



SPECIAL COMMENTARY

ABS Conference

Lanka Rating Agency Ltd (LRA) along with its parent company Rating Agency Malaysia Berhad (RAM) held a conference on Asset Backed Securities (ABS) at the Hilton on the 19 of June 2006. The conference attracted leading personalities from various fields who are interested in securitisation. The objective of the conference was to bring all the stakeholders of securitisation and stimulate discussion on the issues impeding the progress of ABS and to create awareness on how the regulators are seeking to resolve the issues raised from various quarters.

The conference commenced with the Chairman of LRA and Deputy Chairman of RAM, Datuk C Rajandram stating that it was a question on when the Sri Lankan debt market will flourish rather than if it would flourish in this country. He also expressed LRA's commitment to the development of the local bond market and further added that Sri Lanka can benefit immensely from the Malaysian experience. The Chairman's speech was followed by the Director General of the Securities Exchange Commission of Sri Lanka, Mr. Channa De Silva who expounded the potential of a local debt market.

Mr. De Silva cited the USA and many other developed and developing countries where the debt market constitutes 80% of the capital market while the equities' market garners the balance. He showed the audience present that SEC has taken the task of spearheading the ABS law in Sri Lanka and expressed optimism that the regulatory framework being envisaged would ensure that Sri Lanka truly benefits from these debt instruments.

Representing the Central Bank Ms. Joan De Zilva noted the two securitization transactions done by two banks in Sri Lanka were aimed at restoring the bank's liquidity and capital adequacy requirements. Ms. De Zilva also shared with the audience the concerns of the regulators regarding likelihood of some banking institutions misusing ABS and therefore Central Bank would issue guidelines in this regard.

Ms De Zilva's speech was followed by HDFC General Manager, Mr C A Sarathchandra, who said that securitisation transaction was done amidst a non conducive regulatory infrastructure viz absence of ABS law and other antiquated legislation. This rendered the transaction uneconomical. While from the legal perspective Mr. Naomal Gunewardene voiced his concerns that presently the greatest risk posed to ABS transaction was inadequate structuring and cautioned that arrangers maybe overlooking certain legal clauses in the interest of expediency. Mr. Gunewardene also emphasized that presently all parties to the transaction pay scant regard to post transaction surveillance. From the arrangers' perspective, representing First Capital Treasuries Ms Anoma Bandara noted that large investors are restricted by unfavorable government policies in investing in ABS instruments.

Sharing the Malaysian experience Mr Micheal Oh-Lau of AseamBankers, mentioned that the private sector in Malaysia realized that they were overly dependent on the banking system. He also showed that the government of Malaysia took the initiative and provided the private sector the required confidence to enter the bond market. Mr. Kalwant Singh of Aseambankers also showed the audience of a recent ABS deal. Aseambank presenters also shared with the audience that a typical ABS transaction cost is about 25 basis points (0.25%) and ABS transaction

becomes viable alternative for large scale investments. They also cautioned against high disintermediation costs which could also hinder the development of the instruments.

Mr Chong head of structured finance rating of RAM explained to the audience the components that make up asset backed securities and elaborated on how a rating agency dissects the structural components of the instrument in determining the rating. Mr. Chong also explained that ABS affords great flexibility as it is a rating driven product which allows the arrangers to structure the ABS instruments in to various rating trenches and yields, providing the investor and the originator the requisite returns.

Ms. Kerry Adbby who is presently being retained by the SEC as a consultant for the ABS project revealed the legislative and fiscal hurdles that prevent the country from realizing vibrant ABS market. Ms Adby also explained to the audience that Sri Lanka's problems are not peculiar to this country and all nations have resolved these problems by convincing the tax authorities that ABS does not deprive the department of its revenues. She also revealed that the ABS law that is being drafted is intended to be an ambit law, which possesses overriding powers of other laws.

The discussion which followed the presentations brought out various concerns the participants had on ABS. Salient points that emerged from the discussions were that, though market participants are interested in unlocking the potential of this financial instrument, there is a need for regulation, which will ensure tax neutrality in order to make it a viable product. Further, it came to light that investors needed to consider the instrument rather than the originator. Finally, ABS provides investors an arbitrage opportunity and implementation of ABS law was paramount to ensure that Sri Lanka realize its full potential.

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