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BSN Commercial Bank (M) Fully Repaid Danamodal's Loan of RM420 Million

Danamodal Nasional Berhad

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Danamodal Nasional Berhad - the Malaysian approach to bank recapitalisation, revitalisation and restructuring

There was a general consensus that when the Asian financial crisis started in July 1997, the Malaysian banking sector was in a relatively healthy condition and more resilient : risk weighted capital ratio was 12%, i.e 4% higher than the minimum international standard as prescribed by the Bank of International Settlement (BIS), net non-performing loan (NPL) was at a historic low of 2.2%, and loan loss reserve to NPL was at a healthy 92%. Past initiatives have placed the financial sector in an improved position to withstand financial stress. Indeed, the industry had performed well over the last ten years due partly to continuous strengthening and improvement in the regulatory and supervisory framework shaped by government's policy towards progressive liberalisation and deregulation of the industry.

As the financial and economic crisis intensified, signs of stress within the Malaysian banking industry began to emerge. The currency crisis in the region led to massive outflow of funds from the regional economies causing severe liquidity crunch and curtailment of business and commercial activities within the real sectors. The ability of businesses to service their debt obligations was seriously impaired. Consequently, there was an unprecedented rate of increase in NPL among banking institutions and generally, accelerated deterioration of the banking institutions' asset quality.

Asset quality problem in banking institutions caused deterioration in their profitability and in some institutions with weak balance sheet positions, their solvency was threatened. These institutions reacted by curtailing their lending activities, which worsened further the liquidity problems faced by the real sectors. Concerns were raised by the public in the ability of these institutions to absorb fully the impact of the crisis should it worsen.

The continued and efficient functioning of the payment system and intermediation role of the banking institutions were called to question. Confidence in the safety and soundness of the banking industry in general was also put to severe test.

The Government's Response

In July 1998, the government through the National Economic Action Council (NEAC) announced a comprehensive National Economic Recovery Plan (NERP) to bring about stability and expedite economic recovery. One of the objectives of the NERP is to maintain financial market stability through the preservation of the integrity of the banking system, establishment of special purpose agencies to address specific problems in the industry, recapitalisation of the banking sector, monitoring of the credit creation process, improvement of the capital market, and the development of the private debt market.

Danamodal - Averting a full blown banking crisis

Danamodal Nasional Berhad was incorporated on 10 August 1998 as a fully owned subsidiary of the central bank. Its specific tasks are to recapitalise, revitalise and restructure the banking sector.

The establishment of a special purpose vehicle (SPV) to undertake the system-wide recapitalisation exercise serves several objectives. It allows greater focus, speed, allocation and commitment of necessary resources, and establishes accountabilities that ensure results. Delays in addressing recapitalisation will create a drag effect on the financial and economic recovery process. Speedy completion of the banking sector stabilisation program becomes the impetus for accelerated economic recovery. It is important however that Danamodal's activities are in tandem and well coordinated with those of other agencies involved in the economic recovery plan such as Pengurusan Danaharta Nasional Berhad (Danaharta) and the Corporate Debt Restructuring Committee (CDRC). Coordination of the activities of these agencies is undertaken by a Steering Committee established at Bank Negara Malaysia, in addition to leadership and guidance provided by the NEAC.

Danamodal's Mission and Vision Statement



DANAMODAL'S VISION AND MISSION STATEMENTS

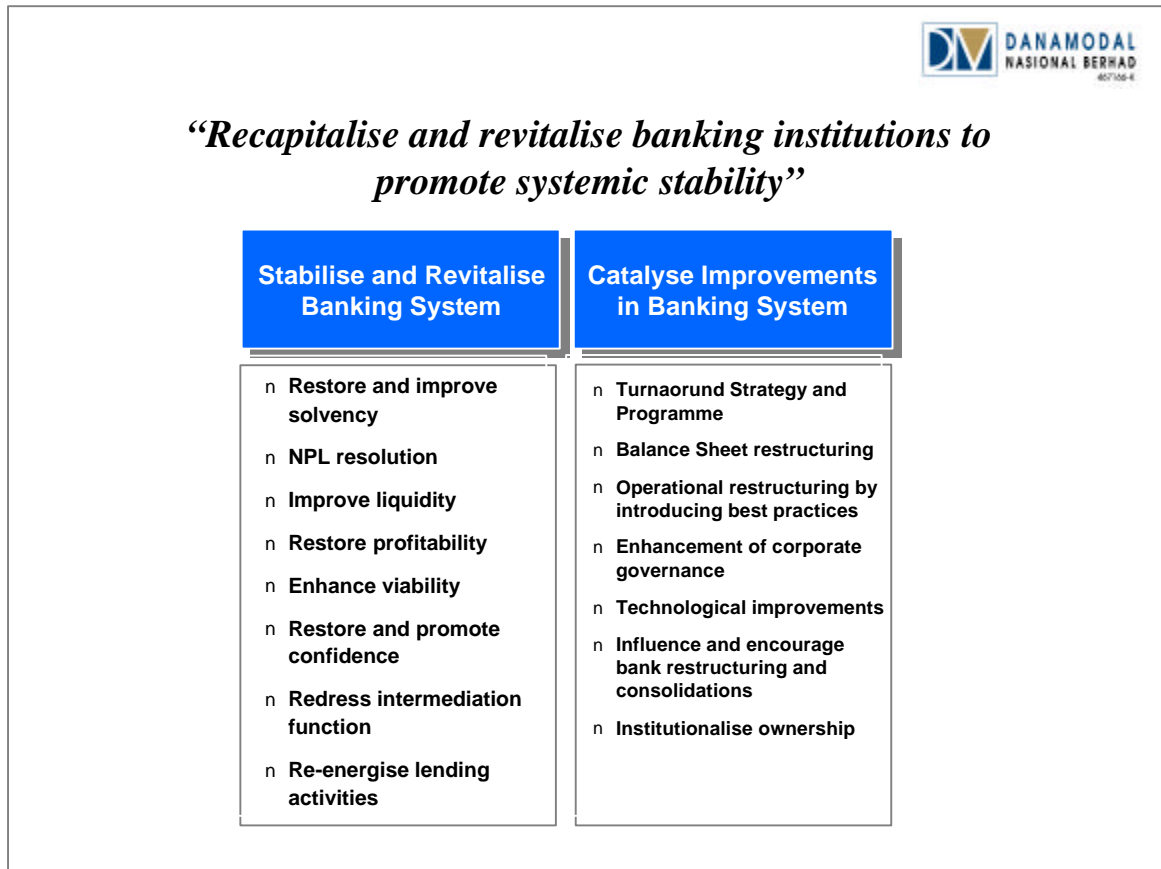
Danamodal's mission is to **revitalise** the financial services industry in Malaysia. It will achieve this by **recapitalization** of, and **active management** of its investment in, banking institutions. It will act within the framework defined by Bank Negara Malaysia in an independent, fair and transparent manner.

Revitalization will be measured by institutions being **competitive** and **well capitalised** and showing **sustainable levels of profitability**, and having **good corporate governance**. Danamodal's financial objective is to operate profitably over its lifetime, but successful revitalization will be given higher priority than maximizing returns

In order to achieve these objectives, Danamodal will intervene as required by **influencing corporate governance structure and process** and helping to set the **management agenda**. Danamodal will exit or **divest its stake**, when restructuring and financial criteria have been accomplished, or can be, achieved without it's roles.

The roles of Danamodal

A stable, healthy and dynamic banking system is crucial to the recovery of Malaysian economy. Prompt restoration of confidence in the banking system and smooth functioning of intermediation functions are the key objectives of Danamodal's missions. Once these are accomplished, the focus of Danamodal will be to play a role and facilitate changes and reforms at micro level. Danamodal will play a supportive and complementary role in the overall government's program towards the consolidation and restructuring of the banking system.



Danamodal is expected to ensure that the banking sector recapitalisation process is commercially driven and that investment decisions are made on market-based principles. It strives to avoid moral hazards and promote shareholders' vigilance. Danamodal encourages private sector solution within a framework of strategic government intervention with a view to minimise use of public funds and achieve an optimal balance of public policy and commercial objectives.

Danamodal envisages that it will have a finite life of not more than 5 years. By then, the short and medium term objectives of recapitalisation would have been achieved. At the same time, it is expected that during this period the longer term objectives of systemic consolidation and restructuring would have shown significant progress and realisation. More importantly, Danamodal would have

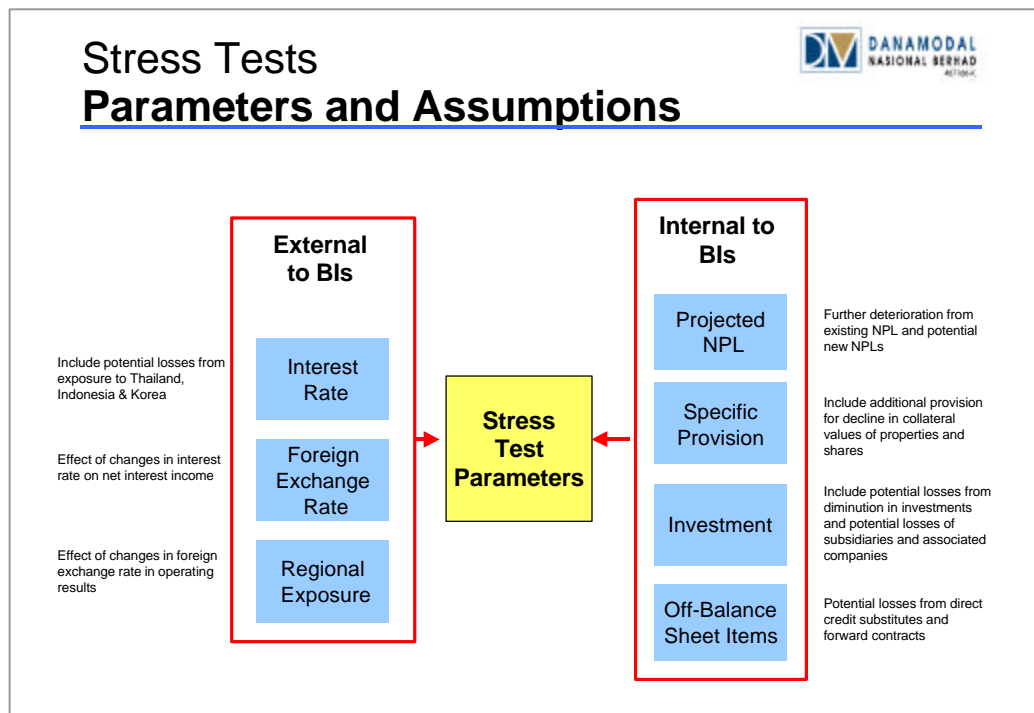
played critical roles in preparing the industry to face the challenges in the next millennium.

The future Malaysian banking industry will be characterised by well managed, efficient, resilient, strongly capitalised, technologically advanced and globally competitive domestic banking institutions. These institutions will have adequate profitability to fuel business growth, adequate investment in innovative products and services, competent management which is accountable to shareholders for results, lending practices that encourage economically sound projects, and subject to an efficient balance of market influences and regulatory process.

Funding for System-wide Recapitalisation

Since the beginning of the economic turmoil in mid 1997, BNM has intensified the monitoring of the financial health of the banking institutions and continuously assesses the impact of the deteriorating asset quality and profitability of these institutions on their solvency.

In May 1998, BNM undertook an intensive industry-wide stress test to ascertain the potential recapitalisation requirements for the Malaysian banking system should the regional crisis worsen. The stress tests were conducted on a case-to-case basis using a set of assumptions and parameters which were stringent and highly conservative.



These assumptions and parameters were tailored to each institution based on its specific characteristics and historical performance, and were continuously validated against actual data as the regional crisis unfolded.

Stress Tests



Generic Assumptions Under Various Scenarios

| | Scenario 1 | Scenario 2 | Scenario 3 (worst case) |
|--|------------|------------|----------------------------|
| 3-month KLIBOR | 10% | 12% | 13% |
| Exchange Rate USD/MYR | RM4.00 | RM4.50 | RM5.00 |
| % decline in property prices | 20% | 30% | 50% |
| % decline in KLCI (from 470) | 10% | 15% | 20% |
| Loss rate from exposure to : | | | |
| ▫ Indonesia | 20% | 30% | 50% |
| ▫ Thailand | 10% | 15% | 20% |
| ▫ Korea | 5% | 10% | 15% |
| Projected Peak NPL (institution specific) | | | |

The results of the stress tests indicated that under the worst case scenario, a total of 14 banking institutions would be very likely to experience varying degrees of insolvency problems. A total of RM12.8 billion would be required to restore the risk-weighted capital adequacy ratio of these institutions to not less than 9%. In addition, 11 banking institutions were identified as having lower likelihood of getting into less serious insolvency situations. Nevertheless, these 11 institutions were placed under constant and close monitoring. An estimated amount of RM1.6 billion would be needed to maintain the risk-weighted capital adequacy ratio of these 'watch list' institutions at not lower than 9%. After providing a contingency amount of 10% or RM1.6 billion, the total amount required for system-wide recapitalisation was estimated at RM16 billion or about 12% of GDP. The recapitalisation exercise was to be carried out in 2 phases : the first phase involving 14 institutions and the second phase involving 11 institutions, both to be completed by end of June 1999.

System-Wide Banking Sector Recapitalisation



Estimated Recapitalisation Requirement

| Category of Banking Institutions | Nos of BIs | | Amount | | Recapitalisation required to maintain 9% RWCR (RMb) |
|----------------------------------|------------|---------|---------|---------|---|
| | Phase 1 | Phase 2 | Phase 1 | Phase 2 | |
| Comercial Banks | 8 | 5 | 8,586 | 475 | 9, 061 |
| Finance Companies | 3 | 6 | 3,603 | 1,094 | 4, 697 |
| Merchant Banks | 3 | - | 579 | 52 | 631 |
| (10% buffer) | - | - | - | - | 1, 611 |
| Total | 14 | 11 | 12,768 | 1,621 | 16, 000 |

The Recapitalisation Process

The tasks involved in recapitalisation process are multi-level, knowledge-intensive, and in some situations, highly technical. Danamodal has identified five core processes which it has to perform in order to achieve its mission, as briefly described in the table on this page.

| | Core Process | Objective | Tasks |
|--|---|--|---|
| <p>Assessment of Recapitalisation Requirement</p> <p>Recapitalisation / Investment And Funding</p> <p>Exit</p> | Assessment of recapitalisation requirements | <ul style="list-style-type: none"> To assess the criticality of capital deficiency To quantify the amount of capital required by the banks to withstand the full impact of the crisis | <ul style="list-style-type: none"> Establish the framework to assess capital needs Establish methodologies and tools to assess recap requirements Conduct due diligence Quantify capital needs |
| | Recapitalisation/ Investment | <ul style="list-style-type: none"> To speedily inject capital into viable banking institutions To structure investment in order to optimise safety, control, return, capital adequacy, exit potential and monitoring capabilities To satisfy stakeholders' expectation To maintain or promote objectivity, consistency, independent, credibility of process. | <ul style="list-style-type: none"> Establish selection criteria and assess each potential candidate against these criteria, which will include (but would not be limited to): <ul style="list-style-type: none"> Criticality of capital deficiency Systematic impact of the bank's failure Non-feasibility of market solutions Potential synergies to be realised through consolidation specific requests from shareholders Formulate options Structure the recapitalisation investment (i.e. price, terms and conditions, type of securities) Negotiate with banks on recap amount, valuation, timing, mode of investment, representation, and other terms and conditions Finalise contractual agreements |
| | Financing of the Recapitalisation | <ul style="list-style-type: none"> To obtain cost-effective funds to finance Danamodal's recapitalisation initiatives | <ul style="list-style-type: none"> Ascertain the funding requirements vis-à-vis quantum and timing Evaluate financing alternatives (sources and modes of financing) Liaise with BNM and other agencies to ensure a well-coordinated capital and fund raising programme |
| | Restructuring and Monitoring | <ul style="list-style-type: none"> To restore stability. To effect turnaround. To use shareholder's rights to inject best practices, promote managerial excellence, enhance operating efficiency, and improve profitability To protect the value of investments through constant monitoring of financial, operational, and managerial performance of banks To promote consolidation and restructuring of the industry | <ul style="list-style-type: none"> Participate actively in the corporate governance process Influence management agenda Establish performance targets and regular reviews of performance/status Act decisively and effectively in dealing with deviations from expectations Formulate restructuring strategies and determine specific policies and instruments for achieving the goals Seize opportunities to strengthen the banking sector through consolidation and restructuring |
| | Exit | <ul style="list-style-type: none"> To dispose of Danamodal's stake in banks and optimise returns on Danamodal's investments and the achievement of restructuring objectives | <ul style="list-style-type: none"> Determine timing and amount of disposals Evaluate disposal alternatives <ul style="list-style-type: none"> initial public offerings (IPOs) strategic sales direct sale to market Distribute gains on disposal to Danamodal's shareholder |

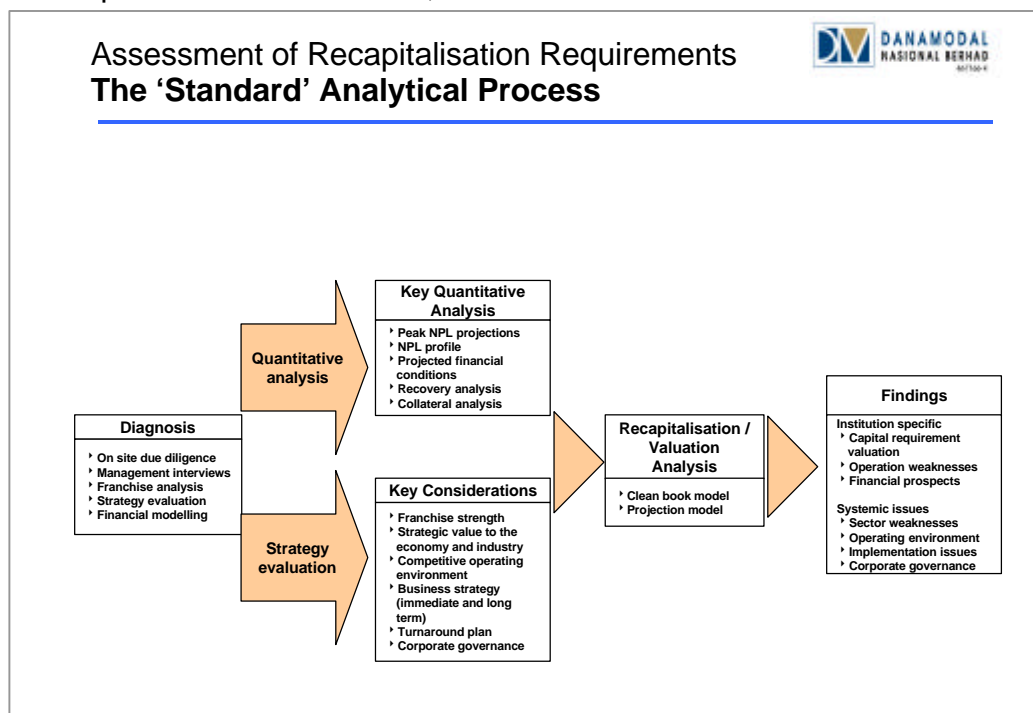
Transparency and Credibility of Recapitalisation Process

Danamodal adopts and brings into the country the best practices in banking sector recapitalisation, focussing on the objectives of maintaining transparency and credibility throughout the process. The engagement by Danamodal of two world renown investment banks as its independent financial advisers - Goldman Sachs and SalomonSmithBarney, helps achieve these objectives. Other roles of the advisers include -

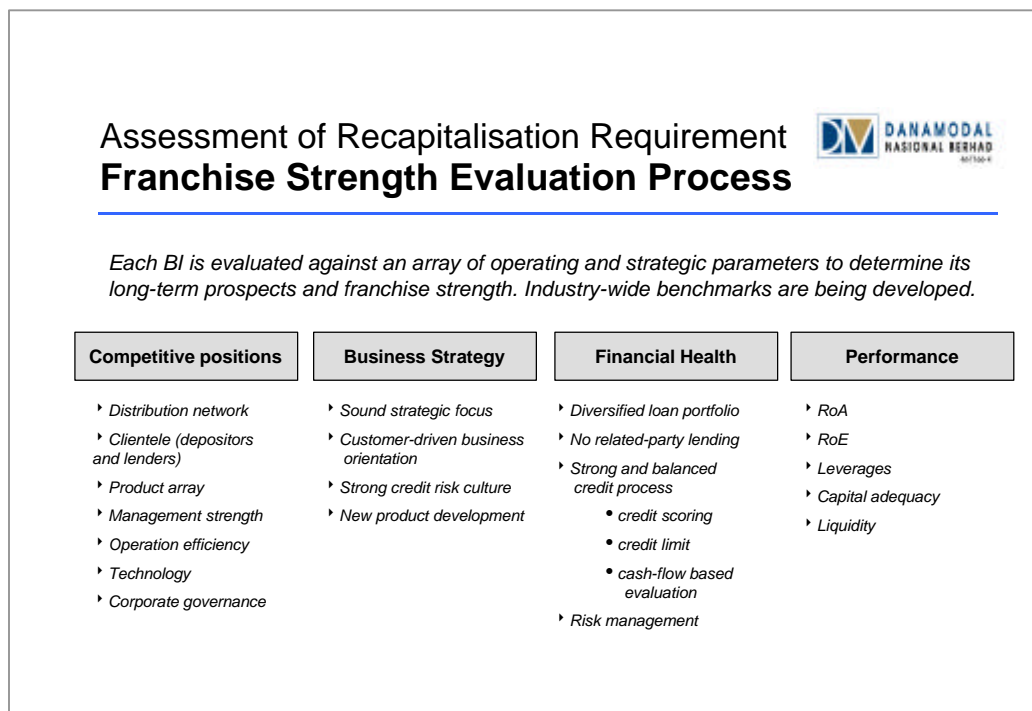
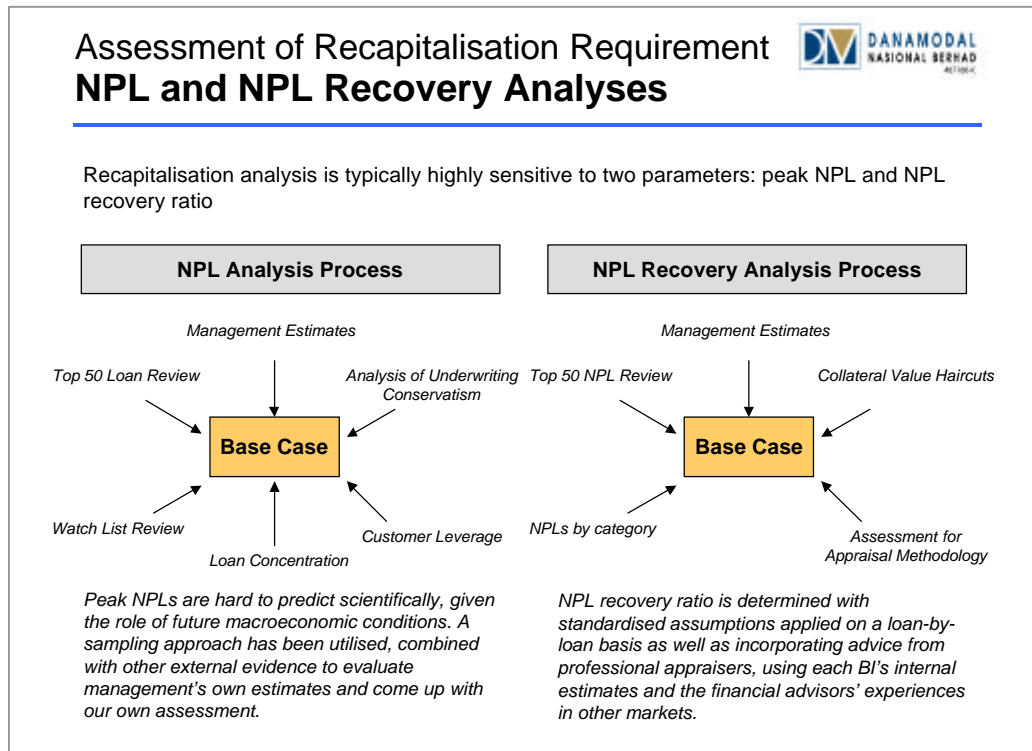
- Advise Danamodal on operational infrastructure setup
- Assist in the formulation of overall policies and procedures governing recapitalisation
- Provide immediately highly trained resources, thus bridging the learning curve gap
- Supplement Danamodal's resources needed to meet performance expectations
- Provide third party objective and independent viewpoint
- Provide expert advice, skills and methodologies to ensure effectiveness of recapitalisation process.

Core Process 1 : Assesment of Recapitalisation Requirement

The process is highly critical and involves a rigorous three-step exercise under "standardised" parameters, using proven techniques and methodologies. It aims to maximise the precision of the overall analysis and findings, ensure equitable treatment to all institutions, speedy completion and establish credibility. The process is diagnostic in nature, and addresses both financial and non financial aspects of the institutions, as summarised below :



Two crucial groups of tasks involved in the assessment of recapitalisation requirement are the Non Performing Loan (NPL) and NPL Analyses and Evaluation Of Franchise Strength at each institution. The important elements in these two groups of tasks are summarised below :



Core Process 2 : Recapitalisations / Investment

Central to the recapitalisation and investment process is the negotiations with the stakeholders to arrive at the final terms and conditions of the contractual agreement between Danamodal and the shareholders of the BIs that received Danamodal's injection of capital. The so called Definitive Agreement (DA) spells out in details the structure of Danamodal's investment and various enabling provisions to allow Danamodal to achieve the above mentioned objectives. Whilst ensuring consistency, some variations in the terms of the DA were inevitable because :


- Each BIs presents a unique set of problems, issues and prospects, thus requiring certain degree of customisation
- The need for timely completion of the recapitalisation exercise prompted Danamodal to adopt a flexible and pragmatic approach in dealing with or resolving specific issues and problems.

Danamodal is guided by six primary principles in determining its investment structure in recapitalised banking institutions. Adherence to these basic principles will ensure consistency of treatment, avoid moral hazard issues, promote shareholders' vigilance, minimise use of public funds, optimise Danamodal's participation in the upside, and promote strong commercial orientation in Danamodal's operations.

Danamodal's Investment - General Principles, Policies and Guidelines

- Safety - Application of First Loss Principle which requires existing shareholders to absorb losses from past and present operations before Danamodal injects new capital.
- Control - The use of appropriate instruments or arrangements to maximise Danamodal's ability to influence managerial and operational processes.
- Return - To achieve an optimal balance of commercial and public policy objectives and avoid moral hazards.
- Capital Base - Effective resolution of solvency issues and compliance to internationally accepted capital adequacy standards.
- Exit Potential - Maximise flexibility for Danamodal's exit, while at the same time meeting the recapitalisation objectives.
- Monitoring Requirements - Ability to obtain data/information to allow effective performance monitoring.

The choice of instrument of investment appropriate to each specific case is determined taking into account the above consideration. Generally three main instruments are used : ordinary shares, irredeemable non cumulative convertible preference shares (INCEPS) and subordinated debts. Main considerations for the selection of appropriate instruments are summarised below :

| Danamodal's Instrument of Investment | |  | |
|--------------------------------------|---|--|--|
| Criteria for Choice of Instrument | Common Equity | Convertible Preferred Equity | Subordinated Debt |
| Adequate Control | <ul style="list-style-type: none"> Offers the most direct control through proportionate voting rights and Board Representation | <ul style="list-style-type: none"> Moderate control through Board Representation (attained only through negotiation) and potential of conversion into common equity | <ul style="list-style-type: none"> No control |
| Reasonable Return | <ul style="list-style-type: none"> Depends on the performance of the company Pro-rata share of upside. Upside potentially unlimited | <ul style="list-style-type: none"> In most scenarios, preferred dividend guarantees a level of consistent income If converted can participate in upside potential | <ul style="list-style-type: none"> Fixed at coupon level |
| Downside Protection | <ul style="list-style-type: none"> Potential for complete erosion of equity value if company performs poorly | <ul style="list-style-type: none"> Preferred dividend offers some level of downside protection Structural priority to common equity upon any liquidation proceedings | <ul style="list-style-type: none"> Highest downside protection behind senior debt through coupon payments |

The definitive agreements fundamentally allow Danamodal to influence the corporate governance structure and process in each institutions. Through effective board representation in the recapitalised institutions, Danamodal, could also influence the managerial as well as operational functions and processes. The salient terms and conditions of a typical definitive agreement are summarised below :

SALIENT TERMS AND CONDITONS OF RECAPITALISATION AGREEMENT

| Area | Major Provisions |
|--|--|
| 1. Recapitalisation amount and instruments used | <ul style="list-style-type: none"> ❑ Amount of recapitalisation based on results of Core Processes 1 : ❑ Assessment of Recapitalisation Requirement. ❑ Instruments to be used, either : <ul style="list-style-type: none"> • Ordinary shares • Preference shares • Subordinated Debts ❑ Tenure of subordinated debts ❑ Prepayment of subordinated debts |
| 2. Pricing of investment instruments | <ul style="list-style-type: none"> ❑ Generally, Danamodal expects annual return of 12% for ordinary shares, 8% |

3. Investment protection

- for preference shares and 10% for subordinated debts
- ❑ Board representation
- ❑ Representation on significant management committees
- ❑ Formula for future conversions of preference shares and debt instruments into ordinary shares
- ❑ Call options on existing shares held by current shareholders to compensate Danamodal if the value of the recapitalise institutions gets diluted subsequent to recapitalisation
- ❑ Affirmative vote on critical decision, activities and issues
- ❑ Requirements for comprehensive business and risk management plan
- ❑ Requirements for periodic reports
- ❑ Additional voting rights to further protect Danamodal's interests against dissenting shareholders

4. Exit option

- ❑ Put option by Danamodal on existing shareholders
- ❑ Put option exercise period by Danamodal
- ❑ Conversions of preference shares and debt instruments into ordinary shares, covering the following aspects:
 - Moratorium period for conversion
 - Events for mandatory conversion
 - Conversions formula
- ❑ Exchangeability against shares of holding companies or other listed shares
- ❑ Public listing
- ❑ Third party sale and right of first refusal to existing shareholders


5. Shareholder's call option

- ❑ Call option exercisable by existing shareholders
- ❑ Validity period for exercise of call option
- ❑ Minimum and multiple of exercise amount

Core Process 3 : Financing of the Recapitalisation


Sources of Funds

Danamodal and Bank Negara Malaysia had evaluated in mid 1998 that, on the worst case scenario, the total recapitalizations need of the domestic banking institutions was RM16 billion, Given the unfavorable external conditions prevailing then funding was confirmed to domestic sources. Funding in options include equity, debts and direct borrowings.



| Sources of funds | Initial estimate RM | Revised estimate RM |
|-------------------------|--------------------------------|--------------------------------|
| Seed capital | 3 billion | 5 billion |
| Domestic bonds | 10 billion | 10 billion |
| Foreign funds | 3 billion | 1 billion |

Bank Negara Malaysia injected RM3.0 billion as seed capital into Danamodal. Danamodal raised a further RM7.7 billion through the issuance of zero-coupon bonds in October 1998. The bonds with nominal value of RM11.0 billion, discount rate of 7.25% per annum and a 5-year tenure, were subscribed by a consortium of 57 banking institutions.



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RM11,000,000,000 NOMINAL AMOUNT OF
ZERO COUPON BONDS DUE 2003

Primary Subscribers:
35 Commercial Banks

| | |
|------------------------------------|---|
| ABN Amro Bank Berhad | Arab-Malaysian Bank Berhad |
| Ban Hin Lee Bank Berhad | Bangkok Bank Berhad |
| Bank of America Malaysia Berhad | Bank Bumiputra Malaysia Berhad |
| Bank of Commerce (M) Berhad | Bank of Tokyo-Mitsubishi (M) Berhad |
| Bank Utama (M) Berhad | BSN Commercial Bank Berhad |
| Citibank Berhad | Deutsche Bank (M) Berhad |
| EON Bank Berhad | Hock Hua Bank Berhad |
| Hongkong Bank Malaysia Berhad | Hong Leong Bank Berhad |
| International Bank Malaysia Berhad | Malayan Banking Berhad |
| Multi-Purpose Bank Berhad | OCBC Bank (M) Berhad |
| Overseas Union Bank (M) Berhad | Oriental Bank Bhd |
| Pewira Affin Bank Berhad | PhilsoAllied Bank Berhad |
| Public Bank Berhad | RHB Bank Berhad |
| Sabah Bank Berhad | Sime Bank Berhad |
| Southern Bank Berhad | Standard Chartered Bank Malaysia Berhad |
| The Bank of Nova Scotia Berhad | The Chase Manhattan Bank (M) Berhad |
| The Pacific Bank Berhad | United Overseas Bank (M) Berhad |
| Wah Tat Bank Berhad | |

12 Merchant Banks

| | |
|---|--|
| Amanah Merchant Bank Berhad | Arab-Malaysian Merchant Bank Berhad |
| Aseambankers Malaysia Berhad | BSN Merchant Bankers Berhad |
| Bumiputra Merchant Bankers Berhad | Commerce International Merchant Bankers Berhad |
| Malaysian International Merchant Bankers Berhad | Perdana Merchant Bankers Berhad |
| Pewira Affin Merchant Bank Berhad | RHB Sakura Merchant Bankers Berhad |
| Sime Merchant Bankers Berhad | Utama Merchant Bank Berhad |

10 Finance Companies

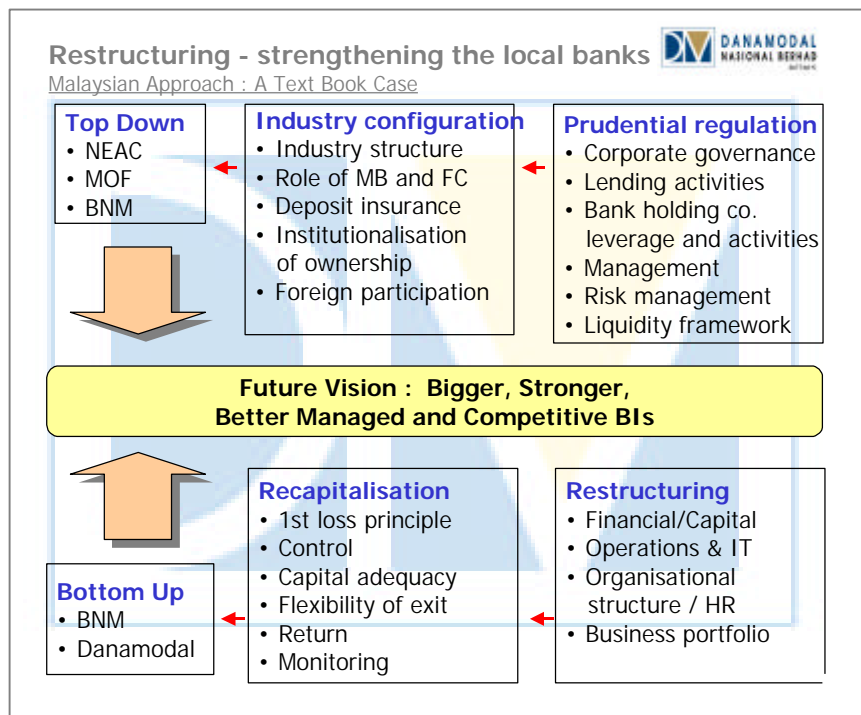
| | |
|------------------------------|--------------------------------|
| Arab-Malysian Finance Berhad | Asia Commercial Finance Berhad |
| Affin Finance Berhad | Credit Corporation (M) Berhad |
| EON Finance Berhad | Hong Leong Finance Berhad |
| Mayban Finance Berhad | MBF Finance Berhad |
| Public Finance Berhad | United Merchant Finance Berhad |

Issued On 21 October 1998

Core Process 4 : Restructuring and Monitoring

A major portion of Danamodal's activities after the injections of capital into the identified banking institutions are aimed at achieving the following objectives : to restore stability and to effect quick turnaround at the BIs level, to inject best practices into these institutions, to help accelerate the process of banking sector consolidation and restructuring, and ultimately to promote progress and development within the Malaysian banking industries.

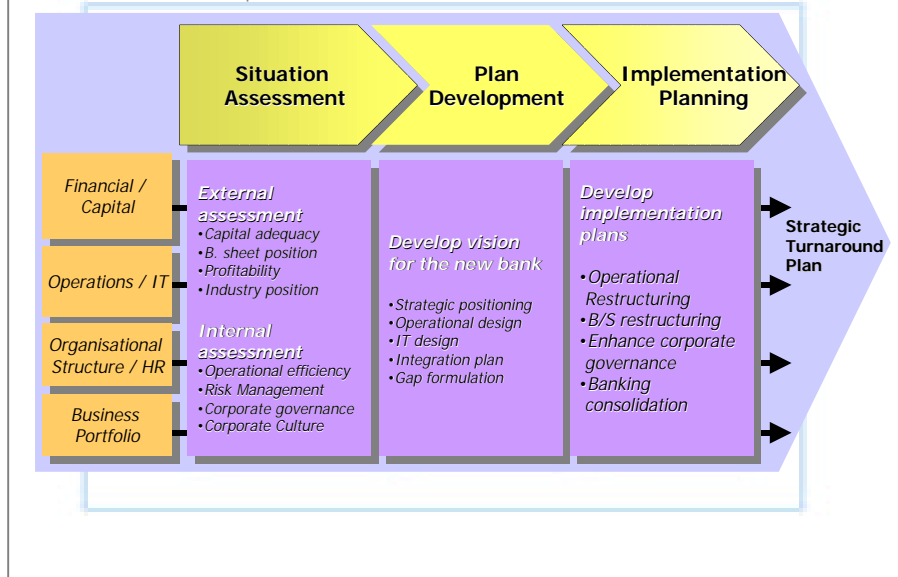
Being an instrument of public policy and as an agency participating in the overall Government's programs of banking sector stabilisation and development, Danamodal complements and supports other agencies and initiatives. While Danamodal together with BNM take measures at the firm level to recapitalise, revitalise and restructure the banking institutions, such measures should be consistent with the overall objectives and goals of the NEAC and the Ministry of Finance towards the restructuring, consolidation and strengthening of the Malaysian banking industry.



To achieve the immediate goals of strengthening the financial position and operations of the recapitalise BIs, Danamodal continuously monitors the BIs' plans for corporate recovery and restructuring, and the effective implementation of such plans. A typical process of formulating a turnaround plan will involve basic elements as summarised in the following diagram.

Restructuring - strengthening the local banks

Framework for Improvement



The monitoring phase would typically involve the following tasks :

- ❑ Establishment of performance targets
- ❑ Regular reviews of the BIs' financial and operational performance
- ❑ Continuous dialogues with BIs' management and BNM
- ❑ Active participation in the BIs' Board
- ❑ Swift and fair remedial action, where necessary, against banks failing to meet targets

Monitoring Key Indicators of Financial Recovery

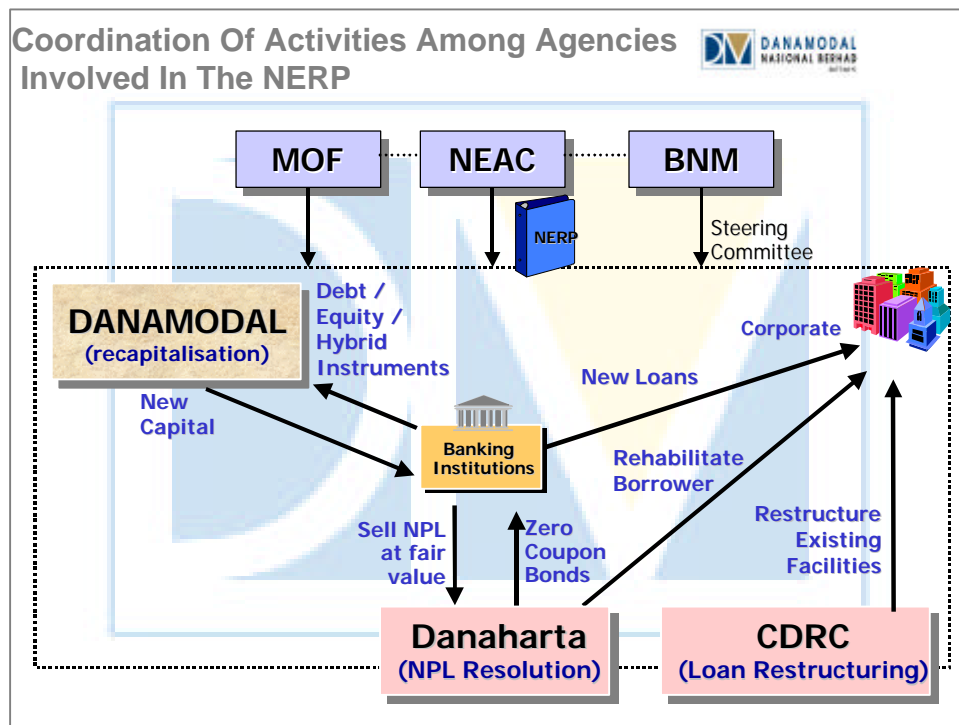
The performance monitoring system that Danamodal puts in place focuses on several critical measures of financial performance, as follows :

| Performance Measures | Monitoring Strategy for Banking Institution Recovery |
|---|---|
| Rate of Migration of Performing Loans to Non Performing Loans | <ul style="list-style-type: none"> • Monitor percentage of loans in each loan class (current, substandard, doubtful, bad) on a monthly basis, by type blending • Monitor loan migration between classes of loans |
| NPL Recovery | <ul style="list-style-type: none"> • Monitor amount of NPLs converted into collateral • Monitor amount of collateral sold in each period |
| Average Recovery Rate | <ul style="list-style-type: none"> • Make assessments of FMV of underlying collateral on all categories of loans on a periodic basis • Monitor actual cash values received versus estimates. Encourage cash sales of collateral/loans |
| Net Interest Margin | <ul style="list-style-type: none"> • Monitor performance and trend of Net Interest Margin on a monthly basis • Identify sources of strengths and weaknesses of Net Interest Margin • Conduct monthly reviews of pricing by product compared to competitors |
| Non-Interest Income Growth | <ul style="list-style-type: none"> • Performance of fee-based business lines as well as prospects for growth • New initiatives that may be undertaken to develop new fee-based businesses |
| Cost Structure | <ul style="list-style-type: none"> • Identify and monitor the sources of strengths and weaknesses in overall cost structure |
| Non-Interest Expense Growth | <ul style="list-style-type: none"> • Encourage major focus by management on appropriate level of overhead needed to match current business opportunities • Detailed management reports on salary, overhead expenses, and other operational costs |
| Cost to Income Ratio | <ul style="list-style-type: none"> • Benchmark progress in improving overall efficiency relative to other Bis |
| Loan Growth | <ul style="list-style-type: none"> • Gross loan production figures provided monthly with periodic assessment of negative or positive trends that serve as “early • Amounts and trend of new loan disbursements |
| Deposit Growth | <ul style="list-style-type: none"> • Total deposits figures provided monthly with periodic assessment of any trends |

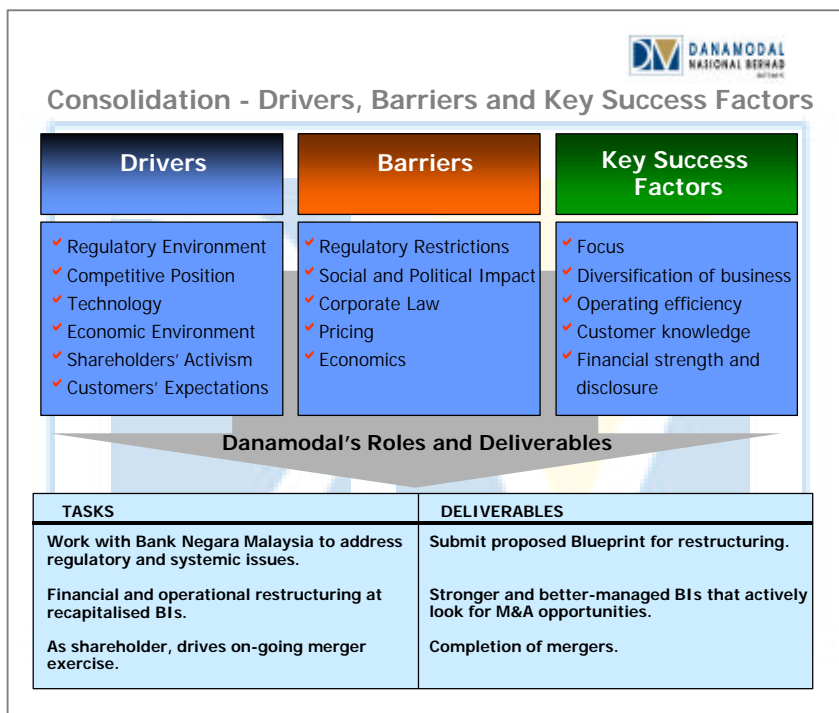
Banking Sector Restructuring and Consolidation Process

Under the National Economic Recovery Plan (NERP) 6 major strategic steps have been identified to achieve the goal of preserving and promoting financial market stability : preserving the integrity of banking system, resolution of NPLs within the banking sector and debt servicing capacity of the corporate sector, recapitalisation of banking institutions, monitoring of overall credit expansion in the economy, development of capital and private debt securities markets.

Danamodal's activities must be seen in the context of the above identified strategic initiatives. Recapitalisation process, monitoring of performance of recovery at banking institutions level, restoration of confidence and stability within the banking industry, and ultimately the acceleration of the overall economic recovery will significantly depend on the coordination of activities between all agencies involved in the NERP.



Looking at the long term goals of banking industry's consolidation and restructuring, Danamodal was expected to contribute significantly in the formulation of the blueprint for the banking industry development, to prepare the recapitalised BIs for the next phase of merger initiatives, and to actively drive the on-going merger processes towards completion.



Core Process 5 : Exit

Danamodal's exit strategies and plan are founded on the following basic principles :

- ❑ Danamodal will seize the earliest opportunity to exit.
- ❑ Danamodal may exit if it is satisfied that it has achieved the objectives of recapitalisation, or if it is satisfied that its exit may enhance the prospects of achieving the objectives.
- ❑ In exiting, Danamodal aims at full recovery of its investments with expected minimum return of 12% per annum on equity and 10% per annum on debt instruments.
- ❑ The economic recovery may help restore market based solutions to solvency issues among banking institutions, which may reduce the need for Danamodal's continued roles and accelerate its exit.

- Danamodal is guided by the prevailing policies and views of the Government and BNM in determining the most desirable timing, mode and approach of its exit.

The crucial tasks within this core process include the determination of amount and timing of divestment, and the formulation and evaluation of divestment alternatives. Danamodal is committed to demonstrate its commercial orientation in its divestment decisions, taking into account in some deserving cases, the prevailing public policy objectives and priorities. Danamodal recognises that its strategies and plan for exit are formulated and implemented in the context of a highly fluid and dynamic environment which will necessitate changes, adaptations, modifications and realignment to suit the current needs and demands.

Conclusion

Malaysia learns and benefits from the experiences of other countries in dealing with banking crisis. Its approach and orientation towards banking sector recapitalisation adopt and integrate the best practices from around the world, taking into accounts its specific needs, context, aspirations and capacities. The recapitalisation process was carried out with a strong commercial orientation, focus on speed and outcomes, transparency in its policies and operations, sense of public accountability and credibility, and bias for hope and possibilities.

By end of June 1999, the Malaysian approach in banking system recapitalisation had gained recognition for its effectiveness despite initial scepticism and reservation expressed by market analysts. The fund raising exercise was carried out within one month of Danamodal's operations solely from domestic sources. The injections of funds into banking institutions to enhance their capital positions was also carried out speedily and completed within two months after Danamodal commenced operations.

The impact of system wide recapitalisation was also immediately felt. The average capital adequacy ratio of recapitalised BIs improve significantly from 9.8% at end of August 1998 to about 13% in June 1999. With improved solvency ratio, the management of the BIs focussed their attention to the restoration of organisational and operational stability. The sale of NPLs to Danaharta, complemented by other measures to address asset quality problems, led to stabilisation of average NPL level at recapitalised BIs to about 19.4% at end of June 1999 as compared to about 22.5% as at end of August 1998. As a group, the recapitalised BIs showed significant resumption in their lending activities and improvement in liquidity position.

At the industry level, the recapitalisation process averted a full blown banking crisis in Malaysia. There was no systemic banking failure in Malaysia. As at end of June 1999 the average risk weighted capital adequacy ratio of the industry was restored to pre-crisis level of about 12%. The public confidence in the safety and soundness of the banking system was intact. The payment system continued

to function efficiently. Viable businesses continued to have access to credit and there was no credit crunch in Malaysia although total banking system credit contracted by 1.8% in 1998.

The success of the recapitalisation process without doubt contributed to the speedy recovery of the Malaysian economy. The restoration of stability within the banking sector and the resumption of intermediation functions of the financial institutions helped to boost consumer confidence and revive business and economic activities in domestic real sector. The Malaysian real economy contracted by 6.7% in 1998. However on a quarter - to - quarter basis, improvements were seen since the second quarter of 1998. On a year - to - year basis, the turnaround in the economic activities was evident since February 1999. The Malaysian economy recorded a positive growth of 4.1% in real GDP in the second quarter of 1999, emanated from recovery in domestic demand as well as strong performance of external sector. More important, Malaysian economic recovery took place in the condition of stability characterised by continued social harmony, low inflation, improved labour market conditions, favourable trade performance, increasing external reserves and a low external debt position.