

Chapter 7

Conclusion

7.1 Lessons learnt from the study

Researchers claim that evergreening practices in the banking institutions of Malaysia may have caused NPLs to be misleading indicators of asset quality before the crisis and during times of strong economic growth. After the crisis, better prudential measures were imposed by Bank Negara so that NPLs can be detected and monitored earlier. This is to avoid fragility in the banking institutions from happening again during an economic downturn like in the 1997-1998 crisis and therein incurring a high restructuring cost to remedy the problem. Yet, eventhough there are better prudential practices in the banks since 1996, they are still far from the international best practices (see Table C in Appendix C).

Danaharta, Malaysia's national AMC that was established to address the NPL problem during the 1997-1998 crisis is generally similar to Securum, Sweden's AMC in terms of approach. Both these AMC are government owned long term market driven restructuring AMCs that were established to maximize recovery of loans and assets and at the same time avoid warehousing too much of assets. Danaharta was successful in bringing down the level of NPLs in the banking institutions, although, under a three month NPL classification, its effectiveness is

less evident. Thus, relaxing the NPL classification from three months to six months classification, was a form of forbearance for Danaharta to bring down the level of NPLs as lesser NPLs can be acquired to show its effectiveness.

In terms of its progress in loan disposal, Danaharta has been relatively less successful. Most long term restructuring AMC's are reluctant to conduct fire sales and tend to delay disposal of the assets in their portfolio because it could push asset prices down and recreate the NPL problem in the banks. Yet, Securum managed to dispose 98 percent of its assets in five years of its existence, while Danaharta has merely disposed 30 percent in five years since its inception, which is far less than half the amount of its assets in its portfolio.

This may be due to the faster improvement in the property market in Sweden compared to Malaysia. Nevertheless, a proper incentive mechanism is important in motivating AMC's to recover their loans. Although, the surplus sharing agreement between the selling banks and Danaharta was an incentive for banks to sell their loans to Danaharta, the low recovery rates for acquired NPLs and the low amount of surplus distributed to the selling banks indicates an absence of sufficient incentives to recover the loans acquired.

The central bank plays an important role in creating incentives for Danaharta to successfully dispose the loans. According to IMF (1997), capital should be

injected only to viable banks and if the capital ratio after injecting the capital becomes too high, this could also reduce the incentives for AMC's to recover the loans. Further, most AMC's swap government bonds for non-performing loans. This can increase the capital ratio of the selling banks, because government bonds have a lower risk weight under most capital standards. Since Danaharta issued zero coupon bonds in exchange for NPLs, this could have immediately improved the capital situation of the banks and eventually created lesser incentives for Danaharta to sell their loans.

In addition, some researchers expressed that the loss amortization over a period of five years on loans sold to Danaharta may have created forbearance on Danaharta to recover the loans and assets. It is also possible that the immediate recognition of loss if any, once an asset or loan is disposed, may have affected Danaharta's willingness to sell their loans faster. In any case, the incentives for AMC's to recover the loans would be affected by the degree of government ownership of the banks. According to the Worldbank (2001), government ownership of banks in developing countries rises in times of crisis (see Figure D in Appendix D).

The sufficient funding, the special powers conferred to it through its act, and also the board composition of Danaharta indicates that it was independent of the

government. Nevertheless, in the Swedish case, according to Worldbank (2001), a bank support agency which was highly represented by the opposition party was also established along with Securum, the government owned AMC. The authority to approve the banks that qualified for the blanket guarantee capital support was given to the bank support agency. This truly marks the independence of an AMC.

7.2 Suggestions for further study

There is room for research on the capitalization program on banking institutions in Malaysia during the 1997-1998 crisis through Danamodal, and the loss recognition practices if there were losses incurred from loans and assets disposed by Danaharta. In addition, future study should be done on the governance and the ownership of the banking institutions in Malaysia during the 1997-1998 crisis.

7.3 Conclusion

Best practices in loan classification and prudential measures are pivotal in order to create a resilient banking system in times of crisis to prevent costly remedial restructuring measures. The establishment of Danaharta to address the NPL problem in the banks was useful in bringing down the level of NPLs in the banks. But, its effectiveness in disposing the loans is relatively low. Although, the slow

improvement in the property market can be the reason for its tardiness in disposing the loans, the absence of true independence and the incentives to dispose the loans may also have a great impact on its performance.