitization markets have all but died out in the credit crunch. That's not quite true: they've just gone local.

In March, India's ICICI Bank brought ex-Japan Asia's largest securitization to the market during the past year — but did it in rupees. China Construction Bank has launched the first non-performing loans securitization from a Chinese bank — a landmark deal — done not in dollars but in renminbi. China's currency was also chosen for the country's first ever auto loan, launched in January by GMAC-SAIC, followed by a more than billion-dollar equivalent deal from ICBC in March. And when Telekom Malaysia launched an issue of property-backed Islamic securities,



Local produce is so often the best

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the largest ever securitization of property assets from Malaysia, it opted to do so in ringgit. In fact, the only people still bothering with the dollar are the Koreans, and even then only sparingly.

The box on page 32 spells out what was special about these deals. But underpinning them is an important point which may have a long-term impact: the growing relative importance of local currency funding. That's already evident in the mainstream debt markets — a response, in part, to the rapid withdrawal of international capital from the region after the 1997 crisis — and now it seems clear that the asset-backed markets are following suit. Of the 10 largest asset-backed deals out of ex-Japan Asia up to April 17, just one was in dollars and none in euros. In the short term, that's a natural consequence of problems in the global credit markets. But the proof comes when the credit crunch eases: if it sticks, then a major structural change will have taken place.

"I think in the long term, local currency markets will take the center stage in securitization," says Alec Yang, a director at Barclays Capital. "As local investors become more familiar with the asset classes and structure, they will be more willing to invest in these securitization products. With the liquidity crunch, this is really the time for investors to realize they could get comfortable with local currency issues."

It's already happening: Yang points out that total asset-backed local currency issuance in Malaysia last year was worth \$4.3 billion — the entire ex-Japan cross-border market only hit \$5.6 billion. "The marketplace can't ignore local currency." He expects Taiwan local currency ABS issuance to increase dramatically in 2008, too, "because liquidity is still quite abundant in local currency.

In places like Hong Kong, Taiwan and Malaysia, liquidity is not an issue. There are going to be more and more issues where you take the local currency and avoid cross-border execution.”

Cristina Chang, Asia head of global securitized products in the fixed income capital markets products group at Citigroup, adds: “It’s fair to say domestic markets are becoming more important. Issuers are considering whether deals can be placed in the local markets, and whether that works for them in terms of

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pricing and demand, given that the offshore markets now are fairly limited and the spread required is quite wide.” Boudewijn Berger, who heads asset management for ABN Amro in Asia, adds: “All in all, the cash term market for cross-border deals right now is virtually dead, so that drives issuers even more to the local markets.”

Cross-border markets haven’t gone completely, but they are certainly quiet, for the obvious reason that much of the investor base has disappeared. “We are really just left with real money

investors,” says Chang. “The SIV-type or vehicle-type investors have really disappeared from the market. It’s resulted in a reduction of demand; it’s taken out one of the largest investor classes.” As Berger puts it: “For euro- and dollar- denominated transactions, investors in Asia have been affected equally to any other investor on the globe. It doesn’t make any difference whether you buy an ABS in Orange County or Norway or here in Asia.”

#### **Greater exposure**

Issuers face the same malaise as elsewhere in the world too. For cross-border deals, many issuers have traditionally launched transactions in dollars backed by multi-seller conduits, as is the case globally. “Those transactions are exposed to higher funding costs overall for these conduits,” Berger says. “And it’s a public secret that some transactions that were structured as term deals ended up in conduits or SIVs, and quite clearly these transactions are now also taking a hit.” For new transactions, “pricing has increased substantially, for term transactions but also for asset-backed conduits that are still up and running.”

What little demand is left in cross-border deals is concentrated in pockets of activity, chiefly involving Korean assets. A \$400 million auto funding deal for Hyundai Capital, led by Standard Chartered in January, was a rare beacon for cross-border deals. Correspondingly, Standard Chartered is the

## **Tapping into the home market**

Innovation is alive and well in Asian securitization markets, as several deals show.

In January, Telekom Malaysia completed an M\$1 billion (U.S.\$306 million) asset-backed issue combining commercial real estate and credit-tenant leases.

It was significant in several different measures, starting with its size: this was the largest securitization of property assets in Malaysia. More significantly, though, it was the first property securitization to comply with Islamic law.

Malaysia is in the middle of a huge push to make itself the global centre for Islamic finance — or at least the Asian centre — and this deal should be seen in that context. No country has put greater effort into building a regulatory and legislative environment for Islamic finance to flourish than Malaysia, and its Malaysian International Islamic Finance Centre promotes an open door policy to attract foreign Islamic institutions in to the country. Building Islamic securitizations is part of that process. This one uses a technique called sukuk ijarah.

The deal involved a special purpose vehicle called Menara ABS, set up to buy four properties from Telekom Malaysia and lease them back to it for 15 years. The deal

had eight distinct tranches, ranging from 15 years to seven and from triple-A (local rating) to unrated. This deal was handled by Citigroup. Its hybrid combination of asset risk and tenant risk was particularly unusual, but allowed investors to take exposure to the risk they were more comfortable with.

Also in January, GMAC-SAIC was the originator and servicer on a RMB1.993 billion (U.S.\$249 million) securitization backed by auto loans, the first of its kind in China. GMAC-SAIC is a joint venture between General Motors Acceptance Corp and Shanghai Automotive Industry, and the deal represents nearly 30% of its loan portfolio. With many other auto finance firms active in China, this is expected to open a whole new market.

This deal had two tranches: a RMB1.67 billion issue, rated triple-A by local agency Dagong International Rating, and a RMB235 million single-A rated tranche. Pricing was 155 basis points (bp) and 250 bp over the one-year deposit rate respectively, near the top end of indicated ranges.

Another important China deal followed later in January when China Construction Bank completed an RMB2.77 billion deal securitizing non-performing loans — again, the first from China. Its NPLs were transferred to

a trust which issued two tranches: RMB2.15 billion were senior trust certificates, sold to institutional investors, and RMB615 million are subordinated trust certificates sold to China Cinda Asset Management. Cinda was one of four bad-loan disposal agencies set up in 1999, one for each of the big four state banks.

Local institutions led both China deals: GMAC by Citic Securities, China Construction Bank by CICC.

In March came a deal from India which, while not especially innovative, was big and a much-needed sign of life in the markets. ICICI raised Rs49 billion (\$1.2 billion), the biggest securitization from Asia in a year. This deal combined four pools of loans: commercial vehicles, two wheelers, cars and personal loans — in that regard it was a first, in combining separate asset classes in a single deal.

The most encouraging thing about this deal is that it was reported at being priced at just 30 to 50 bp over corporate bonds with the same rating (triple-A). That’s a tighter spread than would have been expected, which appears to show greater demand than the broader market thinks there is for ABS paper.

only international bank to have been a bookrunner on a top-10 Asian asset-backed deal this year. “Investors are still interested in those traditional deals like mortgages, auto loans and credit cards coming out of Korea,” says Yang. “And in the last few months we have seen a few being done on a private placement basis cross-border.”

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*Alec Yang, director at Barclays Capital*

Korea has maintained a modicum of activity partly because of a widening of swap rates. “While the spreads on term and conduit deals have gone up substantially on the U.S. dollar Libor side, or euribor, the basis swap between U.S. dollar and Korean won has widened dramatically,” says Berger. “For the three year basis swap, and depending on the amount you are looking at, it is 250 to 300 basis points (bp). If a Korean issuer paid 150 bp over U.S. dollar Libor, and translated it back into their benchmark at the 91-day CD rate, they will have a funding advantage of 100 to 150bp. While Korean issuers might not be happy to have to show in the market that they are paying more on the dollar side, they still achieve quite cheap funding compared to Korean benchmarks.”

While local currency markets are a useful alternative source of funding, one should not overstate the case. Local liquidity gives borrowers in the region the constant option of going to the bank for their funding; it's partly for this reason that the markets have never taken off to the same degree as the rest of the world. “Asian issuers in general have been less reliant on these funding instruments,” says Berger.

And it is reckless to generalize. “It is difficult to talk about an Asian market,” says Berger. “All the countries are different in terms of the regulations, their legal systems, their level of activity. Some have relatively well developed markets, like Korea, Taiwan and India; others rely more on the cross-border side, such as Singapore.”

Besides, local markets don't offer everything. Malaysia's growth has been interesting, but it is mainly a domestic story, because the ringgit is still not a free-float currency despite the removal of almost all other foreign exchange restrictions in recent years. “So each foreign currency transaction still has to have Bank Negara approval: that's quite tedious,” says Yang. “But in terms of asset class variation, Malaysia is very interesting — there are a lot of exotic assets being financed through securitization, such as plantations, helicopter leases, lots of asset classes we don't often see.”

India is another market with convertibility issues, and transactions look a little different from elsewhere. “In India

it's more like a single loan repackaging by a bank,” says Berger. “First it's been provided to a company, and repackaged and sold off on the capital markets. It doesn't have any granularity or diversification in it.”

There are always local factors behind the development of these markets, which can be tricky to spot from overseas. In Taiwan's case, for example, activity is likely to pick up now that a general election has brought a more pro-China leader to power, which is considered good for Taiwanese business and finance generally. Additionally, many Taiwanese banks are hitting mortgage-lending limits imposed by the central bank there. “So for them to continue to grow the mortgage portfolio would need them to go for securitization,” Yang says. Several such deals were mooted at the end of 2007 but pulled because of market sentiment; they're likely to appear this year.

In other cases, there's regulation. China has previously rolled out guidelines governing residential mortgage-backed securities and collateralized loan obligations, but momentum slowed down when regulators decided to re-examine those guidelines in light of market developments. They're likely to reappear in the second half of 2008, when pilot programs may be launched.

When cross-border issuance returns, it's going to be simple. “We are looking at more traditional asset classes,” says Chang. “Ideally it's something like mortgage loans, credit cards



*We'll take anything — just not U.S. dollars*

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or auto loans; repeat issuers, where the rating analysis is quite established; and transactions that investors can get their head around and understand the assets.” Anything funkier than that, forget it. “If you're talking about a whole business securitization or a future flow transaction, where they are not so established and investors need to do more homework, that is much more difficult to sell.” ▼

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