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Local banks take long-term views (HL)

Mustapha Kamil

LOCAL banks will make a margin call on, or dispose of, shares used as collateral against loans only when absolutely sure a borrower cannot repay, banking sources say.

They said to shelve making margin calls indefinitely will affect banks' bottom lines and may also create a crisis of confidence among the international community with regard to the level of prudence in the domestic banking sector.

However, while this is so, the traditional practice of local banks is to take long-term views on their association with customers, the sources said.

"Maintaining good relations with their customers is of primary importance for banks here. In Malaysia, customers remember whatever their bankers do to them in good and bad times," one banker said.

Responding to a call to banks to use their wisdom when making margin calls and to give priority to national interest, the sources said local banks are expected to ride the current economic storm with their customers.

They went on to explain that there are primarily two types of share financing instruments in the Malaysian banking system.

The first is an off-the-shelf type of share financing packages, where banks impose minimum requirements to be met by the borrowers. These are mostly used by retail and individual investors.

The mechanics of the loan is fairly simple. If the share prices rise, the borrower profits while servicing the debts. On the other hand, if they decline, the investors would have to top up the value of the collateral shares as soon as possible lest the banks dispose of them.

The second type of financing collateralised by shares are those for corporations and large investors, usually either for purchases of large blocks of shares or for other strategic investments by the corporations.

In this type of facility, the banks would scrutinise the loan application, the profitability of the venture proposed and the credit-standing of the applicant.

The sources said probably the margin calls made by Malaysian banks thus far are those on the first type of financing.

They said this too would explain the continuation of selling activities on the Kuala Lumpur Stock Exchange (KLSE). Another probable explanation for the selling pressure on the KLSE could be the disposal of pledged securities by offshore banks in Singapore, from whom individuals or corporations could have borrowed.

In the second type of financing, local banks have been known to continue to assist their clients in weathering any market setbacks. This is also the practice of foreign banks incorporated in Malaysia.

On Wednesday, Bank Negara said the local banking system is capable of absorbing the effects of the setback on the stock market as loans using shares as collateral make up only 10 per cent of total lending. In addition, the ratio of the value of shares pledged as collateral remained favourable, at 146 per cent, as at the end of October.

Earlier in the week, Prime Minister Datuk Seri Dr Mahathir Mohamad had urged banks to use their wisdom when making margin calls and to adhere to government directives in the face of the current economic problems.

The sources said banking practice in Malaysia are unlike those in the

developed markets where banks are quick to dispose of pledged shares in times of weak prices, even at a loss.

For banks in the developed world, having to address problems such as diminishing values in pledged shares and the inability of customers to top up their margin financing is considered a waste of management time.

These banks would prefer to close the chapter, by disposing of the pledged shares and concentrating on new business.

On the tightening of loan facilities amid the weaker economic sentiments, it is only natural for banks to do so, as within an environment of increased business risks, banks would not want to continue increasing their exposure to loans, the sources said.

This, however, would not affect on-going projects and those considered strategic and of immediate need to the country. Banks will not want to stop financing projects half-way as they - buildings, for example - would have been charged as security for the loans. It is in the banks' interest to have them completed.

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