

SECTION C

Evaluating

How does one measure the success of a non-profit special purpose organisation like an NPL resolution agency?

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Danaharta's Performance

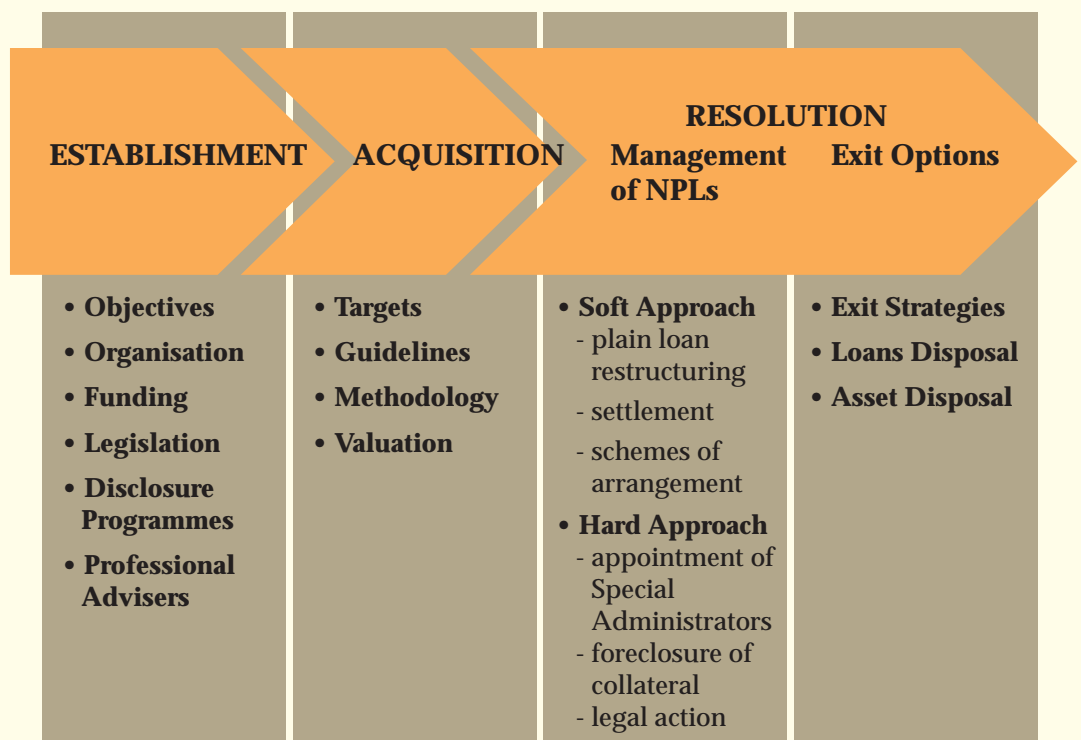
INTERNAL PERFORMANCE TARGETS - KEY PERFORMANCE INDICATORS

Danaharta was possibly one of the earliest Malaysian government agencies to adopt Key Performance Indicators (KPIs) to direct organisational efforts and drive performance. In fact, its staff remuneration was linked to the achievement of KPIs. The KPIs were formulated and adopted by Danaharta's Board in the middle of 1999.

Danaharta's goals were not profit-oriented but to relieve NPL pressure and maximise recovery values. In addition, as a finite life agency, Danaharta moved through its lifecycle very quickly. The goals in each phase of its life were different. Specialised KPIs had to be drawn up to measure the quantity as well as the quality of effort made and propel the organisation to achieve its key goals. Different KPIs came into play over time with some overlapping between phases. Each KPI had a benchmark assigned.

In actual fact, Danaharta managed to meet or exceed the benchmarks set for all its KPIs.

Figure 2: The phases in Danaharta's lifecycle



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Establishment

The announcement of the establishment of Danaharta in May 1998 came with the knowledge that it had to be operational as soon as possible - the first KPI set. Danaharta's Board of Directors noted that AMCs in other countries became operational in periods spanning five to fifteen months. Danaharta had to beat the benchmark of five months for its set-up, during which it had to draft enabling legislation, recruit key staff members and formulate its policies and procedures.

Danaharta managed to begin operations within three months of its announcement, making its first loan acquisition at the end of August 1998.

Acquisition

Given that Danaharta's primary objective was to relieve the pressure of NPLs on the banking system, goals in this phase of operations were set on two fronts – the speed of action taken, as well as the quantity of NPLs that were carved out.

The Board set a deadline of end-December 1999 for the primary NPL carve-out exercise. A secondary exercise, a final call to all financial institutions, was to be completed by the end of March 2000.

Danaharta completed its primary carve-out of NPLs six months ahead of schedule and its secondary carve-out on schedule.

In terms of value, Danaharta was required to have carved out at least RM8 billion worth of loans by the end of December 1998 and a cumulative value of RM33 billion a year later. As it turned out, Danaharta carved out RM19.73 billion worth of loans by the end of 1998 and RM39.33 billion by the end of 1999.

Resolution Phase

KPIs for this phase of operations were also set on two fronts.

First, deadlines were set for the “processing of NPLs”, i.e. meeting borrowers and deciding on an appropriate recovery strategy (not including the implementation of the recovery strategy). In that regard, Danaharta was required to “process” RM30 billion NPLs by the end of June 2000 and the remainder of about RM22 billion loans by the end of 2001. As it turned out, Danaharta processed RM31.5 billion by mid-2000 but due to some complications, processed all but RM30 million of the remainder, by the end of 2001. Nevertheless, the final loans were processed by the end of July 2002.

The other KPI in this phase was the Loan Recovery Rate, a universal method used to gauge an NPL resolution agency's recovery performance. The rate reflects the ability of the agency to implement its loan recovery strategies effectively. The Loan Recovery Rate is calculated by comparing the actual amount recovered against the amount owed. For example, if RM50 million is recovered against a loan amount outstanding of RM100 million, the Loan Recovery Rate will be 50%.

The benchmark for the Loan Recovery Rate was set at 49.8%, which was a rather high target, considering the fact that the loan recovery rates of similar agencies in the region ranged between 20% and 50%. Danaharta recorded a final Loan Recovery Rate of 58%.

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Summary of Danaharta's KPIs

PHASE	KPIs SET	DANAHARTA'S ACTUAL PERFORMANCE
1. Establishment Phase	To commence operations by October 1998, five months after Danaharta's establishment was announced	KPI exceeded - commenced operations, i.e. acquired first NPL in August 1998, two months ahead of schedule
2. NPL Acquisition Phase	Time given to complete carve -out of NPLs	
	i) to complete primary NPL carve -out exercise by 31 December 1999	i) KPI exceeded - completed primary carve -out in June 1999, six months ahead of schedule
	ii) to complete secondary NPL carve -out exercise by 31 March 2000	ii) KPI met - completed secondary carve -out on schedule in March 2000
	Amount of NPLs to carve out in primary NPL carve -out exercise	
	i) RM8 billion of NPLs by 31 December 1998	i) KPI exceeded - carved out RM19.73 billion of NPLs by 31 December 1998
	ii) a total of RM33 billion by 31 December 1999 (cumulative)	ii) KPI exceeded - carved out in total RM39.33 billion NPLs by 31 December 1999 (cumulative)
3. NPL Resolution Phase	Amount of NPLs to process, i.e. to review and decide on the most appropriate recovery strategy	
	i) to process RM30 billion NPLs by 30 June 2000	i) KPI exceeded - processed RM31.5 billion of NPLs
	ii) to process remaining NPLs by 31 December 2001	ii) KPI met - processed all remaining loans except for RM30 million (which was processed by 31 July 2002)
	To achieve a Loan Recovery Rate of 49.8% (total lifetime recovery)	Exceeded - As at 30 September 2005, the Loan Recovery Rate was 58% (total lifetime recovery)

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DANAHARTA'S CONTRIBUTION - A MACRO PERSPECTIVE

Danaharta's efforts also contributed to the following:

- **Prevented a banking crisis**

After Danaharta's primary carve-out exercise in September 1998, the rate of increase of NPLs began to decline at a steady rate of about 5% a month. Prior to Danaharta's establishment, NPLs were rising at an alarming rate of 0.9% a month⁶ between December 1997 and April 1998.

The net NPL ratio which reached a high of 11.4% (6-month classification) in August 1998, just before Danaharta started the primary carve-out exercise, fell to 6.6%, by the end of the secondary carve-out in March 2000. Since then, the net NPL ratio in Malaysia has remained at a manageable level of below 10%. In fact, as at 30 September 2005, the banking system's net NPL ratio was 4.8%.

- **Lower NPL resolution cost**

The total cost of resolving the banking system's NPLs was much lower than expected.

Danaharta was part of a larger plan to restructure Malaysia's banking sector to a stronger footing. In 2002, BNM estimated that the total cost of restructuring the banking sector, which included the resolution of NPLs (Danaharta) and recapitalisation of banks (Danamodal) would not exceed 5% of the nation's Gross Domestic Product (GDP) or approximately RM20 billion⁷.

As it turned out, the actual cost was only about RM12.5 billion or 3% of GDP. This is also far less than the International Monetary Fund's (IMF) estimate of 18%, made during the Asian financial crisis.

Of the RM12.5 billion, about RM12 billion was attributed to NPL resolution efforts undertaken by Danaharta. Danaharta's Acquired NPL component accounted for approximately RM1 billion – largely caused by its heavy financing cost – whilst the Managed NPL component accounted for the remaining RM11 billion, which was the shortfall that could not be recovered on the book values of the Managed NPLs.



Danaharta's NPL carve-out exercises had managed to relieve the pressure on the banking system caused by rising NPLs. Banks could concentrate on the business of lending, thereby supporting economic activity. Although beset with problems, the banking system functioned well throughout the Asian financial crisis. Customers could carry out their banking activities without any inconvenience or trouble. This helped the country to recover faster and avoid bank runs or the spectre of widespread social unrest as seen in some countries.

Footnote 6

p.143 "Rewriting the Rules - The Malaysian Crisis Model", by Mahani Zainal Abidin (2002).

Footnote 7

Based on GDP for 2004 which is RM449 billion.

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REGIONAL COMPARISON

Danaharta was featured in a comparative study on AMCs in the region done by the Bank for International Settlements (BIS)⁸, through its Financial Stability Institute .

The report, entitled “**Public Asset Management Companies in East Asia: A Comparative Study**”, was published in February 2004⁹.

The study looked at how each of the region's AMCs (namely China, Japan, Indonesia, Korea, Thailand and Malaysia) tackled the NPL problem. It also compared

the methods adopted for essential functions like asset transfers, valuation, enabling legislation, asset resolution and of course, recovery rates.

In their analysis of the recovery rates of the AMCs, the BIS researchers reported that generally, Asian AMCs were expected to recover between 20% and 50% of the book value of the loans, comparable to the experiences in other parts of the world. Danaharta recorded a final recovery rate of 58%.

In addition, the BIS team identified the following key factors that contribute to the successful operation of an AMC:

- **Strong political will:** a strong commitment from the government to address the NPLs in the system, and the AMC should have independence and freedom from political interference.
- **Supportive legal infrastructure:** effective laws, particularly in bankruptcy and foreclosure, and special legal powers to allow AMCs to achieve quicker resolution and higher recoveries.
- **Efficient market environment:** well-functioning capital markets to facilitate asset sales. If the local market is immature, allowing foreign participation would speed up asset disposition.
- **Clear AMC mandate:** the AMC needs to be clear on its mandate, the types of assets to be acquired and the resolution methods it can use. It should focus on asset sales and not be overly burdened by corporate restructuring.
- **Well defined AMC lifespan:** the tenure of an AMC should generally be limited to prevent it from warehousing acquired assets, in an attempt to prevent realisation of large losses.
- **Adequate governance:** there should be a sound system of internal control and effective external supervision, with regular audits by an independent auditor.
- **Good transparency:** an AMC should periodically disclose the results of its operations vis-à-vis its mandate as well as its audit results, in a manner that will be easily understood by the market.
- **Realistic asset pricing:** generally assets should be transferred to an AMC at market-based prices, with proper incentives to facilitate transfers.
- **Speedy resolutions:** an AMC should aim for speedy disposition of acquired assets. Waiting for an economic turnaround to increase recovery often leads to slower resolution progress and larger losses.

Coincidentally, Danaharta complied with all the criteria identified.

Footnote 8

The report was published by the Financial Stability Institute, which was set up in 1999 and is jointly operated by the BIS and the Basel Committee on Banking Supervision. BIS was established in 1930 and it is the world's oldest international financial institution. It was formed under the Hague Agreements, as were the International Monetary Fund (IMF) and the World Bank. BIS is an international organization which fosters cooperation among central banks and other agencies in pursuit of monetary and financial stability. The BIS has two administrative offices in Hong Kong and Mexico City.

Footnote 9

Ben Fung, Guonan Ma, Stefan Hohl and Jason George

THE CHALLENGES

1. PUBLIC RELATIONS

Danaharta was established at lightning speed. The announcement of its creation was made in May 1998 and by June, Danaharta was formally incorporated. Within three months, the Danaharta Act was drafted and passed in Parliament.

Accompanying the pressure to do things quickly and effectively was the "public relations" war it had to face from the day its establishment was announced.

Critics and observers, both foreign and local, were doubtful of Danaharta's "true" purpose – many believed it to be a bailout agency for politically linked business personalities – and its ability to carry out its functions. Many also questioned its ability to stay transparent, independent and free of Government intervention. Within Malaysia, the misconception that Danaharta would forgive all NPLs that it would acquire dominated the public arena.

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The war was fought on several fronts:

(i) Transparency

From the start, Danaharta was committed to prove to the public that it would be transparent in its operations.

Press conferences were held and public announcements were made regularly to keep the public informed of Danaharta's progress. The first press conference was held a fortnight after the announcement of its proposed establishment. Danaharta made a start by explaining its aims, strategy and management philosophy towards resolving the NPL problem.

Danaharta also began publishing half-yearly operations reports. Danaharta's Operations Reports contained key statistics and explanations pertaining to the operations of the AMCs. In conjunction with the issuance of the reports, briefings were held for the press and analyst community, giving them the opportunity to seek clarification of the contents.

Later it introduced quarterly reports, providing updates on key statistics in between the issuance of the Operations Reports.

A website containing information, both historical and current, as well as reports and announcements, was set up and constantly updated. Public and press queries were entertained and replied to on a timely basis.



AMCs will be fully transparent, says Azman

AMANAH Capital Malaysia chief executive director Mohamed Azman Yusoff, who was appointed chief executive of the umbrella body for asset management companies (AMCs), yesterday promised full transparency.

"To develop a strong confidence base in the market, it is important to have full disclosure and transparency in the AMCs' operations," he said.

The AMCs are new private sector-driven entities initiated by the Government to take over assets of troubled companies pledged to banking institutions and whose debts have since become non-performing loans.

The institutions would sell the NPLs and assets at market prices to the AMC who would revive and later sell them at higher prices.

Deputy Prime Minister and Finance Minister Datuk Seri Anwar Ibrahim who announced AMANAH's appointment on Thursday said the Government had set a two-week target for the umbrella body to start its operations.

Azman said he was grateful for Anwar's confidence and trust in him, adding that he looked forward to work closely with the Ministry of Finance, Bank Negara and other relevant regulatory authorities.

"A study on the operational structure of the AMCs is currently being conducted together with Bank Negara Malaysia and other consultants," he added.

Azman, 34, is an associate member of the Institute of Chartered Accountants in England and Wales and a member of the Malaysian Institute of Accountants.

He holds a first-class honours degree in BSc Economics from the London School of Economics and Political Science, University of London. — Bernama

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(ii) Independent board

The Danaharta Act provided for a nine-member board, which comprised a non-executive Chairman, a Danaharta Managing Director, two Federal Government officials, three members from the private sector and two members from the international community.

Danaharta's Boards featured influential and well known figures, whose professionalism was well respected. (Please see pages 84 to 85 for a full list of Danaharta's board members).

The composition of the Board reflected well on the AMC's independence and professionalism.

(iii) Internal practices

From the beginning, Danaharta effected a strong internal structure which incorporated good corporate governance.

It voluntarily adopted and kept strictly to the Malaysian Code on Corporate Governance, issued in March 2000. Even before that, Danaharta had already established a manual on Standards of Business Conduct, with its accompanying guidelines for its staff. The Standards of Business Conduct set out high ethical business standards and practices for business conduct and a code of behaviour for employees to adhere to.

Every division within Danaharta was required to set out a list of procedures and guidelines for the division. Requirements included annual declaration of assets by employees and their spouses.

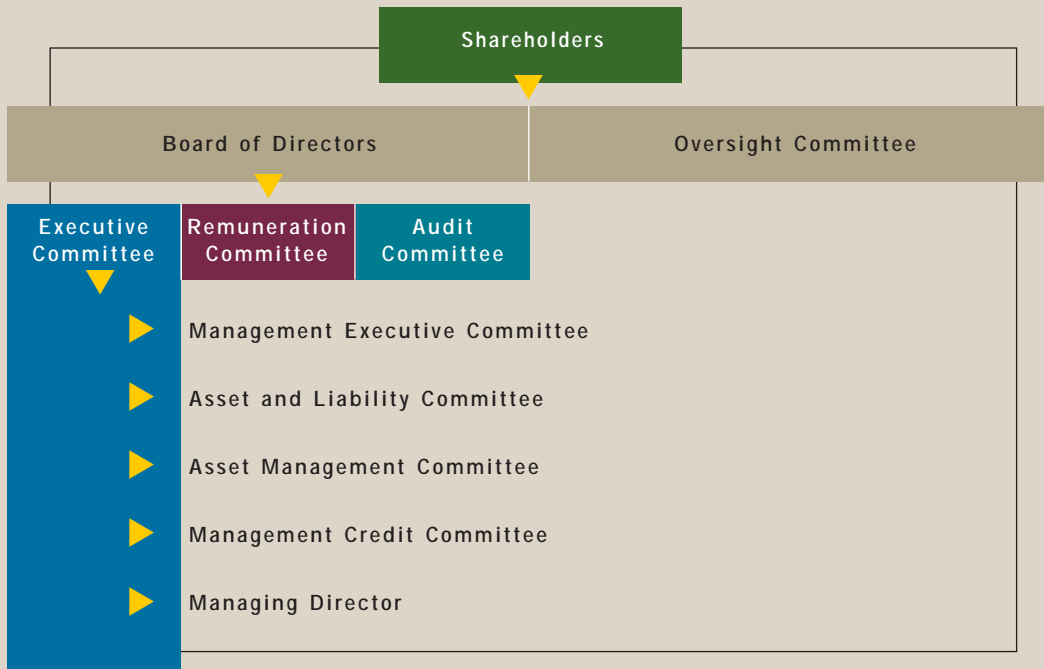
For the Board and top management level, the Danaharta Authority Manual gave clear guidelines on the rules of engagement in day-to-day operations. An integral part of Danaharta's internal control system, the Authority Manual laid out the defining lines and boundaries of responsibility and delegation of authority to the various Board and Management Committees. Throughout Danaharta's life cycle, the manual was updated regularly to cater to Danaharta's evolving roles.

Apart from good corporate governance, Danaharta also emphasised greatly on integrating risk management into the AMC's day-to-day operations. For example, all loan resolution proposals had to be reviewed by the Risk Management team before being put forward for deliberation. The risk management team lent a "third eye" to all proposals and procedures to ensure that potential risks were identified.

Another unique feature of Danaharta's decision making structure was that no single individual, not even Danaharta's Managing Director, was able to make a unilateral decision on the treatment of NPLs. The Managing Director also did not have voting rights at Board meetings. All key decisions were made via committees.

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Figure 3: Danaharta's Governance Structure



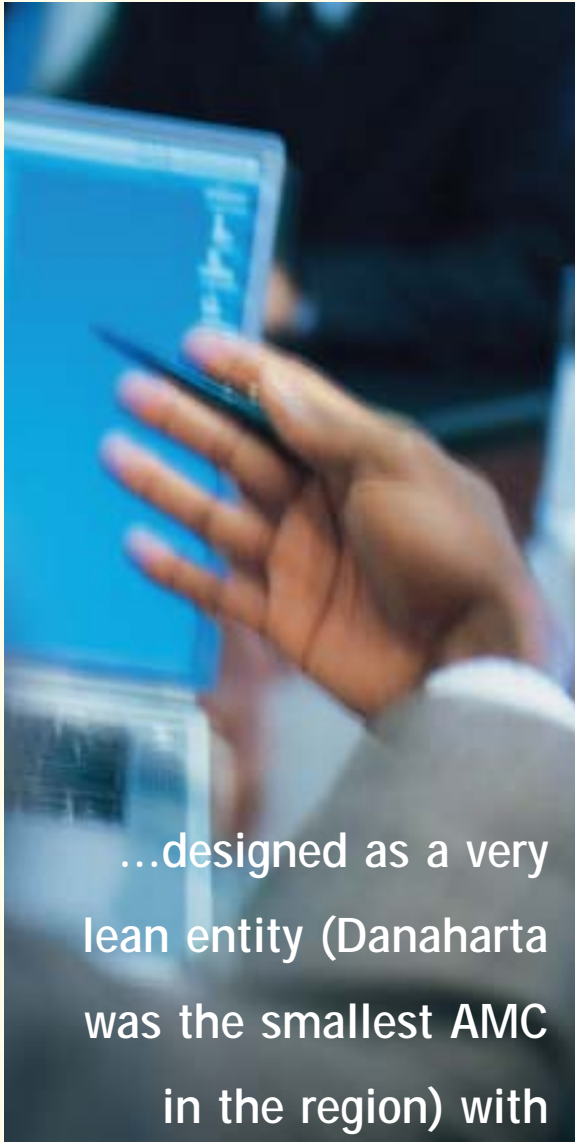
For day to day operations, Danaharta's top level management was divided into three management committees which were in turn overseen by a Management Executive Committee. The composition and functions of the sub-committees changed over the period of Danaharta's lifetime, according to the functions it was performing at the time, for example, loan acquisitions and loan management.

The roles of the sub-committees were as follows:

Management Executive Committee	<ul style="list-style-type: none"> • Oversaw and decided on key management decisions and overall guidelines for the operations of Danaharta. • Ensured adherence to overall policies and guidelines
Management Credit Committee	<ul style="list-style-type: none"> • Reviewed and decided on matters relating to loan/asset acquisitions and disposals.
Asset Management Committee	<ul style="list-style-type: none"> • Reviewed and decided on matters pertaining to the purchase and sale of property assets, including approving additional investment in assets.
Asset and Liability Committee	<ul style="list-style-type: none"> • Controlled liquidity, market and interest risks to ensure that they were in line with Danaharta's risk appetite, policy and liquidity requirements.

Eventually, the tide turned in the public relations war. As the agency proved by its deeds that it was serious about accomplishing its mission, the early fears receded. This was bolstered by the open and transparent relationship the agency strove to maintain with the press and public at large. In addition, the key statistics released periodically were testament to Danaharta's performance.

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...designed as a very lean entity (Danaharta was the smallest AMC in the region) with

very few layers of hierarchy so as to promote functionality, quick decision making and flexibility.

2. HUMAN RESOURCE

There were also specific challenges faced on the organisational and human resource front.

From the onset, Danaharta had been envisioned as a project type organisation with a limited life. This led the organisation to be designed as a very lean entity (Danaharta was the smallest AMC in the region) with very few layers of hierarchy so as to promote functionality, quick decision making and flexibility. Periodic reorganisation exercises proved to be a common feature of Danaharta's life as it sought to respond to different requirements posed by the different phases of its mission.

Recruitment needs were quite specific. Danaharta needed to be operational from the word go and cope with a multitude of complex situations. There was very little time for training, at least during the initial stages. Sourced from the banking fraternity, multinationals and consultancy firms, almost all Danaharta staff had substantial work experience. There was no room for fresh graduates. Remuneration practices were benchmarked to local banks and staff were rewarded based on merit. This added a private sector flavour to Danaharta that was important in incentivising staff to meet targets.

To cope with the volume of work, Danaharta put into practice a "virtual organisation" philosophy. Virtual organisation referred to the panels of accountants, lawyers, valuers and real estate agents that assisted Danaharta staff in their work. Typically, in a "hub and spoke" model of interaction, Danaharta staff would control teams of professionals that worked on an assignment basis or when required. This significantly reduced the need to employ many permanent staff and hence, eased the process of closing down Danaharta.

With limited human resources and only one office, Danaharta also emphasised the use of technology to facilitate achievement of tasks and goals. As an example, to facilitate borrowers' efforts to repay loans, Danaharta and Malayan Banking Bhd (Maybank) - Malaysia's largest bank - worked out a technical arrangement where borrowers could bank in repayments to any of Maybank's branches, nationwide.

In addition, a number of initiatives and strategies were successfully implemented to enhance staff performance by improving camaraderie, developing capabilities, initiating self-belief and supporting the team ethic.