

Frequently Asked Questions (FAQs) on Danamodal

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The Objectives and Background of Danamodal

1. Question: What are the objectives of Danamodal?

Answer: The main objectives of the Danamodal are to: (i) raise funds to recapitalise and strengthen the banking industry; and (ii) promote a healthy and competitive banking system to support the next phase of economic development. Danamodal will act to restore investor confidence and encourage the mobilisation of domestic capital as well as inflows of foreign capital.

The creation of Danamodal is a vital part of the overall financial sector restructuring efforts which aim to: (i) promote the development of a safe, sound and efficient domestic banking system; (ii) minimize the use of public funds over the long-term; (iii) initiate market oriented reform; and (iv) ensure burden sharing between shareholders and management.

2. Question: Why establish Danamodal? Why doesn't the government invest directly in the banking institutions?

Answer: The government wishes to guide the process of recapitalisation, while also encouraging banking institutions to raise capital on their own. Danamodal will be free to decide to which banking institutions it injects

capital and the terms on which it does so. The rationale for establishing Danamodal is to ensure that the banking sector recapitalisation process is commercially-driven and that investment decisions are made according to market-based principles.

3. Question: *How will these objectives be achieved?*

Answer: Danamodal will serve as an interim funding vehicle for banks that cannot raise capital directly. It will facilitate the creation of stronger banking institutions which can attract equity on their own in the capital markets. In addition, Danamodal will facilitate mergers of financial institutions with the vision of creating a core group of healthy and well-capitalized banks which can effectively compete within an increasingly competitive global banking industry.

4. Question: *Is Danamodal a bailout vehicle for banks and their shareholders?*

Answer: No. Danamodal has been set up to facilitate the recapitalisation of the banking sector. As a market-driven process, shareholders will be expected to share in potential losses - they already have. In order to enhance the health of the financial system during this process and establish a strong foundation for future growth, Danamodal has been established to play a key role in boosting bank equity. This role, however, is expected to be a transitional one - Danamodal will provide capital to banks which have difficulty meeting minimum capital requirements but only after their capital needs, business strategies and rehabilitation plans have been carefully evaluated. Capital injections from Danamodal, accompanied by restructuring and potential mergers of individual financial institutions, are expected to precipitate the entry of private capital into these banks. Indeed, the banks will be encouraged to raise debt and/or equity independently. In line with this, Danamodal's stakes in individual banks are expected to be sold down. Potential gains from Danamodal's stakes in various banks will be distributed to Danamodal's shareholders.

Governance and Management of Danamodal

5. Question: *What is the governance structure of Danamodal and who will regulate it?*

Answer: A Board of Directors will provide oversight and ensure that Danamodal's activities are independent, consistent with government policies, and properly coordinated with Bank Negara. The ultimate regulation and supervision role resides with Bank Negara.

6. Question: *Is there a conflict of interest in the roles that Bank Negara will play as shareholder and regulator? What safeguards will be put in place to ensure that Danamodal operates on a commercial basis and in a manner that reduces the risk of moral hazard?*

Answer: In theory, there might be possible areas of conflict of interest but we are devoting considerable efforts in order to avoid these. Safeguards include: (i) the independent Board, (ii) the transparency of the process, (ii) the internationally accepted standards used to evaluate the performance of individual banking institutions, (iii) the objective selection criteria for recapitalisation and consolidation, and (iv) the swift and market oriented manner for the implementation of Danamodal's program will minimise the risks of moral hazard and conflicts of interest.

Funding Issues

7. Question: Will Danamodal be allowed to have majority foreign shareholding?

Answer: No. Whilst foreign and domestic shareholders may be sought, government entities will retain a majority ownership. This may be revisited as operations progress.

8. Question: How much funding does Danamodal need to recapitalise the banking sector? What parameters were assumed to arrive at this figure?

Answer: The total funding requirement is estimated at RM16 billion. This allows for a higher peak NPL level than is currently expected and a minimum risk weighted capital adequacy requirement of 9%. To be conservative, we have not assumed any recovery rate for NPLs. Although we do not expect such a severe level of asset deterioration, our approach to banking restructuring is to take early necessary steps to pre-empt the worst-case scenario.

9. Question: In the event that Danamodal is financed through debt and in return, channels its investments into banking institutions as equity, how would Danamodal resolve its cash flow mismatches?

Answer: Firstly, Danamodal will charge the banking institutions into which it injects capital for that capital to provide itself an appropriate return. Secondly, Danamodal will have cash capital and lines of liquidity to provide for that eventuality. Finally, Danamodal may also charge a recurring fee for its services.

Danamodal's Operations

10. Question: *How are the activities of Danamodal coordinated with those of Danaharta?*

Answer: We envision a three-stage process to restructuring, with the result of the first phase having considerable effects on the remaining stages. How much funds Danamodal needs to raise depends partly on the initial phase. Firstly, NPLs of banks will be separated and sold to Danaharta. The sale of NPLs will create banks with better asset quality and the proceeds of such sales will inject some liquidity into banks. Coordination with Bank Negara and Danaharta is vital at this juncture in order to determine the amount and timing of capital needs. Secondly, following NPL sales to Danaharta, Danamodal will encourage banks to raise further capital on their own (equity, hybrid or subordinated debt). Thirdly, Danamodal will recapitalise banking institutions and facilitate mergers.

11. Question: *What selection criteria will be used to recapitalise financial institutions?*

Answer: Together with Bank Negara, Danamodal will assess the financial health as well as long-term viability of banking institutions. Banking institutions will be required to submit rehabilitation plans to Danamodal and BNM. These will be carefully evaluated to determine a bank's future competitive position and fundamental strength. Weaker banking institutions may merge or be guided to restructure to form a core group of strong financial institutions. Danamodal's capital injections will be based on the rehabilitation plans submitted, ensuing mergers or restructurings that take place and the capital needs of individual institutions to meet minimum requirements. The selection criteria will thus be constantly evolving as Danamodal and BNM carefully evaluate the proposals of individual banking institutions and determine optimal solutions.

Similarly, to identify weaker institutions that need to be merged or recapitalised, Danamodal must establish clear and objective guidelines. Danamodal and Bank Negara will take the following steps, among others: (i) conduct in-depth analyses of the competitive position and financial standing of each banking institution; (ii) quantify potential synergies and advantages to be realized by each banking institution through consolidation, and (iii) perform CAMEL analysis (capital, assets, management, earnings, liquidity) with particular attention to the appraisal of asset quality of individual banks.

12. Question: *What conditions for capital infusion ought to be met by financial institutions?*

Answer: Eligibility to receive capital from Danamodal will be subject to stringent conditions as well as continuous monitoring of those banking institutions. These conditions will include, amongst others: (i) the submission of a thorough business plan, (ii) the establishment of a list of comprehensive performance targets, (iii) monthly reporting; and (iv) swift and firm remedial actions against the banks in the event of material shortfalls in performance relative to such targets. The decision to invest in

individual banking institutions will be made by Danamodal, based on commercial principals.

13. Question: *How do you ensure transparency of the recapitalisation and restructuring processes?*

Answer: Danamodal will at all times maintain transparency and disclosure in management, operations and selection criteria, and it will regularly publish its own financial statements in accordance with international accounting standards.

14. Question: *How will Danamodal determine the value of its investment in banks?*

Answer: In making the investment decisions, Danamodal will use market based valuation methods. The majority of the recapitalisation investments by Danamodal are expected to be made during the first two years.

15. Question: *By what means would the recapitalisation occur?*

Answer: To meet capital adequacy requirements, it is anticipated that capital infusions of Danamodal into banking institutions will primarily be in the form of equity or equity-linked investments.

16. Question: *Will Danamodal manage the recapitalised banking institutions?*

Answer: Danamodal will not be in the business of running the day-to-day operations of the recapitalised institutions. It will, however, have a voice in the management of those institutions in which it has a significant equity participation. It is expected that as the consolidation and restructuring process develops and stronger institutions evolve, Danamodal's stakes in banks will be reduced via sales to private investors.

17. Question: *How will the operations of Danamodal and Danaharta be coordinated and sequenced?*

Answer: Danamodal and Danaharta will have a continuous dialogue to synchronize their respective activities particularly with respect to capital raisings and consolidation of the system. The proceeds realised from the sales of NPLs will be key determinants of the capital injection required from Danamodal. Moreover, these factors will be crucial for BNM's and Danamodal's restructuring and consolidation strategy for the banking sector. Thus the activities of Danamodal and Danaharta will be inextricably linked. The Managing Director of Danaharta will sit in as a non-voting member of Danamodal's Board and this will help in facilitating clear dialogue between the two entities.

18. Question: *How will Danamodal facilitate bank mergers? Can Danamodal force merger of banks? If so, how?*

Answer: Danamodal is expected to play an important role in facilitating the restructuring of banking institutions. This will be conducted in conjunction with Bank Negara, which will continue its responsibilities for

regulation and supervision. As a potential or actual strategic shareholder in the recapitalised banking institutions, Danamodal will be in a position to assist and guide the restructuring, consolidation and merger of the banking system. To the extent that Danamodal and BNM together conclude that mergers among certain financial institutions are an appropriate means of restructuring, BNM will use its authority to facilitate this process.

19. Question: *How many banks does Bank Negara and Danamodal expect to remain after the recapitalisation exercise?*

Answer: The process of recapitalisation and consolidation will expedite the formation of a core group of strong domestic banking institutions. A healthy and competitive banking system will restore confidence and stimulate the real economy, as well as increasing the sector's own contribution to GDP growth. Whilst it is too premature to determine the exact number of surviving banks post-restructuring, we visualise a number of core or champion banks and a few smaller banks with particular niches or markets.

20. Question: *What types of financial performance or operating benchmarks, if any, will the Danamodal be held accountable to?*

Answer: Danamodal will develop its own operating criteria and performance objectives and its equity investors will bear commercial risk. Clearly, its main objective will be to maximise returns for its investors.

21. Question: *Are there financial institutions that may be candidates for liquidation? What are the criteria for liquidation? How would liquidations be undertaken?*

Answer: Given that our approach is proactive rather than reactive, we are not anticipating the need to liquidate any banks. However, as the rehabilitation process is a continuous one that extends over a reasonable period of time, we would not rule out the option of liquidation, if necessary. Under such a scenario we would envision that the stronger banks would acquire the good assets of liquidated banking institutions and Danaharta would purchase non-performing assets.

Termination of Danamodal

22. Question: *How will investors in Danamodal be rewarded? What is the exit strategy for the investments?*

Answer: Over time, Danamodal will dispose of its stakes via: (i) initial public offering; (ii) strategic sales of its holdings; and (iii) sales of its holdings directly in the market. It is envisaged that Danamodal will be able to realise the significant upside potential from a rejuvenated banking sector. Upon sale of its final equity stakes, it will liquidate its remaining assets and distribute the residual value to shareholders. Danamodal will

dispose of its holdings in line with its commitment to liberalise the banking sector and its agreement with the WTO.

Danamodal's Relationship with Bank Negara and Danaharta

23. Question: *Please describe the relationship and the checks and balances between the MOF, Bank Negara, Supervisory Board and other agencies.*

Answer: Bank Negara's oversight of Danamodal and its supervisory and regulatory authority will ensure that Danamodal conducts activities that support its mission. On the other hand, the Board of Danamodal and the possible inclusion of multilateral agencies and other private investors as shareholders will maintain the necessary independence of Danamodal.

Other Questions Impacting the Recent Initiatives

24. Question: *What impact on financial sector liberalisation will Danamodal have?*

Answer: We believe that Danamodal will have a positive impact on financial sector liberalisation. It will help facilitate the formation of a group of strong core banks ultimately with improved operations and greater participation from foreign investors. Danamodal's equity stakes are only to be medium term investments which will be sold, markets permitting, to private investors as the operations of the banking sector reaches a sounder footing.

25. Question: *Please describe the government's policy to facilitate mergers and restructuring among financial institutions.*

Answer: Through Bank Negara, the government can impose certain regulatory measures conducive to bank merger and restructuring. For instance, by increasing mandatory provisions banks may be induced to dispose of their NPLs to Danaharta.