

SECTION 5: Recommendations

Issue 1: Reduction in Demand of the Scheme and fee based income - The number and amount of approval under this scheme has reduced since it was introduced in Year 2006

(a) The appropriateness and inappropriateness of alternative courses of action

The management of SME Bank is suggested to perform improvements as mentioned below to boost up the competitiveness and relevancy of the scheme in the eye of the public.

Among others are:

- The management is suggested to give priority to the existing good borrowers that have good track record with SME Bank and also other financial institutions. The credit rating is to be increased one step higher than the previous rating implemented by the Bank. In other words, the Bank will still be able to assist potential borrowers with the guarantee and not to burden them. Besides this, these existing good customers will be identified and be given fast track approval under the Credit Guarantee Scheme, whereby less documentation and collateral will be required. This is also as an appreciation by SME Bank to its existing good customers for their support.
- Fast delivery to customers is required in any service related industry. The management has suggested to improve the delivery and driven it by Key

Performance Index (KPI) for every staff that is involved in the administration and operation of the Credit Guarantee Scheme. Efficiency of a staff is measured by the KPI, whereby it is suggested that the staff need to be competent, dedicated and knowledgeable. It is suggested that the target for monthly approval and number of complaint received from the customers will be cascaded down to every branches. The Bank's client charter will need to be revisited and revised to ensure that the timeframe of delivery is acceptable by the current market environment. The KPI also need to involve every staff and delay is not permitted. If any application of the scheme is rejected, the customers need to be informed in a timely manner on the result. No long waiting time is allowed if this suggestion is implemented by the management.

- The participating Financial Institution that act as lender need to be convinced by the guarantee provided by SME Bank. The claim payment process from SME Bank to the Participating Financial Institution should be performed promptly. Any delay in the claim payment may create bad perceptions towards SME Bank. The flow starts from loan default until the actual payment of claim need to be revisited and revised for improvement. The prompt payment will increase the trust of Participating Financial Institution and portray a good image with regards to the guarantee provided by SME Bank.
- The management is suggested to educate the public on the benefit of the Credit Guarantee Scheme through the SME Bank branches. This is part of SME Bank's vision to become as SME Hub by Year 2010. By implementing, the management

is expected to see more demand from potential existing borrowers on the scheme.

- The management is suggested to focus on giving guarantees to quality customers. The management is suggested to study on opportunity available in the niche market and to utilise it to generate profit in the long term.
- To minimise the negative impact of moral hazard, the management is recommended to select only good rating borrowers and to require Participating Financial Institution to participate actively in monitoring the loan as well. Proper assessment is required to be performed at the initial stage of application process until the respective approval committee. As explained in the literature review, there are some borrowers that have a bad attitude of not paying off the loans since they have obtained a guarantee given to them by the Bank. The management need regularly discussion with the Participating Financial Institution to update on their joint responsibility on lending and guarantee. This will ensure that SME Bank will have a proper control in place and the occurrence of moral hazard will be minimised. More guarantees could be issued by SME Bank with confidence.
- The management should impose additional collateral requirement as in case if there is loan default. By having this requirement in place, SME Bank could broaden its market based to more risky but potential borrower.

- The management is suggested to revise on the risk sharing basis between the guarantor and the lender from the first disbursement to final payment of the loan made by the borrower. This will enhance the responsibility of the lender to take more active participation in supervising the loan and reduce the occurrence of moral hazard. SME Bank will be more secured in issuing further guarantees to the Participating Financial Institution, and will be able to boost the number of credit guarantee issued and mitigate losses or claims.

(b) The rationale for the recommendations

The above recommendations are solutions to tackle issue of reduction in the demand of the facility, which has affected the fee based income of the Bank. Rationally, the policy and procedure need to be revised to enlighten the process of application and encourage good customers to apply. Establishing a fast track would be a solution besides given priority to existing customers with good track records. The collateral requirement also should be minimised on these customers. Satisfaction among customers will establish good reputation on image of SME Bank that will generate more business in future.

Another recommendation is to establish KPI among the staff involved in the administration and operation of the scheme. Rationally, this enhance the spirit of working harder towards target, namely application received and approval granted during a period, and this will determine the annual benefits that they will received after the annual appraisal of their performance is made. Furthermore, this will establish the

sense of responsibility and accountability among the staff in achieving the intended target, and will eliminate unnecessary inefficiency in the operations.

The Bank's Client Charter need to be revised to capture the heart of the public, since speed of delivery is important to the customers. This something that the Bank need to relook seriously. Usually customers would not able to tolerate with long waiting time, since it always refer to loss in opportunity cost. If the speed of delivery can be improved, there is a possibility that the demand of the scheme could also be improved in future.

Another recommendation is to enhance the marketing strategy by using media. This will ensure that the public is aware on the role and benefit of the scheme to assist them to get financing from the commercial bank for their business. Some of the SMEs are not aware on Credit Guarantee Scheme that could be used by them. The awareness is hoping that more good SME customers is applying for the facility and increase the fee based for the Bank.

The contractual agreement with the Participating Financial Institution and SME Bank need to be revised. There is occasion whereby the Bank is not willing to offer the facility to customers due to risk factor of the borrower. This is because the Bank has to bear the risk of loan defaulters since SME Bank is the guarantor to financing facility given by the lender, the Participating Financial Institution. The suggestion is to review the risk sharing basis between the banks, whereby SME Bank will minimise its exposure to loan losses and increase its willingness to offer this scheme to higher risk customers.

(c) The feasibility of the recommendations – the capabilities and resources to implement the suggestions

Policy and procedure is developed internally by the respective departments within the Bank, and then tabled to a committee that consist various heads of function. The committee will give their view on the policy and procedure. Once approval is granted, the policy and procedure will then table to the Senior Management Committee and also to the Board of Directors' Meeting for their further approval. The Bank has the capabilities to perform the revision of policy and procedure since it is done ordinarily and internally within the Bank. In addition to internal resources, the Bank may consider to appoint a consultant during the revision of the policy and procedure. This also is applied to the Bank's Client Charter, which similar to revision of policy and procedure.

In practice, the Bank is usually annually revising KPI for every function in the Bank. The KPI can be divided into 2 categories namely Common and Normal KPIs. Common KPI is shared among all staff within the Bank. Meanwhile, Normal KPI is specifically for individual staff that based on their job description. This recommendation is focusing on staff that involved in Credit Guarantee Scheme, whereby KPI for staff involved in the process workflow can be revised further to improve the quality of their delivery. The Bank has internal resources to perform the revision.

On the marketing strategy, the Credit and Branch Management Office has the capabilities to oversee it. However, external consultant may need to be hired to get fresh ideas to enhance competitiveness of the Credit Guarantee Scheme.

Regarding the contractual agreement between SME Bank and Participating Financial Institution, the Bank may need to negotiate the term of risk sharing basis between the two banks. The bank may need to highlight the long term business relationship to be build and Government's mandate role to get buy in from the Participating Financial Institution. This should also involved the senior management namely Managing Director of the Bank to discuss this issue with its counterpart.

Issue 2: Increase in claims - The accounts under this scheme have high tendency in turning non-performing, whereby this will lead to higher and frequent claims submitted by the Participating Financial Institution.

(a) The appropriateness and inappropriateness of alternative courses of action

- Moral hazard and adverse selection are issues that may increase the possibility of loan becoming bad and the incurrence of claims. To mitigate these risks, the management is recommended to revise the credit review process such as increasing the credit rating on new applications. The selection committee must impose more stringent requirements to ensure that only credible borrowers are granted approval under the credit guarantee scheme. The management is also suggested to revisit and revise the current policy & procedure of the operations of credit guarantee. Regular meeting with the lender is required to ensure that the supervision of the loan is continuously maintained and the borrower is continuously reminded when they are one month in arrears.
- The management is recommended to visit the borrower on regular basis and to get 'first hand information' on the guarantee operations. This is to prevent any abuse of loans for other purpose which is different from the one that is agreed during the loan arrangement. SME Bank has different risk appetite on the borrower on different purpose of loan being used, that requires the Bank to reassess the credit rating of the borrower. There may be a possibility that the credit should not be granted to that borrower on this arrangement. The

management also is suggested to jointly supervise the loan together with the lender.

- The management is suggested to impose requirement on additional collateral, especially on existing borrowers that do not have strong track record with SME Bank. The collateral would minimise the Bank's losses in the event of loan becoming bad and increase the borrower's commitment to service and settle the loan on due dates.
- On the new set up, the management is advised to include additional securities as part of the requirement under the Credit Guarantee Scheme since they do not have any history of doing business but have the potentials. Consideration should only be given to serious new set up and the additional securities requirement will ensure the borrower's commitment towards serving loan properly.
- The management is recommended to revisit contractual agreement between SME Bank and the Participating Financial Institution and the borrower. This could be performed internally by the Bank's Legal Department or the Bank could appoint legal firms to study the tripartite arrangement for further improvement, such as securities and claim payments. Any defect or potential dispute in the contractual agreement and Letter of Offer/Acceptance may cause delay in liquidating the securities or taking action on the concerned parties, whereby it should protect the interest of SME Bank as guarantor.

- The management is recommended to revisit the current organisational structure of Trade Finance and Insurance Department and the branches of SME Bank, including the work flow process and manpower. Sufficient, competent and dedicated manpower is required in handling these activities to ensure the quality of delivery and monitoring of the guarantee and the facilities utilised.

(b) The rationale for the recommendations

One of the recommendations to tackle the issue of increase in claims is to revise current policy and procedure of credit review process. More stringent rules are to be imposed to ensure only good and serious borrowers only will be given consideration during the review. Furthermore, additional collateral should be imposed on higher risk customers to ensure that the Bank willing to materialise it if the loan turns bad. The rational is to ensure that the borrowers are committed with their duty to pay their loans before due and aware on their responsibilities. This will ensure to reduce the possibility of claim from being made unnecessarily.

One of the reasons of the high claims is because the lender does not have much commitment to do the loan collections since their financing facility is fully covered by SME Bank thru Credit Guarantee Scheme. Therefore, there is a need for both banks to conduct regular meeting to ensure that the loan financing is properly monitored by the Participating Financial Institution. The borrowers need to be reminded regularly on the overdue loan payment and to ensure that the loan financing is served accordingly. The

contractual agreement between both banks may need to be revised to ensure that the responsibilities among them are well defined.

Another recommendation is to conduct regular visit to premise of the borrowers. This is a part of the Customer Relationship Management programme (CRM) that needs to be established, to gain the 'first hand' information on the business. Potential loan defaulters will be given more priority in the visit, whereby advisory on the borrowers' business operation may need to be given to ensure they could continue their business and paying back the loan facility. The advise on the daily operations of the borrowers' business such product and marketing strategy, and cash flow management. This will reduce the possibility of unnecessary claims in case of loan default.

The manpower requirement may need to be revised to ensure high quality of delivery is maintained by having adequate, competent and dedicated manpower to manage the Credit Guarantee Scheme. This is also ensure that the management able to get fast feedback from the team on such the discussion with the Participating Financial Institution, meet customers during site visit and departments within the Bank. This recommendation is hope to prevent any loan became default in future and cause claim payment to be made by the Bank.

(c) The feasibility of the recommendations – the capabilities and resources to implement the suggestions

The policy and procedure can be revised internally by Credit, Product Development and Branch Management Office, whereby study will be made on credit review process, requirement on collateral and other requirements to ensure quality of loan approved. A study tour in other bank can be performed to get some new ideas for improvement on the Credit Guarantee Scheme offered by them. The Bank has sufficient resources to perform as recommended.

The management is recommended to conduct regular meeting with Participating Financial Institution, which will be done by departments involved with Credit Guarantee Scheme namely Branch Management Office and Trade Finance & Insurance. This requires the strength of relationship between the management of both banks to agree on the supervision of loan is continuously maintained by the Participating Financial Institution. The branches and Credit Administration department could conduct regular visit to the borrowers' place. At the moment, this practice is in place but frequency of visit need to be increased.

The revision of manpower requirement could be done internally by Human Resource department to get competent and dedicated staff to be employed under Credit Guarantee Scheme. The Bank has the capabilities and resources to perform as recommended.

Issue 3: Viability of the scheme - The scheme is not able to deliver the expected profit, but in fact it is making losses from the huge sum of claims paid.

(a) The appropriateness and inappropriateness of alternative courses of action

The viability of Credit Guarantee Scheme in SME Bank is much depending on the fee based income generated from guarantee issued and claim payment made to the Participating Financial Institution.

The recommendations are as follows:

- The management is suggested to perform regular Cost and Benefit Analysis and maintain robust Forecast & Target on profit generated from the scheme. This is to ensure that appropriate profit is generated and immediate action must be made by the respective parties involved if that any indication of loan default or unnecessary expenses to be incurred. It is also recommended that Weekly Meeting on Performance of the credit guarantee be conducted by Trade Finance and Insurance Department and Branch Management Office, who represents the branches.
- The management is suggested to revisit the workflow process and policy & procedure on operations of credit guarantee regularly to identify any areas that could be simplified without jeopardising the internal control and interest of SME Bank. The long winded flow could cause unnecessary administrative expenses and time consuming for all parties involved in these activities. The management

is advised not to directly replicate any workflow process and policy & procedure from other Financial Institutions since it may not be applicable in the context of SME Bank.

(b) The rationale for the recommendations

The Cost and Benefit Analysis is an acceptable technique used in determining the viability of a product or project. Therefore, it is recommended in analysing the performance of the Credit Guarantee Scheme. This analysis can be presented at the internal weekly meeting that will be conducted regularly to monitor the performance of the scheme, especially on the issues that have been identified in this study. This extra attention given is expected for improvement on the highlighted issues.

Furthermore, shorter process flow is expected to reduce time and cost for each application submitted. Rationally, this will require lesser number of manpower involved in the workflow process means that lesser operational cost such as payroll expenses to the Bank. Shorter workflow process will increase effective processing time for the application of the scheme until the facility is granted to the customers. Effective processing time will reduce the unproductive time cost and increase the customers' expectation on delivery, and expecting more good applicants to apply for Credit Guarantee Scheme and boost up the fee based income for the Bank.

(c) The feasibility of the recommendations – the capabilities and resources to implement the suggestions

The review of the workflow process and analysis on Benefit and Cost of the Credit Guarantee Scheme are to be performed by the departments within the Bank. The duty to revisit the workflow process is by the front and the back office functions namely Credit, Branch Management Office and Trade Finance & Insurance. Areas of concern are to identify the unnecessary documentations and 'bottle neck' that may cause delay in the process flow that contribute to increase unnecessary administration and operational expenditures to the Bank. As being practice by the Bank, the workflow process will then be tabled and discussed at a Committee before finalising it.

The Cost and Benefit Analysis could be implemented by Finance and Budget Committee team immediately in their monthly Financial and Performance Report, and be shared with the operations unit. Weekly Meeting among the respective departments could be conducted to monitor closely the progress of the application and approval of the facility, and also post mortem on any application of claims received.

Issue 4: The Bank's capacity to issue Letter of Guarantee has been depreciated due to depleting balances available in the Guarantee Fund Account.

(a) The appropriateness and inappropriateness of alternative courses of action

The depleting in the Balances available in the Guarantee Fund Accounts is very much related to issues as mentioned earlier, namely reduction in demand of the scheme and increase in the claim payments. Below is an addition to the earlier recommendations:

- To strengthen the monitoring of Credit Guarantee Scheme, the management is recommended to revisit the manpower requirement of Trade Finance and Insurance Department and the branches such as the experience, competency and staff requirement, current organisation structure and work flow process. The management also must impose Key Performance Index (KPI) on every staff that is involved in this scheme.

(b) The rationale for the recommendations

The effectiveness and efficiency of staff in monitoring the scheme is important to ensure that it could be running smoothly. By having the KPI system in place, this will ensure that the responsibility and accountability is enforced to everyone who involved in the process, starting from the Branches (Front Office) until the Back Office. This will ensure everyone involved aware on their responsibility, no duplication of work and every area in the workflow is properly covered.

(c) The feasibility of the recommendations – the capabilities and resources to implement the suggestions

The recommendation is feasible since the KPI system has been successfully implemented in other areas in the Bank. The KPI will be reflected in each staff appraisal form that will be assessed by Head of Departments at the year end. This will reflect the staff's performance rating that determines their annual bonus, annual salary increment and promotions. This is implemented since it involves only internal functions within the Bank such as Human Resources and respective departments.