STATE OWNERSHIP IN BANKS AFTER THE CRISIS – A NEW PARADIGM.

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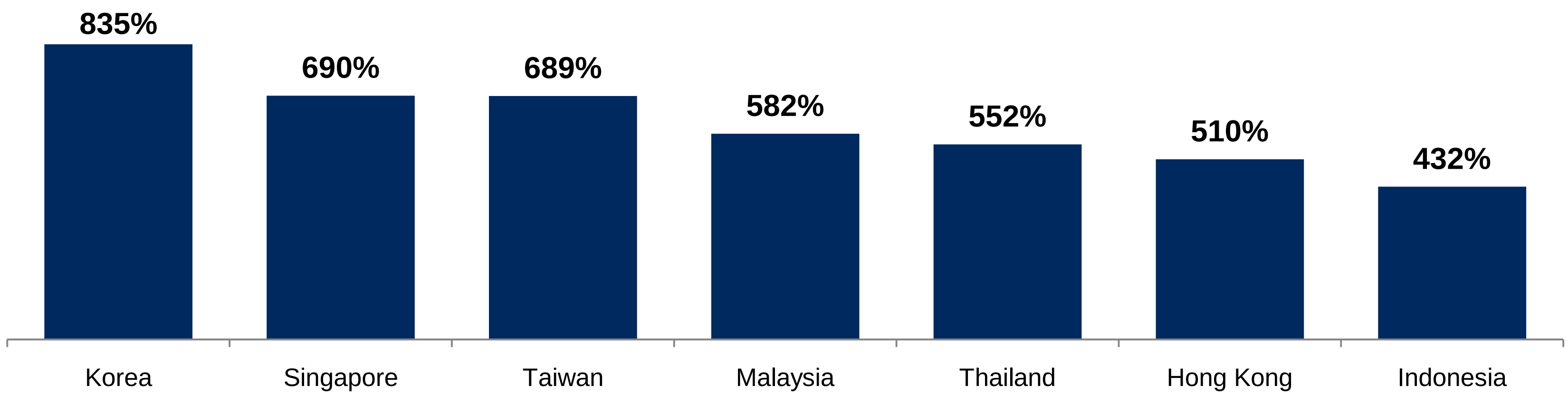
Agenda

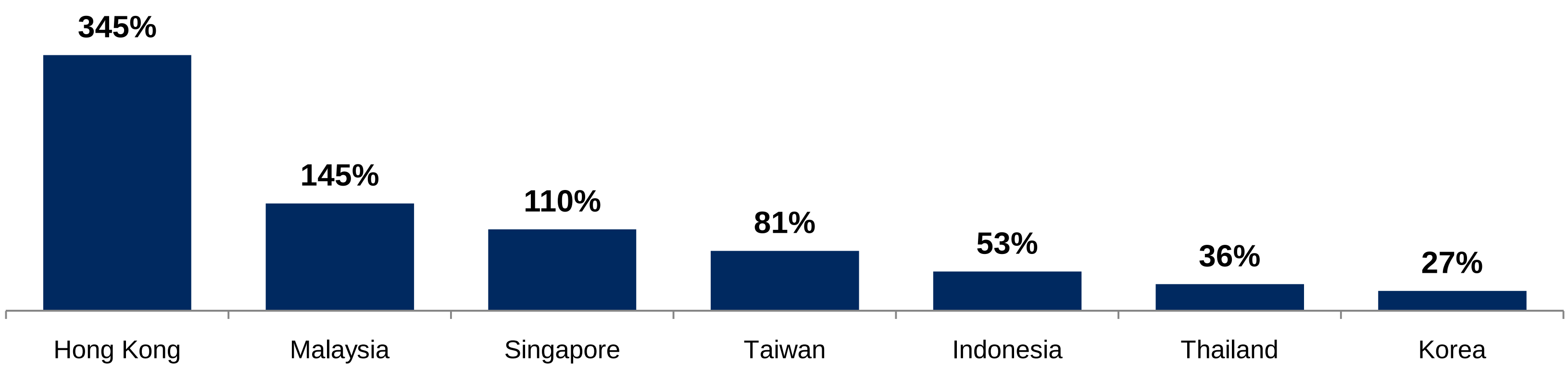
1. Background of the Asian Financial Crisis:
2. Impact the Crisis to Indonesia:
3. Recapitalization Banks from Public Funds;
4. Banks Restructuring in Indonesia: Danamon Turnaround
5. State-Ownership in Banks After the Crisis
6. A New Paradigm.

In 1993, the World Bank published a book entitled "The East Asian Miracle". The story was an apparently compelling one, of eight nations – Japan, Korea, Hong Kong, Singapore, Taiwan, Indonesia, Malaysia, and Thailand. These countries had grown faster than other regions of the world: 2x as fast as the rest of East Asia. 3x as fast as Latin America and South Asia. 25x faster than Sub-Saharan and Africa. More than 2x as fast as the OECD economies, or the United States.

The Increased GDP Growth of Selected Countries since 1970 – 1996 (prior to the crisis)

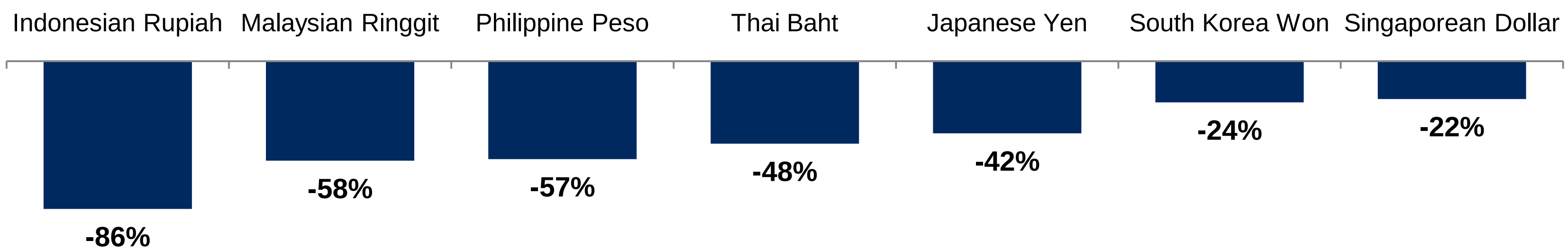


The Increased Stock Indices of Selected Countries since 1990-1996 (prior to the crisis)



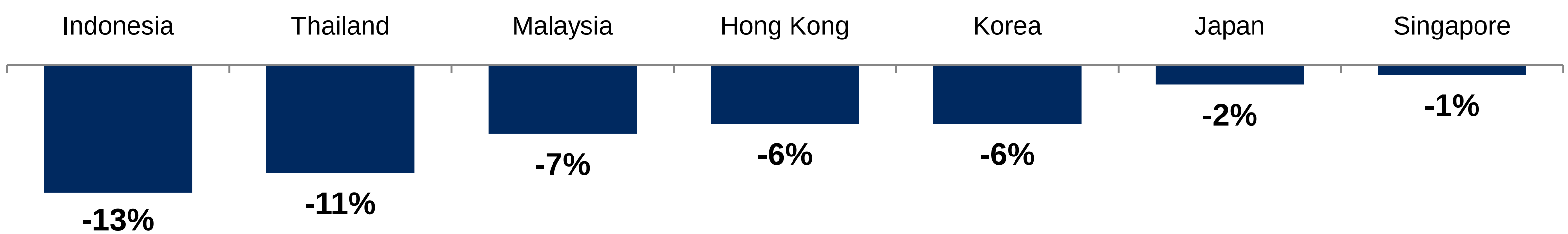
Beginning in summer of 1997, the economic picture of the Asian Miracle began rapidly change. Initiated by two rounds of currency depreciation. First round was a precipitous drop in the value of Thai Baht, Malaysian Ringgit, Philippine Peso, and Indonesian Rupiah. Second round began with downward pressures hitting Taiwan Dollar, South Korea Won, Brazilian Real, Singaporean Dollar, and Hong Kong Dollar….

The Change in Exchange Rates against USD for selected Asian Economies, Jan1997–Dec1998.

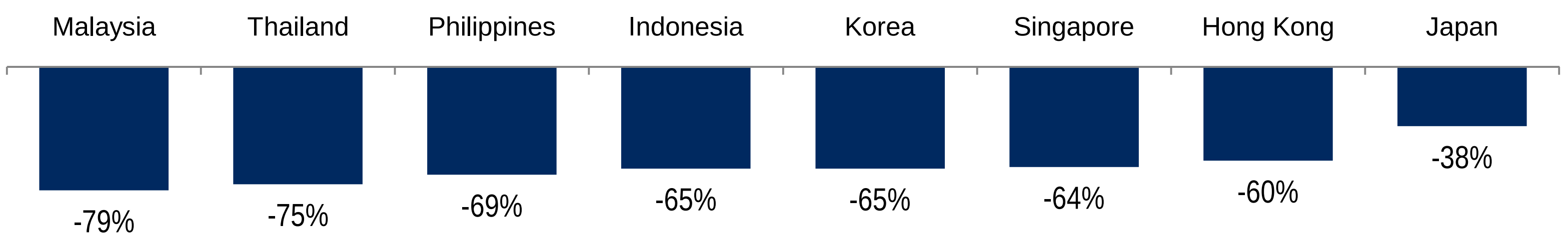


Governments have countered the weakness in their currencies by selling foreign exchange reserves and raising interest rates, which, in turn, have slowed economic growth and have made interest-bearing securities more attractive than equities…

The Change in Annual GDP during 1997 – 1998.



The Change in Stock Market during Jan 1997 – Dec 1998.



The causes of financial problems in The Asian Tigers economies are many and differ . Their fast economy growth achieved by opening their economies to FDIs, foreign good and services, capital flows, and were relying heavily on US Dollar market to absorb their exports. In order to attract FDIs and facilitate capital flows, their currency exchange rates were kept fairly close alignment with the US Dollar or a basket of currencies dominated by US Dollar….

The financial services sector in these countries had been developing rapidly and without sufficient regulation, oversight , and Government control..

As capital markets were liberalized, banks in these countries could borrow abroad at relatively low rates of interest in USD and re-lend the funds domestically mostly in local currency…

Over the past decade, foreign borrowing by these countries had shifted from Government to Private sector borrowing. In 1990s, a local bank might borrow directly from a large New York money center bank.

The financial crisis in Asia began in currency markets, but this exchange rate instability was caused primarily in the banking sectors of the countries in question..

GCG Issues

The causes and structural factors contributing to the financial crisis:

- Private-sector debt problems and poor loan quality
- Rising external liabilities for borrowing countries
- The close alignment between local currency and the USD
- Weakening economic performance and balance-of-payments difficulties
- Currency speculation
- Technological changes in financial market, and
- A lack of confidence of the governments to resolve their problems

The Banking Crisis

Indonesia's banking sector was devastated by the crisis that began in October 1997. The massive real depreciation of the rupiah, combined with sharp rise in interest rates and the refusal of creditors to roll-over loans, lead to insolvency of many Indonesian banks and businesses. The number of private-banks are halved from 157 to 79…

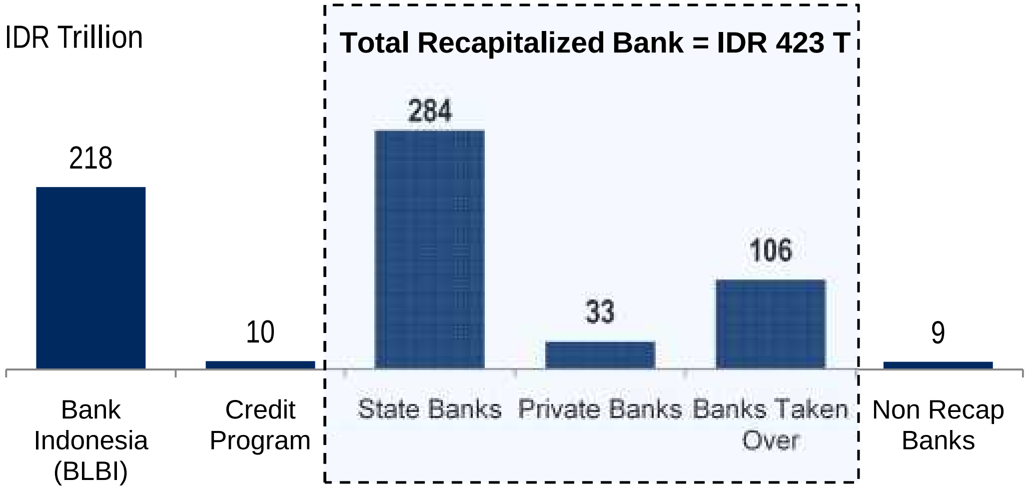
BANK MERGERS, CLOSURES, AND SURVIVALS During The Crisis 1997-1999

		LOST		REMAINING		
	Initial	Closed	Merged	Private & JV	Nationalized	State & Regional
Sate Banks	7		3			4
Regional Development Banks	26					26
Private Banks	157	65	9	79	4	
Closed in 1997	16	16				
Nationalized in 1998	4		2		2	
Audited in March 1999						
Category A	73	1		72		
Category B						
Closed in March 1999	21	21				
Eligible for recapitalization	9			7	2	
Nationalized*)	7		7			
Category C	17	17				
Joint Venture Bank	32	2		30		
Audited in March 1999						
Category A	15			15		
Category B	17	2		15		
TOTAL	222	67	12	109	4	30

*) The seven banks nationalized (taken over) in 1999 were subsequently merged with Danamon, which had already been nationalized in 1998.

Note: Category A: those that did not need to be recapitalized
Category B: those deemed to be potentially worth saving, but in need of recapitalization
Category C: those that were to be liquidated

As the crisis deepened in mid-1998, it become apparent that a policy of closing down all insolvent banks – would wipe out a large portion of the entire banking sector. More than 60% of loans are NPLs. Of more than 200 banks, experts said that perhaps 10 would emerge from the crisis intact. The Government and IMF therefore drew up plans for recapitalizing some of the insolvent banks and merging or closing down the rest….

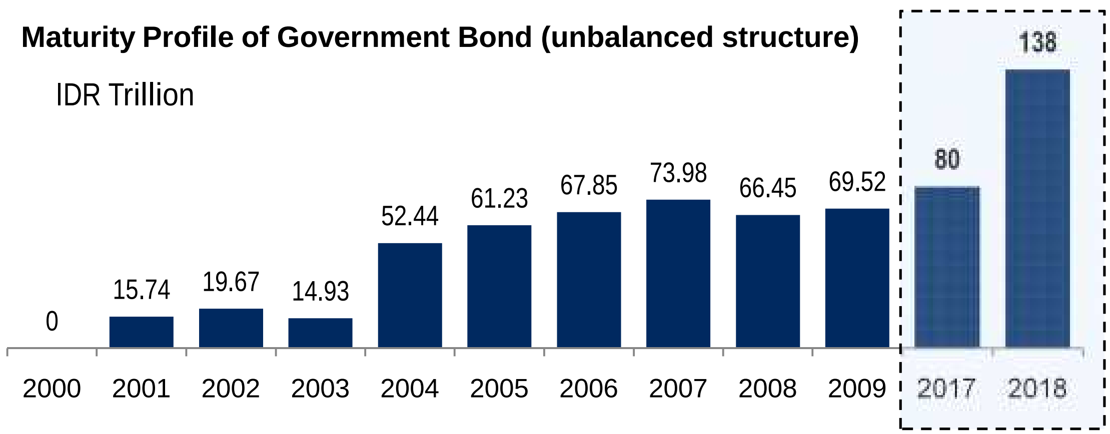


The Cost of Bank Restructuring,
As July 2000: IDR 659 Trillion (equivalent to 58% annual GDP 1999)
Compare to cost of US S&L Crises in 1980s and 1990s: USD 160 Bio..

Because of injection of government-bonds, risk-weighted CAR has been rebuilt. All banks have met the mandated CAR of 4%.

Government owned 40 banks (5 SOBs, 9 Banks BTOs, 26 Reg. Dev. Banks, with Share in Net Worth 66% of Total. (Oct 2000)

Maturity Profile of Government Bond (unbalanced structure)



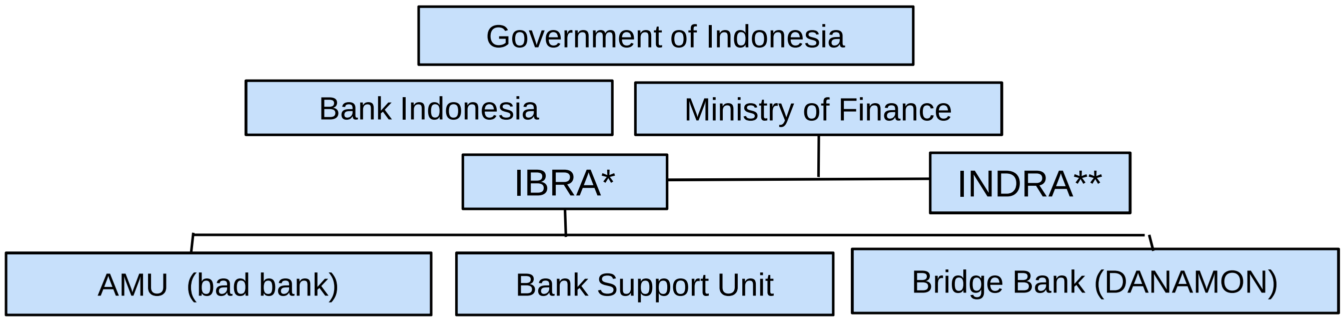
The issuance of large amount of government bonds for bank recap has doubled the stock of public sector debt to over 100% of annual GDP. Interest cost of government's domestic debt (mostly recap bond), is hovering around 4% GDP (2000&2001). 1% increase in interest rate is expected to raise government expenditure by IDR 2,2 T. Amortization of the recap bonds will add to the fiscal cost as they are falling due beginning from 2004.

This fiscal distress will be overcome through: decentralization program, cutting subsidies, raising revenue through better tax administration, privatization of SOEs (incl. SOBs) and through recovery of IBRA Assets(incl. divestment of recapitalized bank).

It hopes that the injection of public funds (Government Bonds) to strengthen bank capital, together with additional financial and operational restructuring of banks, will restore public confidence in the banking system, reduce uncertainty, accelerate resolution of the banking crisis, and promote economic recovery through reestablishing banking and payment services, and ensuring that viable businesses can fund their operations…

In systemic bank restructuring, public funds may be needed to : (1) make payouts to depositors of closed banks; (2) compensate banks that agree to accept deposit transfers; (3) facilitate an acquisition, merger, or purchase and assumption; (4) help recapitalize banks; and (5) restructure assets.

INSTITUTIONAL FRAMEWORK TO RECAPITALIZE BANKS with PUBLIC FUND



**) IBRA = Indonesian Bank Restructuring Agency; **) INDRA = Indonesian Debt Restructuring Agency*

CRITERIA FOR BANKS TO BE RECAPITALIZED :

At the onset of the crisis, the government was in the process of raising the minimum CAR from 8% (or 9% by Sept 1997, 10% by Sept 1999, and 12% by Sept 2001). There were 3 Categories of Banks in terms of CAR during the crisis:

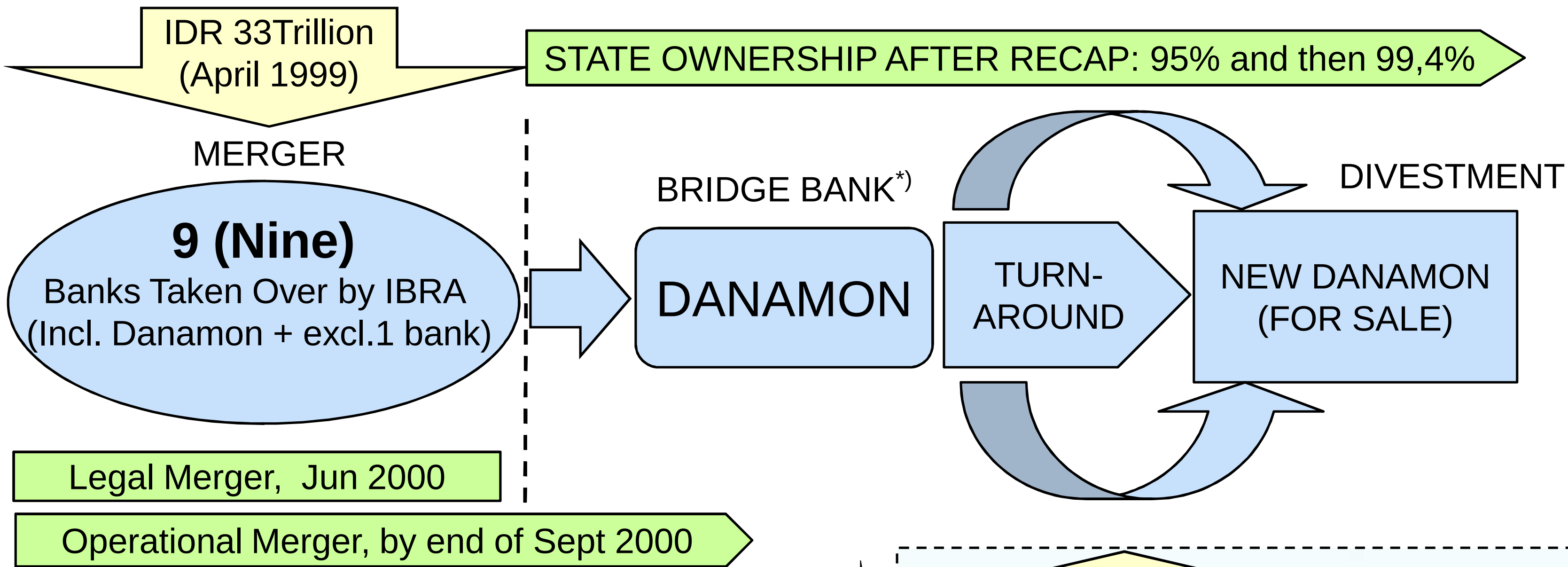
CATEGORY “A” : those with a CAR above the new minimum of 4% ⇒ NO NEED RECAP
CATEGORY “B” : those with a CAR less than 4% but more than minus 25% ⇒ RECAPITALIZED
CATEGORY “C” : those with a CAR less than 25% ⇒ LIQUIDATED

Eligibility conditions for public assistance in a bank recapitalization should reflect financial and operational criteria that also assess viability and good governance. More specifically, the eligibility conditions should ensure that a bank:
- has “fit-and-proper” owners and managers (including new ones);
- recognizes the full extent of its losses, based on realistic valuation criteria;
- submits an acceptable business plan that covers recapitalization to required capital levels ; and
- mobilizes private sector owners (existing or new) to put up, at least, an agreed portion of the new capital;
- make arrangements for the repayment of public assistance and the return of ownership to the private sector.

CASE STUDY: Bank Danamon

Bank Danamon Indonesia (DANAMON), was established in 1956 under the name of Bank Kopra Indonesia. In 1976, the Bank changed the name. The Bank was the first Indonesian private foreign exchange bank in 1976 and become a listed bank in 1989. In 1997, Danamon ran into liquidity solvency and was placed under IBRA. In 1999, the government , through IBRA, recapitalized the Bank with IDR 33 trillion of government bonds..

In the same year, another BTO bank was merged into Danamon as part of the restructuring program of IBRA. In 2000, Danamon took under its wings eight other BTO banks. As the surviving entity, Danamon came out of the merger as one of the pillar banks of Indonesia



Integration of Clearings, Account Number, Assets (Buildings), Branches, IT / ATM, Human Resources :

	1997	Addition	Closed/Resign	2002
Branches	752	278	559	471
ATM	1035	307	603	739
Employees	17249	11408	15357	13300

Turnaround Story

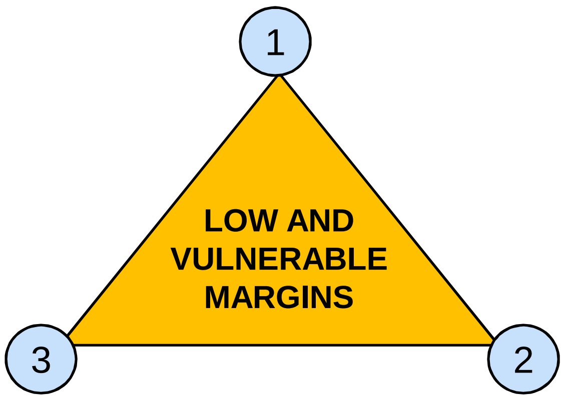
- CAR post Recap: 32.5%
- 2000's Business Projection:
  - CAR 24.4%
  - Assets: IDR 55.2 Trillion
  - Profit Projection: IDR 13 Billion

My Story
"180 Degrees"

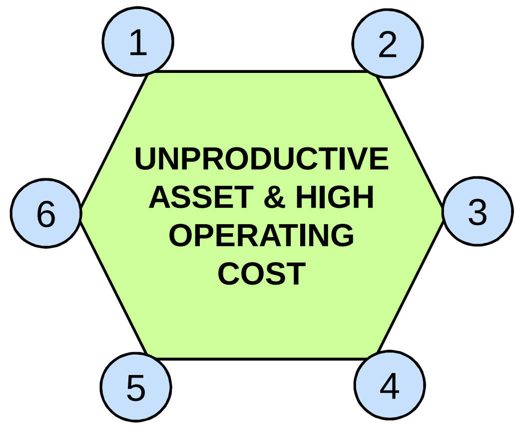
***) Bridge bank.** *A newly chartered, nationalized bank established and operated by the authorities on an interim basis to acquire the assets and assume the liabilities of failing institutions, until final resolution can be accomplished.*

The Turnaround Story started. Where do I begin? Danamon's biggest problem was its balance sheet. What did that signify in real terms? Very bad! On a given day, Danamon lost IDR 2-3 trillion. At the end of every working day, we must to fill the liquidity gap. Already dealing with a surmounting NOP of US$ 316 Mio, we confronted another serious problem – debts of IDR12 trillion, inherited from the 9 merged banks. Including interest and penalty, the total amount was IDR15 trillion. Indeed, it was a gloom and doom situation….!

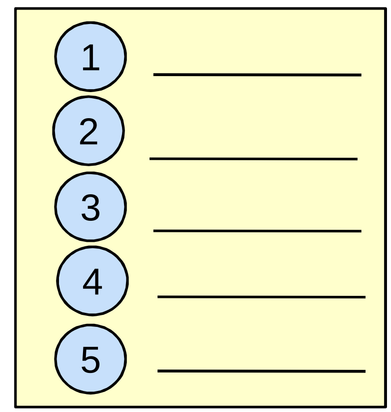
Killer Triangle: Live or Die time



The Problem Box: Short-term fixed



Control Point List (C-List)



NEXT 3 MONTHS

1. **Low asset yield.**
   - Reliance on Recap Bonds (76%)
   - Small Loan Base (LID 19%)
2. **High cost of fund.**
   - Low Deposit/Total Liabilities
   - High proportion of Time Deposit
   - Expensive Non Deposit Liabilities
3. **High interest rate.**
   - 70% Recap Bonds are Fixed-rate
   - Low Fee Based Income

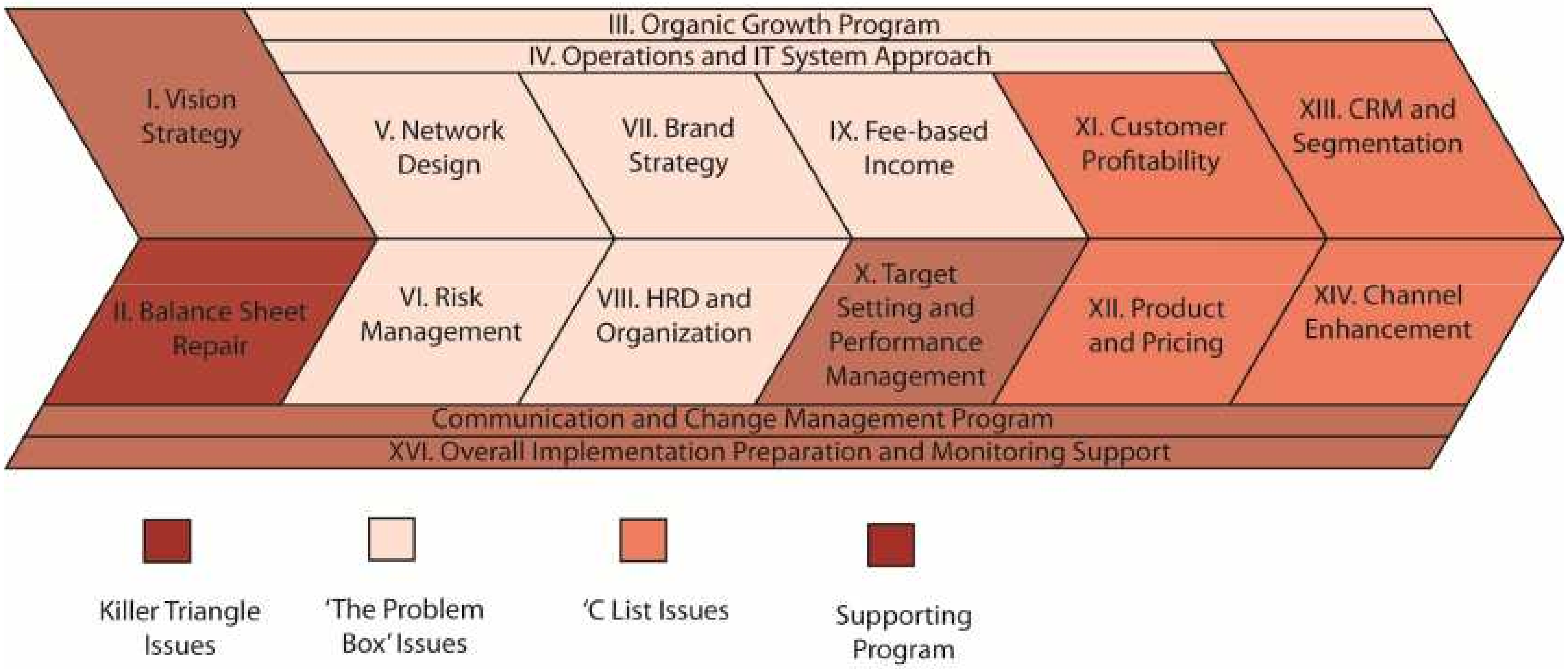
WITHIN 6 – 12 MONTHS

1. **Scale:** Too small
2. **Network:** Low productivity.
3. **Brand:** Weak corporate identity.
4. **HRM and Risk Management:**
5. **IT System and Process**: business processes at branch offices too complex.
6. **Fee-based income:** Too little compared to total revenue; low exposure to trade financing.

1 YEAR ONWARDS

1. To add **more capital** as required.
2. To introduce **new products** with competitive prices.
3. To expand **network scale** and geographical coverage.
4. To build **customer relationship** skills and product knowledge.
5. To focus on **attractive market segment** and to improve relationship with customers

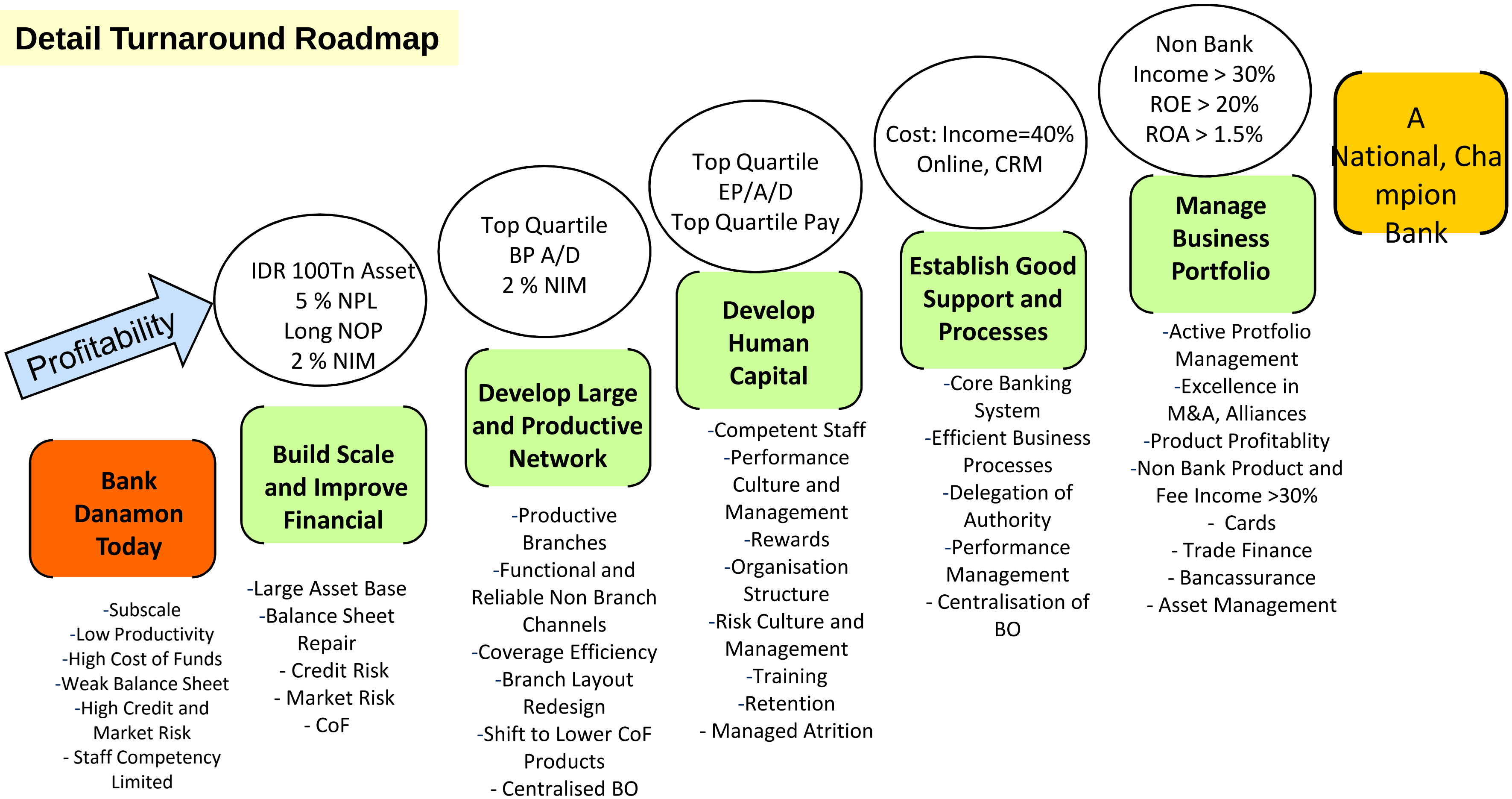
The following diagram illustrates what we had done since 2001 to achieve our next target – divestment. These were also the answers for those challenges or issues (Killer Triangle, Problem Box and C-List). The period between 2001 and 2003 was the era of a 180-degree shift – a turnaround – to reverse our condition after the crisis. There were 39 feasible solutions further grouped into 16 implementation modules, as described in the framework that follows:



This experience only made it clear that we definitely weren't doing any lip service when it came to good corporate governance. We realized that **good corporate governance** was central to ensuring a delivery of quality banking service and a sustainable long-term shareholders value.

Mapping the road. To realize the new vision to be a national champion bank, we emphasized our strategy on 5 major foundations: (1) To expand the business scale and improve the financial condition. (2) To expand the network to boost coverage and productivity. (3) To develop the competency of human capital. (4) To acquire elements needed to support business processes. (5) To manage business portfolio. …

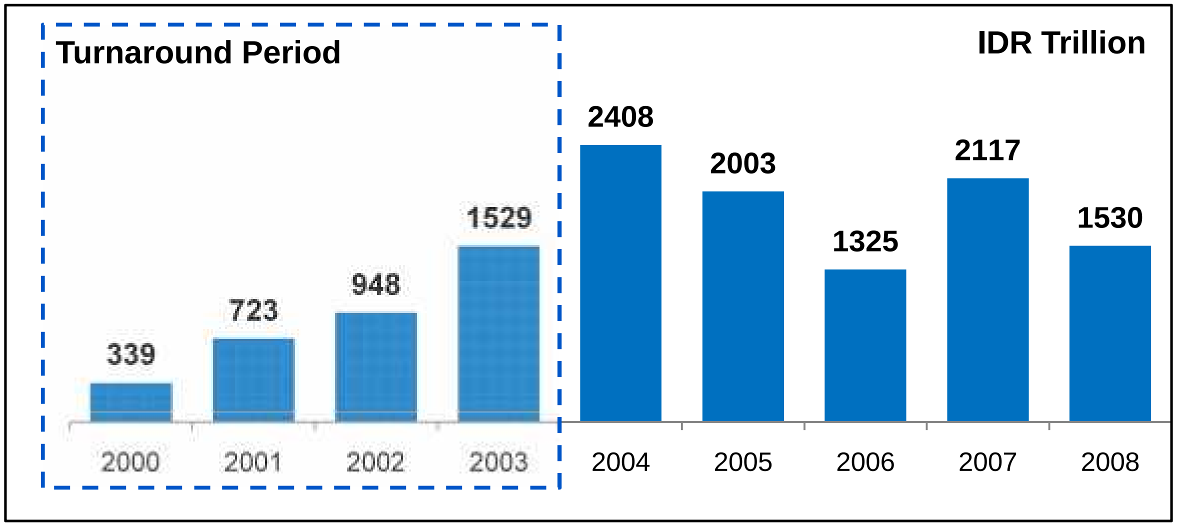
Detail Turnaround Roadmap



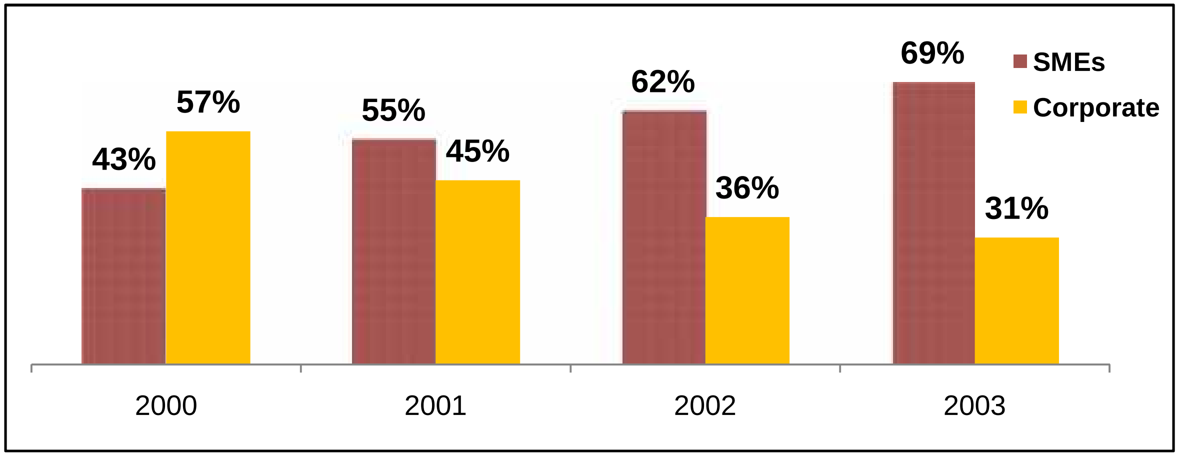
Such objectives would be realized only with the right positioning in the retail and SME sectors as the tool that would set the direction of each of the objectives. Therefore, the approach to employee recruitment and training for instance, should be in line with the plan mapped out in the positioning.

Divestment Phase.
As if it had been a bride, by 2003 Danamon was ready to be proposed. I believed that as an institution, Danamon was more than ready for divestment because what attracted investors in the first place was its prosperous future..

Net Profit After Tax (NPAT) continued to grow during the Turnaround period….



Turnaround Danamon had changed the focus of its business…



It was obvious for Investors what Danamon would be like:

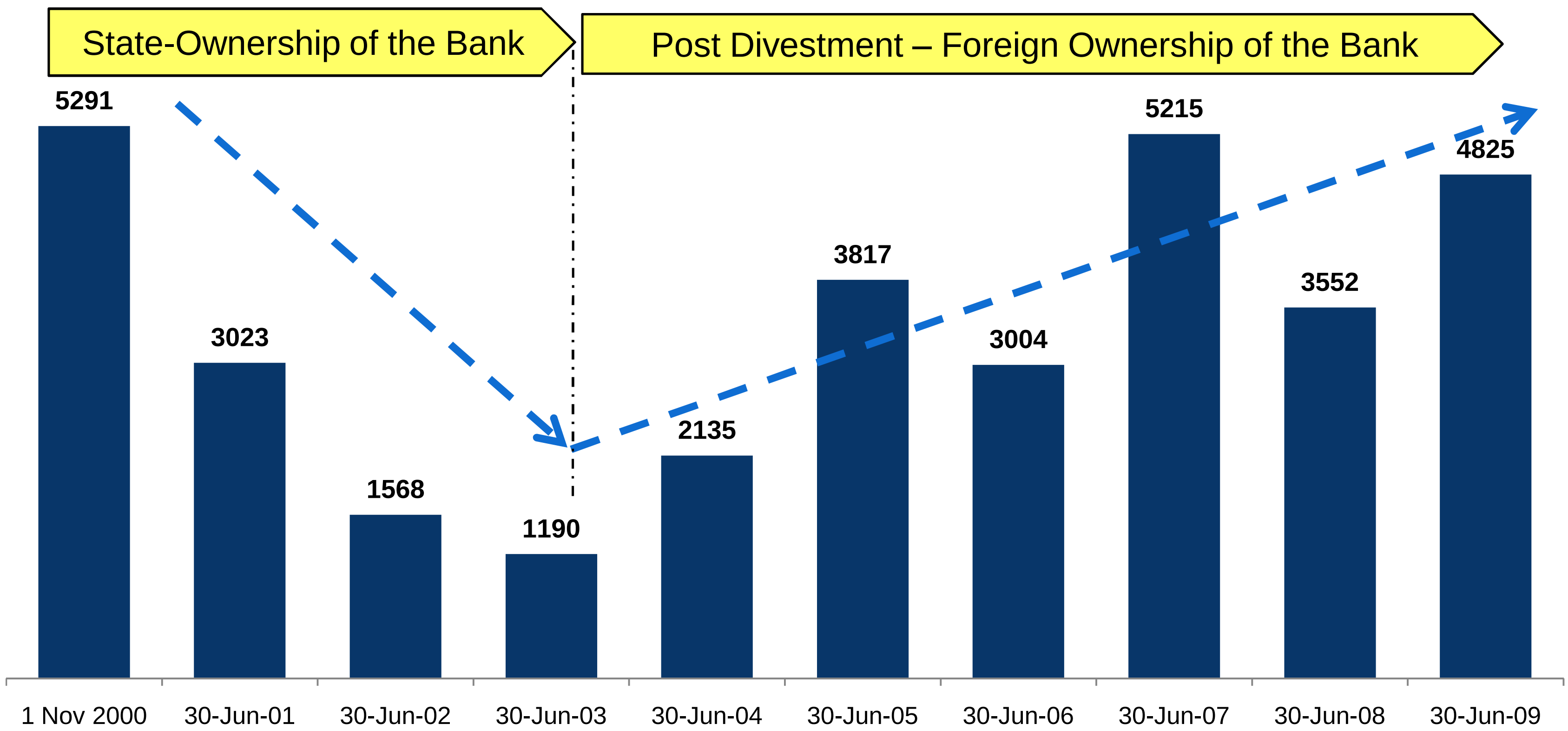
A bank with:

- A strong financial foundation.
- A well functioning, in-place IT system.
- An impressive growth of credit portfolio with NPL less than 5%, and loan-loss reserve more than twice that amount.
- A strong foundation to grow as a retail and SME bank.
- A reputation as one of the best banks in Asia.

READY FOR DIVESTMENT

The final episode:
Finally on November 12, 2002, upon delivery of explanation for justification by Minister of Finance, Minister of State-owned Enterprise, and IBRA Chairman, the Parliament approved the divestiture of 51% of the Government's stocks in Danamon by means of a strategic placement and another 20% through the capital market. The Government owned 99.4% of Danamon stocks by the way.….

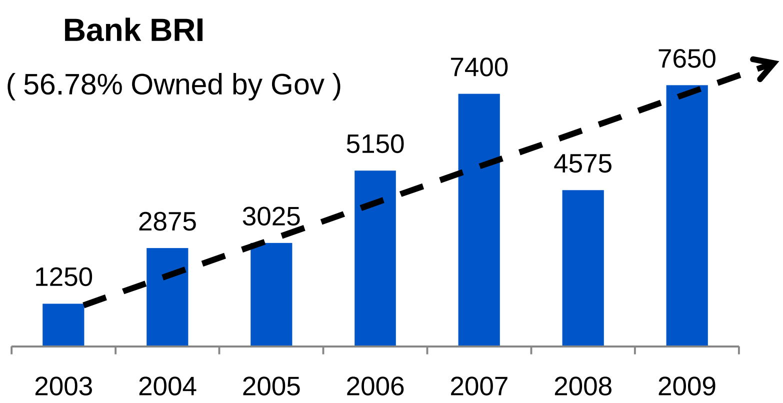
Share Price of Danamon at selected days, IDR / shares

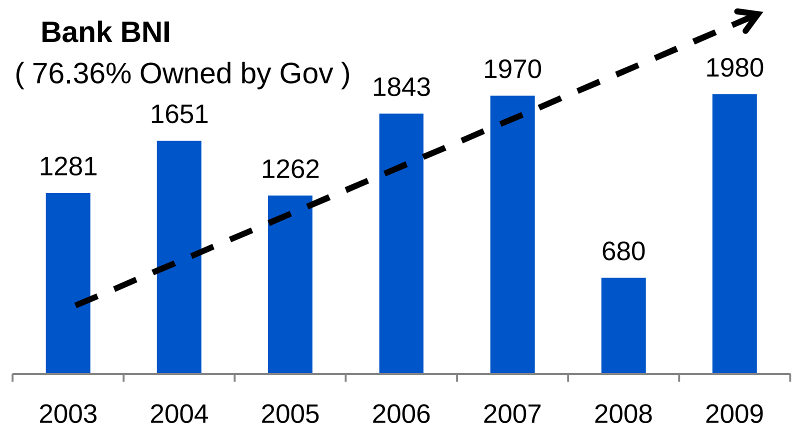


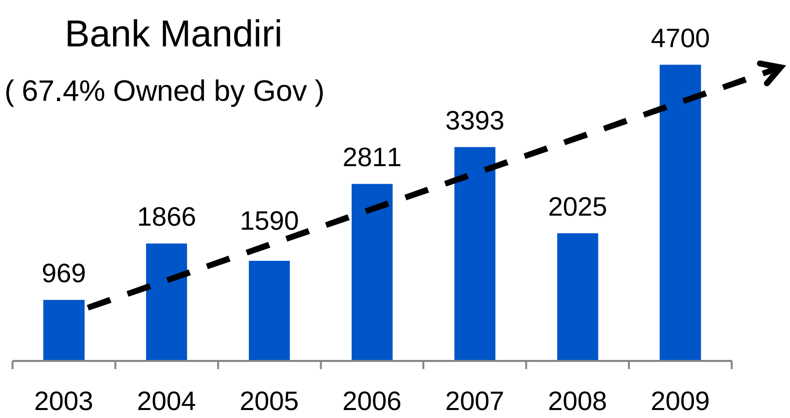
Finally starting June 2003, Danamon officially became the subsidiary of Asia Financial Indonesial (AFI), owned by Temasek Holdings Pte. Ltd., following the divestment of 51% of Danamon shares owned by the Government to AFI for Rp. 3 trillion.

After DANAMON successfully SOLD and change the ownership from Government to Private Investor, I learned form the road-show that investors put an extra attention on corporate strategy. Not coincidentally, Danamon had something to show them – a visionary strategy that expanded beyond operational effectiveness, supported by proven management tools…..

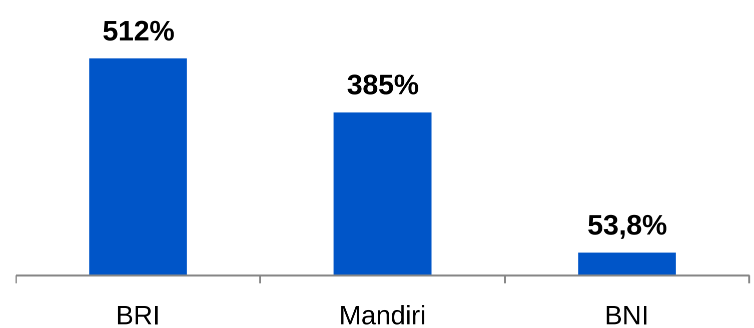
After the Crisis, Amount of State-Ownership in Banks are declining into FOUR State Banks remain (w/o BTN) with Total Market Capitalization of SOB = IDR 224.4Trillion (incl. Bank BTN), it's about 11,11% from Total Market Cap in IDX







After the Crisis, All State Banks tends to increase their Share Prices, from 2003 till 2009:



Total Share-Ownership Government in SOBs after the crisis achieved IDR 117.86 Trillion (combined from 4 SOBs) or it is equivalent to 52% in 2009 and changed from 66% of total net worth in October 2000.

Learned from the successful divestment of Bank Danamon, Government of Indonesia has extensive experience in managing banking crisis and turning the crisis into opportunities. It is time to leverage that experience by shifting a new paradigm in promoting State-ownership in banks after the crisis for doing "State-Business" in future by maximizing the use of public funds….

OLD PARADIGM	NEW PARADIGM
State-ownership in Banks as a part of Crisis Management (Recap, "Bail-out", Restructuring, Divestment)	**State-ownership in banks as a part of Government's Business as Usual; (Investment, Rebuild/ Reform, Divestment)**
State-Ownership in Banks as a "Political Decision"	**State-Ownership in Banks as a Government's "Business Decision"**
State-Ownership in Banks were Managed by Ministry of Finance And State Ministry of SOE	**State-ownership in Banks can be managed under a new Government body such as: "National Sovereignty Wealth"**

Benefits of NEW PARADIGM: (1)The Private Development Sector can be more promoted through Public-Private Partnership. (2) More conducive climate for attracting Foreign Direct Investment (3) Creating more opportunities for Private Sector in doing business by purchasing Government assets..

THE END