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Danaharta - Asset Management Company in Malaysia

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Danaharta – Malaysia

Mallory Dreyer¹

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Abstract

After the devaluation of the Thai baht in 1997, the Malaysian economy experienced turmoil (Meesook, p4). As a part of the government’s response to the financial crisis, Danaharta was established as a national asset management company, alongside a recapitalization agency, Danamodal, and a debt restructuring body, the CDRC, to address instability in the financial system (DFR 2005, p10-11). Danaharta was established with the purpose of removing NPLs from the financial system and maximizing the recovery value of the NPLs (DFR 2005, p10). The Danaharta Act granted the agency special legal authority to more efficiently resolve NPLs (DFR 2005, p12). Danaharta received funding from the government and issued zero-coupon, government guaranteed bonds in exchange for assets, which it purchased at market value (DFR 2005, p 16-19). To incentivize financial institutions to sell NPLs, Danaharta established an incentive and penalty structure which included a profit sharing arrangement (DFR 2005, p17-18). Danaharta also managed RM27.97 billion in NPLs previously acquired by the government and central bank (DFR 2005, p32). To resolve loans from viable borrowers, Danaharta used methods such as loan restructuring, settlement, or schemes of arrangement (DFR 2005, p23). Danaharta appointed special administrators, foreclosed on property collateral, or took legal action for nonviable borrowers (DFR 2005, p23). To convert non-cash recovery assets to cash, Danaharta used open tender exercises for property sales and the first issuance of a CLO in Malaysia (DFR 2005, p27-28). Over its lifetime, Danaharta’s portfolio totaled RM52.42 billion (\$13.8 billion) in face value of NPLs, and it recovered RM30.35 billion (58 percent), and recognized a net loss of RM1.14 billion on RM8.94 billion total invested (DFR 2005, p31-32, 37). When Danaharta ceased operations in December 2005, the remaining RM2.88 billion in residual assets were transferred to a subsidiary of the Ministry of Finance, Prokhas, for collection (DFR 2005, p40).

Keywords: Malaysia, asset management company, NPL, ABS,

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Malaysia – Danaharta

At a Glance

Economic instability heightened in Malaysia after the devaluation of the Thai baht in July 1997 (Meesook, p4). Though Malaysia was not subject to a debt crisis like other Asian countries, it had structural vulnerabilities in its financial system including increased foreign capital and rapid growth of foreign bank debt (Pepinsky, p124). The government established Danaharta, the national AMC, in addition to a debt restructuring body and a recapitalization vehicle in response the growing NPL problem in 1998 (DFR 2005, p10). Danaharta was established with special legal authority from the Danaharta Act, and had the purpose to remove NPLs from the financial system and achieve maximum recovery on its resolution of NPLs (DFR 2005, p10, p12).

Danaharta acquired assets at market price in exchange for zero coupon government-guaranteed bonds with a five-year maturity (DFR 2005, p19). All financial institutions were eligible to transfer NPLs with a value of RM5 million or more to Danaharta (DFR 2005, p15-16). In order to incentivize the sale of NPLs, Danaharta established an incentive and penalty structure which included a profit sharing arrangement (DFR 2005, p17-18). Danaharta also managed NPLs on behalf of the government and central bank, though it required no capital to acquire the assets (DFR 2005, p20). Over its lifetime, Danaharta’s portfolio totaled RM52.42 billion (\$13.8 billion) in assets, both managed and acquired (DFR 2005, p31). Danaharta utilized loan restructuring, settlement, and arrangement schemes to resolve NPLs of viable borrowers; for non-viable borrowers, it appointed special administrators, foreclosed on property, or took legal action (DFR 2005, p23). Danaharta recovered RM30.35 billion, or 58 percent of its portfolio, and recognized a net loss of RM1.14 billion on a total investment of RM8.94 billion (DFR 2005, p33, p37).

Summary of Key Terms

Purpose: “Danaharta’s primary mission is to remove the non-performing assets from the system and manage them with the goal to maximize the proceeds from the recovery process” (Fung 2003, p30).

Launch Dates Announced May 20, 1998 (DFR 2005, p2)
Established June 20, 1998 (DFR 2005, p2)
First transfer: August 26, 1998 (Press Release)

Wind-down Dates Date of Last Transfer: March 2001
Date of Last Asset Disposal: December 31, 2005

Program Size Bond issuance limited to RM15 billion (\$3.95 billion)

Usage Acquired NPLs: RM 19.71 billion (\$5.2 billion) (book) for RM8.94 billion (\$2.35 billion)
Managed NPLs: RM27.97 billion (\$7.4 billion) (book) at no cost

Outcomes Recovered RM30.35 billion (\$8 billion) on managed and acquired NPLs for a total loss of RM1.14 billion (\$300 million) (DFR 2005, p31, 37)

Mandate Resolution and asset purchase

Ownership Structure Public

Notable Features Incentive / penalty structure to encourage banks to sell NPLs

Summary Evaluation

Danaharta has been described as a successful example of a national AMC in reports published by agencies, such as the IMF, World Bank, and BIS (Cerruti, p93; Fung 2003, p35). It is recognized as having strong legal authority, appropriate pricing, political backing, adequate financial support, and a clear mandate. It has been noted that Danaharta's recovery totals were improved by including the NPLs it managed on behalf of the government, as these loans did not require payment (Cerruti, p94). These loans had a higher recovery than acquired assets, and the income from these loans prevented Danaharta from incurring a greater loss (Cerruti, p94).

Danaharta: Malaysia Context	
GDP	<p>\$80B USD in 1998</p> <p><i>Source:</i> IMF International Financial Statistics</p>
GDP per capita	<p>\$3263 USD in 1998</p> <p><i>Source:</i> IMF International Financial Statistics & World Bank Database</p>
Sovereign credit rating (5-year senior debt)	<p>As of Q3 1998, Fitch: BB Moody's: Baa3 S&P: BBB-</p> <p><i>Source:</i> Bloomberg</p>
Size of banking system	<p>\$122B USD in total assets</p> <p><i>Source:</i> World Bank – Global Financial Development Database</p>
Size of banking system as a percentage of GDP	<p>153% in 1998</p> <p><i>Source:</i> World Bank – Global Financial Development Database</p>
Size of banking system as a percentage of financial system	<p>N/A</p>
5-bank concentration of banking system	<p>61.5% of total banking assets in 1998</p> <p><i>Source:</i> World Bank – Global Financial Development Database</p>
Foreign involvement in banking system	<p>18% of total banking assets in 2001</p> <p><i>Source:</i> Cull et al. p47</p>
Government ownership of banking system	<p>0% of banks owned by the state in 2001</p> <p><i>Source:</i> Cull et al. p47</p>
Existence of deposit insurance	<p>No</p>

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I. Overview

Background

Malaysia’s economy expanded rapidly between 1988 and 1996, growing an average of 9 percent annually (Ariff and Yap, p305). The Kuala Lumpur Stock Exchange (KLSE) likewise grew sharply, quadrupling between January 1988 and January 1997 (Trading Economics). In June 1997, the net NPL ratio in the banking sector was 2.2 percent and the ratio of loan provisions to NPLs was approximately 100 percent (Ariff and Yap, p311). Furthermore, the risk-weighted capital ratio was 12 percent, exceeding the 8 percent Basel Committee requirement (BNM AR 1998, Ch4 p9). Compared to other countries impacted by the Asian Financial Crisis (AFC), Malaysia was relatively less exposed to external debt, with the total outstanding foreign debt equal to \$45.2 billion or 42 percent of GDP as of June 1997 (Ariff and Yap, p306).

Despite its relative strength, there were signals of economic weakness and structural vulnerability in Malaysia (Meesook, p3), which included “rapid growth of foreign bank debt, imprudent lending to a booming property sector and share market, a pegged exchange rate, and rapid inflows of portfolio capital into the KLSE” (Pepinsky, p124). Rapid growth in the property sector and equities and securities market led to a heavy concentration of lending with 42.6 percent of domestic loans to the two sectors (Pepinsky, 122-23). In 1997, Malaysia had the highest ratio of loans to GDP in Asia, with a ratio of private-sector debt to GDP of 192.5 percent (Pepinsky, p122).

Figure 1. Malaysian Ringgit to US Dollar Exchange Rate January 1997-December 1998



Source: FRED

Because of economic structural weaknesses in Malaysia, the country was subject to contagion effect and was impacted when Thailand floated its currency, the baht, in July 1997 (Meesook, p4). This led to pressure on the Malaysian currency, as the ringgit faced a drastic and rapid devaluation with the exchange rate falling from 2.48 ringgit per dollar in March

1997 to 3.77 ringgit per dollar by the end of 1997 (Ariff and Yap, p313). The central bank, Bank Negara Malaysia, attempted to defend the ringgit by raising short-term rates, though this was ultimately unsuccessful (Doraisami, p585-586). The ringgit fell to 4.88 per dollar by January 1998 (Ariff and Yap, p316).

Figure 2. Kuala Lumpur Stock Exchange (KLSE) Composite Index between 1990-2000



Source: Trading Economics

The stock market collapsed in tandem with the rapid decline in the exchange rate, as investors began selling stocks on the KLSE due to economic uncertainty and exchange rate devaluation (Ariff and Yap, p314). The KLSE Composite Index fell from 1,216.7 in January 1997 to 594.4 by the end of 1997 before falling even further to 262.7 by September 1, 1998 (Azmi 2013, p383).

Unlike other Asian countries, Malaysia did not receive an IMF assistance package, though the country did receive technical advice and guidance (Meesook, p4). As a part of the government's initial response, it implemented policies in line with the IMF's recommendations such as raising interest rates and tightening fiscal policy (Ariff and Abubakar, p421). As Malaysia had a relatively low level of external short-term debt, it avoided the external debt crisis impacting other Asian countries that received IMF packages (Meesook, p4). Malaysia had financial regulations in place that prevented an excess of hedged or unhedged short-term foreign debt (Doraisami, p585).

However, conditions did not improve, as the NPL ratio reached 11.4 percent by August 1998 and was projected to reach 15 percent by the end of the year (DFR 2005, p16). Despite tighter monetary and fiscal policy, devaluation of the ringgit continued (Doraisami, p585). On September 1, 1998, BNM introduced selective exchange controls and essentially eliminated the offshore market for the ringgit by prohibiting the transfer of funds between external accounts in order to prevent currency speculation and trading (BNM Speech 1998). BNM also pegged the ringgit to the US dollar at 3.80 ringgit per dollar (BNM Speech 1998). These moves were considered controversial and unconventional when they were implemented (Ariff and Yap, p305).

The Malaysian government adopted new banking industry regulations in response to the crisis (BNM AR 1998, ch4 p6). Because of the high portion of lending to the property and investment sectors, BNM imposed a cap on banks to limit the total percent of loans outstanding to 20 percent for the property sector and 15 percent for the purchase of stocks or shares (1997-03-28 Press Release). The NPL classification standard was loosened, as the period was extended from three months to six months (BNM AR 1998, ch4 p6). The NPL ratio decreased from approximately 13.6 percent on the three-month measure to less than 8 percent using the new six-month measure by the end of 1998 (Fung 2003, p31). More stringent requirements were passed for NPL provisioning, and banks were required to comply with the risk weighted capital ratio on a quarterly basis, from a previous annual requirement (BNM AR 1998, ch4 p6-7).

Program Description

The government established the National Economic Action Council in January 1998 to prepare a National Economic Recovery Plan (NERP) to restore financial and economic stability (DFR 2005, p10).² The NERP included a recommendation that the government establish a national asset management company to purchase NPLs in addition to an agency to recapitalize financial institutions (DFR 2005, p10). Thus, the government announced the creation of Pengurusan Danaharta Nasional Berhad (Danaharta), the national AMC, in May 1998 (DFR 2005, p2). Danaharta was established with dual objectives to “remove the NPL distraction from the financial institutions and thereafter extract maximum recovery value from the NPLs” (DFR 2005, p11). Danamodal, an SPV established to recapitalize financial institutions, was established in August 1998, and the Malaysian government established a debt restructuring agency, the Corporate Debt Restructuring Committee (CDRC) (DFR 2005, p10-11).³ The CDRC provided a platform for financial institutions and viable borrowers with outstanding loans of RM50 million or more to negotiate debt restructuring outside of court proceedings (BNM AR 1998, Ch4 p5). A Steering Committee chaired by the BNM Governor coordinated the work of the Danaharta, Danamodal, and the CDRC (BNM AR 1998, ch4 p13).

Danaharta was incorporated on June 20, 1998 (DFR 2005, p11). The Danaharta Act, which was passed by the Malaysian Parliament on August 5, 1998, became operational on September 1, 1998 (DFR 2005, p2). Additional legal authority was designated through amendments to the National Land Code Act and the Development Funds Act, which were enacted in mid-September 1998 (DFR 2005, p2). The Minister of Finance was responsible for the oversight of Danaharta, and it had a Board of Directors and a three-member Oversight Committee (Fung 2004, p56; DFR 2005, p13). The Minister appointed the nine-member Board of Directors (DFR 2005, p85 footnote 1).

The Danaharta Act granted Danaharta special legal authority (DFR 2005, p12). The Danaharta Act granted it the authority to appoint a special administrator and bypass the court process for foreclosure (DFR 2005, p12). Though the Danaharta Act gave Danaharta

² The NEAC was a consultative agency to the Cabinet and was chaired by the Prime Minister, Mahathir Muhammed (DFR 2005, p10).

³ For more information on the capital injections, see the Danamodal case by Devyn Jeffereis.

special powers, it did not specify criteria for eligible assets, pricing, or financing (Cerruti, p91).

The government provided the initial capital for Danaharta in stages, totaling RM3 billion, though Danaharta borrowed from the Employee Provident Fund (EPF)⁴ and Khazanah Nasional Berhad⁵ to meet its interim operational funding needs (DFR 2005, p18). In order to purchase assets, Danaharta issued zero-coupon, government guaranteed bonds with a five-year maturity to the transferring financial institutions (DFR 2005, p19). In some cases, such as the purchase of unsecured NPLs or the purchase of assets from development financial institutions or Islamic banks, Danaharta paid cash (DFR 2005, p20). All financial institutions were eligible to transfer assets to Danaharta, provided that the NPLs had a value of at least RM5 million (DFR 2005, p16). Danaharta acquired assets in two major purchase windows: the “primary carve-out” focused on removing NPLs from the banking sector while the “secondary carve-out” required assets to meet a more selective set of criteria (DFR 2005, p21). Though it initially intended to acquire NPLs on a first-come-first-serve basis, Danaharta announced a prioritized acquisition approach in October 1998, with priority given to weaker institutions or those recapitalized by Danamodal as well as secured loans (DAR 1998, p20). The purchase price was determined by loan type: secured loans, unsecured loans, and exceptionally large loans (DFR 2005, p16-17). The purchase price for secured loans backed by property collateral was determined by an independent appraiser’s valuation while the price of loans backed by shares was determined by proportional stake in the company and the share prices (DFR 2005, p16). The purchase price for unsecured loans was 10 percent of the outstanding principal, and the purchase price of exceptionally large loans was a nominal sum (though this was used infrequently) (DFR 2005, p17).

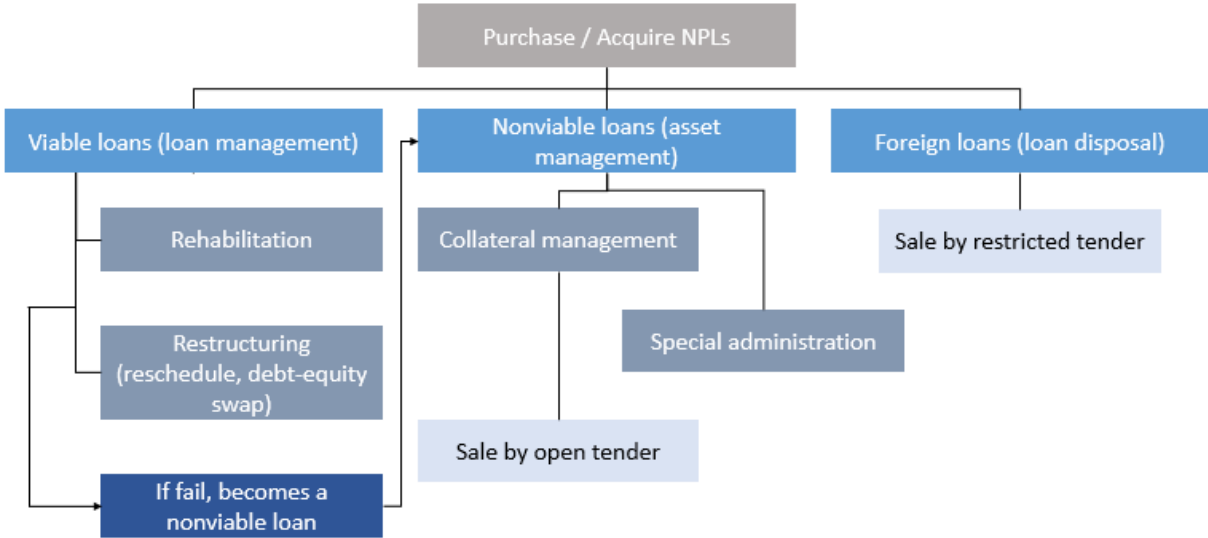
In order to encourage financial institutions to sell NPLs, Danaharta established an incentive and penalty structure (DFR 2005, p17). The first incentive (or “carrot”) was a profit sharing arrangement where the transferring institution received 80 percent of the profit recognized on the recovery of an NPL and Danaharta received the remaining 20 percent (DFR 2005, p17). Additionally, the transferring financial institution could amortize the loss on an NPL over a five-year period (DFR 2005, p18). The two penalties (or “sticks”) included the requirement that NPLs not transferred to Danaharta had to be written down to 80 percent of Danaharta’s valuation and that Danaharta would only make one offer for each NPL (DFR 2005, p18). These incentives and penalties were put in place to encourage financial institutions to rid their balance sheets of NPLs, despite the possibility of losses and erosion of shareholder capital (DFR 2005, p17). Furthermore, BNM required institutions with an NPL ratio greater than 10 percent to sell their NPLs to Danaharta, and financial institutions were required to sell NPLs to Danaharta in order to be eligible for recapitalization by Danamodal (DFR 2005, p17; BNM AR 1998, ch4 p12).

⁴ The Employees Provident Fund (EPF) is the national pension fund of Malaysia. For more information on EPF, see the EPF/KWSP website at <https://www.kwsp.gov.my/>.

⁵ Khazanah Nasional Berhad was established in 1993 as the sovereign wealth fund of Malaysia, and it is responsible for managing the government’s commercial assets and investing for long-term growth. For more information, see the Khazanah Nasional Berhad website at <http://www.khazanah.com.my/>

In addition to purchasing NPLs, Danaharta also managed NPLs acquired by the central bank and government in the forced merger of two struggling banks, Sime Bank and Bank Bumiputra Malaysia, with stronger banks. Sime Bank was merged with RHB Bank Berhad on June 30, 1999, and Bank Bumiputra Malaysia was merged with Bank of Commerce (M) Berhad on September 30, 1999 (BNM AR 1999, ch4 p4). Both banks reported large losses due to nonperforming loans, and BNM recognized that the size and potential impact of the two institutions’ potential failure on the financial system required intervention (BNM AR 1999, ch4 p4). The distressed assets of both banks were transferred to the government and central bank in order to facilitate the mergers (DFR 2005, p20). The government and central bank transferred NPLs to Danaharta for management.; in return, Danaharta collected a management fee and determined a recovery strategy (DFR 2005, p20-21). In reporting, Danaharta referred to the Sime Bank and Bank Bumiputra NPLsas “Managed NPLs” whereas purchased NPLs were referred to as “Acquired NPLs” (DFR 2005, p20). Danaharta relaxed the minimum loan size requirement for “Managed NPLs” to RM1 million and above (DFR 2005, p21).

Figure 3. Danaharta’s Recovery Strategy by Loan Type



Source: Created by YPFS; Takatoshi and Yuko, p33

Danaharta adopted an asset management company approach, as opposed to a rapid disposition agency or a bad debt warehouse⁶ (DFR 2005, p11). Danaharta’s goal was to “elicit maximum recovery from its NPL portfolio” (DFR 2005, p23). Danaharta determined the recovery strategy on a case-by-case basis, though there were two overarching strategies: the soft approach or the hard approach (DFR 2005, p23). Viable borrowers were subject to the soft approach, which involved restructuring and rehabilitation (DFR 2005, p23). Nonviable

⁶ In the Danaharta 2005 Final Report, Danaharta stated that it adopted the AMC approach, in opposition to the rapid disposition agency or bad debt warehouse. This appears to be a component of its communication strategy.

borrowers or those that failed to comply with restructuring were subject to the hard approach, which involved foreclosure and special administration (DFR 2005, p23). Danaharta also acquired foreign loans, which were loans subject to a foreign jurisdiction, where Danaharta did not have special legal authority (DFR 2005, p25). These loans were disposed of through restricted tender exercises (DFR 2005, p25).

Outcomes

Danaharta completed asset acquisition during two windows: the primary and secondary carve-outs (DFR 2005, p21). The primary carve-out occurred between September 1998 and June 30, 1999 (DFR 2005, p21). It removed the bulk of NPLs from the banking system and focused on removing NPLs to allow the banking sector to return to normal lending. In the primary carve-out, Danaharta acquired RM39.3 billion of loans at face value, while financial institutions rejected RM1.78 billion in offers (DFR 2005, p21). The secondary carve-out occurred between July 1999 and March 31, 2000, and had a more selective set of criteria for eligible assets (DFR 2005, p21; BNM AR 1999, ch4 p10).

At the end of its operations in September 2005, Danaharta’s portfolio totaled RM47.68 billion in loan rights acquired (LRA), with RM19.71 billion in acquired assets and RM27.97 billion in managed assets (DFR 2005, p22). The adjusted loan rights acquired (adjusted LRA), which included the accrued interest at the time of restructuring, totaled RM52.42 billion (DFR 2005, p31).⁷

In exchange for NPLs, Danaharta issued 15 tranches of five-year, government-guaranteed zero coupon bonds which raised RM7.92 billion in capital and had a total face value of RM11.14 billion (DFR 2005, p54-55). Danaharta paid RM1.02 billion in cash for unsecured loans or assets from Islamic banks and development finance companies (DFR 2005, p55). Bonds or cash were issued in exchange for acquired assets (DFR 2005, p22). On average, Danaharta purchased assets at a discount of 54.6 percent⁸ (DFR 2005, p22). Because Danaharta took over the management of NPLs from the merged Sime Bank (RHB Bank) and BBMB (Bank of Commerce (M) Berhad), these assets did not have an acquisition cost to Danaharta (DFR 2005, p22).

Over the course of its lifespan, Danaharta recovered RM30.35 billion of its portfolio, with a total cash recovery of RM26.69 billion (DFR 2005, p33). The average recovery was 58 percent of book value; for the recovery on acquired NPLs, the average recovery rate was 49 percent while the average recovery rate for managed NPLs was 65 percent (DFR 2005, p32).

Table 1. Danaharta’s Recovery on Acquired and Managed NPLs

Recovery Method	Adjusted LRA RM billion (a)	Recovery RM billion (b)	Recovery rate (%) c=(b)/(a)
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⁷ The Adjusted Loan Rights Acquired included the accrued interest at the time of restructuring, which is why the RM52.42 billion figure is larger than the total Loan Rights Acquired figure of RM47.68 billion.

⁸ According to the Danaharta Final Report (2005), Danaharta paid RM8.94 billion at the time of acquisition for the RM19.71 billion in acquired NPLs.

	<i>Acquired NPLs</i>	<i>Managed NPLs</i>	<i>Acquired NPLs</i>	<i>Managed NPLs</i>	<i>Acquired NPLs</i>	<i>Managed NPLs</i>
<i>Plain loan restructuring</i>	1.07	3.77	0.86	3.58	80%	95%
<i>Settlement</i>	3.55	8.55	3.11	6.41	88%	75%
<i>Schemes of arrangement</i>	3.14	6.82	1.84	4.32	59%	63%
<i>Appointment of Special Administrators</i>	1.66	2.59	0.84	0.58	51%	22%
<i>Foreclosure</i>	9.12	3.69	2.62	1.65	29%	45%
<i>Others</i>	3.81	3.29	1.74	2.60	46%	79%
<i>Legal action</i>	0.28	1.08	0.06	0.14	20%	13%
Total	22.63	29.79	11.07	19.28	49%	65%
OVERALL	52.42		30.35		58%	

Source: [DFR 2005](#), p 32

Of the RM26.29 billion in cash recovery, RM17.48 billion was recovered from NPLs managed for the Sime Group and BBMB group ([DFR 2005](#), p34). The cash recovery on these NPLs was repatriated to the government and BNM after deducting the management fee for Danaharta ([DFR 2005](#), p34). Danaharta distributed RM0.76 billion in cash and an unreported value of securities to 38 financial institutions, as there was a profit on the management of these NPLs ([DFR 2005](#), p34).

Danaharta converted non-cash recovery assets to cash through multiple methods ([DFR 2005](#), p26). Danaharta sold properties via open tender and designed the tender process for Malaysia ([DFR 2005](#), p66)⁹. Danaharta held ten major tenders and fifteen smaller tenders as of September 30, 2005 ([DFR 2005](#), p68). Over the course of its operations, 1,298 properties were listed for tender with a value of RM3.7 billion, and a total of 1,026 properties were sold for RM2.17 billion ([DFR 2005](#), p68). Danaharta sold readily tradable securities through stockbrokers or financial institutions in order to convert the securities to cash ([DFR 2005](#), p71). Danaharta also issued the first occurrence of a collateralized loan obligation transaction in Malaysia through its asset backed securitization (ABS) ([DFR 2005](#), p28). The ABS raised a total of RM308.57 million and had a subscription rate of 3.5 times for the senior notes ([DFR 2005](#), p28).

Danaharta repaid its liabilities by the time it ceased operations, including the RM3.0 billion in initial capital from the government and the RM11.14 billion in bonds ([DFR 2005](#), p38). Due to a mismatch between bond maturity and cash flow for the last two bond redemptions in 2004 and 2005, Danaharta drew RM650 million from its revolving credit facility, which

⁹ An open tender is a bidding process open to qualified bidders. The tender process varies across countries, but tender processes are structured and follow a set of procedures.

was capped at RM1.4 billion, in order to repay the liabilities (DFR 2005, p38). Danaharta repaid the RM650 million by September 2005 (DFR 2005, p38).

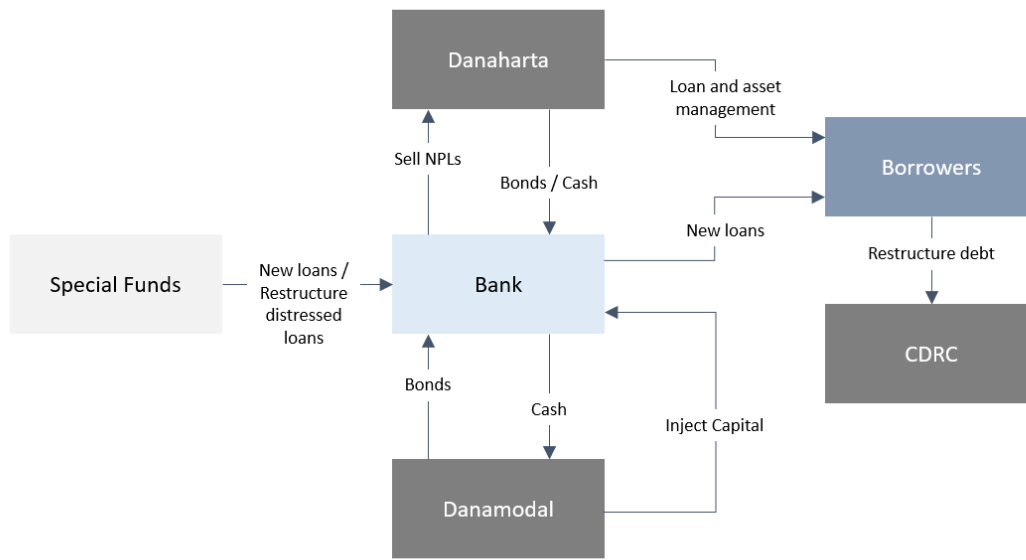
Danaharta recognized a lifetime loss of RM1.14 billion when it ceased operations on December 31, 2005 (DFR 2005, p37). The remaining recovery assets were transferred to Prokhas, a fully-owned subsidiary of the Ministry of Finance Incorporated (DFR 2005, p40). Danaharta transferred RM2.88 billion in assets, which included restructured loans, properties, securities or assets under legal action, to Prokhas, for collection or recovery (DFR 2005, p33, 40). In 2010, Prokhas had collected RM2.92 billion in cash and had an outstanding balance of RM650 million (Edge 2009). Prokhas intended to collect the full RM3.57 billion by the end of 2011 to return to the government (Edge 2009). Since completing the collection of the residual recovery assets, Prokhas evolved into a consulting and advisory body (Prokhas website).

II. Key Design Decisions

1. Part of a package – Danaharta was part of the Malaysian government’s response to the crisis, which included a recapitalization SPV, Danamodal, and a debt restructuring agency, the CDRC.

In January 1998, the Malaysian government established the National Economic Advisory Council (NEAC), a consulting body to the Cabinet, to propose a plan to address the economic and financial instability in Malaysia (DFR 2005, p10). The NEAC proposed the National Economic Recovery Plan (NERP), which was published in August 1998, with six objectives for economic recovery and financial stabilization (DFR 2005, p10; NERP Site). The plan included the creation of a national asset management company and a special purpose vehicle (SPV) to recapitalize financial institutions (DFR 2005, p10). Danaharta was established as the AMC, and Danamodal was established soon after as the recapitalization SPV (DFR 2005, p10). In order to be eligible for capital injections, financial institutions were required to transfer their portfolios of NPLs to Danaharta (BNM AR 1998, ch4 p12). Danamodal followed the first-loss principle, which meant that the financial institution’s shareholders were required to absorb the first losses on the sale of assets to Danaharta (BNM AR 1998, ch4 p12). Danamodal only recapitalized viable financial institutions (BNM AR 1998, ch4 p12). The government also established the Corporate Debt Restructuring Committee to facilitate debt restructuring negotiations (BNM AR 1998, ch4 p13). Danaharta, Danamodal, and the CDRC were overseen by a Steering Committee under the central bank, which coordinated the activities of the three agencies (BNM AR 1998, ch4 p13). Special funds were established to promote investment in priority sectors such as the Fund for Small and Medium Enterprises (BNM AR 1998, ch4 p13). The government announced a merger program for banks and finance companies in January 1998 to consolidate the banking industry, which was separate from the NEAC’s proposal, though the NERP did encourage consolidation (BNM AR 1998, ch4 p11). Figure 4 below shows the relationship between the agencies, banks, and borrowers:

Figure 4. Relationship between Danaharta, Danamodal, and the CDRC



Created by YPFS. Source: [BNM AR 1998](#), ch 4 p13

2. Legal Authority –The Pengurusan Danaharta Nasional Berhad Act (Danaharta Act) was passed by parliament in August 1998 while amendments to the National Land Code Act and the Development Funds Act were passed in September 1998.

The government announced the creation of Danaharta on May 20, 1998 (DFR 2005, p2). Danaharta was established on June 20, 1998 and incorporated under the Companies Act of 1965 (DFR 2005, p2, p; DAR 1998, p13). Danaharta was granted its authority and special powers through the Pengurusan Danaharta Nasional Berhad Act (Danaharta Act), which was passed by the Malaysian Parliament in August 1998 (DFR 2005, p12). In September 1998, amendments to the National Land Code Act and the Development Funds Act were passed by Parliament (DFR 2005, p2). The National Land Code (Amendment) Act of 1998 facilitated the implementation of Danaharta’s special authority (DFR 2005, p14).

The Danaharta Act was amended by parliament on July 31, 2000 (DFR 2005, p3). The amendments were intended to clarify existing provisions and solve problems that arose after Danaharta began operations (DFR 2005, p15). The amendments included provisions regarding statutory vesting, sale by private treaty, legal actions against Danaharta, the Oversight Committee, and special administrators (DAR 2002, p124-126).

3. Special Powers – Danaharta was granted special legal authority to more efficiently resolve its portfolio of NPLs.

Danaharta had special legal authority to manage and resolve NPLs. Danaharta could appoint a special administrator over borrowers unable to repay debts, bypassing court procedures (DFR 2005, p13). Furthermore, Danaharta could foreclose on a loan’s underlying property collateral and avoid court procedures, which expedited its operations (DFR 2005, p14). The

act also granted Danaharta the ability to acquire assets through statutory vesting, which allowed Danaharta to “step into the shoes of the selling financial institution” in order to expedite the transfer and management of NPLs (DFR 2005, p12). Danaharta’s legal authority enabled it to restructure loans in two to three months, rather than fourteen to sixteen under normal restructuring under the Companies Act (Cooke and Foley, p40). The Danaharta Act did not include provisions for pricing, financing, or eligible assets, which were to be determined by the Board and management (Cerruti, p91).

Section 72 of the Danaharta Act prohibited courts from granting injunctions against Danaharta (DAR 2003, p10). A borrower filed a legal suit against Danaharta in 2002, and the Court of Appeals declared that Section 72 was unconstitutional and void (Azmi, p388; DAR 2003, p10). Danaharta filed an appeal against the ruling at the Federal Court, the highest court in Malaysia, arguing that the powers were constitutional and fair (DAR 2003, p10). The Federal Court unanimously decided that Section 72 of the Danaharta Act was constitutional and valid in January 2004 (DAR 2003, p10). The Danaharta Act does not prevent parties from suing Danaharta or winning compensation as determined by the court (DAR 2002, p11).

4. Mandate – Danaharta had a dual asset purchase and resolution mandate.

Danaharta’s primary objectives “were to remove the NPL distraction from the financial institutions and thereafter extract maximum recovery value from the NPLs” (DFR 2005, p11).

5. Communication – Danaharta presented itself as a preemptive and key measure to mitigate economic and financial instability.

When Danaharta was announced, the Managing Director, Azman Yahya, stated that he was confident that Danaharta would be beneficial for the Malaysian economy and allow financial institutions to return to “their vital role in supporting economic growth” (1998-06-04 Press Release). When the Danaharta Act was passed, it was framed as a “critical component in enabling Danaharta to undertake its unique mission” (1998-07-14 Press Release). The press releases related to Danaharta’s operational set up emphasized its quick establishment relative to other countries (1998-09-4 Press Release), and the 1998 BNM Annual Report asserted that “[t]he speed at which Danaharta was set up and the financial commitment extended by the Government clearly demonstrated the serious intention of the Government to restructure and strengthen the banking sector” (BNM AR 1998, ch4 p12). Azman emphasized that Danaharta’s ability to appoint special administrators could expedite resolutions and be a “win-win solution” for the involved parties (1999-03-16 Press Release). The government asserted that Danaharta would not become a bad debt warehouse or a rapid disposition agency; rather, Danaharta would focus on maximizing the recovery value of its portfolio of NPLs and minimizing the cost to the taxpayer (1999-04-07 Press Release). Though there were criticisms that Danaharta would be slow to resolve NPLs, Azman rejected the criticism and reiterated that Danaharta’s “role is to maximize recovery on [its] assets” (Lopez).

The final report on Danaharta framed the creation of the body as a “preemptive measure” to address growing economic distress, as the establishment of Danaharta, Danamodal, and the CDRC was “the Malaysian Government’s pre-emptive strategy in accelerating the

restructuring and strengthening of the financial system” (DFR 2005, p11). Furthermore, Danaharta claimed that it fought a public relations war as soon as it was established, as there were critics who believed Danaharta would bail out politically connected businesses (DFR 2005, p48). Others doubted that it would be transparent and free from political interference; furthermore, there was a common “misconception that Danaharta would forgive all NPLs” it acquired (DFR 2005, p48). Danaharta sought to combat public perception challenges through transparency in its operations, using frequent press releases and reports (DFR 2005, p48). From the time of his appointment as the Managing Director, Azman committed to having “full disclosure and transparency” of Danaharta’s operations (Reuters 1998).

6. Ownership Structure / Funding – Danaharta was fully-owned by the Ministry of Finance and received RM3 billion in capital from the government.

Danaharta was fully owned by the government, as the Minister of Finance Incorporated was the sole shareholder (DOR 1998, p16)¹⁰. The government provided Danaharta with the initial capital of RM3 billion in stages (DFR 2005, p18). Danaharta borrowed from the Employees Provident Fund (EPF) and Khazanah Nasional Berhad to supplement its funding needs while waiting for the full capitalization (DFR 2005, p18). Danaharta borrowed a total of RM1.3 billion from the EPF and Khazanah Nasional Berhad over the course of its lifetime (DFR 2005, p38). Danaharta also had access to a revolving credit facility from a consortium of banks which was established to provide short-term financing in the event of a cash shortage at the time of bond redemption (DAR 2004, p11, p38). Danaharta had access to RM1.4 billion in the revolving credit facility. Danaharta borrowed RM650 million from the revolving credit facility for the December 2004 and March 2005 bond redemptions, due to a mismatch between the cash flow and bond redemption (DFR 2005, p38). The RM650 million loan was repaid by September 2005 (DFR 2005, p38). Danaharta issued government-guaranteed zero-coupon bonds in exchange for NPLs from financial institutions (DFR 2005, p19).

Table 2. Danaharta’s total liabilities (in RM billion)

Liabilities	Purpose	Total amount allocated	Amount utilized
Long-term loans (loans from EPF and Khazanah Nasional Berhad)	Draw down available for working capital	2.00	1.30
Short-term loan (revolving credit)	To remedy a temporary mismatch between loan recovery and bond redemption	1.40	0.65

¹⁰ The Minister of Finance Incorporated (MOF Inc.) is a Government-Linked Investment Company in (GLIC) in Malaysia which was established under the Minister of Finance (Incorporated) Act in 1957. It functions as an investment holding company for the government, and the Act allows the Minister of Finance to be represented by the MOF Inc. and enter into business contracts, acquire companies, and manage assets. For more information on the MOF Inc. and GLICs, see Gomez 2018.

Zero-coupon bonds issued to selling financial institutions	For loan acquisition	15.00	11.14
Total		18.40	13.09

Source: [DFR 2005](#), p38

7. Governance/Administration: Danaharta had a nine-member Board of Directors, a three-member Oversight Committee, and an executive committee and subcommittees responsible for daily oversight and guidance.

The Minister of Finance oversaw Danaharta and its operations, as it was the sole shareholder of Danaharta ([Act 587](#), p16). Danaharta had a nine-member Board of Directors, which consisted of representatives from both the public and private sector, which included a Chairman, a Managing Director (i.e. the CEO), two federal government officials, three individuals from the private sector, and two international members ([Act 587](#), p14). Azman Yahya, the Managing Director from 1998 to 2001, also served as the head of the CDRC ([DFR 2005](#), p84; [Arnold](#)). Because Danaharta, Danamodal, and the CDRC played complementary roles, a Steering Committee was established to ensure coordination across the agencies which was chaired by the BNM Governor (DAR 1998, p19).

Figure 5. Danaharta’s organizational structure



Source: [DFR 2005](#), p51

The top-level management was divided into subcommittees which were overseen by the Management Executive Committee ([DFR 2005](#), p51). The subcommittees evolved over the course of Danaharta’s operations ([DFR 2005](#), p51). The Management Executive Committee oversaw the operations of Danaharta, determined guidelines for the operations, made key

decisions, and ensured adherence to policies (DFR 2005, p51). Other committees included the Management Credit Committee, which was involved in the acquisition and disposal of loans, the Asset Management Committee, which reviewed and decided on the purchase and sale of property assets, and the Asset and Liability Committee, which controlled liquidity, market and interest risks (DFR 2005, p51). As of 2003, Danaharta’s staff totaled 245 individuals (DAR 2003, p11).

The Danaharta Act included a provision for the creation of the Oversight Committee (Act 587, p32). This three-member committee was appointed by the Minister of Finance and was tasked with the following functions: approval of special administrator appointments, approval of extension or moratorium periods for companies under special administrators, and approval of the termination of special administrators (Act 587, p32). The Oversight Committee was established in November 1998 (Fung 2003, p32).

8. Governance/Administration: Danaharta established procedures for transparency, risk management, and corporate governance.

Danaharta established measures to ensure transparency of operations (DFR 2005, p49). Danaharta held press conferences, released public announcements, and maintained a public website (DFR 2005, p49). Danaharta published bi-annual operations reports, quarterly reports, and annual reports (DFR 2005, p49). Danaharta adopted the Malaysian Code on Corporate Governance which meant that it followed standards for professionalism and transparency (DFR 2005, p50). Danaharta also established the Danaharta Authority Manual which defined the responsibilities and authorities of the Board and management committees (DFR 2005, p50). Furthermore, the Risk Management team reviewed all proposals, and Danaharta was established with a structure to ensure that there was no single individual who could make a unilateral decision regarding the resolution of NPLs (DFR 2005, p50).

9. Governance / Administration: Danaharta adopted Key Performance Indicators (KPIs) internally in order to achieve its organizational objectives.

Danaharta established KPIs internally in order to achieve its objectives during each phase of its operations; the phases were establishment, acquisition, and resolution (DFR 2005, p43). Staff remuneration was linked to the achievement of the KPIs (DFR 2005, p43). Each KPI had a benchmark and a timeframe for achievement (DFR 2005, p43). The KPIs and the outcomes related to the KPI are in Table 3 below:

Table 3. Danaharta’s Key Performance Indicators and Performance

Phase	KPI	Actual Performance
Establishment	Complete set-up within 5 months (including draft legislation, staff recruitment and formulation of policies and procedures)	Exceeded KPI: Danaharta began operations within three months of its announcement
Acquisition	<p>Timeframe:</p> <ul style="list-style-type: none"> Complete primary carve-out by December 31, 1999 Complete secondary carve-out by the March 31, 2000 	<p>Timeframe:</p> <ul style="list-style-type: none"> Exceeded KPI: Completed six months ahead of schedule Met KPI: Completed on schedule <p>Quantity:</p>

	<p>Quantity:</p> <ul style="list-style-type: none"> Acquire RM8 billion by December 31, 1998 Acquire RM33 billion (total) by December 31, 1999 	<ul style="list-style-type: none"> Exceeded KPI: Acquired RM19.73 billion in loans by December 31, 1998 Exceeded KPI: Acquired RM39.33 billion by December 31, 1999
Resolution	<p>Processing:</p> <ul style="list-style-type: none"> Process (meet with borrowers to decide on an appropriate strategy) RM30 billion NPLS by June 2000 Process remainder of portfolio by December 31, 2001 <p>Loan Recovery Rate:</p> <ul style="list-style-type: none"> Benchmark of 49.8 percent for the loan recovery rate 	<p>Processing:</p> <ul style="list-style-type: none"> Exceeded KPI: Processed RM31.5 billion by June 2000 Did not meet: Completed processing the remainder by July 2002 <p>Loan Recovery Rate:</p> <ul style="list-style-type: none"> Exceeded KPI: Loan recovery rate of 58 percent as of September 30, 2005

Source: [DFR 2005](#), p45

10. Size: Though the legislation did not specify a size restriction, Danaharta was authorized to issue up to RM15 billion in bonds.

When Danaharta was established, the Danaharta Act did not specify a size restriction that limited the amount of NPLs Danaharta could acquire. However, Danaharta was authorized to issue up to RM15 billion in zero-coupon, government guaranteed bonds in exchange for asset purchases ([DFR 2005](#), p38).

11. Eligible Institutions - All financial institutions were eligible to transfer assets to Danaharta.

All financial institutions were eligible to transfer assets to Danaharta. This included commercial banks, finance companies, development banks, merchant banks, Islamic banks, and locally incorporated foreign banks ([DFR 2005](#), p15). In order to be eligible for recapitalization by Danamodal, financial institutions were required to sell NPLs to Danaharta ([BNM AR 1998](#), ch4 p12). BNM required financial institutions with an NPL ratio of 10 percent or higher to sell NPLs to Danaharta ([DFR 2005](#), p17).

Table 4. Danaharta Usage by Institution Type

Institution Type	# of Accounts	Loan Rights Acquired	Fair Purchase Price
<i>Commercial Banks</i>	451	11,402.2	4,427.7
<i>Finance Companies</i>	131	3,769.5	1,804.1
<i>Merchant Banks</i>	172	3,211.9	1,811.7
<i>Development Financial Institutions</i>	42	1,161.2	749.1
<i>Offshore</i>	1	123.1	104.7
<i>Others</i>	1	42.7	42.7
Total	798	19,710.6	8,940

Source: [DFR 2005](#), p56-61

12. Eligible Assets – NPLs with a value of RM5 million or greater were eligible for Danaharta to acquire.

Danaharta could acquire NPLs with a value of RM5 million or greater ([DFR 2005](#), p16). The size criteria narrowed Danaharta's operations and allowed it to focus on the higher value loans while addressing approximately 70 percent of the total NPL value in the banking sector ([DFR 2005](#), p16).

13. Acquisition Consideration (Funding): Danaharta issued 5-year, zero-coupon, government-guaranteed bonds as consideration for acquired NPLs from transferring financial institutions.

Danaharta elected to issue domestic bonds in order to finance the purchase of NPLs ([DFR 2005](#), p19). Danaharta considered an international bond issuance, but due to exchange rate uncertainty and volatility, it determined that an international source of funding would be costly ([DFR 2005](#), p18). Thus, Danaharta issued domestic bonds directly to financial institutions as consideration for the transfer of NPLs ([DFR 2005](#), p19). The bonds were government-guaranteed, zero-coupon bonds with a five-year maturity ([DFR 2005](#), p19). Danaharta issued 15 tranches of bonds between November 1998 and March 2000, approximately one tranche per month ([DFR 2005](#), p20). Danaharta raised a total of RM8.22 billion in capital from bond issuances; the total face value of the bonds was RM11.14 billion ([DFR 2005](#), p20). Table 5 below shows the details of the fifteen bond issuances:

Table 5. Danaharta Bonds Issued for Acquired NPLs

Date of Issue	Face Value (RM billion)	Price for every RM100 in FV	Yield	PV at issue date (RM billion)	Maturity Date
20 Nov 1998	1.022	69.832	7.150%	0.713	31 Dec 2003
30 Dec 1998	1.580	72.012	6.672%	1.138	31 Dec 2003
29 Jan 1999	1.105	71.301	6.654%	0.788	31 Mar 2004
26 Feb 1999	1.242	72.296	6.475%	0.898	31 Mar 2004
26 Mar 1999	1.393	72.758	6.445%	1.014	31 Mar 2004
29 Apr 1999	1.050	75.584	5.487%	0.793	30 Jun 2004
27 May 1999	0.511	76.229	5.400%	0.390	30 Jun 2004
29 Jun 1999	0.744	76.862	5.330%	0.572	30 Jun 2004
29 Jul 1999	0.527	76.223	5.319%	0.402	30 Sep 2004
26 Aug 1999	0.204	73.585	6.111%	0.150	30 Sep 2004
29 Oct 1999	0.575	76.365	5.283%	0.439	31 Dec 2004
29 Dec 1999	0.392	77.3673	5.194%	0.303	31 Dec 2004
31 Jan 2000	0.162	77.244	5.063%	0.125	31 Mar 2005
29 Feb 2000	0.305	77.697	5.025%	0.237	31 Mar 2005
31 Mar 2000	0.328	77.494	5.165%	0.255	31 Mar 2005
Total Bonds Issued	11.140			8.217	

Source: [DFR 2005](#), p54

The bonds carried a zero risk weight for capital-adequacy purposes, and the bonds could be rediscounted with BNM under the central bank’s role as lender of last resort ([DAR 1998](#), p33). The bonds could be traded on the secondary market ([DFR 2005](#), p20). The bonds also had a rollover option, which allowed Danaharta to refinance the bonds upon maturity for one, three or five years ([DFR 2005](#), p19).

14.Acquisition: Pricing /Valuation – Danaharta used a market-based pricing mechanism to determine transfer price.

BNM required every financial institution to submit details of their portfolio of NPLs with values of RM5 million and greater to Danaharta ([1998-10-6 Press Release](#)). Danaharta relied on the representations from the selling banks regarding the details of sold NPLs and included warranty provisions in the sales agreements ([DFR 2005](#), p16). This allowed Danaharta to return NPLs to the selling financial institutions at a later date if the loan documentation was not in place ([DFR 2005](#), p16).

Danaharta determined the purchase price for NPLs depending on the loan type ([DFR 2005](#), p16). For secured loans, the purchase price was determined using the fair value of the underlying collateral ([DFR 2005](#), p16). For property collateral, the fair value was 95 percent of the market value of the property, as determined by an independent appraiser ([DFR 2005](#), p16). For NPLs backed by shares, the fair value was dependent on the size of the stake in the company pledged as collateral, with premiums for larger stakes ([DFR 2005](#), p16). The fair value was determined using the market price (MP), which was the lower of the three-month average price or the closing price at the point of purchase, and the net tangible assets (NTA) based on the latest audited financial statements of the company ([DFR 2005](#), p16). The table below shows the calculation of the fair value based on the percent stake in the company:

Table 6. Calculation of fair value of shares

Stake in Company	Fair Value
Less than 5%	Lower of MP and NTA
Between 5% and 33%	Average of MP and NTA
Above 33%	Higher of MP and NTA

Source: [DFR 2005](#), p16

For secured loans backed by property or shares, the fair value was compared to the principal or loan amount outstanding to determine the purchase price ([DFR 2005](#), p17). The table below shows the purchase price for various scenarios:

Table 7. Determination of purchase price for secured loans

Scenario	Purchase Price
FV is greater than or equal to the loan amount outstanding	Loan amount outstanding
FV is less than the loan amount outstanding but greater than or	Fair Value

equal to the principal amount outstanding	
FV is less than the principal amount outstanding	Danaharta paid up to fair value but the purchase price was the principal amount outstanding and loss was deferred until recovery

Source: [DFR 2005](#), p17

For the cases when the fair value was less than the principal amount outstanding, Danaharta’s upfront payment was equal to the fair value, though the purchase price was defined as the principal amount outstanding ([DFR 2005](#), p17). After Danaharta completed the recovery of the loan, the surplus recovery was subject to Danaharta’s profit sharing agreement, which capped the profit distributed to the selling institution at the difference between the purchase price (principal amount outstanding) and the fair value ([DFR 2005](#), p17).

For unsecured loans, Danaharta paid 10 percent of the principal amount for unsecured loans, an amount that Danaharta called an “arbitrary figure” ([DFR 2005](#), p17). For exceptionally large loans with a value of more than RM200 million, the purchase price was set at a nominal value equal to a percentage of the loan outstanding or RM1 ([DFR 2005](#), p17). This method was used if the valuation was “onerous or inconclusive,” and it was used infrequently as few NPLs were acquired using this method. ([DFR 2005](#), p17).

15.Acquisition: Incentives and penalties – Danaharta developed an incentive and penalty structure to encourage financial institutions to sell NPLs.

Though Danaharta had to generally acquire loans on a willing-buyer-willing-seller basis, it established an incentive and penalty structure, which included two incentives, or “carrots”, and two penalties, or “sticks”, to encourage financial institutions to sell NPLs ([DFR 2005](#), p17).

The incentives to sell to Danaharta included a profit-sharing arrangement and loss amortization ([DFR 2005](#), p17-18). The profit-sharing arrangement allocated the surplus recovery from the management of NPLs in cases where the fair value of the loan was less than the principal amount outstanding ([DFR 2005](#), p17). 80 percent of the surplus recovery went to the selling institution, while Danaharta kept 20 percent ([DFR 2005](#), p17). The surplus was calculated by account, with the surplus recovery equal to the total recovery less the fair value and direct costs ([DFR 2005](#), p17). Because Danaharta paid up to the fair value in cases where the fair value was less than the principal outstanding, the surplus for the selling institution was capped at the difference between the purchase price and fair value ([DFR 2005](#), p17). There were exceptions to the profit-sharing arrangement, such as in the case of exceptionally large loans ([DFR 2005](#), p18). When Danaharta paid a nominal sum for the loan, 95 percent of the surplus recovery went to the selling institution while Danaharta kept 5 percent ([DFR 2005](#), p18). If Danaharta paid a percentage of the principal outstanding for the loan, the transferring institution received 90 percent of the surplus and Danaharta received 10 percent ([DFR 2005](#), p18).

Selling institutions were allowed to amortize losses from the sale of NPLs to Danaharta over a five-year period, which was the second incentive for financial institutions to sell NPLs to Danaharta (DFR 2005, p18). Financial institutions were required to write off 20 percent of the shortfall in the first year, and a minimum of 20 percent in the following years until the loan loss was written off (DFR 2005, p18). When Danaharta completed the resolution of the loan, the transferring institution was required to write off any remaining loss (DFR 2005, p18).

The two penalties, or “sticks”, included a single opportunity to transfer loans to Danaharta as well as the immediate write-down of loans that were not sold to Danaharta (DFR 2005, p18). Danaharta provided financial institutions with only one opportunity to sell each NPL; any NPL the institution elected not to sell could not be sold to Danaharta at a later date (DFR 2005, p18). Danaharta also gave the financial institutions a limited timeframe to consider offers to drive efficiency and prevent price negotiation (DFR 2005, p18). If a financial institution decided not to sell an NPL to Danaharta, it was required to immediately write down the loan to 80 percent of Danaharta’s valuation (DFR 2005, p18).

16.Acquisition; Asset Purchase Window – Danaharta established two purchase windows, with an open and general purpose for the primary carve-out and a more selective secondary carve-out.

Danaharta acquired assets during two purchase windows (DFR 2005, p21). The first purchase window, the “primary carve-out”, occurred between September 1998 and June 30, 1999 (DFR 2005, p21). The objective of the first round of acquisitions was to “relieve the pressure on the banking system caused by NPLs”; thus, all financial institutions were eligible to sell NPLs to Danaharta during this window (DFR 2005, p21). Danaharta announced that the acquisition would prioritize weaker financial institutions, such as those receiving capital injections from Danamodal, as well as those that were likely to sell NPLs to Danaharta (1998-10-06 Press Release; BNM AR 1998, Annex p18). Financial institutions were able to decline Danaharta’s offers, and RM1.78 billion in offers were declined during the first window (DFR 2005, p21).

The second purchase window, the “secondary carve-out”, occurred between July 1, 1999, and March 31, 2000 (DFR 2005, p21). Danaharta established a more selective set of criteria for assets to be eligible for transfer, which included NPLs from borrowers already in Danaharta’s portfolio, NPLs from borrowers with a total value greater than RM50 million, unsecured NPLs to public companies, or NPLs from financial institutions with a NPL ratio higher than 10 percent (DFR 2005, p21).

There were minor changes to Danaharta’s portfolio following the two purchase windows, as more managed NPLs were transferred to Danaharta (DFR 2005, p22). Danaharta returned a small quantity of acquired NPLs to the selling financial institution (DFR 2005, p22).

17. Acquisition: Management -- In addition to acquiring NPLs from financial institutions, Danaharta managed NPLs on behalf of the central bank and government.

Danaharta managed NPLs on behalf of the central bank and government for two defunct banking groups (DFR 2005, p20). Sime Bank reported massive losses in 1998 due to increased loan defaults, and BNM took over the bank in 1998 (DFR 2005, p20). In order to facilitate a merger of Sime Bank with RHB Bank Group, another commercial bank, BNM carved out Sime Bank's NPLs and moved them to Danaharta for management (DFR 2005, p20). Danaharta Managers Sdn Bhd (Danaharta Managers) was established and incorporated to manage the NPL portfolio from Sime Bank. Similarly, Bank Bumiputra Malaysia Berhad Group (BBMB Group), a government-owned banking group, reported large losses due to NPLs in 1998 (DFR 2005, p20). BBMB Group was merged with Bank of Commerce (M) Berhad after its NPLs were transferred to Danaharta for management (DFR 2005, p20). In 1999, Danaharta Urus Sdn Bhd (Danaharta Urus) was created to hold the NPLs. Danaharta Managers and Danaharta Urus were fully owned subsidiaries of Danaharta (DFR 2005, p20).

Unlike acquired NPLs, NPLs from BBMB Group and Sime Bank did not require payment from Danaharta to take over the management of the NPLs (DFR 2005, p20). Thus, there was no reported purchase price for these NPLs, as the government and BNM already owned these NPLs (DFR 2005, p22). However, Danaharta had to have legal ownership in order to use its legal authority to manage and resolve the NPLs (DFR 2005, p20-21). Thus, Danaharta Managers and Danaharta Urus issued zero-coupon bonds to Bank Negara Malaysia and the Ministry of Finance as consideration for the loans and redeemed them with the recovery from the respective loans (DFR 2005, p21). These bonds were different from the bonds issued by Danaharta to acquire NPLs from other financial institutions (DFR 2005, p21). The loan size restriction of RM5 million was relaxed for BBMB Group and Sime Bank, Danaharta managed loans with minimum value of RM1 million from the bank groups (DFR 2005, p21).

In exchange for managing the NPLs from Sime Bank and BBMB for BNM, Danaharta received a management fee (DFR 2005, p21). If the recovery value was less than or equal to the net book value, Danaharta received 2 percent of the net recovery value (DFR 2005, p21). If the recovery value was more than book value, Danaharta received 20 percent of the excess recovery in addition to the 2 percent of net book value (DFR 2005, p21). After deducting management fees, the recovery on the management of these loans accrued to the government and BNM (DFR 2005, p21).

18. Exit strategy – Danaharta's resolution approach was to achieve maximum recovery value from the NPLs.

Danaharta's goal for its portfolio of both managed and acquired NPLs was to recover the maximum value on the resolution of NPLs (DFR 2005, p23). Danaharta adopted the asset management company approach, as opposed to the warehousing agency or rapid disposition agency approaches (DFR 2005, p11). Danaharta elected to manage NPLs on an account by account basis to determine the recovery strategy (DFR 2005, p12). Recovery strategies depended on the nature and circumstances of each NPL account (DFR 2005, p12).

19. Disposal: Danaharta adopted a “soft approach” for borrowers with viable businesses and a “hard approach” for borrowers with nonviable businesses or who failed to comply with loan restructuring.

Danaharta evaluated the viability of a borrower’s business, and if the business was considered viable, the NPLs were addressed using the “soft approach” method (DFR 2005, p23). Danaharta’s soft-approach, or loan management, included loan restructuring, loan settlement, and schemes of arrangement (DFR 2005, p23)¹¹. The goal of loan restructuring, which included the extension of repayment periods or rescheduling of loan payments, was to have the NPL become performing (DFR 2005, p24). Every viable borrower was given one opportunity to restructure the loan in compliance with Danaharta’s Loan Restructuring Principles and Guidelines (DFR 2005, p23). These guidelines included measures to maximize recovery, minimize taxpayer burden, ensure equal treatment of stakeholders, and utilize Danaharta’s special powers (DFR 2005, p62-63). Danaharta also provided additional guidelines for corporate borrowers, individual borrowers, and guarantors (DFR 2005, p62). Loan settlement was another option for viable borrowers; these borrowers opted for an expedited settlement of the loans, usually within a year (DFR 2005, p24). Schemes of arrangement required agreement between creditors and borrowers and required court approval (DFR 2005, p24).

For borrowers with non-viable businesses or for borrowers that failed to comply with loan restructuring, Danaharta’s resolution strategy, the “hard approach”, included the appointment of special administrators, foreclosure, legal action or other resolution methods (DFR 2005, p23).

Danaharta could foreclose on collateral if the borrower failed to repay its loan (DFR 2005, p14). Danaharta was required to issue a 30-day notice to a borrower of its intent to foreclose and dispose of the property collateral if the borrower failed to repay the loan within the timeframe (Azmi, p387). Danaharta’s special powers for foreclosure allowed it to bypass court procedures (DFR 2005, p14). Because of statutory vesting, the borrower maintained the ownership of the collateral properties, though Danaharta ultimately sold the property (DFR 2005, p66). However, Danaharta owned the properties that were transferred to it as a form of loan repayment (DFR 2005, p66). Danaharta adopted the open-tender approach to sell properties (DFR 2005, p66). Properties put up for tender were required to have their current value listed publicly, in addition to a confidential reserve price to prevent fire sales (DFR 2005, p66). Danaharta recruited real estate agents to assist with marketing properties nationally (DFR 2005, p67). Prospective buyers could reference the latest valuation report of the property, the sale and purchase agreement, and terms and conditions of the sale before placing a bid (DFR 2005, p67). Buyers received a stamp-duty waiver for all properties bought from Danaharta (DFR 2005, p68).¹² Danaharta also provided financing at competitive rates

¹¹ As Malaysia does not have an equivalent of Chapter 11 bankruptcy, a court administered scheme of arrangement is an option for debt restructuring. Pursuant to the Companies Act, the scheme of arrangement requires the approval of the High Court. See [Options for Debt Restructuring in Malaysia](#) for a brief explanation.

¹² A stamp duty is a tax on legal documents such as a sale and purchase agreement.

for the first seven tenders and promised vacant possession of the property¹³ (DFR 2005, p68-69 FN2). The properties were promised to buyers free of encumbrances within nine months of the signing of the sale and purchase agreement or the buyer could terminate the sale (DFR 2005, p68). At the close of each tender exercise, the bids were collected by a Tender Committee, which was composed of senior management at Danaharta not involved in the tender process (DFR 2005, p67). The winning bids were presented to the Tender Board, which was compromised by the Managing Director of Danaharta, another Danaharta representative, an appraiser, and a representative from the Foreign Investment Committee (DFR 2005, p67). Only the agent whose client successfully won the bidding received a commission on the sale (DFR 2005, p68). Overall, Danaharta paid approximately 5 percent of the sale proceeds for agency fees and marketing costs (DFR 2005, p68).

Legal action against a borrower was the “last resort” option for Danaharta, after it had attempted the other strategies (DFR 2005, p24). This was not a preferred resolution method due to the extensive time and monetary commitment and the minimal recovery value (DFR 2005, 24). Other methods included partial resolution, company liquidation, or the appointment of receivers or managers over a company or assets (DFR 2005, p24).

20. Special Administration – The Danaharta Act provided special legal authority to Danaharta to appoint Special Administrators to companies in order to manage the resolution of NPLs.

The Danaharta Act granted Danaharta the power to appoint a special administrator over a corporate borrower, a subsidiary, a security provider, or a company whose shares Danaharta acquired, in the event that the borrower could not repay its loan (DFR 2005, p13). The appointment of a Special Administrator effectively suspended the management and powers of the company’s Board, as the special administrator was the only party allowed to manage the company’s assets (DAR 2004, p116). The Oversight Committee first approved the appointment of a special administrator (DFR 2005, p13). The special administrator assumed temporary control of the company under administration, and the company was automatically placed under a year-long moratorium which prevented actions from being taken against the company by creditors (DFR 2005, p13). The special administrator prepared a workout proposal, which was reviewed for reasonableness by an independent advisor appointed by the Oversight Committee, and then approved by Danaharta (DFR 2005, p13). A meeting with the secured creditors followed, where a majority in the value of secured creditors was required to approve the proposal before it was implemented (DFR 2005, p13). During the course of its operations, Danaharta appointed special administrators over 73 companies (DFR 2005, p24).

¹³ Vacant possession refers to the readiness of a property to be occupied and includes certification that the property is completed and safe for occupation and readiness to be connected to electrical and water supplies.

21. Disposal of foreign loans – Danaharta disposed of foreign loans and marketable securities through restricted tender exercises.

Danaharta did not exclude foreign loans in its acquisition of eligible assets. Foreign loans included those that were non-Ringggit loans or marketable securities extended to or issued by foreign companies (DFR 2005, p25). The majority of these loans came from Sime Bank, Sime Labuan, and BBMB (DFR 2005, p25). For foreign loans and marketable securities, Danaharta determined that the best method to recover underlying value was to dispose of the NPLs for cash or swap for domestic debt, as Danaharta's special legal authority did not apply to foreign loans (DFR 2005, p25). Danaharta elected to use the restricted tender exercise to dispose of foreign loans (DFR 2005, p25). International banks that expressed interest in purchasing the foreign loans were invited to participate; participants were divided into Principal Bidders, who could bid on loans and securities, and Marketable Account Bidders, who could bid only on marketable securities (DFR 2005, p25). Danaharta held four restricted tender exercises, with a total offering of 110 accounts with principal of \$743.32 million (RM195 million) (DFR 2005, p25). In total, Danaharta sold 85 accounts for \$631.84 million, at an average recovery of 48 percent (DFR 2005, p25).

22. Disposal - In order to recover non-cash assets, Danaharta managed its portfolio of securities and issued the first collateralized loan obligation in Malaysia.

Danaharta owned and managed a portfolio of securities that included irredeemable, redeemable, or convertible securities (DFR 2005, p70). Danaharta acquired these securities in cases where loan settlements were made in securities (DFR 2005, p70). Irredeemable securities included ordinary shares and irredeemable convertible loan stocks. Redeemable securities included secured loan stocks, unsecured loan stocks, and preference shares (DFR 2005, p70). Convertible shares were loan stocks and preference shares that were convertible to equity shares. Danaharta disposed of shares if the share price exceeded a predetermined target price (DFR 2005, p70). However, if the target price was not met, Danaharta used tender exercises for controlling blocks of irredeemable securities, market mechanisms for non-controlling blocks of irredeemable securities, and redemption of redeemable securities to dispose of the securities in its portfolio (DFR 2005, p70). Danaharta sold readily tradable securities through stockbrokers or financial institutions (DFR 2005, p71). For securities subject to call and put options, the decision to dispose was governed by its specific call and put option agreement (DFR 2005, p71).

Danaharta adopted asset-backed securitization (ABS) as a method to expedite the recovery on restructured loans (DFR 2005, p28). Danaharta transferred a portfolio of loans and cash, valued at RM595 million, to an SPV, Securita ABS One Berhad, in exchange for cash and subordinated notes from the SPV (DFR 2005, p74). The portfolio included RM579.2 million in loans, a discount of RM1.5 million, and RM14.7 in reserve funding (DFR 2005, p74). On December 20, 2001, Danaharta issued RM310 million AAA-rated senior notes with a maturity of December 2005 and coupon rate of 3.75 percent (DFR 2005, p74). The senior notes were issued at 99.54 percent of par value, and the response to the issuance was positive with orders totaling over RM1 billion which is a subscription rate of 3.5 times (DFR 2005, p74). Danaharta assumed the RM285.4 million unrated tranche of subordinated notes,

which meant it would absorb any shortfall up to RM285.4 million (DFR 2005, p74). Danaharta raised RM308.57 million from the issue (DFR 2005, p75). Securita ABS One began redeeming the senior notes in stages from May 2003 to June 2004 and completed redemption eighteen months ahead of schedule, including RM18.4 million in interest costs (DFR 2005, p75). Danaharta only did one ABS exercise because the alternate recovery options “were generating cash well enough to retire Danaharta’s bond on time” (DFR 2005, p28). Danaharta’s ABS issuance was the first occasion of a collateralized loan obligation (CLO) transaction in Malaysia (DFR 2005, p28).

23. Time frame: Danaharta did not have a predefined sunset date at the time of its establishment but ultimately ceased operations on December 31, 2005.

At the time of its establishment, Danaharta did not have a predefined sunset date. In the 1998 BNM Annual Report, it was estimated that Danaharta’s lifespan would be between seven and ten years (BNM AR 1998, Annex p19). However, by 2001, Danaharta set a target to wind down by the end of 2005 (DAR 2001, p17). Danaharta ceased operations on December 31, 2005, and transferred remaining cash to the Ministry of Finance (DFR 2005, p31).

Danaharta projected that a total of RM2.88 billion in residual recovery assets would remain by December 2005 (DFR 2005, p40). The residual recovery assets were transferred to the Minister of Finance Incorporated, for conversion to cash beginning January 1, 2006 (DFR 2005, p40). The Minister of Finance Incorporated designated Prokhas Sdn Bhd (Prokhas), a fully-owned subsidiary, the collection agency for the remaining residual recovery assets (DFR 2005, p40). Thus, the ownership of the assets remained with Danaharta, which became a dormant company, until the completion of recovery (DFR 2005, p40).

III. Evaluation

In evaluations of AMCs, Danaharta is often considered a “success story” (Cerruti, p93). Scholars recognize that Danaharta prevented further increases in NPLs, repaid its bonds on time, completed its operations in seven years, and incurred a small loss for the government (Cerruti, p93). The IMF considered the plan for Danaharta to be “well-conceived,” as it had a manageable portfolio of loans to resolve and an appropriate focus on resolution instead of warehousing or rapid disposition (Meesook, p76). The Bank for International Settlements (BIS) considered Danaharta to be a “fairly effective policy instrument in removing and resolving NPLs in asset recovery” as it had legal authority, a coordinated strategy, financial support, and political backing that enabled it to operate efficiently (Fung 2003, p35).

During Danaharta’s operations, the IMF warned that Danaharta’s purchase price could operate as a tool to bail out existing shareholders if the price was set at a value higher than the fair value (Meesook, p76). The IMF noted that Danaharta was using an appropriate, market-based mechanism for valuation, as selling banks rejected Danaharta’s offers on RM4.2 billion in book value because the offers were considered too low (IMF 1999, p64).

Cerruti attributes Danaharta’s success to a combination of factors which were the design, economic environment and operations. The design had a “clear mandate and enabling legal

environment” which enabled Danaharta to operate effectively with strong guidance (Cerruti, p95). The economic environment was also improving, as the economy rebounded and the capital controls and interest rates contributed to a positive environment for borrowers (Cerruti, p95; Doraisami, p586). Furthermore, Danaharta had “strong corporate governance and transparency”, as it adopted KPIs, followed the Malaysian Code of Corporate Governance, published frequent reports, and had stable management and governance. (Cerruti, p95). The IMF recognized similar attributes, such as the broad legal mandate which enabled Danaharta to operate efficiently (Meesook, p74). Furthermore, Danaharta’s incorporation under the Companies Act required it to undergo regular auditing to ensure transparency and accuracy (Meesook, p74-76).

Danaharta provided ample self-evaluation in its final report. Danaharta asserted that it met all of the BIS’s criteria for an effective AMC which include strong political will, supportive legal infrastructure, efficient market environment, clear AMC mandate, well defined AMC lifespan, adequate governance, good transparency, realistic asset pricing, and speedy resolutions (DFR 2005, p47). Danaharta was visited by international agencies, such as the World Bank and IMF, as well as other national AMCs during the course of its operations (DFR 2005, p3). Danaharta credits its operations with preventing a banking crisis and lowering the cost of NPL resolution, as the NPL ratio began to decrease after Danaharta began its acquisition (DFR 2005, p46).

However, Danaharta’s recovery figures were improved by including the managed loans from BBMB and Sime Bank, as Danaharta did not have to purchase these assets (Cerruti, p94). The managed loans yielded a higher recovery rate than the acquired assets. Without the income from the managed loans, Danaharta would have incurred a greater loss (Cerruti, p94).

Furthermore, Inoguchi evaluated the effects of AMCs on the NPL ratio in Thailand and Malaysia and found that the effect of selling loans to Danaharta is unclear (Inoguchi, p605). This is due to the NPL ratio increasing after the period in which the asset management company completed its asset purchases (Inoguchi, p629). Inoguchi concludes that “[i]t is possible that the increase in loans sold to Danaharta affected the NPL ratio because some coefficients were significant and the NPL ratio rose after the period in which the asset management company ceased purchasing loans” (Inoguchi, p629). He concludes that it is likely that Danaharta’s role in solving the NPL problem was smaller than the impact of Thailand’s AMC (Inoguchi, p629).

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