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The Fiscalization of Financial Institutions Development Fund's Losses

In accordance with several measures implemented by the Government and the Bank of Thailand to resolve the economic and financial crisis and restore stability and public confidence in financial institutions, the Financial Institutions Development Fund (FIDF) has been given the responsibility to administer such measures. These included the full guarantee of depositors and certain creditors of financial institutions pursuant to the cabinet resolution on 5 August 1997, and the Financial Sector Restructuring Plan pursuant to the cabinet resolution on 14 August 1998 involving bank recapitalization and other rehabilitation measures. As a result, the FIDF has been put under a problematic financial situation, with liquidity shortages and substantial losses. The actual as well as estimated future losses from operations are as follows:

Estimate of FIDF Losses

1. Breakdown of estimated losses classified by type of assistance

Unit: Million Baht

Type of assistance	Net Losses
1. Assistance to depositors and creditors and liquidity support (56 closed finance companies and other financial institutions)	554,149
2. Losses from recapitalization in intervened financial institutions	169,139
3. Losses from managing non-performing assets	650,750
4. Interest and other expenses	165,975

Less FIDF premium and others	138,563
TOTAL	1,401,450

2. The Bt 1.4 trillion estimated total loss has already been partially fiscalized by the issuance of Bt 500 billion worth of government bonds in 1998 with total receipt of Bt 512,824 million. However, the remaining Bt 888,626 million has yet to be fiscalized. In 2000, the Government gave assistance to the FIDF by providing MOF guarantee on Bt 112 billion of FIDF bonds. The interest expense on these bonds has been paid for from the government budget. This assistance, though helping to reduce the FIDF's interest burden and restructure its liabilities, has not completely resolved the losses of FIDF.

Resolution Principles

In the process of resolving FIDF losses, the Ministry of Finance and the Bank of Thailand jointly agreed on the principles that the resolution must be clear, acceptable to all parties, and has minimal impact on the Government's fiscal position and minimal burden on taxpayers in both short and long terms. The resolution must be transparent, must be in keeping with good governance and has minimal adverse impact on the bond market.

In order to completely resolve the problem, the resolution of the losses has 2 components:

1. The fiscalization of uncompensated losses

2. The redemption of the Bt 500 billion government bonds.

Resolution Methodology

(1) On 21 June 2002, the Government passed an Emergency Decree empowering the Ministry of Finance to issue bonds up to Bt 780 billion to fiscalize actual FIDF losses.

In order to comply with the resolution principles, the Ministry of Finance will be responsible for the interest expense to be paid for from the budget. As for the amortization of the principal, the Bank of Thailand will meet this obligation by using annual net profits from

Currency Reserve from 2002 onwards. A separate account will be set up within the Bank of Thailand's General Account to keep such profits in order to ensure the transparency and accountability of this operation.

The use of the profit flows from the Currency Reserve will not affect the levels of international reserves.

(2) As for the redemption of the Bt 500 billion bonds issued according to the Emergency Decree Empowering the Ministry of Finance to Borrow and Administer the Borrowing to Assist the Financial Institutions Development Fund B.E. 2541, which stipulated that the amortization is to be funded by the privatization proceeds and 90% of net profits of Bank of Thailand's General Account operations, very little proceeds have been received so far from the privatization program. Meanwhile, the Bank of Thailand's General Account continues to accumulate losses since the 1997 currency stabilization policy. To ensure that the Bank of Thailand has the capacity to remit profits to the government for this amortization, two Emergency Decrees were passed to eliminate the accumulated losses and to allow the use of assets in the Special Reserve Account for backing issued banknotes such that the Bank of Thailand will have more flexibility in managing its assets to generate earnings and profits as well as will increase its efficiency in implementing monetary policy.

Bond Issuing

It is expected that the size of the new government bonds issuance will not exceed Bt 780 billion and the issuing time frame will be set according to FIDF's cash requirement. Market conditions will also be taken into account in order to minimize the impact on the bond market.

Between August and December 2002, FIDF's obligations of Bt 115 billion to pay depositors of the 56 closed finance companies will fall due and its outstanding borrowing from the repurchase market is Bt 300 billion. Consequently, the FIDF would need to issue a large amount of bonds. In order to minimize the impact on the bond market, the Government will instead offer saving bonds with 5-, 7- and 10-year maturities with the total size of Bt 300 billion to specific groups of savers who currently do not transact in the money market, namely individuals, cooperatives and foundations.

These saving bonds will not only resolve the FIDF's losses incurred from providing assistance to the financial institutions but also serve as an alternative investment option for retail investors, which offers higher yields with longer maturity than commercial banks' deposits.

The saving bonds can be purchased via commercial banks' branches nationwide serving as selling agents. Subscription period of 45 days will be between July 15 - August 30, 2002 and the 45-day settlement period will be from September 2 – October 15, 2002. Subscribers will be able to choose their preferred settlement dates so that they can plan to reinvest their maturing time deposits or other investments in the saving bonds.

The remaining bonds of Bt 480 billion will, based on the same principle of minimizing adverse effects on the bond market, be issued according to the FIDF's cash requirement while taking into consideration the prevailing market conditions. Hence, the government may not issue bonds every year and, if market conditions are not suitable, FIDF may choose to temporarily borrow from the repurchase market. Furthermore, depending on the FIDF's actual losses, the government may not need to issue the whole remaining amount of bonds.

The fiscalization of FIDF's losses by MOF bond issuance with budgeted interest expense provides a transparent solution to the FIDF's problem, with parties responsible and sources of funds clearly identified. The use of the profits of the Bank of Thailand for the redemption of these bonds should not be construed as monetization as it is the normal practice for central banks to remit their profit flows back to governments. The Bank of Thailand will continue to ensure the appropriate level of liquidity in the money market consistent with its monetary policy stance under the inflation targeting framework, thereby supporting Thailand's ongoing economic recovery.

Bank of Thailand

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