

Chapter 5

An Overview of Danaharta

5.1 Danaharta as part of the Three Pronged Approach

In anticipation of further deterioration in capitalization and asset quality in the banking system in Malaysia, efforts were made since mid 1998 to revive the economy and create a resilient banking system. NEAC recommended a three pronged approach for this purpose by establishing Danaharta, Danamodal and CDRC in 1998 to deal with the emerging problems in asset quality, capitalization and corporate debts respectively. Danaharta is interrelated with Danamodal and CDRC to complement each other in restructuring the banking system. While CDRC helps Danaharta in its loan restructuring process, Danaharta's support in the form of proceeds distributed to the banks from the sale of NPLs, will determine the amount of capital to be injected by Danaharta to the banks.

5.2 The phases of Danaharta

Pengurusan Danaharta Nasional Berhad, or more commonly known as Danaharta, is an AMC established in June 1998 to transfer NPLs from financial institutions and subsequently recover them. This was to enable banks to focus on lending activities and ensure that residual NPLs in the financial institutions

remained at manageable levels. The progress of Danaharta in resolving the NPL problem is basically divided into 3 phases which is the establishment, transfer of NPLs, and the management of NPLs phase. The time frame estimated for the entire process is about seven years. Danaharta discloses details of its operations in its annual reports every six months.

5.2.1 Establishment

Danaharta is wholly owned by the government through the Ministry of Finance. The board of members in Danaharta includes three non executives from the Malaysian community, two non executive directors from the international community and two non-executive directors representing the government from the Ministry of Finance and BNM.

The maximum capital allocated by the government for Danaharta's funding is RM 20 billion where about RM 3 billion is contributed by the government, RM 2 billion is in the form of loans from EPF and Khazanah and the bulk of the financing which is about RM 15 billion is through the issuance of zero coupon bonds. The amount of funding has not increased since its establishment. Statutory backing was given to Danaharta through its own act i.e. the Danaharta Act, 1998. According to this act, Danaharta would be able to acquire loans and transfer assets without the borrowers consent without court restraining orders. In addition,

the act allows Danaharta to foreclose on assets charged to it. In addition to the statutory backing given to Danaharta, the National Code Act, provides the ability for Danaharta to buy NPLs that are secured by land in an effective and economical manner.

5.2.2 Transfer of NPLs

Danaharta does not intend to purchase all the NPLs from the banking institutions. Danaharta aims to ensure that the residual NPLs in the banking institutions remain at manageable levels. It acquires NPLs from the financial sector which comprise of banking and non-banking institutions. Danaharta categorizes the financial institutions into the weaker ones and the stronger ones, as it makes sense to concentrate on the weaker financial institutions as they are more willing to transact. The NPLs acquired from Danaharta should have a minimum gross value of RM 5 million, because NPLs in Malaysia tend to be concentrated with 70 percent of the NPLs in the system above RM 5 million in gross value (Danaharta Operations Report, 1998).

Although Danaharta adopts a market driven approach as there are no compulsory powers of NPL acquisition, the government provided several incentives to encourage banking institutions to sell their loans to Danaharta. Banks with NPL ratios exceeding 10% are required to sell all their eligible NPLs

to Danaharta. In addition, banks requiring recapitalization from Danamodal are also required to sell all their eligible NPLs to Danaharta. Banks rejecting Danaharta's offer are required to write down their loans by 20 percent below Danaharta's offered price. Further, banking institutions are allowed up to five years to amortize losses resulting from the sale to Danaharta. Surplus of loans recovered would be shared on an 80:20 percent basis among the banks and Danaharta. Finally, banks can use special powers to resolve their NPLs through Danaharta. However, the amount that is deemed recoverable from Danaharta is reported as a deferred asset that in all cases is written down by at least 20 percent a year. Once loans or collateral are sold, the true extent of losses, if any, must be recognized immediately by the bank (Kochhar, et.al,1999)

Besides acquiring loans, Danaharta also manages large loans from the Sime Bank Group and the BBMB Group on behalf of Bank Negara. In consideration of the NPLs managed, it receives fees for managing the loans.

Danaharta acquires the NPLs at a discount. It issues zero coupon bonds to banking institutions and pays cash to non banking institutions and Islamic financing services in exchange for NPLs acquired from the financial institutions. The bonds are issued progressively in tandem with its acquisition process. These

bonds would be redeemed by Danaharta at maturity after distributing the share of recovery surplus to the financial institutions.

Danaharta received NPLs to be acquired and managed from around the end of 1998 to March 2000. After year 2000, Danaharta transferred a small amount of NPLs that were not direct purchases but were due to the put option exercise arising from the mergers of some banks. The bulk of the NPLs were transferred during the primary carve out phase which was from end of 1998 to mid 1999. The NPLs transferred during the primary carve out were taken out from the NPLs that were in the banks till September 1998. A smaller amount of NPLs that was transferred during the secondary carve out phase from June 1999 to March 2000, were taken out from the new NPLs in the banks after September 1998.

5.2.3 Management of NPLs

In this phase, Danaharta restructures and disposes the NPLs. The management phase begins with Danaharta reviewing each NPL account in its portfolio to determine the most appropriate recovery strategy. Danaharta's approach in identifying its recovery strategy is to apply either loan management or asset management strategies depending on whether it finds the loans viable or not. Danaharta will apply loan management strategies to loans that it finds viable. This will involve loan restructuring strategies such as loan rescheduling and debt

equity conversions. It employs three methods for loan restructuring i.e. Plain Loan Restructuring, Settlement of Loans and Scheme of Arrangement. Plain loan restructuring is a formal loan restructuring method by rehabilitating an NPL to become a performing loan, while scheme of arrangement is an informal loan restructuring method arranged by CDRC. When a settlement scheme has been agreed upon, it falls in the category of settlement of loans.

Loans are deemed not viable when the borrower fails to comply with the loan restructuring guidelines. Danaharta would normally resort to asset restructuring methods like foreclosure of collateral, appointment of special administrators and legal action (Danaharta, 2003).

After the restructuring methods are implemented, the recovery strategies are implemented. Different methods or strategies will yield different types of recovery assets namely cash, properties, securities, and restructured loans. The cash category is divided into the cash for foreclosures of collaterals and cash for non-foreclosures. Collaterals are foreclosed using tenders, auction and private contracts. Danaharta prefers to use the open tender approach. The indicative value of the assets foreclosed would be provided by independent professional valuers as a guide for the buyers. Danaharta would set a minimum price for the collaterals below the indicative value. The indicative value is disclosed, but the

minimum price is not disclosed by Danaharta. Assets would be sold if they are not below the minimum price set by Danaharta. Danaharta Hartanah, a subsidiary of Danaharta would be the buyer of last resort of the unsold collaterals that were not sold in the open market. Therefore the unsold collaterals would be warehoused in Danaharta Hartanah, till they are reoffered in the open market.

A share of recovery surplus received by Danaharta would be distributed to the government and the financial institutions as and when the proceeds from disposal of the NPLs are received. Financial institutions would get 80% of the share of surplus, while the government would get its surplus after deducting management fees received by Danaharta. Any excess cash after distributing the recovery surplus would be used by Danaharta to redeem the bonds issued earlier for the purchase of NPLs. To date, Danaharta has managed to redeem 8 tranches out of a total 15 tranches of bonds issued.

5.3 Conclusion

Figure A in Appendix A provides an overview of Danaharta's mission at various time periods from the date of inception to the date it expects to wind up. Its effectiveness in addressing the NPL problem of the banks in Malaysia would be a part of the analysis and findings of this study, in the following chapter.