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REPORT AND RECOMMENDATION

OF THE

PRESIDENT OF THE

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

TO THE

EXECUTIVE DIRECTORS

ON A

PROPOSED LOAN

IN THE AMOUNT OF US$350 MILLION

TO THE KINGDOM OF THAILAND

FOR

FINANCE COMPANIES RESTRUCTURING

December 16, 1997

CURRENCY EQUIVALENTS
(As of December 4, 1997)

Currency Unit	= Baht (B)
$1.00	= B 42.35
B 1.00	= $0.0236

ABBREVIATIONS

ADB	-	Asian Development Bank
AMC	-	Asset Management Corporation
B/Es	-	Bills of Exchange
BIBF	-	Bangkok International Banking Facilities
BOT	-	Bank of Thailand
FC	-	Financial Company
FIDF	-	Financial Institutions Development Fund
FRA	-	Financial Sector Restructuring Authority
FRACU	-	FRA Coordinating Unit
FRCP	-	Finance Companies Restructuring Program
FSIAP	-	Financial Sector Implementation Assistance Project
GDP	-	Gross Domestic Product
IFC	-	International Finance Corporation
KTB	-	Krung Thai Bank
KTT	-	Krungthai Thanakit Public Co., Ltd.
IMF	-	International Monetary Fund
MOF	-	Ministry of Finance
MOU	-	Memorandum of Understanding
NCDs	-	Negotiable Certificates of Deposit
NEP	-	Note Exchange Program
NPL	-	Nonperforming Loan
P/L	-	Promissory Note
PLMO	-	Property Loan Management Organization
PN	-	Promissory Note
RADP	-	Regulatory, Accounting and Disclosure Practices
SEC	-	Securities and Exchange Commission
SFI	-	Specialized Financial Intermediaries
VAT	-	Value Added Tax

KINGDOM OF THAILAND - FISCAL YEAR
October 1 - September 30

Vice President:	Jean-Michel Severino, EAP
Country Director:	Jayasankar Shivakumar, EACPF
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CONTENTS

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LOAN AND PROGRAM SUMMARY

Borrower: Kingdom of Thailand.

Amount and terms: $350 million—Single Currency Loan (SCL) in US dollars for 15 years, including a 3-year grace period, at the Bank's standard fixed US dollar (SCL) interest rate.

Description: The proposed Loan would provide balance of payments assistance to the Kingdom of Thailand in implementing a program for restructuring finance companies. The loan supports government efforts toward the resolution of suspended finance companies and ensuring safety and resiliency of the remaining finance companies through (a) better handling of weak companies, (b) strengthening prudential regulations, and (c) ensuring that finance companies pursue more viable strategies. The operation also sets the agenda for future reform of all financial institutions by initiating actions to improve the incentive for financial market participants to be prudent and responsible in their decisions. This is the first step in the government's program to make the financial sector efficient, competitive and robust. The program would strongly complement the macroeconomic stabilization package agreed by the Government with the International Monetary Fund (IMF). The Government's commitment to the program supported by this loan is set out in a Letter of Development Policy.

Benefits and risks: The structural measures supported by the loan will help restore confidence in Thailand's ailing financial sector. The proposed framework for restructuring finance companies lays out a process of accountability through closing down nonviable finance companies and creating better incentives for creditors, depositors and debtors. The emphasis in the program on strengthening the regulatory and supervision regimes will ensure the safety and soundness of the remaining finance companies and will help prevent similar crises from recurring. Credible streamlining of finance companies will strengthen the rest of the financial sector and will restore confidence, which is key to the resumption of capital flows. This, in turn, will improve the balance of payments and provide much needed liquidity, at lower interest rates, to the corporate sector to resume growth.

There are many risks. Political instability and economic leadership that lacks credibility would cause further loss of market confidence and instability. These, in turn, would increase the stress on the already fragile financial sector. Under weak leadership, the program for restructuring finance companies would lack credibility and would not yield the benefits listed above. The objectives of the loan would be put at risk also if the macroeconomic stabilization program falters either because the political cost of the adjustment is perceived to be too high or because of a failure to manage expectations regarding outcomes. Inflexibility in the design of the macroeconomic program that limits policy options in the face of continued economic contraction would prolong the crisis and would pose a risk to the loan. The program would be at risk if the Thai authorities failed to mobilize the skills needed in financial restructuring, if the Thai market could not absorb the impaired loans and if the process was not transparent. Finally, failure of a large bank could trigger further deposit shifting and could lead to a systemic collapse.

However, a number of recent developments indicate that these risks are being mitigated. Thailand has a new government with a respected economic team that has reaffirmed its commitment to both macroeconomic stabilization as well as the program for financial sector restructuring. The recent revisions in the macroeconomic framework are leading to more realistic predictions regarding outcomes and performance targets. The pressure to take decisive action on finance companies is dictated by the realization that the economic crisis would otherwise deepen and the cost of inaction would mount.

Bank operations will also help to mitigate the risk to the loan by providing timely technical assistance that will lend credibility to government decisions regarding both the resolution of the closed finance companies and the policy framework for strengthening the remaining finance companies. This assistance is provided via the ongoing Financial Sector Implementation Assistance Project.

Poverty Category: N.A.

Estimated Disbursements: The loan would be disbursed in a single tranche upon effectiveness.

Project ID Number: TH-PE-53615.

THAILAND

PROPOSED LOAN FOR FINANCE COMPANIES RESTRUCTURING

1. INTRODUCTION

1. I submit for your approval the following report and recommendation on a proposed loan for restructuring Thailand's finance companies. The proposed loan is designed to restore confidence in Thailand's financial sector by supporting government efforts toward the resolution of closed finance companies and reestablishing the subsector on a sound basis. The loan would be part of a broad effort to support the macroeconomic stabilization and structural adjustment program that Thailand has embarked upon to restore sustainable levels of economic growth.

2. The Bank's initial contribution to this effort consisted of a Financial Sector Implementation Assistance Project (Loan 4233-TH) approved by the Board on September 11, 1997. The proposed loan, focused on restructuring the finance companies, constitutes the first phase of the Bank's expanded lending operations in Thailand. A follow-up operation will focus on the remaining agenda for the financial sector as well as on broader structural measures designed to strengthen the macroeconomic policy implementation and competitiveness of the Thai economy. The Bank's contribution would complement the standby facility provided by the International Monetary Fund (IMF) and the emergency financing package from bilateral and multilateral sources agreed upon in Tokyo (August 1997).

2. BACKGROUND AND RATIONALE

A. THE ECONOMIC CRISIS AND THE FINANCIAL SECTOR

3. Structural weaknesses in Thailand's financial sector helped the economic crisis. Since the early 1990s, the sector has expanded rapidly, registering a fourfold increase in six years. This expansion took place in a setting of weak prudential regulations and regulatory forbearance so that problems such as high exposure to risky activities, related party lending and rapid accumulation of foreign exchange risk were not dealt with in time. Furthermore, due to inadequate accounting and disclosure requirements, market discipline did not exert pressure on financial institutions to improve performance and reduce excessive risk-taking. These problems were especially acute in the finance company subsector, which accounted for 20 percent of financial system assets.

4. Macroeconomic developments in the early 1990s put further stress on finance companies and exposed their vulnerabilities. Thailand had enjoyed rapid export-led economic growth for a decade, which fueled optimism externally and internally and led to an investment boom. Macroeconomic policy (fixed exchange rate and high domestic interest rates) and the institutional framework (tax advantages that encouraged foreign borrowing through the Bangkok International Banking Facility, restrictions on foreign equity ownership and the absence of a domestic market for long-term debt) provided incentives for short-term foreign borrowing,

despite the high domestic saving rate of 34 percent. At end-1996, total short-term liabilities held by the private sector stood at $39.1 billion.

5. The financial sector's fragility, a slowdown in export earnings, a collapse of demand in the property sector, a sustained bearish sentiment on the stock market and depreciation of the Baht would each have led to serious macroeconomic and financial sector problems. In 1996 and 1997, all four moved adversely and fed on each other. Exports stagnated, the real estate bubble finally burst, the stock market lost 80 percent of its value relative to its peak in 1993 and the Baht depreciated by nearly 50 percent. The combination of these events has resulted in severe difficulties for the financial sector, and has clouded Thailand's medium term growth prospects.

6. The economic crisis has had a particularly adverse impact on **finance companies**, viz., (a) the fall in share prices and the collapse of the property sector has resulted in a sharp deterioration of the assets of finance companies; (b) the exchange rate depreciation has led to difficulties for corporate borrowers in repaying loans and has resulted in increased losses to finance companies due to their unhedged foreign exchange liabilities; and (c) the sharp rise in interest rates has further exacerbated the difficulties of corporate clients in servicing their loans to finance companies and has also led to rapid decapitalization as short-term funding rates have risen more rapidly than lending rates. All of these factors have combined to cause a massive deterioration in the loan portfolios of finance companies.

7. The difficulties noted above and the already poor financial situation of many finance companies led to the need to suspend the operations of 58 finance companies on June 27 and August 5, 1997 and the subsequent closure of 56 of the suspended companies.

B. The Thai Authorities' Stabilization Program

8. The Government's stabilization program designed with IMF assistance in the Standby Arrangement of August 24, 1997 has two prongs. The first is an orthodox program of bringing down the current account deficit to manageable levels to relieve the pressure on the Baht. The second prong addresses financial sector difficulties and has been designed in close collaboration with the Bank. The two together were expected to restore confidence and stabilize the economy.

Macroeconomic Developments

9. Because of political uncertainty, slow progress in addressing financial sector problems and regionwide pessimism, the macroeconomic program has met with limited success in restoring confidence. In early December, four months after the program was put in place, the exchange rate had depreciated to B 42 per $1 and its volatility remains high. Capital outflows were larger than expected. Uncertainties in the financial sector continue to fuel depositors' flight to quality, exacerbating liquidity problems of small banks and finance companies that are perceived to be weak. In this climate of uncertainty, even the larger banks flush with liquidity are reluctant to lend.

10. As a result of continued macroeconomic and financial sector difficulties, Thailand is experiencing an economic contraction after decades of rapid economic growth. The adjustment in

the current account deficit, down to 3.9 percent of gross domestic product (GDP) from 7.9 percent in 1996, has come about largely from a sharp decline in private investment. Some adjustment in private investment was necessary following the excesses associated with the investment boom, especially in the property sector. However, even manufacturing firms are now curtailing their activities. The index of manufacturing production has shrunk in the last two quarters and corporate income tax receipts are likely to fall by nearly B 29 billion this year. Increasing job separations and declining real incomes have weakened private consumption, and are evidenced in the sharply reduced retail sales and the larger-than-expected reduction in value added tax (VAT) collections.

11. The program had envisioned that following the sharp depreciation of the exchange rate, recovery would be led by external demand. Although exports have picked up in recent months, the effect of the real exchange rate depreciation on exports has been partly offset by manufacturers' difficulties in accessing credit and regional developments. Competitor countries in the region have also experienced sharp adjustments in the exchange rate. Moreover, regionwide reduction in GDP growth has curtailed intraregional trade, which was a large proportion of Thailand's international trade prior to the crisis.

Short-Term Macroeconomic Outlook and Financing Need

12. As a result of the adverse developments outlined above, the short-term economic outlook remains worrisome. Real GDP growth is expected to decline by up to 2 percent of GDP in the first half of 1998 before recovering later in the year. Because of the contraction, the inflationary pressure will be checked at about 12 percent in mid-1998, falling to about 6 percent by end-1998. Given the steep nominal depreciation, the substantial real depreciation of the Baht is expected to bring down the current account deficit to 3.9 percent of GDP at end-1997 (1.8 percent of GDP in 1998).

13. The capital account is expected to register a deficit of about $18 billion for 1997 and to be in balance in 1998. A fall of $7 billion in short-term debt will result from difficulties in rollover ($1 billion in 1998) while payments associated with the Bank of Thailand's (BOT's) unwinding of forwards and swap obligations are estimated at $12 billion ($8.9 billion in 1998).

14. Thus, Thailand will record an overall balance of payments deficit of $24.6 billion in 1997 and $2.2 billion in 1998 (see table below). Given the target of four months of imports in reserves, the net financing need is about $9 billion in 1997 and $4 billion in 1998. This total of $13 billion is well within the financing package of $17.2 billion announced at Tokyo in August 1997.

The Need for Flexibility

15. The macroeconomic scenario outlined above is subject to considerable uncertainty arising from political instability and uncertainty related to financial sector restructuring. However, the new Government, in place since early November 1997, is determined to redress these shortcomings. It has demonstrated credible leadership and is fully committed to the macroeconomic stabilization program.

THAILAND: BALANCE OF PAYMENTS AND FINANCING NEED, 1997-98
($ billion)

	1997 Revised Program	1998 Revised Program
1. Current account balance	-6.4	-2.5
2. Capital account balance	-17.9	0.3
3. Errors & omissions	-0.3	0.0
4. Net balance 1+2+3	**-24.6**	**-2.2**
5. Targeted changes in official reserves (increase,-)	15.7	-1.8
6. Financing need -4-5	**8.9**	**4.0**

Source: IMF.

16. The Government's fiscal policy program provides the cushion to cope with the cost of financial sector restructuring. A number of new fiscal measures have been implemented recently to make up for the revenue shortfall due to the weakening of economic activity. These included a rise in VAT rates, excise taxes, and import duties as well as cuts in investment expenditures. However, in view of the faster-than-expected decline in output and better-than-expected current account and inflation outlook, there is some risk that the tight fiscal stance could further depress aggregate demand and economic activity. The authorities, therefore, will review the fiscal target in the next quarter to retain flexibility.

17. Monetary policy seeks a balance between the objectives of currency stabilization and low domestic interest rates to prevent a sharp downturn in growth. Following the July 2, 1997 float of the Baht, domestic interest rates have risen sharply—with the repo rate rising to the 20-25 percent range against 10-15 percent before the crisis, while credit and monetary aggregate growth have been well below the authorities' targets, reflecting the weaker-than-expected real sector and the increasing difficulties of the financial sector. The authorities remain mindful of the need to avoid exacerbating corporate and financial sector difficulties and will review interest rate policy in view of developments.

18. A number of measures are being taken to encourage a supply response to the real depreciation of the Baht: (a) firms are allowed to deduct from their tax bill the valuation loss resulting from the depreciation of the Baht during 1997, (b) a credit line has been opened to supply working capital to exporters through commercial banks and the Thai EXIM Bank, (c) the rise in the minimum wage—the reference wage in the manufacturing sector—has been limited to 2 to 3 percent, well below inflation, and (d) customs procedures are being streamlined to reduce costs to domestic producers.

19. With assistance from the World Bank and the Asian Development Bank, a comprehensive program is being prepared to provide safety nets for the poor.

20. Several policy options are being considered to revive capital flows but especially to encourage more stable forms of capital. These include (a) removal of restrictions on the borrowing of Baht by nonresidents to help restore investor (domestic and foreign) confidence, (b) streamlining of the tax regime to encourage development of the bond market and the domestic interbank money market, (c) liberalization of the strict rules on foreign equity ownership, and (d) better management of market expectations through improved dissemination of economic information and regular consultation with foreign creditors.

A Vision for the Financial Sector and Streamlining of Finance Companies

21. Recognizing the linkages between macroeconomic stabilization and financial sector reform, the government has designed a comprehensive program for reforming the financial sector. Over the medium term, the financial sector needs to become more efficient and robust. It has to be more balanced in terms of the type of services provided, including greater emphasis on capital markets. A reformed financial sector would constitute an important pillar of the overall strategy for promoting competitiveness of the Thai economy to resume sustainable long-term growth. In the near term, five steps are needed to realize this vision:

- a streamlined **finance company subsector** that allows faltering companies to exit, facilitates company restructuring, is subject to tighter supervision and provides sufficient information to market participants to weigh the risk of available options.

- a streamlined **banking sector** that is free of weak institutions and is governed by "best practice" supervision and regulatory standards.

- strengthened loan classification, loan loss provisioning, interest income recognition and capital adequacy requirements to bring them up to international standards;

- eased entry for foreign equity owners to facilitate recapitalization of financial institutions and tougher licensing procedures .

- enhanced market discipline through tougher public disclosure requirements and accountability.

22. While all five steps are important for the realization of a robust and efficient financial sector, and are being supported through a series of operations by multilateral institutions, the first, i.e., streamlining of the finance companies, has taken on particular urgency for the following reasons:

- Delay in restructuring the suspended finance companies has signaled a lack of government resolve to take tough decisions to restructure the financial sector.

- Continued deterioration of assets "locked" in the suspended finance companies has led to a more rapid deterioration in the loan portfolios for the remaining financial institutions.

- Measures aimed at the resiliency and soundness of the operating finance companies will help prevent the recurrence of similar crises that jeopardized the entire financial sector.

3. THE FINANCE COMPANY SUBSECTOR

23. Thailand has a highly monetized economy and a relatively deep financial sector for its level of income. High growth and savings rates together with substantial capital inflows led to rapid growth in the ratio of broad money to GDP during 1986-96 (from 59 to 74 percent). At the end of 1996, total financial sector assets amounted to B 9 trillion ($355 billion at the then exchange rate of B 25.25/$1). Commercial banks dominate the sector with approximately two-thirds of assets and of funds mobilized from households. However, 91 finance companies accounted for the next largest group of financial institutions (FIs), with around 20 percent of assets and 17 percent of funds from households (Table 2.1).

TABLE 2.1: OVERVIEW OF KEY FINANCIAL SECTOR INSTITUTIONS

Figures for banks and finance companies as of December 1996, SFIs as of March 1996	Commercial Banks	Finance Companies	Specialized Financial Intermediaries (SFIs)	Total (see Note)
Number of Institutions:	29	91	6	4,870
of which Foreign:	14	0	0	n.a.
Total Assets (million Baht)	5,627	1,812	842	9,030
Share of Financial System Assets (%):	62	20	9	100
Total Funds from Households (Deposits):	2,643	661	321	3,948
Share of Financial System Deposits (%):	67	17	8	100

Note: Total includes Credit Foncier, mutual fund management and insurance companies, agricultural and savings cooperatives (estimated at end-1995), and provident funds.

Source: BOT.

24. **Key Features of the Finance Company Subsector.** While some finance and securities companies were independent, many originated as affiliates of commercial banks to provide specialized services that banks were not permitted to provide (e.g., securities dealing) or as specialized providers of high-margin, high-risk consumer finance.[1] Finance companies fund their operations by issuing large-denomination promissory notes (PNs), as well as negotiable certificates of deposit (NCDs) and bills of exchange (B/Es). Loans and overdrafts from domestic

[1] A number of finance companies have securities business. In 1995, finance and securities companies were required to split their finance and securities businesses into two separate companies; however, compliance has been slow.

and foreign banks are also significant sources of funds. Finance companies' assets as of December 1996 were dominated by loans (77 percent of total assets) and securities investments and receivables (18 percent). Due to commercial banks' regulatory and cost advantages, finance companies sought profits by allocating a major share of their portfolios in high-risk areas, including real estate (28 percent), margin loans and hire purchase (15 percent) and personal consumption loans (26 percent). The profitability of finance companies declined by 60 percent over the period 1993-96, due to the glut in the real estate market and the 70 percent decline in the securities exchange index.

25. The legal, regulatory and supervisory framework governing finance companies is such that they cannot effectively compete for most commercial bank mainstream business and are left largely with more risky activities that banks choose not to engage in. Their activities are covered by the Law on the Finance Business, Securities Business and Credit Foncier Business of 1979 (B.E. 2522), as amended in 1983 and 1985.[2] While this law allows finance companies to conduct similar business to commercial banks, several important restrictions apply to their activities. They cannot (a) mobilize sight or time deposits, but are permitted to issue fixed-term promissory notes and negotiable CDs; (b) offer overdrafts or credit cards; (c) offer credit facilities related to trade finance; (d) provide foreign exchange services; or (e) establish a domestic branch network in the Greater Bangkok area.

26. Finance companies are therefore structurally predisposed to greater cyclical fluctuations in their returns than are banks and have been a destabilizing factor for the financial sector. This problem is exacerbated by the fact that, in spite of the greater risks, finance companies have been subject to less stringent prudential requirements than banks.

A. Historical Antecedents

27. This is not the first crisis in the finance company subsector. In the early 1980s, Thailand experienced a financial crisis associated with a slowdown in the economy, globally high interest rates, and fraud and mismanagement on the part of several finance companies and of a few banks. The economic downturn was particularly detrimental for finance companies: BOT intervened at that time in around 50 finance companies and 5 commercial banks. In 1994-95, liquidity was provided to several institutions through the so-called April 4 Lifeboat Scheme and 24 finance companies were closed. Their depositors were repaid the principal on their deposits over a 10-year period.

28. This experience led to the creation of the Financial Institutions Development Fund (FIDF) in 1985, a separate legal entity under BOT with a mandate to reconstruct, develop and provide liquidity support to financial institutions. The FIDF is funded by a fee paid by FIs (0.1 percent of deposits) and by BOT contributions. It is playing a key role in the resolution of the current financial crisis (Chapter 4).

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[2] Securities companies are governed by the Securities and Exchange Act of 1992.

B. Structural Weaknesses

29. The origins of the weaknesses in Thailand's financial sector fall into two broad categories.

30. **Misjudgments and Poor Incentives as Sources of Weaknesses.** Risky behavior led to four major types of problems on the assets side of balance sheets for finance companies: (a) unduly rapid asset growth, with a twelvefold increase in finance company assets during 1986-96, compared to a sevenfold increase for banks and a twofold increase in real GDP; (b) misallocation of funds, especially to finance speculative investments in real estate (25 percent of lending); (c) excessive concentration of risk; and (d) aggressive term transformation: more than 35 percent of finance company loans are long-term (often 5-7 year real estate loans), compared to less than 5 percent of finance companies' borrowings.

31. Finance companies' problems on the asset side were compounded on the liabilities side of the balance sheet by errors with regard to: (a) concentration on volatile sources of fund and (b) excessive foreign exchange exposure arising from significant foreign currency borrowing to take advantage of high domestic interest rates.

32. **Regulatory Forbearance and Inadequate Recognition of Problems.** At the end of 1996, there were a reported B 225 billion in nonperforming loans on the books of finance companies (15 percent of gross loans) and another B 487 billion on the books of commercial banks (11.5 percent of gross loans). Most banks and finance companies have failed to adopt appropriate loan classification, resulting in vastly understated nonperforming loans, postponed loan loss provisioning and continued accrual of interest on nonperforming assets. Regulations governing income recognition on nonperforming loans are lenient by international standards. Provisions are far below what would be required to address the problems at hand, and the ratio of provisions to non-performing loans actually fell for both finance companies and banks during 1996. Finally, auditing and disclosure practices have been weak, resulting in underreported lending to related parties and a limited role for market discipline. Reported capital adequacy ratios vastly overstate the capital positions of both finance companies and banks: the gap between their capital positions, adjusted for proper asset classification and provision, and the capital they require to meet minimum capital adequacy standards are estimated at B 353 billion to B 570 billion.

33. Until early 1997, there appears to have been a presumption that problems were short-term and would largely be resolved with liquidity support from the FIDF. The FIDF's support was also provided at below-market interest rates, often with inadequately perfected collateral, and was not related to increasingly stringent conditions or holding actions.

C. Recently Taken Measures

34. **The Measures Taken Prior to August 1997** to deal with the crisis included: (a) establishment of a (largely inactive) Property Loan Management Organization (PLMO) to fund viable, unfinished real estate projects; (b) direct intervention in Bangkok Bank of Commerce following a run on deposits; (c) phasing in of tighter asset classification, income

recognition and provisioning requirements, and higher capital adequacy standards for finance companies; (d) imposition of controls on deposit rates; (e) issuance of decrees to facilitate mergers and acquisitions in the finance company sector; and (f) provision of liquidity support through the FIDF to almost 70 finance companies and at least 2 banks. These measures, taken during the first half of 1997, were piecemeal and half-hearted and did not stem the growing loss of confidence.

35. When these measures failed to resolve the problems, they were followed by: (a) suspension of the operations of 58 weak finance companies; (b) blanket guarantees to eligible depositors and creditors of suspended financial institutions; and (c) a mandatory program involving recycling of excess deposits from certain banks via BOT to banks with liquidity shortages. In retrospect, the measures adopted inadvertently compounded the scale of the crisis, increased resolution costs for Government, and increased the danger of contagion from finance companies to the banking sector and thus the potential for a systemic crisis.

36. **Measures Taken After August 1997.** Since the launching of the IMF program and World Bank support in August 1997, the Government has begun to implement a more structured program aimed at stabilizing and reforming the financial sector. The recent measures are presented in Chapter 4.

4. GOVERNMENT'S PROGRAM FOR RESTRUCTURING FINANCE COMPANIES

37. The Government's Finance Companies Restructuring Program (FCRP) that this loan supports is anchored in the overall plan for reforming the financial sector so that it contributes more effectively to future economic growth. This plan will be phased in over several years and is being supported by a series of operations by multilateral institutions (the Bank, IMF and the ADB). The FCRP is a critical first step in the realization of the medium term plan. It seeks to:

(a) redefine and clarify the policies of the Financial Institutions Development Fund (FIDF) with respect to future liquidity support to finance companies and the program of emergency comprehensive guarantee;

(b) develop an institutional and policy framework for the resolution of the suspended finance companies;

(c) reestablish the finance company subsector on a sound basis through stricter supervisory standards, strengthened prudential regulations, and more viable operating strategies; and

(d) reduce systemic risk to the financial sector as whole by improving incentives for financial market players to be efficient and prudent.

38. These objectives are to be met through a program of actions already taken (with extensive Bank/Fund technical support) and a number of agreed future actions that are contained in the attached Letter of Development Policy (Schedule 1).

A. Liquidity Support and the Comprehensive Guarantee

39 The FIDF provided nearly B 400 billion in liquidity support over several months prior to the suspension of the 58 finance companies, but this did not succeed in arresting the financial sector crisis. The support had been provided without effective agreement with the recipient finance companies on: (a) stabilization strategies, (b) changes in management and shareholder rights, (c) collaterization and subordination to other creditors, (d) contingency plans for exit in the event the cash infusions proved inadequate, (e) penal interest charges for resorting to support from lender of the last resort, and (f) transition to a limited deposit insurance regime.

40. The emergency comprehensive guarantee provided by the Government at a potentially large fiscal cost was also not viewed as sufficiently credible by the market. There was confusion with respect to the depth of the Government commitment to honor it, the exact liabilities that were or were not covered and the mechanisms for funding the guarantee and executing it for individual liability holders. Thus neither the FIDF liquidity support nor the comprehensive guarantee had helped to bolster confidence and stem the depositor flight to quality and the associated instability in the financial sector.

41. The authorities have taken aggressive steps to remedy these inadequacies:

(a) FIDF interest rates for loans to financial institutions have been raised to the repurchase agreement rate plus 1 percent and could rise to 2.5 percent depending on the extent of uncollateralized lending and the level of indebtedness; at over 20 percent per year in nominal terms (as of October 1997), the FIDF liquidity support rate is now well above the highest deposit rates.

(b) Depending on the extent of borrowing, FIDF liquidity support now triggers the following: (i) cessation of all dividend payments and bonuses or benefits to directors and executives; and (ii) once FIDF borrowings equal 75 percent of Tier One capital, FIDF may assign a representative to the board of the borrower, restrict asset growth and take additional actions.

(c) A Decree was issued on October 25, 1997 that defines depositors and creditors, clarifies the liability holders covered by the guarantee, and specifies that subordinated debt holders, off-balance sheet creditors, and shareholders' funds are not covered. The Decree promises additional government support to FIDF. FIDF is required to administer the guarantee program, which is to be funded with a fee of 0.4 percent per year on all covered liabilities.

(d) Deposit rates are capped at a maximum 3 percent above the average deposit rates of the five largest commercial banks to prevent weak, liquidity constrained institutions from paying rates that are higher than lending rates. As a result, interest rates throughout the system have risen substantially.

42. The authorities have also agreed to:

(a) undertake a thorough review of the objectives, roles and functions of the FIDF in the aftermath of the immediate crisis. The review will include an assessment of the FIDF's role in liquidity support, resolution programs, procedures for taking collateral and converting advances to capital and quasi-capital. Recommendations for reforming the FIDF based on the review would be presented by December 1998.

(b) prepare an action plan for the phasing-in (to begin by April 1998 and be completed by December 1998) of a permanent limited deposit insurance system to replace the present emergency comprehensive guarantee.

B. Resolution of Suspended Finance Companies

43. Rapid and credible resolution of the 58 suspended finance companies is seen by the market as a critical first step in restoring confidence. It would also cap the costs that delay has imposed on the suspended companies, their creditors, depositors, and debtors who have not been able to obtain liquidity and repay loans. Market estimates are that as a result of deterioration in the loan portfolios, as many as 50 suspended companies now have a negative capital ratio.[3] Timely exit of insolvent finance companies is particularly important to enhance prospects of the open finance companies and minimize contagion to the commercial banking sector.

The Newly Established Institutional Structure for Resolutions

44. The passage of six emergency Decrees in October 1997 has created a well-defined institutional structure for overseeing the resolution of the 58 suspended finance companies. The new structure has proven far more effective than the previous Ministerial Screening Committee. The legal and institutional impediments to the resolution process are now being addressed in a systematic and comprehensive manner. Based on the Decrees, two new institutions, the Financial Sector Restructuring Authority (FRA) and the Asset Management Corporation (AMC), have been established as the focal points for resolving the suspended finance companies.

45. The new Decrees permit FRA to take over and rapidly change management in the suspended companies. FRA serves as the focal point for the resolution of all suspended finance companies as described in Annex 1. It is assigned the responsibility for reviewing all rehabilitation proposals submitted by the suspended companies using criteria discussed below. In addition, it is to oversee the orderly closing-down of finance companies not reopened and the disposition of their assets.

46. With strong economic leadership provided by the new Government, FRA is moving with impressive speed, decisiveness and transparency in dealing with the resolution process. It has been effectively supported by experts from consulting, accounting, law and public relations firms

[3] This assumes that nonperforming loans as a percent of total loans are 30 percent for all 58 suspended finance companies taken together. These calculations have also adjusted capital for the existing deficient practices in interest income recognition.

of international standard, mobilized at short notice, and funded under the World Bank-financed technical assistance loan.

47. AMC's role is to bid for impaired assets auctioned by FRA at a reserve price. AMC is designed to overcome the near-term impediments to asset liquidations, create a market for distressed assets, and utilize new troubled debt restructuring techniques to assist in what will be a large number of industrial restructurings. AMC thus acts as a disposition corporation for open or suspended finance companies as well as for commercial banks. Its goal is to maximize the value of the assets to be sold and maintain an orderly real estate market. AMC Board members and the chief executive officer have been appointed and its financing and governance structure are being developed. It will be staffed and operational by January 31, 1998. By that date, it will have established a business plan, capital and funding strategy, and will have written policies and procedures on asset bidding (valuation), asset management and restructuring and asset sales. The authorities have authorized B 1 billion in AMC capital, of which B 250 million have been approved.

Progress in the Rehabilitation/Resolution Process

48. The rehabilitation criteria issued by FRA include recapitalization required of both existing and new owners; guidelines for conversion of FIDF debt to equity; requirements that existing shares be fully written down; imposition of upper limits on allowed conversions; and allowance for up to 100 percent foreign equity investment for 10 years with the investment, but not the percentage ownership, grandfathered thereafter. FIDF debt can now be restructured provided other creditors restructure their claims in a similar manner. BOT has announced criteria for assessing new management and fresh sources of capital for finance companies whose rehabilitation plans are approved by FRA.

49. FRA adopted a three-step process for deciding on rehabilitation proposals: (a) design of a modeling framework within which the FRA evaluated the submitted rehabilitation and business plans, (b) validation of asset valuations implicit in the rehabilitation proposals, and (c) examination by an independent third party to ensure that the process is consistent with the criteria designed in close coordination with the Bank and the IMF. Following this process, the finance companies whose rehabilitation plans are accepted would be allowed to reopen while those finance companies whose plans are rejected would be closed down.

50. On December 8, as per schedule, the authorities announced that only 2 of the of the 38 rehabilitation plans submitted to FRA by suspended finance companies had been approved, and 36 rejected. Thus, 56 of the 58 suspended companies are to be closed down. This bold decision has been welcomed in Thailand and abroad.

51. The next step is to put in place a framework for the orderly disposal of assets of the finance companies that have been closed down. This involves appointing committees[4] for finance

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[4] The Committees consist of representatives from the Ministry of Finance (MOF), BOT, FRA, and FIDF.

companies to replace the original boards of directors. The committees are to appoint special managers with responsibility for (a) assuming control of each company, (b) stratifying the assets into categories according to their quality, and (c) recommending specific options for the resolution to a special advisory board (the Sales Group) under FRA. To ensure the integrity of the asset disposal process, the government established on December 15, 1997 the Financial Restructuring Authority Coordination Unit (FRACU). FRACU will monitor and conduct surveillance of the committees and managers engaged in asset disposition. The Government is committed to begin selling the closed finance company assets in the first quarter of 1998, and to complete all asset sales by December 1998.

Treatment of Suspended Finance Company Depositors and Creditors

52. Depositors in the 16 first suspended finance companies, and depositors and creditors in the 42 finance companies subsequently suspended, were given the option of exchanging their claims for notes issued by the KTT/KTB (publicly-controlled financial institutions) under two distinct note exchange schemes (see Annex 2). While these programs are administered by KTT and KTB, FIDF will service payments of interest and principal on the notes. Creditors of the first 16 suspended finance companies do not have the option of exchanging their claims, and will have to modify the claims under a shareholder rehabilitation program or negotiate them out of the proceeds of FRA-administered liquidation of the finance company's assets.

53. As part of the commitment to a transparent and credible process for liquidating companies, the FIDF has been empowered to relinquish its preferential claim over collateral it has perfected in cases where specific finance companies are taken into liquidation.

Fiscal Impact of the Resolution Process

54. The costs of restructuring finance companies could potentially be large, are not transparent and need to be monitored. The costs arise from the following: (a) FIDF liquidity support that may become solvency support; (b) debt to equity conversions by the FIDF or other forms of support, e.g., stretch-out of FIDF repayment terms; (c) Government contribution to initial capital or contingent liabilities associated with AMC; and (d) FIDF costs associated with paying interest and principal payments on KTB and KTT notes held by depositors and creditors. The Government is committed to monitoring these costs carefully and on a regular basis by implementing a fiscal monitoring framework for the financial sector restructuring program. Based on the framework, the costs incurred by FIDF, AMC and all other agencies involved in the resolution process will be reflected explicitly in the budget.

C. Reestablishing the Finance Company Subsector on a Sound Basis

55. The Thai authorities are well aware that, while the 33 nonsuspended finance companies controlling roughly 40 percent of finance company assets are considerably stronger as a group than those suspended, they are also facing significant risks. For the most part, these companies have been more conservatively managed and about 75 percent of them are strengthened by close relationships with much larger commercial banks. Nonetheless, they, too are heavily concentrated in high risk lending arenas and with generally more marginal borrowers who were

unable to raise all their credit requirements from cheaper funds from banks. Also, the remaining finance companies have, until recently, been losing deposits as their credibility has been undermined by the wide publicity associated with the 58 suspensions.

56. Therefore, in parallel with the FRA program for resolving the suspended companies, BOT has launched an effort to deal directly and quickly with the underlying causes of poor finance company performance to mitigate the high potential risks the remaining institutions pose to the overall financial system. They are doing so through implementing a three-pronged program for the remaining 33 finance companies by (a) quickly identifying and addressing problems in nonsuspended finance companies; (b) strengthening finance company prudential regulations; and (c) ensuring that surviving finance companies pursue more viable future strategies. This program is described below in greater detail.

Identifying and Addressing Nonsuspended Finance Company Problems

57. BOT, based on its review of monthly off-site reports and more focused on-site examinations, stratified all 33 operating finance companies based on present capital adequacy (following application of classification and provisioning requirements that will be effective December 31, 1997), projected capital adequacy, the seriousness of their problems, and their principal shareholders' financial strength.

58. BOT is aggressively taking action based on these findings. Under its new intervention powers created by October 1997 amendments to the Finance Company Act and the Banking Act, it has (a) taken over management of one finance company where fraud was alleged and which BOT plans to close down in an orderly fashion; and (b) replaced management of a second small finance company that was experiencing serious liquidity problems. BOT plans to sign memoranda of understanding (MOUs) by December 31, 1997 with companies identified with serious problems. BOT will follow-up carefully on compliance with time-bound MOU targets and is prepared to take increasingly stronger intervention steps where situations worsen or there is significant noncompliance. To help monitor the MOUs, BOT will conduct diagnostic reviews under specific terms of reference and with external assistance. In parallel, BOT plans to sign MOUs and monitor compliance, in line with the submitted rehabilitation plans, of the previously suspended finance companies that have been allowed to resume operations.

59. BOT has established the principle that it will intervene in seriously undercapitalized open finance companies that are unable to propose, or fall significantly out of compliance with, an acceptable recapitalization plan or that are forced to borrow excessively from FIDF (at penal interest rates) over significant time periods. When BOT intervenes in a financial institution, it will choose one or several actions among the following possibilities: (a) management is replaced by industry professionals or by BOT staff, (b) capital is reduced so that existing shareholders are the first to take losses, (c) FIDF funding is converted in capital or subordinated loans.

Strengthening Finance Company Prudential Regulations

60. Finance company prudential regulations have been less stringent than those for commercial banks, although their operations are significantly and unavoidably more risky than

those of commercial banks. Therefore, finance company regulations have been or will be strengthened as follows:

(a) Finance company regulations will be strengthened by July 1998 in line with commercial bank requirements by (i) limiting maximum total risk exposure of one credit risk to 25 percent of Tier One capital; and (ii) limiting maximum net long foreign exchange position to 20 percent of Tier One capital and net short foreign exchange position to 15 percent of Tier One capital.

(b) New requirements will be imposed by July 1998 on finance companies that will reduce maximum investment in equity shares on a time-bound basis to 20 percent of capital.

(c) Announcements will be made by July 1998 that will subject finance companies, to the same requirements that are imposed on banks with respect to (i) submitting semiannual credit plans to BOT (useful for portfolio diversification, risk profile and growth planning); and (ii) loan-to-deposit (promissory note) ratio guidelines.

61. In addition, other prudential regulations will be strengthened for both banks and finance companies as follows:

(a) Announcements have been made, to be applied to both banks and finance companies, that will tighten loan classification by requiring provisioning for all loans more than six months overdue, effective December 31, 1997 and prohibit accrual of interest on all loans more than six months overdue effective January 1, 1998.

(b) New, more stringent, loan classification and provisioning rules, including troubled debt restructuring guidelines, applicable to both banks and finance companies will be announced by March 31, 1998 that will, on a time-bound basis, bring loan provisioning and accrual of interest requirements in line with international standards by year-end 2000.

(c) New licensing requirements will be set progressively. Guidelines have already been issued by BOT for the proper assessment of existing owners, board members and managers in merged finance companies or new banks resulting from the resolution process of the 58. BOT will propose legal amendments to the Banking Act and Finance Company Act to empower BOT and MOF to assess the executive managers, directors and shareholders of both existing and new banks and finance companies. In addition, BOT will issue new guidelines to lay down a comprehensive and single set of licensing procedures for both banks and finance companies in line with international standards. These procedures will apply to licensing of new institutions as well as approving major changes in capital structure and senior management of existing institutions.

(d) New requirements will be imposed on finance companies and banks that will (i) limit maximum lending to a single related party and on a combined basis to all related parties as a percentage of Tier One capital; and (ii) impose stricter limitations on net foreign exchange exposure.

Ensuring that Finance Companies Pursue more Viable Strategies

62. The widespread poor finance company performance during the past six months, (including the collapse of both lending and securities businesses in many cases) together with a significant expansion over time of commercial banks into spheres of activity previously dominated by finance companies has raised questions as to whether the present pattern of finance company structure and *modus operandi* will prove sufficiently viable over the long term. While that question will be answered in the marketplace, the authorities have taken several steps to enhance prospects for viability as follows:

(a) commercial banks, both domestic and foreign, can take 100 percent ownership positions in finance companies so long as they maintain a sound financial condition. Commercial banks may provide much of the capital funding required by some finance companies; the grouped bank and finance company portfolios thus created may reduce finance company risk through diversification.

(b) FRA decisions not to approve 36 rehabilitation plans of companies representing 10 percent of total industry assets will reduce industry capacity relative to demand and thus will reduce pressure to lend to risky clients.

(c) BOT is encouraging additional mergers and consolidation among the remaining companies where appropriate, thus enhancing economies of scale, strengthening management, and easing the future supervision requirement. Estimates suggest that the number of finance companies could be reduced by about 15 percent through merger.

(d) Agreement has been reached with the management of each finance company to recommend to their assembly of shareholders that dividend not be paid for the remaining of 1997 and the first half of 1998.

D. Strengthening the Enabling Environment for Financial Institutions

63 The Thai authorities are convinced that weaknesses in the financial institutions' enabling environment have played a major role in contributing to the present financial sector crisis. Thus, the authorities have committed themselves to implement a consistent and reinforcing set of actions to improve the institutional and incentive framework for the financial system over the next six months to one year. In particular, they have identified serious weaknesses in three areas, i.e.,

- inadequate financial institution supervision systems, policies, and procedures;
- inadequate financial institution accounting, auditing and disclosure standards; and
- inadequate legal and regulatory framework for corporate workouts and debt collection.

64. Reforms in policies and processes in these areas will require a significant period of time to prepare. Considerations relating to design and planning are often complex. The process of

consultation and achieving consensus can be time-consuming, as changes can affect a number of stakeholders, many of them outside the banks and finance companies. Implementation, too, requires time as it involves institutional change and/or changes in legislation.

65. Therefore, the authorities, during this first-phase response to the crisis, have appropriately focused their attention on the most urgent issues and those for which action can achieve rapid and significant impact. However, they intend, over the next months, to initiate a significant reform program, which the Bank intends to support in the proposed second adjustment operation, in each of these three areas.

Strengthening Financial Institution Supervision Systems, Policies and Procedures

66. The Thai authorities are taking a number of immediate steps to effectively utilize supervision and liquidity support resources augmented by important policy changes, to deal with the immediate finance company crisis. However, to address the causes of the inadequate supervisory response that contributed to the depth of the crisis, they are also preparing a more fundamental longer-term reform program to strengthen their ability to supervise financial institutions. In addition to regulatory changes affecting both finance companies and banks that have earlier been presented (see above), this supervision and regulatory reform program will, inter alia, include:

(a) **Establishment of Policies and Procedures for Dealing with Troubled Financial Institutions Through Prompt Corrective Action.** In view of the high costs that were incurred due to delays in dealing with the finance companies when they first became seriously troubled, BOT plans to establish objective criteria and formal procedures that mandate remedial actions by supervisors commensurate with any financial or management weaknesses or rule violations that are detected. By May 1998, BOT will develop and implement internal guidelines for prompt corrective action based on specified triggers, e.g., capitalization ratios and need for liquidity support. By the end of 1998, BOT will propose legal amendments to strengthen the applicability and enforcement of these internal guidelines.

(b) **Consolidated Supervision of Financial Groups.** MOF, BOT and the Securities and Exchange Commission (SEC) will develop and issue regulations that will deal with consolidated supervision of financial groups (groups comprising banks, finance companies, and/or securities companies).

(c) **New Prudential Regulatory and Accounting Standards for Specialized Banks.** The Government intends to issue requirements for the specialized banks that it supervises (and that are, for the most part, less immediately affected by the crisis) that parallel those required for commercial banks, including, in particular, similar loan classification, provisioning, and interest accrual requirements.

(d) **Review of Overall Supervisory Regime.** By April 1998, the Government will establish an interagency task force that will review and recommend changes in the legal and regulatory framework for supervision. This will be conducted in light of the Thai strategy to modernize its financial structure and services.

67. Finally, BOT has agreed to develop by March 1998 a medium-term institutional development plan for strengthening its supervisory capacity. This plan will primarily aim at strengthening on-site and off-site supervision as well as enforcement procedures.

Strengthening Financial Institution Accounting, Auditing and Disclosure Standards

68. In retrospect, it is obvious that the authorities, depositors and, to some extent, even the finance company managers themselves were unaware that a number of finance companies were experiencing seriously deteriorating financial condition and performance for many months before the initial group of 16 finance companies were suspended. Annual audited statements provided inadequate transparency and largely failed to disclose the extent of deterioration and, more generally, the quality of information available to credit institutions (e.g., information on real estate prices and markets) was insufficient to permit proper credit evaluations. Hence, depositors were slow to begin withdrawing deposits and there were long delays in bringing the discipline of the marketplace to bear on the poor performers, with the consequent costs borne by many creditors and the taxpayers.

69. The new loan classification, provisioning and interest income recognition requirements being phased in (see above) will address the most serious accounting disclosure inadequacies. However, audited statements now being produced, which are regulated as stock exchange requirements designed for listed firms generally, not for financial institutions specifically, fall far short of meeting international financial institution disclosure requirements. In addition, the disclosures to be required of financial institutions and the existing nonuniformity in the information disclosed to the public by financial institutions (e.g., nonperforming loans) are also short of international standards. Finally, BOT has not established a policy with respect to the public disclosure of the information it now collects.

70. To improve the quality of information available to market participants and the public, the authorities will embark upon a series of steps. Initially, they will announce (at the end of December 1997) a stricter and uniform definition of nonperforming loans, which financial institutions will need to disclose beginning with end-of-year 1997 financial statements. Under the new definition, loans in nonaccrual for six months will automatically be classified as nonperforming with no account taken of collateral (see Policy Conditionality Matrix—Schedule 2).

71. Subsequently, by December 31, 1998 (see the Letter of Development Policy, Schedule 1), BOT will finalize a public disclosure program to be required of all financial institutions under its supervision [Regulatory Accounting and Disclosure Practices (RADP)]. It will include guidelines and a phase-in schedule for disclosing information in such areas as volume of renegotiated loans, rollovers, loan loss provisions, and lending to related parties. In addition, BOT will establish an overall policy by December 31, 1998 with respect to public disclosure of information it now collects (e.g., credit plans of financial institutions, large debtor reports, etc.). Finally, and more broadly, the authorities will outline improvements to be made in enforcing or modifying

accounting and auditing standards. This program will focus on areas such as how to utilize internal and external auditors and related guidelines to assist supervisors in improving the quality of information provided to market participants by financial institutions.

Addressing Inadequacies in the Legal and Regulatory Framework for Debt Collection and Corporate Workouts

72. Highly inefficient, time-consuming bankruptcy and collateral foreclosure procedures have proven dysfunctional, contributed to an inadequate credit disciplinary environment, and exacerbated the crisis. Finance institutions' ability to collect overdue debts has been undermined. The procedures discourage voluntary debt restructuring and creditor willingness to provide liquidity to solvent but illiquid companies under reorganization.

73. To overcome these critical problems the authorities have already submitted legislative changes to the bankruptcy act. However, they intend to submit additional, more comprehensive, legislative proposals by March 31, 1998) to permit a more efficient process of corporate reorganization, speed collateral foreclosure, facilitate financing to companies undergoing reorganization, and permit greater scope for out-of-court settlements. On the side of lenders, the phase-in of troubled debt restructuring guidelines will be a critical determinant in supporting the process of voluntary workouts.

5. BANK GROUP STRATEGY

A. THE BANK

74. The last Country Assistance Strategy (CAS) prepared for Thailand was discussed by the Board in August 1994. At the time, Thailand was experiencing high rates of growth and therefore Thai officials and Bank staff agreed that Bank assistance would be selective, focused on infrastructure, human resources development, and protection of the environment. Given the changed circumstances of the country, this strategy will be revised.

75. A new CAS, reflecting recent developments, is under preparation and is expected to be presented to the Board in April 1998. Under the new CAS, the Bank would pursue a two-pronged strategy: first, the Bank would address immediate macroeconomic and financial sector issues and, second, the Bank would respond to medium- and long-term requirements for macroeconomic and financial sector strengthening and assist Thailand's reform of its public sector, financial system, economic management system, enabling environment to attract foreign investment, and related social dimensions. By means of instruments such as lending, economic and sectoral analyses, and technical assistance, the CAS will also set out a series of real sector interventions. These are expected to focus on infrastructure development, energy, environment, and human resource development (including skills development) which will clearly enhance Thailand's international competitiveness but—at the same time—also address the country's poverty alleviation and regional equity concerns.

76. The onset of the current Thai financial crisis has required the Bank to intensify its analytical work, drawing upon the experience of similar operations in other countries. The first operation was a fast-track loan designed to provide implementation assistance to the Government for enhancing the resiliency and soundness of the financial sector, and developing a strategy for the resolution of the suspended finance companies. This Financial Sector Implementation Assistance Project (FSIAP, Loan 4233-TH) of $15 million was approved by the Board on September 11, and is under implementation. The proposed loan has benefited directly from the technical assistance provided under FSIAP. The next planned operation will focus on the remaining agenda in financial sector reform and will be presented to the Board in Spring 1998. Follow-up operations, focusing on broader structural measures to strengthen the macroeconomic framework and the international competitiveness of the Thai economy, will benefit from the background work under the proposed Economic Management Assistance Loan that we intend to present to the Board in January 1998.

77. Total lending by the Bank to Thailand amounts to approximately $5.6 billion under 115 loans and six credits. During the 1980s, Thailand made use of two single-tranche structural adjustment loans from the Bank. The current portfolio consists of 15 projects amounting to approximately $1.5 billion, with projects in the rural development, energy, education, transport, and economic/financial sectors.

B. The International Finance Corporation (IFC)

78. IFC is looking to work closely with the Bank for ways to contribute to the Bank's program for financial sector reforms and restructuring of Thai industries for long-term competitiveness. In past discussions, the Thai Government has expressed appreciation of IFC's investment and advisory activities in Thailand. In recent years, IFC's investment activities have focused mainly on infrastructure, petrochemicals and capital markets. IFC has played a critical role in developing Thailand's petrochemicals industry by arranging nearly $1 billion in financing for six petrochemical projects. In social infrastructure, IFC approved a pioneering project in financing a private hospital in Bangkok in FY93, and is pursuing additional opportunities in this area. There is interest by private investors for IFC support in other social infrastructure projects such as private technical schools and universities. A current priority of IFC is to play a role in the financial restructuring process in which it has an interest.

C. Coordination with IMF and the Asian Development Bank (ADB)

79. In August 1997, under the IMF-coordinated Tokyo Pledge, the Thai authorities committed themselves to a stabilization program. This program is supported by an IMF standby arrangement, bilateral pledges by Southeast and East Asian countries, and multilateral support by the World Bank and the Asian Development Bank amounting to $17.2 billion. The Bank's operations described above would complement the other components of this support package.

80. On August 20, 1997, IMF's Executive Board approved a 34-month Standby Arrangement (SBA) for Thailand for an amount equivalent to SDR 2,900 million (505 percent of quota). SDR 1,200 million (209.1 percent of quota) was disbursed upon Board approval. Access under the SBA exceeds normal limits in light of Thailand's exceptionally large balance of payments

needs, and is heavily frontloaded in order to ensure the early availability of external financing deemed essential for the restoration of confidence. SDR 600 million (104.5 percent of quota), as well as the second-tranche disbursements of bilateral contributions under the financing package for Thailand, were released upon the satisfactory completion of the first review on December 8.

81. The Bank has been working closely with IMF in Thailand. Since the outbreak of the financial crisis, the Bank and Fund have jointly assisted the government in designing the comprehensive financial sector restructuring program that is currently being implemented. IMF has paid special attention to issues related to commercial banks, while the Bank has focused on the resolution framework for finance companies and on strengthening the supervision and regulatory framework for the entire financial system.

82. ADB pledged $1.2 billion at the August 1997 Tokyo Pledge meeting on Thailand. This amount represents expected disbursements from ADB over the period 1997-99. One-half of the disbursements would be from ongoing projects and other project loans that are expected to be approved by ADB over the same period. The other half would be disbursements from two proposed program loans—the Capital Markets Development Program Loan and the Social Sector Program Loan.

6. THE PROPOSED LOAN

83. The proposed loan, consistent with the objectives of the new CAS under preparation (discussed in Chapter 5), is a strong response to the current economic crisis, and would ensure that appropriate actions are taken by the Thai authorities to restore solvency and soundness of the financial company subsector. The loan is also a critical element in the coordinated response of the Bank, IMF, ADB, and bilateral lenders to assist Thailand in attaining macroeconomic and financial stability. As noted above, this loan builds on FSIAP, approved by the Board on September 11, 1997. The Bank's current and proposed operations, and strategic approach for program design are an outcome of intensive discussions with the Thai authorities.

84. **Loan Size.** A single-tranche loan of $350 million is proposed to be made available upon loan effectiveness, anticipated for early January 1998. The Closing Date of the loan would be June 30, 1998.

A. CONDITIONS FOR BOARD PRESENTATION

85. The Thai authorities have submitted a Letter of Development Policy (Schedule 1) that describes the current economic crisis and its impact on the finance company subsector, explains the design of the overall financial sector restructuring program and presents the actions to be taken for restructuring finance companies.

B. LOAN ADMINISTRATION

86. **Terms and Conditions.** At the request of the Government, and consistent with the country's external debt management policy, the proposed loan, in the amount of $350 million,

would be a Single Currency Loan (SCL) in US Dollars, with a 15-year maturity, including a 3-year grace period, at the Bank's standard fixed US Dollar SCL interest rate.

87. **Disbursement and Procurement.** The proposed loan would support the finance companies' restructuring program of the Government described in the Letter of Development Policy, and would disburse against expenditures except for items specified in Schedule 1 of the Loan Agreement. The Government will open and maintain a deposit account with BOT. Upon effectiveness, the Government will submit a simplified withdrawal application to the Bank, against which the Bank will disburse the loan proceeds in one tranche into the Deposit Account. Disbursements will not be linked to specific purchases, and supporting evidence for disbursements is therefore not required. If after deposit is made in the Deposit Account the proceeds of the loan and any part thereof are used for ineligible purposes as defined in the Loan Agreement, the Bank will require the borrower to either (a) return the amount to the Deposit Account for use for eligible purposes, or (b) refund the amount directly to the Bank, in which case the Bank will cancel an equivalent undisbursed amount of the loan.

88. **Accounts and Audit.** BOT, on behalf of the Government, will maintain the accounts for this loan in accordance with sound accounting practices. The accounts under the program will be audited within four months of Bank request.c

89. **Monitoring Arrangement.** MOF and BOT will be responsible for monitoring the implementation of the restructuring program with the help of the Letter of Development Policy, through regular reviews, as well as in the context of the preparation and supervision of other projects. MOF and BOT will prepare a final report on the progress of the program within six months after the closing date of the loan, and submit the report to the Bank.

90. **Environmental Assessment Requirements.** In accordance with the Bank's Operational Directive on Environmental Assessment (OD 4.00, Annex A), the proposed operation has been placed in Category "C" and will not require an environmental assessment.

C. BENEFITS AND RISKS

91. **Benefits**. The structural measures supported by the loan will help restore confidence in Thailand's ailing financial sector. The proposed framework for restructuring finance companies lays out a process of accountability through closing down nonviable finance companies and creating better incentives for creditors, depositors and debtors. The emphasis in the loan on strengthening the regulatory and supervision regimes will ensure the safety and soundness of the remaining finance companies and will help prevent similar crises from recurring. Credible streamlining of the finance company subsector will pave the way for comprehensive restructuring of the entire financial sector. This will restore confidence, which is key to the resumption of capital flows and increasing domestic credit. This will improve the balance of payments and provide much needed liquidity, at lower interest rates, to the corporate sector to allow growth to resume.

92. **Risks.** Political instability and weak economic leadership would cause further loss of market confidence and continued exchange rate instability. These, in turn, would increase the

stress on the already fragile financial sector. Under wavering leadership, the program for restructuring finance companies would lack credibility and would not yield the benefits listed above. The objectives of the loan would also be put at risk if the macroeconomic stabilization program falters either because the political cost of adjustment is perceived to be too high or because of a failure to manage expectations regarding outcomes. Inflexibility in the design of the macroeconomic program that limits policy options in the face of continued economic contraction would prolong the crisis and pose a risk to the loan. The program for restructuring finance companies would be at risk if the Thai authorities failed to mobilize the needed human resources, if the Thai market could not absorb the impaired loans, and if the process was not transparent. Finally, failure of a large bank could trigger further deposit shifting and lead to a systemic collapse.

93. However, a number of recent developments indicate that these risks are being mitigated. Thailand has a new government with a respected economic team that has reaffirmed its commitment to both macroeconomic stabilization as well as to a significant restructuring of the financial sector. Recent revisions in the macroeconomic framework are leading to more realistic performance targets. The pressure to take decisive action on financial sector restructuring is dictated by the realization that the economic crisis would otherwise deepen and the cost of inaction would mount.

94. Bank operations will also help to mitigate the risk to the loan by providing timely technical assistance that will lend credibility to government decisions regarding both the resolution of the closed finance companies and the policy framework for strengthening the remaining finance companies. This assistance is provided via the ongoing Financial Sector Implementation Assistance Project.

7. RECOMMENDATION

95. I am satisfied that the proposed loan complies with the Articles of Agreement of the Bank and I recommend that the Executive Directors approve it.

James D. Wolfensohn
President

by Sven Sandström

Washington, D.C.
December 16, 1997

Attachments

TABLE 1: THAILAND: MACROECONOMIC FRAMEWORK, 1994-98

	1994	1995	1996	1997		1998	
				Prog.	Rev.	Prog.	Rev.
Real GDP growth (percent)	8.9	8.7	6.4	2.5	0.6	3.5	0-1
Consumption	8.0	7.3	6.2	3.3	0.5	0.8	-1.1
Gross fixed investment	11.5	13.2	6.7	-10.2	-13.3	-0.8	-6.5
CPI inflation (end period, percent)	5.3	7.1	4.8	9.5	10.0	5.0	6.0
CPI inflation (period average, percent)	5.1	5.8	5.9	7.0	6.0	8.0	10.0
Saving and Investment (percent of GDP)							
Gross domestic investment	40.4	42.3	41.0	36.3	35.8	35.9	33.3
Private, including stocks	31.7	33.1	31.3	26.4	25.3	26.1	23.7
Public	8.7	9.2	9.7	9.9	10.5	9.8	9.6
Gross national saving	34.9	34.3	33.1	31.3	31.8	32.9	32.5
Private, including statistical discrepancy	22.6	22.2	21.5	21.0	21.3	21.5	21.7
Public	12.2	12.0	11.6	10.2	10.6	11.5	10.8
Foreign	5.6	8.0	7.9	5.0	3.9	3.0	0.8
Fiscal accounts (percent of GDP) 1/							
Central government balance	1.7	2.6	2.2	-1.1	-0.9	1.0	1.0
Revenue and grants	18.7	18.8	19.1	17.3	17.6	17.8	16.6
Expenditure and net lending	17.0	16.2	16.8	18.4	18.5	16.8	15.6
Overall public sector balance	1.8	2.5	2.2	-1.6	-1.5	1.0	1.0
Monetary accounts (end period, percent)							
M2A growth	18.1	18.1	12.7	7.0	1.5	11.0	6.8
Reserve money growth	14.5	22.6	12.0	8.0	4.4	11.0	6.8
Balance of payments (billions of US$)							
Exports, f.o.b.	44.6	55.7	54.7	56.2	56.4	61.0	60.9
Growth rate	22.3	25.0	-1.3	2.8	3.2	8.6	7.9
Imports, c.i.f.	53.4	70.4	70.8	66.5	64.2	67.6	64.3
Growth rate	19.2	30.4	1.8	-6.1	-9.3	1.6	0.2
Current account balance	-7.8	-13.2	-14.4	-9.0	-6.4	-5.3	-2.5
(percent of GDP)	-5.6	-8.0	-7.9	-5.0	-3.9	-3.0	-1.8
Capital account balance	12.2	21.9	18.0	-16.4	-17.9	1.8	0.3
Medium- and long-term	4.6	9.3	12.2	5.5	6.5	5.3	8.5
Short-term 2/	7.6	12.6	5.8	-21.9	-24.4	-3.5	-8.2
Overall balance	4.2	7.2	2.2	-24.7	-24.6	-3.5	-2.2
Gross official reserves	30.3	37.0	38.7	23.0	23.0	24.5	24.8
(Months of imports)	6.8	6.3	6.6	4.2	4.3	4.3	4.6
(Percent of short-term external debt)	104	90	103	69	75	74	87
External debt (percent of GDP)	44.9	49.0	48.9	55.5	58.6	59.6	76.4
Total debt (billions of US$)	64.8	82.5	90.6	99.1	94.9	105.5	102.5
Public sector	15.7	16.4	16.9	27.3	27.8	33.4	35.4
Private sector	49.2	66.2	73.7	71.7	67.1	72.1	67.1
Medium- and long-term	20.2	25.2	36.1	38.5	38.0	39.2	39.0
Short-term	29.0	41.0	37.6	33.2	29.1	32.8	28.1
Debt service ratio 3/	11.4	11.1	12.3	15.5	15.0	16.5	16.8

Source: IMF

1/ On a fiscal year basis.
2/ Including outflows associated with the closing of swap and forward contracts by the Bank of Thailand.
3/ Percent of exports of goods and services

TABLE 2: THAILAND: SUMMARY OF PUBLIC SECTOR OPERATIONS, 1994/95-1997/98 1/

	1994/95	1995/96	1996/97 Prog.	1996/97 Prel.	1997/98 Prog.	1997/98 Prel.
			(in billions of baht)			
Central government						
Revenue and grants	763	872	870	865	996	895
Expenditure and net lending	659	765	924	912	940	839
Current expenditure	438	483	552	516	515	460
Capital expenditure	217	273	354	380	415	370
Net lending	4	10	18	15	11	9
Overall balance	104	107	-54	-46	56	56
Local government						
Overall balance	3	6	1	1	2	2
Nonfinancial public sector operations						
Retained income	132	153	146	146	133	133
Capital expenditure	148	149	179	178	133	133
Overall balance	-16	4	-33	-32	0	0
Consolidated public sector balance	101	122	-80	-72	60	60
Financing	-101	-122	80	72	-60	-60
External	17	11	13	17	27	27
Domestic	-117	-133	67	55	-87	-87
Banking system 2/	-122	-145	175	167	-87	-87
Other	5	11	-108	-113	0	0
			(in percent of fiscal year GDP)			
Central government						
Revenue and grants	18.8	19.1	17.3	17.2	17.8	16.6
Expenditure and net lending	16.3	16.8	18.4	18.5	16.8	15.6
Current expenditure	10.8	10.6	11.0	10.5	9.2	8.6
Capital expenditure	5.4	6.0	7.0	7.7	7.4	6.9
Net lending	0.1	0.2	0.4	0.3	0.2	0.2
Overall balance	2.6	2.3	-1.1	-0.9	1.0	1.0
Local government						
Overall balance	0.1	0.1	0.0	0.0	0.0	0.0
Nonfinancial public sector operations						
Retained income	3.3	3.4	2.9	3.0	2.4	2.5
Capital expenditure	3.6	3.3	3.6	3.6	2.4	2.5
Overall balance	-0.4	0.1	-0.7	-0.7	0.0	0.0
Consolidated public sector balance	2.5	2.7	-1.6	-1.5	1.1	1.1
Financing	-2.5	-2.7	1.6	1.5	-1.1	-1.1
External	0.4	0.2	0.3	0.3	0.5	0.5
Domestic	-2.9	-2.9	1.3	1.1	-1.6	-1.6
Banking system 2/	-3.0	-3.2	3.5	3.4	-1.6	-1.6
Other	0.1	0.2	-2.1	-2.3	0.0	0.0
			(in billions of baht)			
Memorandum items:						
Fiscal year GDP	4,055	4,566	5,031	4,923	5,599	5,378
Revenue, treasury accounts basis	761	850	847	844	973	872
Expenditure, treasury accounts basis	643	750	900	888	903	802
Cash balance, treasury accounts basis	118	100	-53	-44	70	70
Gross cost of financial sector restructuring 3/	...	...	...	...	1.1	1.3

Source: IMF

1/ The fiscal year is October 1 to September 30
2/ Including, in 1996/97, a drawdown of deposits (amounting to B 57 billion) to capitalize the Government Pension Fund, which is offset in domestic nonbank financing.
3/ Estimate based on the imputed interest cost of servicing FIDF loans to the financial sector. In percent of fiscal year GDP.

TABLE 3: THAILAND: MONETARY PROJECTIONS, 1996-98

	1996	1997							1998				
	Dec.	Mar.	Jun.	Aug.	Sept.		Dec.		Mar.	Jun.	Sept.	Dec.	
	Actual	Actual	Actual	Actual	Prog.	Actual	Prog.	Rev.	Rev.	Rev.	Rev.	Prog.	Rev.
	(In billions of baht, end period)												
Reserve Money	453	462	514	436	456	434	489	473	476	461	469	543	505
Net foreign assets 1/	991	987	833	833	726	804	448	452	364	301	328	339	377
Net domestic assets	-538	-525	-319	-397	-270	-370	41	20	112	159	141	204	128
Net credit to public sector	-290	-240	-255	-186	-213	-191	-187	-165	-165	-218	-231	-228	-205
Credit to financial institutions	62	18	261	268	349	213	565	533	591	652	630	661	573
FIDF credit	28	145	311	513	530	554	572	572	577	582	587	592	592
Indirect instruments	-5	-164	-90	-284	-228	-380	-52	-80	-27	29	2	23	-60
Other	40	38	40	40	46	39	46	41	41	41	41	46	41
Other items net	-310	-304	-326	-479	-405	-390	-337	-347	-314	-274	-257	-229	-240
Memorandum items:													
Reserve money growth (percent)	12.0	12.4	29.9	9.9	12.9	7.5	8.0	4.4	3.0	-10.4	5.9	11.0	6.8
Money multiplier (seasonally adjusted)	10.6	10.5	9.0	10.3	10.5	...	10.5	10.3	10.3	10.3	10.3	10.5	10.3
M2A (billions of baht) 2/	4,725	4,721	4,721	4,622	4,862	...	5,056	4,796	4,777	4,841	4,911	5,612	5,121
Growth rate (percent)	12.7	7.3	4.6	2.1	6.9	...	7.0	1.5	1.2	2.6	5.9	11.0	6.8
Velocity (Dec. 1996 = 100, seas. adj.)	100	100	101	105	106	...	104	107	108	109	109	104	109

Source: IMF

1/ Including expected reserve losses, owing to swap and forward transactions of the bank of Thailand, consistent with the balance f payments; at the program exchange rate

2/ M2A consists of currency in circulation and the deposits of banks and finance companies.

TABLE 4: THAILAND: BALANCE OF PAYMENTS AND FINANCING NEED, 1996-98

	1996	1997		1997			1998		1998	
	Actual	Original Program	Revised Program	First Half Actual	Second Half Original Program	Second Half Revised Program	Original Program	Revised Program	Second Half Original Program	Second Half Revised Program
	(In billions of U.S. dollars)									
1. Current account balance	-14.4	-9.0	-6.4	-5.0	-2.8	-1.4	-5.3	-2.5	0.5	-3.0
Trade balance	-16.1	-10.3	-7.8	-6.2	-3.3	-1.6	-6.6	-3.5	-0.3	-3.2
Exports, f.o.b.	54.7	56.2	56.4	27.4	29.1	29.0	61.0	60.9	30.2	30.7
Imports, c.i.f.	70.8	66.5	64.2	33.6	32.4	30.6	67.6	64.3	30.5	33.8
Services and transfers	1.8	1.3	1.4	1.2	0.5	0.2	1.3	1.0	0.8	0.2
2. Capital account balance	18.0	-16.4	-17.9	1.3	-15.3	-19.2	1.8	0.3	-2.6	2.9
Medium- and long-term capital	12.2	5.5	6.5	4.3	1.3	2.2	5.3	8.5	5.0	3.6
Short-term capital	0.0	-5.3	-6.9	0.4	-4.7	-7.3	0.0	-0.9	-2.0	1.1
Other capital 1/	5.8	-5.4	-6.0	-3.4	-0.7	-2.6	2.2	1.6	-0.5	2.1
Forwards/Swaps	...	-11.2	-11.5	...	-11.2	-11.5	-5.7	-8.9	-5.0	-3.9
3. Errors and omissions	-1.5	0.6	-0.3	-2.7	-0.4	2.4	0.0	0.0	0.0	0.0
4. Net balance = 1+2+3	2.2	-24.7	-24.6	-6.4	-18.4	-18.2	-3.5	-2.2	-2.1	-0.1
5. Targeted changes in official reserves (increase, -)	...	15.7	15.7	...	9.3	9.3	-1.5	-1.8	0.0	-1.8
6. Financing need = -4-5	...	9.0	8.9	...	9.0	8.9	5.0	3.9	2.1	1.9
7. Financing package	...	9.0	8.9	...	9.0	8.9	5.0	3.9	2.0	1.9
Fund	...	2.4	2.4	...	2.4	2.4	0.7	0.7	0.4	0.3
Other 2/	...	6.6	6.4	...	6.6	6.4	4.3	3.2	1.6	1.6
	(in percent; unless otherwise specified)									
Memorandum items:										
Current account balance/GDP	-7.8	-5.0	-3.9	-3.5	-1.6	-0.4	-3.0	-1.8	0.3	-2.1
Export growth	-1.3	2.8	3.2	0.9	5.4	5.4	8.6	7.9	10.2	5.8
Import growth	1.8	-6.1	-9.3	-7.4	-6.2	-11.2	1.5	0.2	-9.2	10.6
Gross official reserves	38.7	23.0	23.0	32.3	23.0	23.0	24.5	24.8	23.0	24.8
(In months of imports)	6.6	4.2	4.3	5.8	4.2	4.5	4.3	4.6	4.5	4.6
(In percent of stock of short-term debt)	103.0	69.2	77.7	87.5	69.2	77.7	73.8	86.6	83.3	86.6

Source: IMF

1/ Consists mostly of unidentified portfolio flows
2/ Consistent with the agreed financing package and assuming that bilateral creditors disburse proportionally with the Fund.

TABLE 5: FIDF CREDIT OUTSTANDING, JUNE-NOVEMBER 1997

	Suspended FCs	33 Open FCs	Banks	Total
June	285	6	20	311
July	368	8	47	423
August	368	16	128	512
September	365	21	168	554
October	360	25	206	591
November 05	359	25	209	593

Source: Bank of Thailand.

TABLE 6: SELECTED INTEREST RATES, 1992-97
(In Percentage)

	BOT Bank Rate	Interbank Rate	Minimum Loan Rate	Inflation Rate (CPI)
Dec 31, 1992	11.00	7.95	11.50	-
Dec 31, 1993	9.00	4.38	10.50	3.36
Dec 31, 1994	9.50	7.22	11.75	5.10
Dec 31, 1995	10.50	11.15	13.75	5.77
Dec 31, 1996	10.50	9.66	13.00	5.85
Mar 31, 1997	10.50	8.34	13.00	4.55
Jun 30, 1997	10.50	15.10	12.75	4.40
Sep 30, 1997	12.50	23.87	14.15	7.00
Dec 04, 1997	12.50	22.00	14.25	7.50

Source: Bank of Thailand.

TABLE 7: THAILAND: NET CAPITAL FLOWS[1], 1992-96
(In $ million)

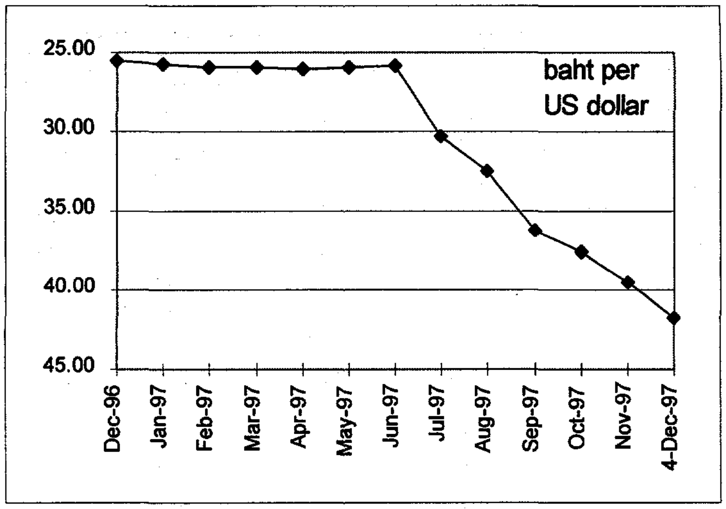
	1992	1993	1994	1995	1996
Net Capital Flows ($ million)	9,652	10,515	12,183	21,921	18,031
Medium and long term	4,263	7,396	4,606	9,332	12,242
Private Sector	3,972	6,647	4,628	8,140	10,964
Direct investment (equity)	1,548	1,232	813	1,129	1,602
Loans and credits	1,745	1,847	3,161	3,915	8,243
Portfolio and other [2]	679	3,568	654	3,096	1,119
Public Sector	291	749	-22	1,192	1,278
Public Enterprises	501	622	192	810	828
Central Government	-210	127	-214	382	450
Short term capital	5,389	3,119	7,577	12,589	5,789
Net Capital Flows (as % of Total)	100.0	100.0	100.0	100.0	100.0
Medium and long term	44.2	70.3	37.8	42.6	67.9
Private Sector	41.2	63.2	38.0	37.1	60.8
Direct investment (equity)	16.0	11.7	6.7	5.2	8.9
Loans and credits	18.1	17.6	25.9	17.9	45.7
Portfolio and other [2]	7.0	33.9	5.4	14.1	6.2
Public Sector	3.0	7.1	-0.2	5.4	7.1
Public enterprises	5.2	5.9	1.6	3.7	4.6
Central Government	-2.2	1.2	-1.8	1.7	2.5
Short term capital	55.8	29.7	62.2	57.4	32.1

Source: IMF

[1] These capital flows do not include any movements in monetary capital such as monetary gold or net balances in IMF accounts.

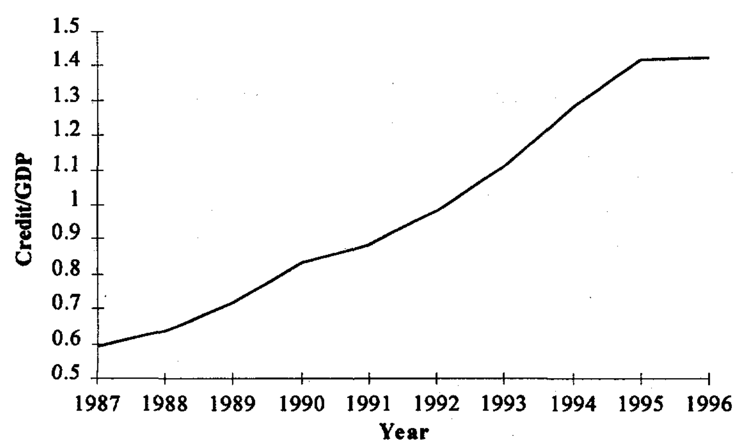
[2] Including debt securities.

FIGURE 1: BAHT PER US DOLLAR, SPOT EXCHANGE RATE, DECEMBER 1996 - DECEMBER 1997



Source: Bank of Thailand.

FIGURE 2: RATIO OF CREDIT TO GDP, 1987-96



Source: IMF International Financial Statistics.

SCHEDULE 1: LETTER OF DEVELOPMENT POLICY

(English Translation of Original Document in Thai)

[Date]

Mr. James D. Wolfensohn
President
International Bank for Reconstruction and Development
1818 H St. N.W.
Washington, D.C.

Subject: Proposed Loan for Restructuring Finance Companies Letter of Development Policy

1. Following a decade of macroeconomic stability and rapid economic growth, the external environment for Thailand began to deteriorate in the last two years and resulted in a large current account deficit that peaked at 8 percent by the end of 1996. On the domestic front, rapid expansion of the stock market and a construction boom absorbed a large proportion of national savings. Even though asset prices had risen considerably, the quality of assets was doubtful and reflected poor intermediation by financial institutions. The finance companies sector, in particular, was afflicted with excessive loan growth in the property sector and a large exposure in the volatile stock market. Meanwhile, finance company liabilities increasingly took the form of short term foreign borrowings subject to considerable foreign exchange risk.

2. In June 1997, we decided to float the Baht because it was clear that the market no longer viewed our exchange rate regime (i.e. a fixed exchange rate pegged to a basket of currencies) as tenable and that large reserve losses would be incurred to support the forward and swap positions taken by the Bank of Thailand. The rapid depreciation of the Baht following the decision to float, along with a fall in export earnings, a collapse of demand in the property sector, and a sustained bearish sentiment on the stock market have led to serious macroeconomic and financial sector difficulties.

3. The main short-term impact of the economic crisis on the financial sector as a whole has been to reduce liquidity in both foreign and domestic currency. In the domestic Baht market, there has been a flight to quality as funds have been moved to the strongest Thai banks or to branches of foreign banks. In the offshore markets, many short term credit lines have not been rolled over.

4. The economic crisis has had a particularly adverse impact on finance companies, viz., (i) the fall in share prices and the collapse of the property sector has resulted in a sharp deterioration of the assets of finance companies; (ii) the exchange rate depreciation has led to difficulties for corporate borrowers in repaying loans and has resulted in increased losses to finance companies due to their unhedged foreign exchange liabilities; and (iii) the sharp rise in interest rates has further exacerbated the difficulties of corporate clients in servicing their loans to finance companies and has also led to rapid decapitalization as short term funding rates have risen more

rapidly than lending rates. All of these factors have combined to cause a massive deterioration in the loan portfolios of finance companies.

5. We are responding to the crisis by implementing a strong macroeconomic stabilization program and initiating the much needed reform of the financial sector beginning with a restructuring of the finance companies. The actions that we have already taken to streamline the finance companies and those that that we propose to take in the near term, prepare the ground for a comprehensive reform of the financial sector (outlined in the remaining agenda below). Simultaneously, we will be addressing problems of the real sector to strengthen the competitive foundations of the economy, which will involve rationalizing public expenditure programs, trade facilitation and modernizing industry. We also propose to put the privatization program on a fast track to generate revenues and to increase further the role of the private sector in the economy.

The Macroeconomic Stabilization Program

6. In August, we announced a number of measures to bolster investor confidence and strengthen the economy. These include cutting back public expenditure, raising the VAT and suspending 42 troubled finance companies (in addition to the 16 suspended earlier). We also entered into a standby arrangement with the IMF, obtained bilateral pledges by Southeast and East Asian countries and secured multilateral support from the World Bank and the Asian Development Bank amounting to a total $17.2 billion.

7. The macroeconomic framework for stabilizing the economy, developed jointly with the IMF and modified somewhat in the first quarterly review in November, is aimed at achieving balance of payments adjustment with a minimum loss of output and employment. The modified program manages better the expectations regarding macroeconomic outcomes and embodies more realistic fiscal, monetary, inflation, and GDP growth targets. Our fiscal policy program aims to restore confidence through building the cushions needed to cope with the cost of financial sector restructuring. The monetary policy program seeks a balance between the objectives of currency stabilization and low domestic interest rates to stimulate growth. We are mindful of the need to avoid exacerbating corporate and financial sector difficulties and will review interest rate policy in view of market developments. We have retained flexibility in setting fiscal and monetary targets to strike a proper balance between the objectives of stabilization and economic growth.

8. We have taken a number of measures to strengthen the supply response to the real depreciation of the Baht viz.: (i) firms are allowed to deduct from their tax bill the valuation loss resulting from the depreciation of the Baht during 1997, (ii) a credit line has been opened to supply working capital to exporters through commercial banks and the Thai EXIM Bank, (iii) the rise in the minimum wage, which is the reference wage in the manufacturing sector, has been limited to 2 to 3 percent, well below inflation, and (iv) customs procedures are being streamlined to reduce costs to domestic producers.

9. With assistance from the World Bank and the Asian Development Bank, we are preparing a comprehensive program to provide safety nets for the poor.

10. We are considering several policy options to revive capital flows and especially to encourage more stable forms of capital. These include: (i) removal of restrictions on Baht sales and a review of restrictions on Baht lending to nonresidents to help restore investor (domestic and foreign) confidence; (ii) a review of the regulatory and tax regime for Baht denominated debt instruments with a view to facilitate the creation of a domestic debt market; and (iii) better management of market expectations through improved dissemination of economic information and smoother relations with foreign creditors.

The Program for Reforming the Thai Financial System

11. Recognizing that macroeconomic stabilization and reform of the financial sector are intertwined, we have designed a comprehensive program for reforming the financial sector. Over the medium term, the financial sector needs to become more efficient, competitive and robust. The financial system would be more balanced in terms of the type of services provided, including greater emphasis on capital markets. This would constitute an important pillar of our overall strategy for promoting competitiveness of the Thai economy to resume sustainable long term growth. In the near term, five steps are needed for the realization of this vision:

- a streamlined finance company sector that allows faltering companies to exit, facilitates company restructuring, is subject to tighter supervision and provides sufficient information to market participants to weigh the risk of available options; the ultimate objective is to avoid the recurrence of a finance company-led financial sector crisis.
- a streamlined banking sector that is free of weak institutions and is governed by supervision and regulatory practices in line with international standards.
- strengthened loan classification, loan loss provisioning, interest income recognition and capital adequacy requirements to bring them up to international standards;
- eased entry for foreign equity owners to facilitate recapitalization of financial institutions and tougher licensing procedures.
- enhanced market discipline through improved public disclosure requirements and accountability.

12. While all five steps are important for the realization of a robust and efficient financial sector, and will be phased in over the next year with support from multilateral institutions, we are of the view that the first, i.e. streamlining of the finance companies sector, has taken on particular urgency for the following reasons:

- Delay in restructuring the suspended finance companies has been interpreted as a lack of resolve to take tough decisions to restructure the financial sector.
- Continued deterioration of assets "locked" in the suspended finance companies and lack of access to financing for their solvent borrowers has led to a rapid deterioration in the loan portfolios of the remaining financial institutions.
- Doubts about the resiliency and soundness of the remaining finance companies have put at risk the entire financial sector.

13. We believe that the decisive and credible actions that we propose to take to address the problems of finance companies will boost confidence, thereby helping to restore liquidity through both a resumption of capital flows and through the gradual easing of domestic credit.

Restructuring Finance Companies

Rapid Resolution of Suspended Finance Companies

14. We have put in place a well defined institutional framework for the orderly resolution of suspended finance companies. Emergency decrees passed in October have created a Financial Sector Restructuring Authority (FRA) and an Asset Management Corporation (AMC). Based on the criteria announced on October 13, 1997, FRA made an assessment of the rehabilitation plans of the suspended finance companies and on December 8 we announced that 56 of the 58 companies are to be closed and only 2 will be allowed to reopen. Thus we have kept our promise of taking firm action to restore the health of the financial sector

15. We are committed to taking a series of steps to complete the institutional framework for rapid resolution of the suspended finance companies. We are currently finalizing the guidelines for the handling of good and impaired assets of the suspended companies that will be issued publicly by January 15, 1998. In order to minimize the fiscal costs associated with excessive delay in the final resolution/liquidation of finance companies, we shall, ensure that the FRA will have completed the sale of all assets of closed finance companies by December 31, 1998. To implement this process in an orderly manner, a Financial Restructuring Authority Coordinating Unit (FRACU) has been established for the monitoring and appropriate surveillance of the activities of the special managers and the board of directors of each closed finance company (Section 13 committees).

16. The AMC will be staffed, operational, and adequately funded by January 31, 1998. It will have issued regulations regarding its administration, operations and personnel management, and established its budget. It will have developed written policies and procedures for asset valuation for bidding purposes, for asset management and asset sales. Of the initial authorized capital of B 1 billion for the AMC to support its asset purchase operations, we have already approved the first B 250 million. We stand ready to participate with private investors in making further injections of capital to support its operations. We are committed to providing adequate funding to all agencies involved in the resolution process. However, to reduce the number of institutions involved in the process, we expect the Property Loan Management Office (PLMO) to play no substantive role in the future.

17. We expect the fiscal cost of resolving the 58 suspended companies to be manageable. To monitor these costs on a regular basis, we will establish and implement a fiscal monitoring framework for the financial restructuring program. We will reflect explicitly in the budget the costs of financial sector restructuring, including those incurred by FIDF, AMC and all other agencies involved in the resolution process.

18. We are concerned that depositors are treated fairly and do not bear the costs of the resolution process. To that end, we have established two note exchange schemes; one for

depositors in the 16 suspended companies and the other for depositors and creditors in the 42 companies suspended later. These schemes give depositors the option of exchanging their promissory notes issued by the suspended finance companies for promissory notes issued by KTT or KTB (publicly controlled financial institutions). The note exchange programs allow timely payments to eligible depositors that are more attractive the smaller the size of the deposit. The scheme for creditors is designed to allow some losses to be borne by these claim holders.

19. Our commitment to implementing the liquidation process in a transparent and credible manner is evidenced by our announcement on December 8, 1997 that creditors, both domestic and international, can rest assured that they will be treated equally and in *pari passu* with the FIDF and that the asset disposal process will be orderly.

Reestablishing the Resiliency and Soundness of the Finance Company Sector

20. We are aware that the remaining 33 nonsuspended finance companies, while considerably stronger than those that have been suspended, are also facing significant risks.[1] Consequently, we have launched a three-pronged program to deal urgently with the underlying causes of poor performance. The program will focus on early recapitalization, strengthening prudential regulations and ensuring that operating finance companies pursue more viable strategies in the future.

21. We have developed and begun to implement a short term plan for strengthening supervision of the remaining 33 finance companies. Following careful off-site analysis and on-site examinations, BOT has stratified all 33 remaining finance companies and has identified near-term capital inadequacy and/or other problems, and has pursued aggressive actions, including interventions based on these findings. These actions have included replacement of the Board in one finance company experiencing severe liquidity problems and taking over management in another after discovery of fraud. In addition, we are initiating the first steps toward requiring time-bound action plans for all companies which have not yet met the 8 percent capital adequacy requirement.

22. By December 31, 1997 we will have entered into memoranda of understanding (MOUs) with finance companies that need to increase their capital. To evaluate recapitalization plans the BOT will conduct diagnostic reviews with expert assistance in the case of finance companies under MOUs, beginning in February 1998. Terms of reference for these diagnostic reviews would be prepared in January 1998. BOT will monitor compliance with the terms of those MOUs and will take increasingly stronger intervention steps where there is no compliance.

23. The emergency decrees issued in October have removed legal impediments to timely intervention and have outlined principles that will guide the intervention process in those cases where a finance company must be intervened. The policy and procedures we have been employing in interventions are based on the principle that BOT will intervene seriously

[1] The two suspended finance companies whose rehabilitation plans were accepted on December 8, 1997 will be transferred to BOT for supervision after they have satisfied the conditions of the rehabilitation plans.

undercapitalized finance companies which are unable to propose and comply with an acceptable recapitalization plan, or which are forced to borrow excessively from FIDF over an extended period of time. Moreover, in intervening financial institutions, BOT will choose to act among the following possibilities: (i) replacing management by industry professionals or by BOT staff; (ii) requiring writing off of capital so that existing shareholders are the first to take losses; and (iii) converting FIDF funding to equity or to subordinated loans or restructured loans.

24. To ensure a stronger structure for the entities that would emerge from the process of resolution of the 58 suspended finance companies, we issued in November 1997 guidelines for "fit and proper" tests to be met by (i) shareholders of any merged finance company, and (ii) shareholders and managers of any new bank which may result from the resolution the 58 finance companies. These guidelines have been applied when considering specific merger and rehabilitation proposals submitted by different types of acquirers (e.g. other suspended companies, operating companies, commercial banks).

25. We are aware that certain key prudential regulations for finance companies have been less stringent than those for commercial banks, thus exacerbating the risks associated with their inherently nonconservative practices. We intend to tighten these prudential regulations for finance companies to bring them to the standards applicable to commercial banks. This process will be phased in the manner set forth below.

26. We have imposed new loan classification standards applicable to both banks and finance companies that will take effect at the end of December 1997. This step will be followed by the adoption in March 1998 of a package of new loan classification regulations (see below). We will further tighten the prudential regulations for finance companies by July 1998, by applying to them the same prudential rules applicable to commercial banks, according to an agreed phase-in schedule namely: (i) maximum investment in equities limited to 20% of capital; (ii) maximum total risk exposure to any one credit limited to 25% of capital; (iii) net long and short foreign exchange positions limited to 25% and 20% of Tier 1 capital respectively; and (iv) submission of semiannual credit plans to BOT.

27. We have taken two additional steps to facilitate recapitalization of finance companies to enhance their viability. First, a consensus was reached with the management of every finance company to recommend to their shareholders that dividends not be paid in the remainder of 1997 and the first half of 1998. Second, we have established a clear policy authorizing commercial banks, both domestic and foreign, to take up to 100% ownership positions in finance companies.

The Remaining Agenda to Strengthen the Financial Sector

28. The reforms we have outlined above for the finance company subsector constitute only the initial significant efforts that we must make to strengthen the institutional and incentive framework for all financial institutions (both banks and finance companies). The framework for a well-functioning financial sector is based on a system of mutually reinforcing incentives that allows all participants in the sector to perform their functions efficiently and responsibly. It includes: proper incentives for managers and owners to manage financial institutions safely; fortified incentives for supervisory agencies to enforce regulations and take prompt corrective

action; improved ability of and incentives for market participants to monitor financial institutions; and less costly workouts between lenders and borrowers. This framework will be developed over the next six months to 1 year.

29. In moving forward with this agenda it is critical to reform the operations of the FIDF. Although the FIDF cannot be radically restructured in this critical stage of the ongoing financial crisis, we are convinced of the need to streamline the FIDF and its many roles to make it more effective and to reduce the burden on the budget. As a start to this process, we have decided to conduct a careful review of the objectives of the FIDF and examine its day to day operating procedures for providing different forms of financial support. We would expect this review to begin in April 1998 and conclude before December 31, 1998. The review would result in specific recommendations for reforming the objectives and functions of the FIDF and defining more clearly its relationship to the BOT.

30. To create better incentives for owners and managers of financial institutions, BOT will issue by December 31, 1997 a circular requiring information that will permit a more accurate assessment of the "fit and proper" condition of new managers and directors of existing finance companies. Moreover, BOT will propose amendments to the Commercial Bank Act and the Finance Company Act to empower MOF and BOT to evaluate executive managers, directors and shareholders of both existing and new commercial banks and of finance companies. Based on these amplified powers, we plan to develop uniform licensing procedures, that are in line with international standards, for both commercial banks and finance companies. These procedures will focus not only on the fit and proper test but will also include: verification of minimum capital requirements; assessment of the sources and quality of capital; assessment of future viability; and transparency of ownership structure. These procedures will apply in licensing new institutions as well as in approving changes in the capital structure and management of existing institutions.

31. Building on the ongoing reform of finance companies, we will establish processes for finance company and commercial bank interventions that make clear to owners and managers the consequences of imprudent and unsound banking practices. Defining and executing a clear policy in respect to exit and loss allocation will force directors and managers to act more prudently.

32. We are committed to improving prudential regulations in several key areas that will have particularly important implications for the incentives for owners and managers. Specifically, we will develop new prudential regulations with respect to: (i) lending to related parties; (ii) foreign exchange exposures; and (iii) consolidated supervision of financial groups (banks, finance companies, and securities), all according to a time-bound phase-in schedule. Weaknesses in these areas and problems of enforcement contributed to the current crisis and it is important to improve incentives of bank management to properly address these risks.

33. Finally, to better place all financial institutions under the same prudential regulatory framework and to limit the fiscal costs to Government of the operations of the specialized banks, we are committed to issuing and beginning to phase in, by September 30, 1998 new accounting and prudential regulations similar to those for commercial banks.

34. For improving incentives for supervisors to take forceful corrective actions, the BOT will adopt by May 31, 1998 (with technical assistance from the Bank), and publicize to the industry guidelines for prompt corrective actions for all financial institutions. In addition, the BOT shall submit specific amendments to the Commercial Bank Act and the Finance Company and Credit Foncier Act by December 31, 1998 to strengthen the enforcement of prompt corrective actions. These amendments, coupled with new loan classification guidelines (see below), will enable us to act much more forcefully in dealing with distressed institutions and will reduce incentives for delaying action.

35. To strengthen supervision capability, the BOT will, by March 31, 1998, prepare an Institutional Development Plan (IDP) for strengthening its supervision capacity particularly in the areas of on-site examinations, off-site supervision, and enforcement. In addition, we will form, in January 1998, a special interagency task force to review the location of the supervision function and examine revisions needed to financial legislation to better align responsibilities with regulatory jurisdiction, and minimize overlap of Thailand's five separate supervisory agencies.

36. We are committed to taking three reinforcing sets of actions to improve the quality of information available to market participants and supervisors to assess the financial condition and risk management capacities of financial institutions: (i) loan classification standards will be strengthened by requiring all financial institutions by December 31, 1997 to set aside provisions for all loans that are more than six months overdue; (ii) by January 1, 1998 accrual of interest will be prohibited on loans which have been under nonperforming status for more than six months as opposed to the current 12 month rule and (ii) as a last and essential next step we shall issue by March 31, 1998, a new regulation for loan classification and provisioning that is consistent with international standards. These new requirements will be gradually phased in and will be fully implemented by December 31, 2000.

37. In order to improve the quality of information available to market participants and the public, we shall embark on a series of steps. First, the BOT will announce no later than January 15, 1998 a stricter and uniform definition of non performing loans that will be applicable to December 1997 financial statements. Under the new definition, loans in nonaccrual for six months will automatically be classified as nonperforming with no account taken of collateral. Moreover, in the calculation of nonperforming loans, netting out of restructured loans will no longer be permitted. The BOT will issue by June 30, 1998, for comment by the industry, public disclosures to be required of all financial institutions under its supervision (Regulatory, Accounting and Disclosure Practices or RADP). These will be finalized by December 31, 1998. Guidelines will include a well defined phase-in schedule for disclosing information in such areas as volume of renegotiated loans, rollovers, loan loss provisions, and lending to related parties. More broadly, we shall develop an action program for strengthening and enforcing accounting, auditing and disclosure standards for financial institutions by December 31, 1998, and subsequently for the remaining corporations.

38. We are committed to phasing out the emergency comprehensive guarantee and replace it with a self-financed limited deposit insurance regime. Amendments to legislation introducing such a scheme will be developed by December 31, 1998, with technical support from both the

Bank and the IMF. This legislation will aim to eliminate incentives for undercapitalized banks to take excessive risk given the broad nature of liabilities covered under the emergency comprehensive guarantee.

39. We are implementing measures to limit the impact of the financial crisis on the real economy. This involves both preventing the closure of illiquid solvent enterprises as well as the efficient winding up of insolvent businesses. Unfortunately, our legal/regulatory framework (as in many developing countries) is not conducive to corporate restructuring and has not provided adequate incentives to borrowers and lenders to restructure loans of viable companies. Bankruptcy proceedings typically take many years and collateral foreclosure can be very time consuming and cumbersome.

40. To address these critical problems, we have already submitted legislative changes to the Bankruptcy Act. However, we intend to submit for legislative approval by March 31, 1998, additional measures to permit a process of corporate reorganization, speed-up collateral foreclosure, and facilitate financing to companies undergoing reorganization.

Signed

Minister of Finance

SCHEDULE 2: POLICY MATRIX

OBJECTIVES AND PROGRAM	BOARD CONDITIONS	LETTER OF DEVELOPMENT POLICY
I. MACROECONOMIC AND FISCAL STRATEGY		
1. Maintain macroeconomic stability and fiscal balance		
Issue: The Government has agreed with the IMF on a program for macroeconomic stabilization that needs to be maintained. Objectives and Program: Pursue agreed strategies to ensure economic stability and sustained growth.	Satisfactory progress made in implementing the macroeconomic stabilization program announced on August 20 and revised on November 24, 1997.	Government will maintain the macroeconomic program including an adequate reserve position, a small fiscal surplus and a prudent monetary policy to stabilize the economy.
2. Facilitate stable capital flows		
Issues: (i) Recent measures to restrict the flow of Baht between residents and nonresidents have undermined confidence, destabilized capital flows and reduced opportunities to hedge foreign exchange and interest rate risk through the currency swap (CCS) market. (ii) Regulatory restrictions and the tax regime have hampered the development of a long-term domestic debt market. Objectives and Program: Remove recently introduced exchange controls to improve confidence and increase the liquidity of domestic and offshore funding markets while facilitating improved exchange rate risk management. Review the regulatory and tax regime governing Baht debt instruments.		Government will remove restrictions on Baht sales and review restrictions on Baht lending to nonresidents. Government will review existing restrictions on capital outflows with a view to liberalizing the two-way flow of capital. Government will review regulatory and tax regime for Baht-denominated debt instruments to facilitate the creation of a long-term debt market.

OBJECTIVES AND PROGRAM	BOARD CONDITIONS	LETTER OF DEVELOPMENT POLICY
II. FINANCE COMPANY RESTRUCTURING PROGRAM		
1. Resolution of Suspended Finance Companies		
1. Establish institutional structure for the resolution of suspended finance companies		
Issue: A well-defined institutional structure is required for orderly resolutions. The roles and responsibilities of relevant agencies need to be well defined. Objectives and Program: (i) Establish the structure for resolutions and define the roles and responsibilities of the key agencies; (ii) Establish new institutions, including the FRA and AMC; and (iii) define policies governing asset disposition (for impaired and performing assets).	1. FRA established by decree promulgated on October 25, 1997. 2. FRA Decree allows prompt closure and takeover by FRA of suspended finance companies. 3. FRA fully staffed . 4. FRA fully operational. It has: • established processes for evaluating rehabilitation plans, including, (i) development of models to evaluate viability of proposed business plans and (ii) validation, in accordance with BOT rules, of the asset values utilized in submitted rehabilitation plans; • established step by step procedures for takeovers of suspended companies; and • developed guidelines to be used by the committees and managers appointed to resolve closed companies. 5. AMC established by decree promulgated October 25, 1997. It will be able to purchase impaired assets from either suspended finance companies or commercial banks and operating finance companies that are intervened. 6. AMC Board members appointed on December 2, 1997. Search for a Manager underway. 7. Responsibilities of BOT, MOF, FIDF, FRA and AMC in the resolution of suspended finance companies rationalized via decree package of October 25, 1997. 8. Financial Restructuring Authority Coordinating Unit (FRACU) established (December 15) for the monitoring and appropriate surveillance of the activities of the special managers and the Board of Directors of each closed finance company (section 13 committees).	1. AMC will be staffed, made operational, and adequately funded (January 31, 1998). It will: • issue and implement regulations on administration, operations and personnel management. • develop and implement all written policies and procedures for asset bidding (valuation), asset management and asset sales. • establish its budget. 2. FRA will adopt guidelines for asset disposition, including asset bidding, and begin disposal of impaired assets of closed finance companies during the first quarter of 1998, and complete sale of all assets by December 31, 1998. 3. Institutional and policy framework for the disposal of good and impaired assets outlined by the Government (January 15, 1998)

OBJECTIVES AND PROGRAM	BOARD CONDITIONS	LETTER OF DEVELOPMENT POLICY
2. Progress in the rehabilitation/resolution process		
Issue: The FRA needs to finalize its decision on the rehabilitation or resolution of each finance company. Objectives and Program: Implement resolution options and show concrete progress.	1. Final Rehabilitation criteria announced on October 13, 1997, in agreement with the IMF and World Bank. 2. Rehabilitation Plans submitted by the suspended FCs to FRA on October 30, 1997. 3. Rehabilitation plans for all 58 suspended finance companies, consistent with the above criteria, reviewed by FRA. 4. An independent third party review of the FRA decisions completed (December 8, 1997). 5. Decision taken and announced on December 8, 1997 to close—suspended finance companies and approve—rehabilitation plans.	
3. Fiscal impact of the resolutions process.		
Issue: The Government has not been explicitly accounting for the fiscal impact of the finance company restructuring program. Objectives and Program: Establish the financing strategy and arrangements for restructuring and resolving suspended finance companies and define a realistic budgetary process for their resolutions	1. Emergency Decrees of October 25, passed enabling the Government to provide appropriate financial assistance if losses are incurred by FRA or AMC. 2. The Decree amending the BOT Act, promulgated enabling Government to provide FIDF with financial assistance to finance the note exchange program for the 58 suspended finance companies and for losses incurred. 3. Separate accounts established by FIDF to reflect costs it incurs in financial sector restructuring. 4. Government has (on December 9, 1997) authorized all funding, B 500 million for the FRA. In the case of AMC initial capital of B 1 billion authorized. The first payment has been approved.	1. The Government will carry out fiscal monitoring of financial sector restructuring costs. 2. The Government will establish the principle that it will explicitly reflect in the budget, the costs of financial sector restructuring.
4. Treatment of depositors and creditors		
Issue: Whereas creditors of the 42 finance companies suspended in 8/97 have the option to participate in notes exchange schemes, the creditors of the first 16 finance companies to be suspended (6/97) were not given this option. (All depositors were given the option). Objectives and Program: Ensure equitable resolution of suspended financial institutions by revising the FIDF's claims on payments and assets of suspended finance companies.	1. Note Exchange Programs in place and operating. 2. Decree passed to empower FIDF to relinquish preferential claim on collateral. 3. Announcement made that creditors can request stretch-out of FIDF repayment terms if they similarly restructure their own claims. Other creditors can convert claims to equity *pari passu* with the FIDF. 4. Creditors (domestic and international) will be treated equally and in *pari passu* with the FIDF and that the asset disposal process will be orderly.	

OBJECTIVES AND PROGRAM	BOARD CONDITIONS	LETTER OF DEVELOPMENT POLICY
2. Liquidity Support		
1. Conditions of liquidity provision by FIDF		
Issue: Conditions for granting liquidity advances by FIDF were not well defined and advances were provided at nonmarket rates creating incentives for finance companies to rely excessively on government (FIDF) liquidity support. Also procedures for granting liquidity and the practice of requiring collateral only after advances have been made has compromised the solvency of the Fund. Objectives and Program: Implement a series of reforms to FIDF operations to charge rates above "market" rates for liquidity advances and start to set conditions for the granting of liquidity. Review operating procedures to ensure FIDF solvency.	1. Interest rates payable on FIDF advances raised beyond the highest deposit rates in the financial system. 2. Decision taken that FIDF advances are to be made at a minimum (in case of collateralized advances) of the repurchase agreement rate (RP) plus 1% (i.e. over 20% per year nominal): rates can rise to RP+2.5% in the case of noncollateralized advances. 3. Conditions for granting advances to financial institutions beyond certain thresholds implemented by FIDF. If the ratio of a financial institutions borrowing from FIDF to its Tier 1 capital is 75% or greater, further advances will be granted under the following conditions: • an immediate cessation of dividends will be required and all bonuses or benefits to directors and executives will be eliminated. • FIDF representative(s) may be appointed as member(s) of the Board of the borrowing finance company (FC) and will restrict future asset growth as well as not permit payment of dividends.	The Government will review the objectives, role, and functions of the FIDF and possible changes needed in its operating procedures (e.g. the procedures for taking collateral when providing advances), after the immediate crisis subsides. The review will begin by April 1998 and completed by December 1998.
3. Strengthening the Supervision and Regulatory Environment for Financial Institutions		
1. Handle weak open finance companies		
Issue: The economic crisis and the suspension of the 58 suspended Finance Companies (FCs) have led to a deterioration in the financial condition of some nonsuspended financial institutions. It is very important for the stability of the financial sector that other problem FCs be detected early and handled by supervisors. Objectives and Program: Conduct indepth assessments of the financial condition of the weakest nonsuspended Finance Companies and undertake corrective action/rehabilitation for these institutions.	1. Intervention of unsafe or unsound Finance Companies (FCs) advanced: • principle established that distressed FCs will be intervened in by the BOT/FIDF. • Finance Company Act amended by Emergency Decree of October 1997 to permit timely intervention of FCs by BOT/FIDF • BOT actually intervened in two FCs (in one FC experiencing serious liquidity problems, the Board has been replaced; in another FC, the management has been taken over by BOT after discovery of fraud) 2. A short term plan for strengthening supervision of the 33 nonsuspended FCs*/ prepared by BOT, including: • stratification of all the 33 FCs in categories through careful off-site analysis • undertaking of diagnostic reviews in specific FCs	BOT will complete all supervisory actions laid in the short term plan for strengthening supervision of the 33 remaining FCs. In addition, diagnostic reviews will be initiated by BOT in February, 1998 and will be completed by June 1998, for FCs under an MOU with BOT. These diagnostic reviews will be performed with the assistance of international experts under terms of reference to be agreed upon in January 1998.

Objectives and Program	Board Conditions	Letter of Development Policy
	• agreement on MOUs with undercapitalized FCs • intervention of distressed FCs that are unable to propose an acceptable recapitalization plan 3. A Preliminary screening of all non suspended FCs undertaken by BOT (applying the new stricter loan classification and provisioning criteria to be applied year end 1997) to stratify them into categories: • standard FCs (in compliance with statutory risk adjusted capital adequacy ratios); • undercapitalized FCs (risk adjusted capital adequacy ratios under 8%) that are expected to be recapitalized by their shareholders; • undercapitalized FCs (risk adjusted capital adequacy ratio under 8%) whose parent companies are weak ; • unsafe and unsound FCs that require sound supervisory measures. 4. Steps taken by BOT to promote capital strengthening of undercapitalized FCs: • each FC has been communicated the amount of capital estimated to fully meet the forthcoming imposition of tougher loan classification and provisioning requirements to be issued at the latest on March 31, 1998 with progressive implementation (see Section II.3.2.), and has been asked to voluntarily increase capital in anticipation of these needs. • agreement has been reached with the management of each FC to recommend to their shareholders that no dividend be paid for the remaining of 1997 and the first half of 1998. • foreign investment framework has been liberalized for FCs as well as commercial banks. */ The two suspended finance companies whose rehabilitation plans were accepted will be transferred to BOT for supervision, after they have satisfied the conditions of the rehabilitation plan.	Stratification outcome will be updated by the end of the first quarter of 1998.
2. Ensure stricter loan classification, income recognition and provisioning requirements, to be consistent with international standards		
Issue: Timely detection of any deterioration in the asset quality of financial institutions and assessment of its impact on profitability and solvency is crucial for both financial institutions and supervisors. Objectives and Program: Ensure compliance with strict loan classification, interest income recognition, loan provisioning, and restructured debt regulations in line with international	1. Law passed to permit Financial Institutions to treat all loan loss provisioning required by BOT as a tax deductible expense. 2. Provisioning requirement for substandard loans set to 15% for commercial banks and 20% for finance companies as of June 1997, to be fully phased by December 31, 1998; immediately applicable for all loans classified after June 1997.	1. BOT will adopt, at the latest on March 31, 1998, a package of new regulations covering inter alia loan classification and provisioning requirements, that is consistent with international standards. The package will be gradually phased-in and fully implemented by December 31, 2000. 2. An international workshop (with participation by Thai authorities and banking community) on loan classification

OBJECTIVES AND PROGRAM	BOARD CONDITIONS	LETTER OF DEVELOPMENT POLICY
standards. These new standards will facilitate timely detection of problems with portfolio quality, solvency and profitability and provide incentives for appropriate classification and provisioning.	3. FCs and commercial banks required by BOT to set aside provisions for all loans that are more than 6 months overdue, effective December 31, 1997. 4. Accrual of interest on nonperforming loans for more than 6 months prohibited by BOT for FCs and commercial banks (versus current regulations that permit 12 months), effective January 1, 1998.	and provisioning will be conducted in Bangkok to help strengthen prudential standards used in the region. The outcome of this workshop will be used to finalize the package of new regulations to be issued on March 31, 1998.
3. Establish procedures for prompt corrective action		
Issue: Delays in dealing with problem institutions increase the difficulty and cost of restructuring or resolving them. Pressures on supervisors and lack of clear guidelines can lead to delayed responses to problems, especially when supervisors are granted considerable discretion on the timing and nature of supervisory actions. Objectives and Program: Establish objective criteria and formal procedures that mandate remedial actions by supervisors commensurate to any weaknesses or rule violations that are detected. Enable supervisors to monitor the liquidity situation of problem institutions.		1. BOT will adopt, with support under the Technical Assistance program of the Bank, and publicize among the industry guidelines for Prompt Corrective Action for finance companies and banks (May 30, 1998). 2. Specific criteria will be established for triggering supervisory actions. These will include, inter alia, triggers based on capitalization ratios, liquidity support and unsafe and unsound practices etc. for: (i) holding actions under a preventive surveillance regime; (ii) establishing a recapitalization plan; (iii) undertaking diagnostic reviews; (iv) requiring an MOU; and (v) takeovers by BOT/FIDF. 3. BOT will submit by end 1998 a series of amendments to the Banking Act and the Finance Company Act for improving the overall legal framework of supervision, including specific amendments to strengthen the applicability and enforcement of BOT corrective actions.
4. Strengthen licensing requirement		
Issue: The resolution of suspended FCs is likely to attract both foreign and domestic investors into the Thai financial sector. These newcomers should bring adequate financial expertise and run financial institutions in a safe and sound manner; regulations governing their rights and responsibilities as shareholders need to be clarified. Objectives and Program: Strengthen licensing procedures for financial institutions to ensure the selection of qualified investors, and issue appropriate regulations for share ownership and the role of foreign investors in financial institutions.	1. Guidelines issued by BOT on the "fit and proper" conditions, to be met by: • shareholders of any merged FC • shareholders and managers of new banks resulting from the resolution process of the 58 FCs. 2. Announcement made by Government that financial institutions will be allowed to purchase up to 100% of an existing finance company so long as they maintain a sound financial condition. 3. New licensing policy adopted and announced whereby the capital base, liquidity position, loan portfolio quality, and management quality of an institution will be the primary criteria for getting a bank license, in addition to its asset size.	1. By December 31, 1997, BOT will issue a circular to request specific information to conduct a more accurate and credible assessment of the "fit and proper" condition of new executive managers and directors of FCs. 2. BOT will propose legal amendments to the Banking Act, and Finance Company Act to empower BOT and MOF to evaluate the executive managers, directors and shareholders of both existing and new Banks and FCs. 3. BOT will issue new guidelines (building partially on guidelines issued in November 1997 on the "fit and proper" conditions) to lay down a comprehensive and single set of licensing procedures for both banks and finance companies in line with international standards and will ensure that conditions are maintained.

OBJECTIVES AND PROGRAM	BOARD CONDITIONS	LETTER OF DEVELOPMENT POLICY
5. Strengthen prudential regulation		
Issue: The financial crisis has highlighted the risks associated with foreign exchange exposures. Another important source of potential risks is excessive lending to related parties. More generally, although FCs have proven for more risky than banks, they are subject to more lenient prudent regulations. Objectives and Program: Strengthen prudential regulations for banks and finance companies to limit foreign exchange risks and reduce risks associated with insider lending. Strengthen prudential regulations for finance companies so they are at minimum equal to that for banks		1. By July 1998, MOF/BOT will amend existing prudential regulations or issue new regulations so that finance companies are subject to the same prudential rules as commercial banks. Implementation of these new provisions will occur according to an agreed phase in schedule. The regulations will include: • maximum investment in equities (20% of capital); • maximum credit risk exposure to one credit risk (25% of capital); • limit on net long and short foreign exchange positions (25% and 20% of Tier One capital) • require all FCs to submit semiannual credit plans to BOT 2. MOF/BOT will strengthen key prudential regulations applicable for both banks and finance companies in the areas of i) lending to related parties, and ii) limit to foreign exchange positions. 3. MOF/BOT/SEC will develop and issue regulations that will deal with consolidated supervision of financial groups (groups comprising banks, finance companies, and/or securities companies). 4. Government will develop new prudential regulatory and accounting standards by September 1998, to be phased in for specialized financial institutions.
6. Strengthen supervisory regime		
Issue: Quality and consistency in the supervisory regime needs to be ensured for different categories of financial institutions and financial groups. Timely detection of and response to problems in financial institutions requires adequate capacity for both off-site monitoring and on-site examinations. Objectives and Program: Rationalize the supervisory system to better coordinate and integrate supervision of banks, finance companies, specialized banks, securities companies, and financial groups (i.e., groups comprising at least two of these institutions). Strengthen off- and on-site monitoring of financial institutions.		1. By March 1998, BOT will develop a Medium Term Institutional Development Plan for strengthening its financial supervision capacity (particularly on-site examination, off-site supervision and enforcement). 2. Government will establish by January 1998 an interagency task force that will review and recommend changes in the legal and regulatory framework for supervision. This will be conducted in light of the Thai strategy to modernize its financial structure and services.

OBJECTIVES AND PROGRAM	BOARD CONDITIONS	LETTER OF DEVELOPMENT POLICY
	IV. Strengthening Market Discipline	
1. Legal and regulatory framework for corporate workouts		
Issue: The cost of existing bankruptcy procedures and of foreclosure on collateral is high because of the time it takes to resolve disputes. This discourages voluntary debt restructuring. In addition, the bankruptcy statute discourages creditors from providing liquidity to solvent but illiquid companies under reorganization (given provisions in Section 94(2)). Objectives and Program: Establish adequate legal infrastructure to simplify the restructuring of problem borrowers. In particular, address problems associated with the lack of well defined out-of-court settlement procedures for workouts; collateral foreclosure; and uncertainties in lending to companies under reorganization.	1. Amendments to the Bankruptcy Act passed first reading of the of Parliament in November 1997, and now in second reading.	The authorities will submit for approval by March 31, 1998, legislative proposals that will: • permit a process of corporate reorganization • speed collateral foreclosure • facilitate financing to companies under reorganization
2. Strengthen and enforce accounting, auditing and disclosure standards		
Issue: In Thailand, generally accepted accounting principles; disclosures regarding portfolio quality, income recognition practices and ownership structures; and auditing standards fall short of international standards in certain critical areas. Enforcement of existing standards has also been uneven. Objectives and Program: Facilitate greater market discipline by upgrading standards to international standards in a phased manner and strengthen enforcement of standards.		1. Stricter Definition of Non Performing Loans (NPL) adopted and will be announced no later than January 15, 1998; and it will be applied to December 1997 financial statements: • definition of NPLs to be 6 months in nonaccrual rather than 12 months with no account taken of collateral • netting out of restructured loans will no longer be permitted in calculations of NPLs 2. The BOT will issue for comment by the financial industry on June 30, 1998 guidelines on public disclosure to be required of financial institutions under supervision [Regulatory Accounting and Disclosure Practices (RADP)] . The guidelines will be finalized and will start to take effect under a phase in schedule by December 31, 1998. 3. The BOT will issue for comment a proposed policy by June 30, 1998 in respect to public disclosure of information it now collects. It will implement this policy beginning in December 31, 1998. 4. The authorities will develop an action program for strengthening and enforcing accounting, auditing, and disclosure standards—including financial institutions by December 31, 1998 and subsequently for remaining corporations.

OBJECTIVES AND PROGRAM	BOARD CONDITIONS	LETTER OF DEVELOPMENT POLICY
3. Strengthen capability of the Emergency Comprehensive Guarantee and develop strategy for Phasing it out		
Issue: The Government has provided a comprehensive guarantee through FIDF to eligible depositors and creditors as an emergency measure. The Government is aware that this has systemic implications and can result in inappropriate incentives for market participants beyond the immediate crisis. It had also become clear that market participants were questioning the Government's commitment to provide fiscal resources if payouts were required. Objectives and Program: Take actions (including legislative) to underline the Government's near term commitment to make the comprehensive guarantee credible. Over time phase out the emergency comprehensive guarantee and replace it with a limited, self-financing deposit insurance scheme.	1. Emergency comprehensive guarantee program implemented by amending the BOT Act in the October decree package. 2. A guarantee fee of 0.15% introduced for the remainder of 1997. In 1998 it will be 0.4% and will be applied to all covered liabilities. This includes the previously existing fee of 0.1%. 3. Deposit rates capped at 3% above the average deposit rate of the five largest banks (implemented September 26, 1997 and in force).	Government will propose a plan by December 31, 1998 for phasing out the emergency comprehensive guarantee and replacing it with a new limited deposit insurance system that will be largely self-financed.

ANNEX 1: RESOLUTION OF SUSPENDED FINANCE COMPANIES

1. This annex sets out in greater detail the institutional arrangements and policies that the authorities have put in place to deal with the resolution of the suspended finance companies. It outlines government actions to resolve the situation of the 16 finance companies suspended on June 27, 1997, and the 42 finance companies suspended on August 5, 1997.

1. BACKGROUND

2. **Structure and Size of the Finance Company Industry.** The Thai financial system includes 91 finance companies (FCs) and finance and securities firms worth B 1.7 trillion in assets as of May 1997. Over 40 percent of this amount was held by 11 FCs prior to the suspension of the 58 companies. The FC sector accounts for about 22 percent of total banking assets. (This includes commercial banks, finance companies, and five specialized public banks.) Many FCs are affiliated with and controlled by commercial banks, often in a nontransparent manner. Specifically, of the remaining 33 nonsuspended finance companies, 5 are affiliated with foreign banks and 20 with wholly domestically owned Thai commercial banks.

3. FC loans and investments are concentrated in real estate or construction lending, consumer hire-purchase loans (primarily automobile financing), loans against shares, and other securities operations (much of which is linked to the real estate market). The quality and value of all these assets have deteriorated sharply during the current economic downturn. Most FCs are funded with wholesale liabilities, and thus run significant liquidity risk. FCs also typically run significant interest rate risk due to the maturity mismatch between their assets and liabilities—35 percent of loans and 5 percent of funding have on average a maturity of over one year. The recent increase in interest rates therefore has resulted in significant losses. Finally, FCs also obtained foreign funding via syndications (particularly the largest FCs), and in many cases these funds were onlent to nonhedged companies or sectors.

4. The fixed exchange rate regime coupled with a lack of adequate information relating to the sectors (notably real estate) to which the FCs lent contributed to the severe problems facing the FCs. First, the fixed exchange rate made it attractive to borrow at low rates internationally and to on-lend funds at higher rates into risky sectors. Second, the poor quality of information about the sectors where FC lending was concentrated made it difficult for such entities to properly assess the risks to which they were exposed.

5. **Suspension of 58 Finance Companies.** On June 26, 1997, the Ministry of Finance (MOF) ordered 16 FCs into suspension, effectively halting their operations. A further 42 FCs were suspended on August 5, 1997. The suspended companies were ordered by the Committee to Supervise the Mergers and Acquisitions of Financial Institutions (Screening Committee) to submit rehabilitation plans and be subjected to due diligence by independent accountants under terms of reference designed by the Bank of Thailand (BOT). Four categories of rehabilitation

plan were invited to be submitted: self-recapitalizations or recapitalizations with new ventures, mergers among suspended finance companies, mergers with other local financial institutions as a core, and mergers with commercial banks. The companies had until October 30, 1997, to submit the rehabilitation plans after issuance of final rehabilitation criteria on October 13, 1997.

2. Bottlenecks to the Resolution Process

6. **Lack of Accurate Information on the Solvency of Financial Institutions.** The capacity of BOT to ascertain the present solvency situation of financial institutions and identify insolvent institutions was limited at the time of the suspension. Evidence of this problem is the fact that suspension of the 58 finance companies was largely based upon the extent of borrowing from the Financial Institutions Development Fund (FIDF), rather than their solvency situation. This was largely due to the very poor information available on the quality of financial institutions' loan portfolio. In particular, income recognition policies allowing the accrual of interest into income (for collateralized loans), even in the case of loans in nonaccrual for 12 months, led to great difficulties for the authorities to determine the "true" capitalization of specific financial institutions.

7. **Limited Capacity to Take Control of Insolvent Institutions.** As a matter of good practice, when a financial institution is forced to suspend its operations, the authorities must act aggressively to take control of the institution's records and assets in order to preserve value on behalf of depositors, creditors, and other claim-holders. It is important that the value of assets not be dissipated. BOT, however, lacked the legal power, as well as the institutional capacity, to take immediate control of the suspended FCs and to proceed with disposal of the assets:

(a) BOT did not have the legal power to take immediate control over insolvent or rapidly deteriorating financial institutions. This occurred because existing legislation (the Banking and the Finance Company and Credit Foncier Acts) did not give BOT and/or FIDF the power to rapidly extinguish shareholder rights. During suspension therefore, shareholders and managers remained in control of the institution, and are potentially in a position to strip the institution of substantial value.

(b) BOT lacked the capacity in terms of skills and manpower to practically remove the existing management and put each company under conservatorship.

(c) No institutional framework existed for disposal of the assets of suspended finance companies in the event they were taken over and liquidated. In addition, the role of the public and private sectors in this process had not been clearly defined nor had that of the overall institutional framework.

8. **Other Constraints to a Timely Resolution:** The government faced other practical constraints to liquidating the assets of the suspended FCs, which have delayed the resolution process and undermined market confidence in the authorities' capacity and willingness to act:

(a) A significant proportion of assets in suspended companies were of poor quality; this situation has worsened in the months between suspension and the takeover of the companies on December 8.

(b) Under the Thai legal system, it is difficult to foreclose on assets or take delinquent borrowers to bankruptcy.

(c) Very few, if any, healthy domestic financial institutions existed that could bid for the assets of the suspended FCs.

(d) Market liquidity continues to be limited.

(e) The government had limited institutional capacity and banking and investment banking skills needed to implement a resolution strategy for the FCs.

9. **Effects of Delays in the Resolution Process:** The way the suspension was managed in its early stages had significant adverse consequences for the institutions' customers. Borrowers, including viable firms, have been unable to obtain additional credit from the suspended FCs. As a result, they have increasingly gone into default with other lenders, such as commercial banks and nonsuspended finance companies. In many cases, they have been unable to establish credit relationships with other financial institutions, since their assets and deposit-account relationships are tied up in the suspended institutions. Liability holders generally have not had access to their funds according to original contractual terms, which has contributed to an undermining of confidence in the financial system.

10. As the confidence crisis intensified and the suspension period lengthened, more of the 58 suspended companies became technically insolvent. Calculations based on reasonable assumptions suggest that the suspended FCs came under greater stress than the 33 remaining companies and that at least 51 had a negative capital ratio as of October 1997. This result assumes that nonperforming loans as a percentage of total loans for the suspended FCs together would be almost 30 percent.

3. OBJECTIVES AND INSTITUTIONAL SETUP FOR THE RESOLUTION PROCESS

11. **Objectives of the Finance Company Resolution Strategy:** Against this backdrop, the objectives of the recommended strategy for the resolution of the 58 suspended FCs were to:

(a) obtain adequate legal powers and adopt better institutional arrangements and policies for the speedy takeover and ultimate liquidation of suspended FCs;

(b) rapidly sell obligations of good borrowers in FCs that will not be authorized to reopen;

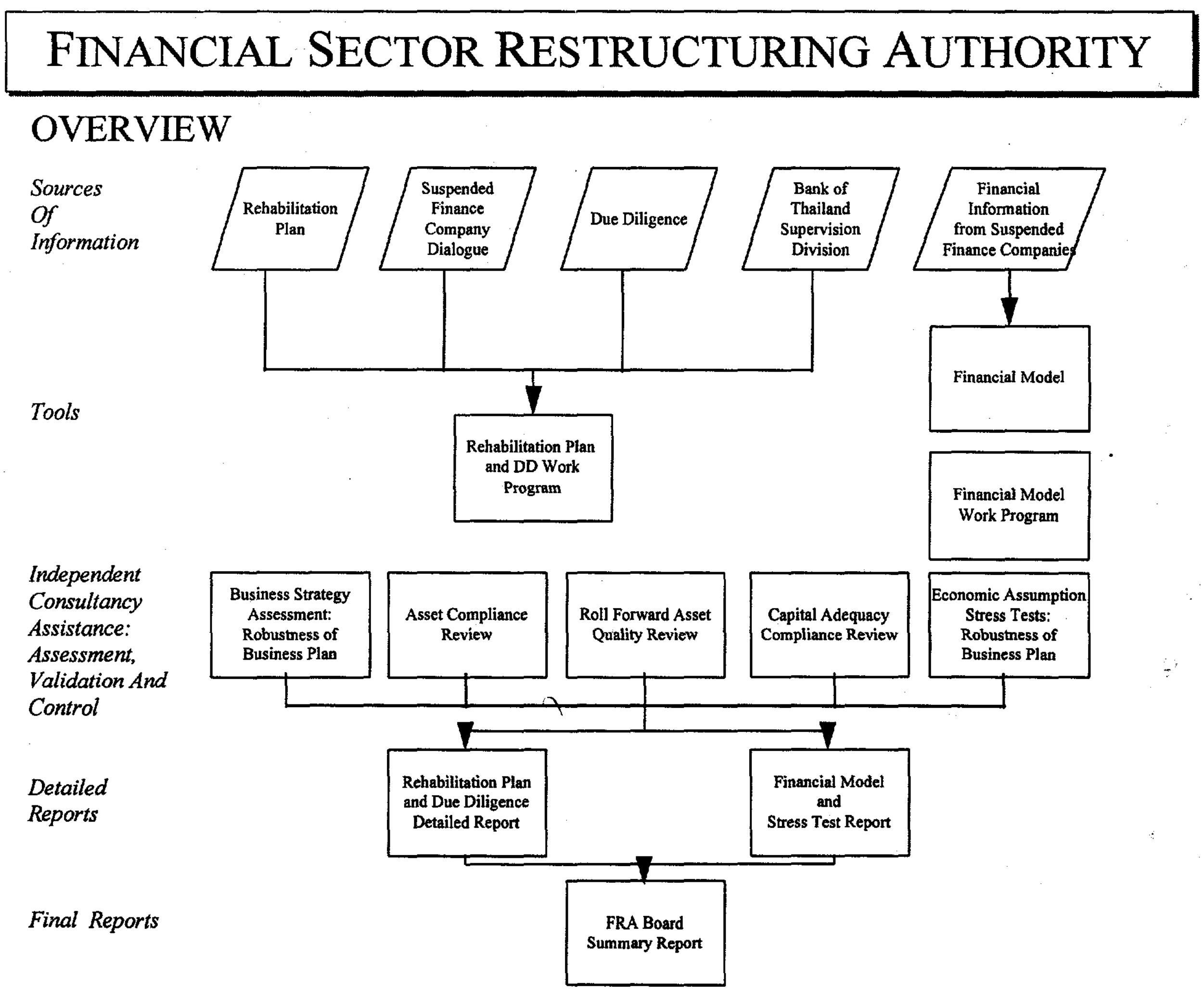
(c) clarify the status of creditor claims in suspended FCs; and

(d) ensure adequate financing to achieve the above.

12. **Institutional Arrangements and Overall Resolution Process.** The large number of suspended finance companies presented BOT and FIDF with difficult management problems Hence, to provide coordination and insure a speedy process for resolution of the 58 suspended finance companies, the authorities issued a package of six new emergency decrees promulgated on October 22, 1997. Two new institutions, the Financial Sector Restructuring Authority (FRA) and the Asset Management Corporation (AMC), were established as the focal points for resolving the suspended finance companies. The new structure addresses these problems in a systematic and comprehensive manner.

13. FRA was established on October 24 as an independent body with the mandate to evaluate the rehabilitation plans submitted by the suspended finance firms in accordance with the Emergency Decree on Financial Sector Restructuring—one of the six emergency decrees. Figure A1.1 below illustrates the functions that FRA has undertaken from the time the 38 rehabilitation plans were submitted, until the final decision on rehabilitation plans, which was made public on December 8, 1997.

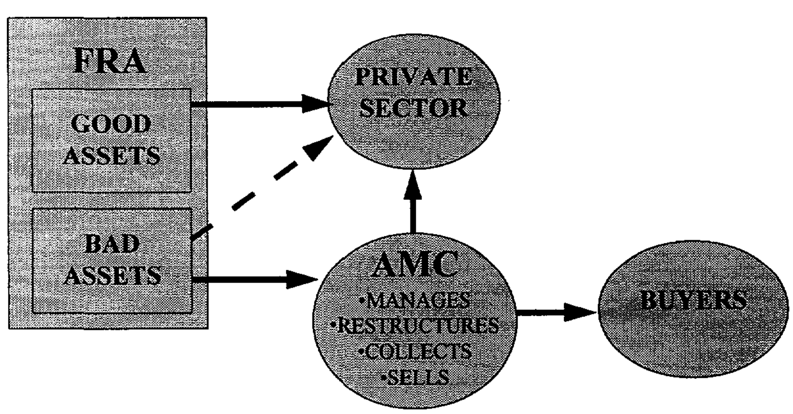
FIGURE A1.1: FRA RESOLUTION PROCESS



14. FRA was responsible for reviewing the rehabilitation plans submitted by the suspended FCs according to explicit criteria outlined in Attachment 1 to Annex 1 and in the following section. In addition, it is to oversee the orderly winding up of finance companies not reopened and the disposition of their assets. This process is discussed in greater detail in section 5 below. FRA is not to engage in the restructuring of individual assets nor will it directly manage or finance note exchange schemes (with Krungthai Thanakit Public Co. Ltd., or KTT, and Krung Thai Bank, or KTB—see Annex 2). FRA is committed to begin selling the closed finance company assets in the first quarter of 1998, and to complete asset sales by December 1998.

15. The second institution created under the October emergency decrees, the AMC, is to act as a *de facto* asset disposition corporation for either suspended finance companies or for open finance companies and commercial banks. This entity is responsible for buying, through reserve bids, impaired assets put up for sale by FRA in competition with private sector institutions (see Figure A1.2). It would subsequently manage, restructure, collect on the assets, and/or resell the assets to corporate buyers. The goal of AMC is to maximize the value of the assets to be sold, and to maintain an orderly real estate market. AMC is designed as a vehicle to overcome the impediments to asset liquidations in the near term, so as to create a market for distressed assets, and to utilize new troubled debt restructuring techniques to assist in what will be a large number of industrial restructurings.

FIGURE A1.2: AUCTIONING SUSPENDED FINANCE COMPANY ASSETS



16. The government has appointed the AMC Board and Chairman, and is in the process of examining options for its financing and governance structure. The authorities have committed themselves to a series of additional actions so that AMC will be staffed and operational by January 31, 1998. The authorities have authorized a capital outlay of B 1 billion for AMC, of which B 250 million have already been approved.

4. Evaluation of Shareholder-Led Rehabilitation Plans

17. The shareholders of the suspended finance companies have been given an opportunity to propose voluntary rehabilitation plans. Criteria for the evaluation of these plans were originally issued in early September by the special Screening Committee, and subsequently modified by the authorities, in negotiations with the Bank and the International Monetary Fund (IMF), to reflect relevant agreements between the government and IMF. In particular, it was deemed crucial to the integrity and credibility of the overall resolution package that FCs be permitted to emerge from suspension only if they had adequate equity capital and liquidity, strong management, and fit and proper shareholders.

18. The final criteria against which the rehabilitation plans were measured included (a) adequate recapitalization of the suspended firm for both existing and new shareholders; (b) plans for repayment of debt; (c) guidelines for conversion of FIDF debt to equity as part of rehabilitation plans; (d) sufficient and reliable sources of funds for liquidity management; and (e) quality of management. To gain approval, a submitted rehabilitation plan had to pass evaluation on each of these criteria (see Attachment 1 to Annex 1 for details).

19. The final criteria have been applied by FRA in its evaluation of the rehabilitation plans. A total of 38 rehabilitation plans were submitted in accordance with the prescribed deadlines. Of the 38, 29 involved recapitalizations, 2 were based on mergers among suspended companies, 5 anticipated mergers with other local financial institutions, and 2 involved mergers with commercial banks. Operationally, FRA has implemented a three-step decision making process for rehabilitation proposals:

(a) design of a modeling framework within which FRA evaluated the submitted rehabilitation and business plans;

(b) validation of asset valuations implicit in the rehabilitation proposals; and

(c) examination by an independent third party to ensure that the process followed by FRA in assessing rehabilitation plans is consistent with the criteria designed in close coordination with the Bank and IMF.

20. With strong economic leadership provided by the new government—in place since early November, 1997—and the full backing of MOF, FRA has moved with impressive speed, decisiveness, and transparency in dealing with this stage of the resolution process. It has been effectively supported by experts from consulting, accounting, law, and public relations firms of international standard, mobilized at short notice, and funded under the World Bank-financed technical assistance loan.

21. On December 8, the authorities announced that 2 of the 38 rehabilitation plans had been approved, and 36 rejected. This has meant that only 2 of the 58 suspended companies have been authorized to reopen. Strict conditions have been applied to the companies, whose rehabilitation

plans were approved by FRA in agreement with BOT, particularly in respect to capitalization. FRA will monitor implementation of the approved rehabilitation plans.[1] Once rehabilitation has been satisfactorily completed, FRA will report this to MOF, which will transfer supervision responsibility to BOT.

5. Asset Disposition Process

22. **Asset Recovery Process:** As of the December 8 announcement, those suspended companies whose rehabilitation plans were not accepted and who were put under the direction of committees, which have been established and appointed by the FRA Board in accordance with Section 30 of the Emergency Decree on Financial Sector Restructuring. [2] The committees, in turn, have appointed special managers under a power of attorney to take control and manage the business of each company and to safeguard the interests of creditors. The mandate of the special managers is clear and specific—to preserve and maximize the value of assets on behalf of depositors and creditors.[3] In addition to managing day-to-day operations of the companies, the special managers will conduct a thorough review of all assets and liabilities, make a determination on asset quality and realizable value, and recommend asset disposal strategies with the aim of maximizing recovery for creditors. They will also review the staffing situation at each company in accordance with relevant Thai labor laws and work with remaining staff to rejuvenate loan collection and enhance the value of existing businesses.

23. Guidelines and procedures are currently being finalized for the orderly disposal of assets of the FCs not authorized to reopen. This will include the guidelines to be used in determining how to stratify impaired and nonimpaired assets. Assets are to be sold through competitive bidding. Bidders would include private sector financial institutions and other firms or individuals, the creditors of suspended finance companies, AMC, and one or two "new good bank(s)." Further initial details on the disposition process are set out in the Figure A1.3.

24. Finally, to ensure that the asset disposal process is carried out with speed, integrity, and transparency the. authorities will outline an institutional and policy framework for disposal of good and impaired assets by no later than January 15, 1998. The framework will clearly outline (a) the criteria and processes to be used stratify different assets for disposition; (b) the scope for creditor-led wind-downs or dispositions; (c) the precise roles a of the committees and mangers; and (d) the structure and role of a new bank (good bank) that would compete to buy the good assets via bidding. This process will be of prime importance to the financial outcome of the closure of the designated finance companies. The institutional and policy framework for disposal

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[1] BOT is formally represented in the FRA Board.

[2] Each committee contains three core members who serve on all committees: a Chairman from the Inspector General's office of MOF, a second representative from MOF and a representative of BOT. Each committee also contains three members specific to each individual company, including an FRA representative knowledgeable about the specific finance company, a BOT supervisor and a nongovernment-affiliated representative of the company's creditors.

[3] Shareholders may recover some of their investment in the event that funds remain after repayments to depositors and creditors.

of good and bad assets is to include the specific roles of FRA, AMC, and FIDF. The government has also committed itself to establishing a special FRA Coordinating Unit (FRACU) to ensure integrity of the asset disposition process. The FRACU, which was established on December 15, 1997, has been set up to monitor and undertake surveillance of the special managers and board of directors of each closed finance company.

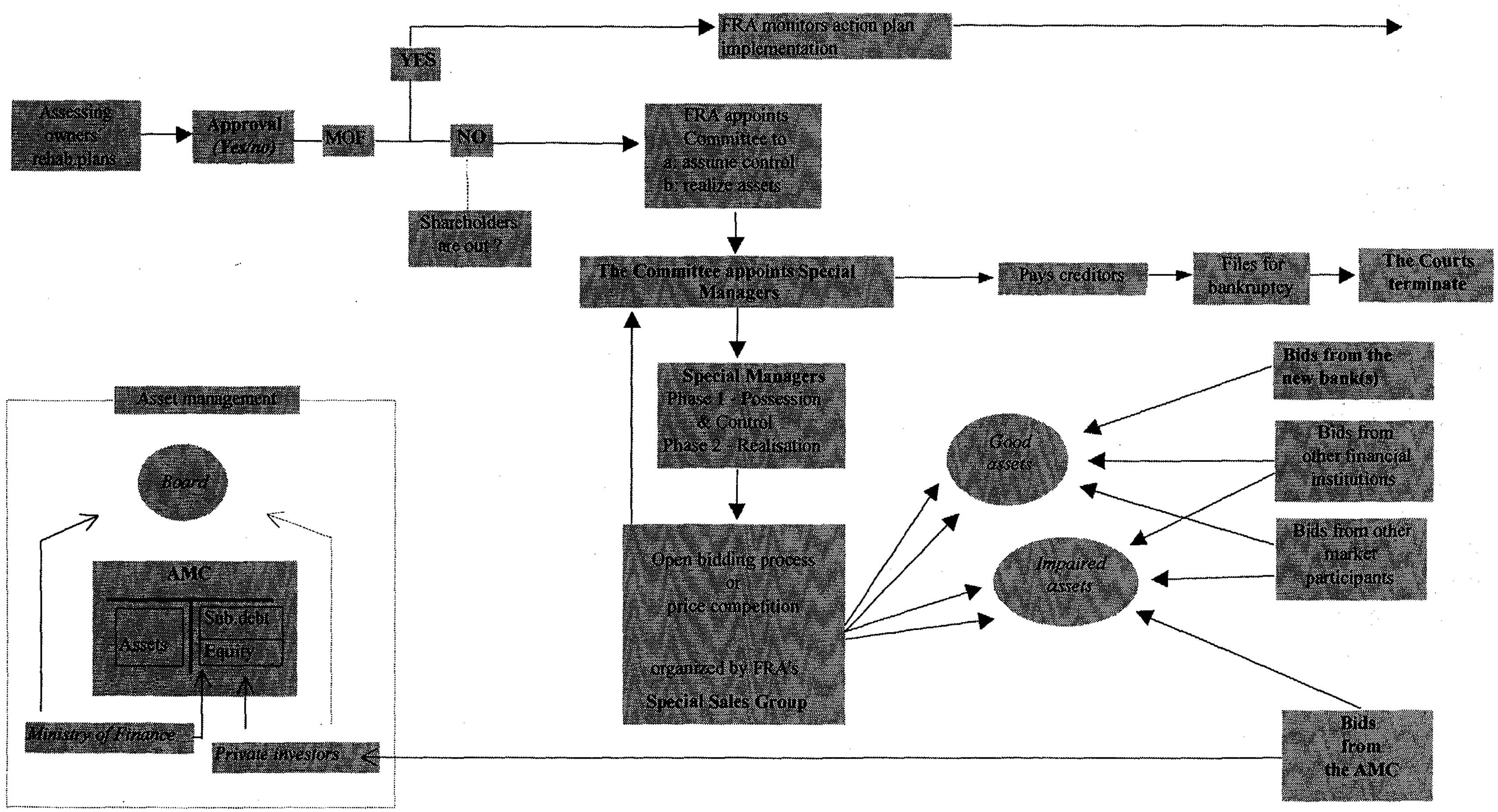
25. **Treatment of Depositors and Creditors.** Depositors in the suspended banks are fully protected through the option of exchanging their claims on the suspended FC for claims on KTB or KTT—two publicly controlled financial institutions. These claims will be serviced (both principal and interest) by FIDF. Similarly, creditors of the 42 FCs suspended in August (but not those of the 16 FCs first suspended) have the option to exchange notes with KTB. The deadline for exchanging to KTB notes, which are fully guaranteed by the government, has been extended to 75 days from the announcement date (December 8, 1997). Creditors in the 16 FCs first suspended do not have the option of exchanging their claims, and will have to modify their claims under a shareholder rehabilitation program, or negotiate their claim to the proceeds of the liquidation of the FCs' assets administered by FRA. (See Annex 2 on the Note Exchange Programs for greater detail.) Creditors, both domestic and international, are to be treated equally and *pari passu* with the FIDF, which is the largest creditor.

26. **Financing:** The principal financing requirements under the overall restructuring plan are for the AMC's purchase of impaired assets in FRA auctions, and FIDF's obligations under the Note Exchange Program. FRA financing needs should be limited to its overhead expenses (that can be covered through its initial capitalization that was recently approved) and the cost of consultants, the latter to be financed in large part by the World Bank under the Financial Sector Implementation Assistance Project.

27. Early estimates suggest that AMC may need to purchase around B 250–300 billion (market value) in assets. This estimate is based on the assumption that about B 500–700 billion (book value) in assets of the companies taken over are likely to be judged "impaired." Although the initial capital of B 1 billion has been authorized, with a first payment of B 250 million already approved, capitalization would need to be much greater to support cash purchases. Currently, AMC has the authority to issue notes guaranteed by the government for up to 12 times its capital. The low capital base provided by MOF may hinder the effectiveness of AMC during the resolution process. AMC will be forced to issue notes or equity, either by paying for assets purchased from FRA with those instruments, or by issuing notes or equity into the market to raise cash. There is no guarantee, however, that the latter alternative can be achieved under current market conditions, and paying in notes or equity may leave many liquidating FCs with insufficient cash to satisfy even employee and other priority claims. It is important to realize, however, that in the case of many finance companies taken over, FIDF will be the primary creditor—particularly in the case of the 42 suspended companies if other creditors utilize the note exchange option. In this case, AMC could purchase the impaired assets from FIDF with equity, thereby permitting it to realize some possible gain on the assets through an equity claim on AMC and forcing a proper writing down of its exposure. However, payments owed to employees and severance would still need to be covered.

28. It is estimated that FIDF's total funding requirement associated with the Note Exchange Programs of KTT and KTB will aggregate to around B 500 billion over the next five years under the assumption of maximum utilization of the programs. Hence, this may be an overestimate of the costs of these programs. Even under this assumption, the bulk of the financing would only be required in the fifth year (see Annex 2 for detailed calculations).

CHART 3 -- OVERVIEW OF ASSET REALIZATION PROCESS



ATTACHMENT 1: CRITERIA FOR REHABILITATION AND BUSINESS PLANS OF SUSPENDED FINANCE COMPANIES

This annex provides detailed information about the criteria that will be used in assessments of rehabilitation plans submitted by October 30 and upon which FRA must act by November 30 with approval by the Minister of Finance to be no later than six business days after the recommendations by FRA have been received. The rest of this annex presents a translation of the criteria.

No. 3/2540

Re: Criteria used in evaluating rehabilitation and business plans of suspended financial *institutions*

The Committee would like to announce the detailed criteria, approved by the Minister of Finance and the Bank of Thailand, used in evaluating rehabilitation and business plans of suspended financial institutions as follows;

1. Recapitalizations

1.1 Guidelines for the capital adequacy ratio

1) In the case of self recapitalization or with new ventures or mergers among the suspended firms, the capital adequacy ratio that financial institution must comply with are not less than 15 percent (where first tier is not less than 12 percent) in the first year, 12 percent in the second year, and 10 percent (or that prescribed by law, which ever is greater) in the third year.

2) If the merger is with other local financial institutions that act as core, capital funds after the merger, less loan loss provisions, must be sufficient to maintain the capital adequacy ratio at not less than 12 percent in the first and second years and not less than 10 percent (or at the level prescribed by law, whichever is greater) in the third year.

3) In the case where the merger is with commercial bank, the financial institution must comply with the capital adequacy ratio specified by the Bank of Thailand.

4) The capital adequacy ratio can be calculated from the capital funds, which means the sum of the paid-up capital, including premiums of shares received, statutory reserve, reserve appropriated from net profits at the end of each accounting period, net profit after appropriation, and money which a financial institution receives from issuing a long-term debt instrument with a maturity of over five years, less the loan loss provisions, according to the guidelines approved by the Bank of Thailand as directed by the Committee.

1.2 FIDF's conversion of debt to equity

1) In case of self recapitalization or merger among other suspended firms where the structure of the major shareholders remain unchanged, FIDF will not be permitted to covert its debt to equity.

2) If the merger is with another local financial institution that is acting as core, FIDF may convert debt to equity once the existing shareholders have realized the loss incurred. Nevertheless, the conversion must not exceed 33 percent of the recapitalized funds. An additional clause will also be amended for FIDF to reserve the right to convert debt to equity up to 25 percent of the institution's fully paid-up capital.

3) Loan loss provisions resulting from due diligence are tax deductible.

1.3 An unlimited amount of shares may be held by foreign shareholders up to the period of 10 years. After the end of the given period, foreign investors may not purchase any more shares unless the amount held is less than 49 percent of the total shares, and they may thus acquire further shares until the 49 percent mark is reached.

1.4 Evidence of the source of funds used for rehabilitation may be a Bid Bond, which can be in the form of cash, bonds, and other liquid assets. The evidence presented must not be less than 5 percent of the total recapitalized funds. Once the plan has been approved, the new investors must transfer the total recapitalized funds into an escrow account not less than 15 days prior to pursuing a normal course of business.

2. Repayment of debt to FIDF

The company that submits the rehabilitation plan may request an extension of the period of repayment to FIDF to the maximum of eight years. The interest charged to the suspended financial institutions by FIDF will be equivalent to that of nonsuspended financial institutions, plus an additional penalty fee.

3. Criteria in approving the management

General guidelines for the approval of financial institutions' executives require them to:

- demonstrate that they are good managers and prove that they have a good track record;
- be honest and trustworthy;
- possess an employment history that is free of dishonesty, fraud, irresponsibility, or unfair play;
- prove that they are not substandard customers of any financial institution;
- show that they have not engaged in any business affair that may lead to questioning of their ability or prudence, both in the business matter involved and in the way it was carried out.

Nonetheless, the evaluation will depend largely on the discretion of the Committee.

4. Liquidity management

The source of funds reserved for liquidity management must be sufficient to support customers' withdrawals and other operational expenses. The source of funds must be in the form of cash from recapitalization, standby credit, line of credit, aval line, including the name and status of the strategic alliance, or any other form of fund that is permitted by the Committee on a case-by-case basis.

5. Directive for financial institutions whose rehabilitation plan is unacceptable

In cases where the plans submitted are not justifiable and the Committee does not allow the financial institutions in question to pursue their normal course of business, the authority will step in and implement measures set out by the FRA.

The Committee believes that the criteria and guidelines issued in evaluating the rehabilitation plans of suspended financial institutions will bring about transparency in evaluation of plans, and will make certain that financial institutions that come through will be able to compete effectively in the competitive financial system.

The Secretariat
October 13, 1997
The Committee to Supervise the Merger
and Acquisition of Financial Institutions

ANNEX 2: NOTE EXCHANGE PROGRAMS IN THE SUSPENDED FINANCE COMPANIES

1. This annex describes the operation and funding of the Note Exchange Programs (NEPs). These programs were designed to restructure the liabilities of suspended finance companies in a way that ensures limited losses to small eligible depositors as the suspended finance companies are resolved. The first part of the annex outlines the nature of the programs and the exact arrangements for their financing. The last section provides tentative estimates of the financing that may be required overall to meet the payments on the notes under the assumption of maximum utilization of the programs.

THE 16 SUSPENDED FINANCE COMPANIES

2. The Minister of Finance suspended the operations of 16 finance companies on June 27, 1997. On July 25, 1997, the authorities (i.e., the Screening Committee) issued guidelines for the treatment of promissory note (P/N) holders (depositors) and creditors.

3. **Depositors:** Under these guidelines, *eligible* depositors (see Attachment 1 to Annex 2 for a detailed definition) were allowed to avail themselves of the option of exchanging their P/Ns with the suspended companies for the nonnegotiable P/N of KTT in the principal amount of the original note according to certain prespecified terms. In this case negotiable certificates of deposit were not considered eligible "deposits." (See Attachment 1 to Annex 2 for detail.) These notes were payable by KTT at a market interest rate with principal repayments payable at specific maturity dates as follows:

(a) six months for P/Ns or negotiable certificates of deposit in principal amount less than B 1 million;

(b) three years for P/Ns or negotiable certificates of deposit in the principal amount of at least B 1 million but less than B 10 million; and

(c) five years for P/Ns or negotiable certificates of deposit in the principal amount of B 10 million or more.

4. This option given to note holders within the 16 companies will expire 30 days after December 8, 1997—the time final decisions were rendered on the rehabilitation plans of each company. If a note holder chooses not to swap, he or she will be classified as a creditor after the expiration date. Those that do not participate in the program lose their rights as depositors on the suspended companies, because under a liquidation depositors and creditors have equal standing under Thai law.

5. Almost all depositors in the first 16 FCs have converted their notes to those offered by KTT. As of October, over B 60 billion of deposits (P/Ns) had been swapped for KTT notes, leaving only B 15 billion (see Table A2.1 below). The remainder includes deposits held by managers and directors that are not eligible for this NEP. In most cases eligible depositors have opted for payment of interest monthly at a rate of 12 percent per year. KTT has been permitted to charge an administration fee of 1 percent of the value of the notes exchanged, although most of the fee (0.9 percent) will cover expenses and taxes.

6. **Creditors.** Creditors of the 16 companies include holders of Bills of Exchange (B/Es) and Negotiable Certificates of Deposit (NCDs) along with other lenders and investors (including financial institutions or nonfinancial corporations). They are not entitled to any guarantee or payments under this initial NEP.

7. The final treatment of creditors in these companies is still under active discussion pending the adoption of final processes for resolution in the cases of those companies taken over and closed on December 8, 1997. If the companies will be liquidated, the process will entail the following prioritization of claims: employees, pensioners, severance payments, and outstanding tax payments prior to all other creditors and depositors. Depositors do not obtain a priority claim under liquidation relative to other creditors under Thai law. The NEP for the 16 companies was implemented—as a means of permitting prioritization via a voluntary process at the option of the depositor.

8. In the case of creditors, those with secured claims need to be differentiated from unsecured creditors. It appears that some creditors of the 16 have secured claims on assets, and it is not clear if these claims are perfected relative to FIDF claims. Hence, this raises the issue of FIDF conditioning the release of its rights over collateral upon similar release by all other creditors, which is now possible, given the amendments to the Central Banking Act that empower FIDF to take such actions.

9. **FIDF Exposure.** Data for October 1997 indicate that total FIDF support to the 16 finance companies amounted to B 196.5 billion. The amount is likely to increase substantially over the next few years as the FIDF honors interest and principal repayments on KTT notes (see section on required financing below). FIDF makes advances prior to taking collateral. Based on available information, it is likely that the value of the collateral held by the FIDF is *less* than 50 percent of its outstanding exposure. This gap will only grow wider with the expected increase in FIDF exposure under the KTT NEP.

THE 42 SUSPENDED FINANCE COMPANIES

10. On August 5, 1997, 42 additional finance companies had their operations suspended. In this case, both eligible depositors and creditors were permitted to avail themselves of the NEP.

11. **Depositors.** In these suspended companies, *eligible* depositors (see Attachment 1 to Annex 2 for a detailed definition) were defined to include both P/N and NCD holders (NCD holders were not defined as depositors in the first 16 companies). The depositors have the option of exchanging their deposits with the suspended companies for notes issued by KTB. These

exchanges can be undertaken on the same terms and conditions as for the 16 suspended finance companies as noted above. The only exception is that the KTB notes provided to depositors will be negotiable. Depositors that are related persons or directors are not eligible under this exchange program.

12. FIDF will ultimately honor principal and interest repayments. Total deposits amounted to B 80.7 billion in October 1997 (see Table A2.1) where the applications and actual notes already exchanged amounted to B 87 billion as of November 13, 1997. This amount will gradually be converted into KTB notes and ultimately to FIDF claims on the suspended finance companies as it covers the debt service on the these notes.

13. **Creditors.** Eligible creditors (see Attachment 1 to Annex 2 for a definition) are permitted to swap their claims for notes issued by KTB under the same conditions regarding maturities and size of claims as for the depositors of the 16 and 42 companies. However, the interest rate on these claims will be 2 percent in nominal terms per year—substantially below market rates. Under these terms large creditors that are repaid over five years at a 2 percent rate of interest will lose almost 60 percent of the value in present value terms. Ineligible creditors include those holding debentures, subordinated debt, and convertible debentures. The foreign currency claims eligible for conversion under this program must be converted to their Baht equivalent at the exchange rate applicable on the date of suspension (August 5, 1997).

14. Creditors have claims of about B 85 billion (see Table A2.1 below), which over time may be replaced by KTB and ultimately by FIDF claims if creditors utilize this swap program. As of December 8, no requests for conversion had been made by creditors under this exchange program, since they have just learned the outcome of the rehabilitation process and related criteria.

15. Finally, the option given to depositors and creditors is not open-ended, since they have 75 days from December 8, 1997, before the program expires, as indicated in the recent government announcement.

16. **FIDF Exposure.** FIDF has an exposure to the 42 companies of about B 220 billion. If all depositors and creditors of the 42 companies opt to swap their claims (as a maximum), an additional B 274 billion would be assumed by KTB. Ultimately FIDF will assume the interest and principal repayments on the KTB notes and become the primary creditor of the 42 companies.

17. Even for the 42, the value of the collateral will likely be less than 30–40 percent of total existing and expected future FIDF exposure, particularly if many depositors and creditors ultimately utilize the NEP.

EXISTING LIABILITY STRUCTURE FOR THE 16 AND THE 42 SUSPENDED FINANCE COMPANIES AND NOTE EXCHANGE PROGRAMS

18. The summary table below provides a picture of the liability structure of the suspended finance companies as of the end of July 1997. It does not provide information on the contingent liabilities of these companies.

TABLE A2.1: EXISTING LIABILITY STRUCTURE FOR THE 16 AND 42 SUSPENDED FINANCE COMPANIES
(B billion as of the end of October)

	16 finance companies	Percent of total	42 finance companies	Percent of total
1. Depositors	15.0	4.2	80.7	15.4
Opted for NEP (KTT)	61.0	17.0	87.0	16.6
2. FIDF	196.5	54.8	219.5	41.9
3. Creditors	130.3	36.3	193.4	36.9
Foreign	23.0	6.4	30.8	5.9
Domestic	107.3	29.9	162.6	31.0
4. Others	16.9	4.7	30.6	5.8
5. Equity	-10.8	0.0	33.7	6.4
Total Liabilities	**358.9**		**524.1**	

Source: BOT and IMF-World Bank estimates.

19. Table A2.1 highlights two issues. First, the table highlights the fact that the foreign creditors have about the same exposure to the 16 finance companies as to the 42. The total exposure of foreign creditors is hard to measure, because current information does not allow certification of holdings by foreigners of B/Es, which are part of domestic creditors and off-balance sheet swap exposures. Moreover, given that the number of companies suspended is far smaller in the case of the 16, foreign creditor exposure is relatively more concentrated in these companies.

20. Second, as indicated above, as the NEP takes place, FIDF will have its exposure grow relative to other creditors. Table A2.1 highlights that in the extreme case of all depositors of the 16 converting their notes, the total FIDF exposure as a percentage of total liabilities would be 75 percent. In the case of the 42, if all depositors and creditors opt to swap their claims for KTB notes, the exposure of FIDF would grow to 91 percent of total liabilities. Potentially the exposure of FIDF could amount to roughly B 838 billion if it is assumed that all eligible creditors and depositors participate in the NEPs and if existing FIDF exposure is also taken into account. Of this amount, B 257.5 billion would be the exposure to the first 16 suspended companies, and B 580.5 billion would be the exposure to the remaining 42.

ESTIMATED OVERALL FINANCING REQUIREMENTS: NOTE EXCHANGE PROGRAMS AND FIDF SUPPORT TO SUSPENDED COMPANIES

21. An important element in assuring the integrity of the NEPs was the need to demonstrate that all commitments entered into by the government as part of the liability restructuring process could be fully backed financially. Hence, ultimate funding for the NEPs by FIDF will have to be seen by market participants as earmarked for and sufficient to permit pay-outs on all notes exchanged. FIDF will finance all the interest and principal repayments on the notes issued by KTT under an operating agreement that was defined this past September.

22. According to Table A2.2, the majority of all depositor and creditor claims are above B 10 million in value. This size distribution of claims will determine the terms and conditions under which KTT or KTB notes will be exchanged for depositor or creditor claims.

23. The debt service costs of the NEPs are shown in Table A2.3, under the assumption of *maximum utilization* of all programs.

24. The total value of claims that can be exchanged for notes amounts to B 421 billion (the sum of rows 1 and 2 of Table A2.2). Of this overall amount B 358.6 billion in principal will come due in 5 years, B 56.31 billion in 3 years and the remainder of B 9 billion after 6 months (see Table A2.3).

25. In the case of interest payments, roughly B 27–30 billion per year will need to be covered. This includes B 27.4 billion of interest repayments annually paid to depositors that would swap into KTT or KTB notes at an assumed interest rate of 12 percent per year. In addition, there would be B 3.9 billion in interest repayments made annually to creditors given an interest rate of 2 percent per year. Total cumulative debt service associated with all NEPs will amount to B 561.19 billion over the five-year period under the assumption of maximum utilization of the program.

26. It can be assumed that the 58 suspended finance companies will not be able to immediately service the loans they have obtained from the FIDF for liquidity support of B 416 billion. FIDF will most likely have to roll over the debt service associated with this support. Assuming that the cost of rolling over these liabilities will be 20 percent per year—close to the RP rate—debt service costs per year would amount to an additional B 83 billion.

27. Note that the obligations of the FIDF outlined above (both actual and expected) in respect to the NEPs and existing solvency support could be as large as B 977 billion in stock terms or 19.8 percent of gross domestic product (GDP). This estimate is an extreme value, since it assumes that there is maximum utilization of both NEPs and that all existing FIDF exposures previously made become solvency support. Hence, the cumulative interest cost on the FIDF debt issued to finance the liquidity support granted (B 84 billion per year for 5 years) is added to total debt service for the NEPs of about B 561 billion. The final cost to the FIDF and the government at large will be dependent on the results of the asset disposition process.

TABLE A2.2: SIZE DISTRIBUTION OF CLAIMS AND OBLIGATIONS OF THE FIDF: SUSPENDED FINANCE COMPANIES (JUNE 1997)

	16 companies	42 companies
Size distribution of claims (percent)		
Below B 1 million	3	2
B 1 million to B 10 million	9	14
Above B 10 million	88	84
Obligations of FIDF	In billions of Baht	In billions of Baht
1. Note exchange (depositors)	61	167.7
2. Note exchange (eligible creditors)	--	193.4
3. Subtotal: NEPs	61	361.1
4. FIDF liquidity support	196.5	219.5
of which avaled deposits /a	21	29

/a These are deposits issued by finance companies that were guaranteed by the FIDF.

Source: BOT.

TABLE A2.3. ESTIMATED ANNUAL FINANCING COSTS NOTE EXCHANGE PROGRAM
(B billion)

	1997	1998	1999	2000	2001	Cumulative total
Principal repayments	-	9.1	56.31	-	358.6	424.01
Interest repayments	31.26	31.26	27.06	23.8	23.8	143.1
Total Principal and Interest	**31.26**	**40.36**	**83.37**	**23.8**	**382.4**	**561.19**

Note: Under the assumption of maximum utilization of all note swap programs.

Source: BOT and Bank-IMF staff estimates.

ATTACHMENT 1: DEFINITION OF ELIGIBLE DEPOSITORS AND CREDITORS

1. With respect to the finance companies suspended on June 27, 1997,

(a) "Depositor" shall mean a natural or juristic person, both domestic and foreign, who hold a promissory note, or a natural person who is the original holder of a negotiable certificate of deposit.

"Depositor" shall **not** mean

- Persons and entities who acted in bad faith in obtaining a promissory note or other instrument, or who obtained a promissory note or other instrument outside of the normal course of business, unless such person or entity can establish good faith;
- Holders of subordinated debenture or convertible debentures;
- Affiliates and subsidiaries of such financial institutions;
- Directors, executive officers, and related parties, as defined by the Law on the Undertaking of Finance Business, Securities Business, and Credit Foncier Business, of the finance company or a subsidiary or affiliate of the finance company, unless such person can prove good faith;
- Debtors of any such finance company;
- Any person who has filed suit against the applicable finance company.
- Creditors who hold as collateral assets of the finance company; and

(b) "Creditor" shall mean all other creditors and obligees of such a finance company.

2. With respect to the finance companies suspended on August 5, 1997:

(a) "Depositor" shall mean the holders, both domestic and foreign, of promissory notes and negotiable certificates of deposit. Such a holder shall include a juristic person, such as an asset pool, ministry, bureau, department, partnership, limited company, association, foundation, securities exchange, thrift or credit cooperative, or registered provident fund.

(b) "Creditor" shall mean the holders, both domestic and foreign, of bills of exchange, loan contracts or similar commercial paper and any holders of contingent claims including: avals, discount notes endorsed with recourse, and financial guarantees mature and not mature.

The term shall **not** include any other obligees of such institution.

- Persons and entities who acted in bad faith in obtaining a promissory note or other instrument, or who obtained a claim or other instrument outside of the normal course of business, unless such person or entity can establish good faith;
- Holders of subordinated debentures or mandatory subordinated convertible debentures;
- Affiliates and subsidiaries of such financial institutions unless such entity can prove good faith;
- Directors, executive officers, and related parties, as defined by the Law on the Undertaking of Finance Business, Securities Business, and Credit Foncier Business, of the finance company or a subsidiary or affiliate of the finance company, unless such person can prove good faith;
- Debtor of any such finance company to the extent of the debt; and
- Creditors who hold as collateral assets of the finance company.

ANNEX 3: SHORT-TERM PLAN FOR STRENGTHENING SPERVISION OF THE REMAINING FINANCE COMPANIES

The downturn in the economic sectors that finance companies are most exposed to—real estate, hire-purchase, and securities—makes it is critical for the Bank of Thailand to closely supervise and examine the remaining nonsuspended **finance companies**. Projections conducted by the World Bank team highlight the need for additional capital in the case of between 20 and 28 finance companies within the remaining 33 nonsuspended companies, depending on assumptions. The additional capital required would amount to B 13 to 36 billion (see outcomes and assumptions of the projections used in Annex 1). Estimations conducted later by BOT come up with 9 to 19 finance companies needing additional capital, for a total of B 4 billion (based on loan classification rules as of end 1997) to B 27 billion (based on loan classification loans to be issued in March 1998).

Irrespective of the amount of capital needed that may only be estimated today, the strengthening of finance company supervision will clearly result in a recapitalization process that can be expected to be lengthy and difficult.

BOT should take the following immediate steps to identify and address the weak finance companies:

1. A careful analysis of all 33 remaining finance companies should be conducted so as to stratify these finance companies and identify the weak ones. Criteria to be applied will include shortfalls in provisions to meet with existing and future loan provisioning requirements, noncompliance with the existing statutory capital adequacy guidelines (after deduction of any shortfalls in provisions and accrued interests), liquidity support by the FIDF (also, noncompliance with minimum liquid asset requirements, level and maturity of foreign borrowings, and overall maturity mismatch), and financial condition of shareholders.

This analysis should be based mainly on prudential information collected for off-site supervision purposes. In addition, standard on-site examinations or diagnostic reviews (see below) could be conducted to get more reliable information.

The purpose of this analysis is to identify (a) finance companies that need fresh capital and (b) the finance companies whose financial condition and/or mismanagement requires strong supervisory measures, including BOT or FIDF interventions. Annex 2 describes the outcomes of the stratification undertaken in November 1997 by BOT.

2. All finance companies will be required to demonstrate to BOT their short-term ability to absorb losses already incurred, and to comply with the statutory capital adequacy requirement (taking into consideration the new rules for loan classification and interest

accrual already announced and to be implemented by year-end). In addition, BOT will have to assess the medium-term ability of finance companies to meet the stricter rules on loan classification and provisioning to be issued at the latest on March 31, 1998, and fully implemented by year-end 2000. Discussion will be conducted by BOT with each of the finance companies in order to determine the level of appropriate capital needed. This calculation should incorporate the writing off losses already incurred, as well as complying with the more conservative rules on loan classification and provisioning to be progressively implemented by BOT, and the existing capital requirement.

3. Finance companies identified as undercapitalized through off-site screening or diagnostic reviews will enter into a Memorandum of Understanding (MOU) with BOT by the end of December 1997, demonstrating how the institution plans to raise its capital base to a level deemed appropriate by BOT. Under this agreement, existing owners would be given more time to increase capital, provided that they can provide BOT with reliable, legally binding plans for recapitalization. Until capital is raised, institutions might be required to limit or reduce some of their activities, cease the payment of dividends, or develop concrete plans to issue new capital, including the search for an outside investor. Institutions should be required to provide BOT with specific details regarding their strategy (e.g., whom they plan to hire to raise capital, and institutions they will approach as partners), along with specific dates and performance measures.

The planned increase in capital should be injected as quickly as possible and no later than the first quarter of 1998, so that the finance company complies with prevailing loan provisioning rules as of early 1998. As far as possible, fresh capital should permit finance companies not only to comply with mandatory capital requirement at the end of 1997, but also to head toward meeting stricter loan classification and provisioning requirements to be issued by March 31, 1998.

4. Diagnostic review of each of the weakest remaining 33 finance companies (as identified above) should be conducted by BOT examination teams with expert assistance. Over the next two to three months, such reviews should be programmed at least for all finance companies that will be entered into an MOU by the end of December 1997. These diagnostic reviews could be performed, as deemed appropriate by BOT, either before or after BOT signs the MOU.

These diagnostic reviews would be performed under specific terms of reference satisfactory to the Bank. They would focus on valuation of assets, with particular emphasis on large loans in high-risk sectors like real estate. This process will result in a more accurate assessment of additional provisions and new capital that are needed to restore finance company financial condition. Moreover, they would assess credit risk management procedures and internal control to ensure that presently impaired institutions will be better managed in the future.

Foreign consultants should assist the BOT examination teams in these diagnostic reviews. Thus, they will help BOT staff make an accurate assessment of impaired finance companies. In addition, expert assistance will provide the BOT staff with essential on-the-job training.

5. With respect to finance companies that are unsound and unsafe (according to above criteria) or unable to comply with agreed upon time bound actions under an MOU, BOT

must make clear that FIDF will intervene in these institutions under new power laid down in Emergency Decrees issued in October 1997. The directors and managers of an intervened-in finance company should be immediately dismissed, and replaced either by industry professionals or by BOT staff. After a thorough analysis of the finance company situation and problems, BOT should agree with the new management on actions. With respect to restoring the capital base of the finance company, losses should be written off against capital so that existing shareholders will bear the losses before any new investor comes in or before FIDF converts any liquidity support into new capital or subordinated loans. The impaired institution may be alternatively merged with another institution. If none of these solutions is effective, BOT might envision to orderly wind down the impaired institution.

ANNEX 4: LICENSING REQUIREMENT FOR BANKS AND FINANCE COMPANIES

General licensing requirements are laid down in the Banking Act and the Finance Company Act. The licensing authority has undertaken to complement these general requirements by more specific guidelines in certain areas of particular importance. Thus, BOT has issued guidelines on the "fit and proper" conditions to be met by shareholders and/or managers for merged finance companies and banks that may result from the resolution process of the 58 suspended finance companies. In addition, BOT intends to issue a circular by the end of December 1997 to request specific information to conduct a more accurate and credible assessment of the "fit and proper" conditions of new managers and directors of existing finance companies.

Beyond these very useful improvements in specific areas, all existing legal and regulatory requirements that deal with licensing requirements need to be reviewed to ensure that (a) MOF and BOT have a full range of powers to discharge their licensing responsibilities, and (b) comprehensive guidelines exist so that BOT staff can conduct effective licensing procedures.

The objective is to propose legal amendments and develop regulatory texts that are needed to lay down **a comprehensive and single set of licensing requirements and procedures for both banks and finance companies in line with international standards**. The set of legal **licensing requirements** should empower MOF and BOT to (a) ensure that comprehensive licensing requirements are met before granting a license for new institutions, (b) approve any substantial change in the capital structure or the management of licensed institutions, and (c) ensure that comprehensive licensing requirements are met before rechartering existing institutions after merger. The set of **licensing procedures** should focus, inter alia, on (a) "fit and proper" test for owners, directors and senior managers, (b) verification of minimum capital requirements, (c) assessment of the source and quality of capital, (d) assessment of the future viability of the entity to be licensed, and (e) assessment of the transparency of the financial group structure when the entity to be licensed has capital relationships with other licensed institutions.

1. Granting a License to a New Institution

BOT and MOF may face different situations. Basically, the institution to be licensed may be a single financial institution whose shares are held by companies or individuals who do not hold directly or indirectly the control in other Thai financial institutions. In other cases, the institution to be licensed may be included in a Thai financial group or conglomerate. In such a case, the licensing process must take into consideration both the single entity and the group of related entities. (Attachment 1 provides a detailed list of information to be provided.)

Licensing of Single Institutions. The main requirements for granting a license are usually minimum capital requirement, quality of shareholders, quality of senior managers and directors, and a convincing business plan. Compliance with strict requirements should be checked and would be the sole responsibility of BOT in coordination with MOF.

1. Minimum capital requirement: Generally the capital of a new bank must be sufficiently large to absorb the losses of the bank during the initial period of its operation, and still be sufficient to provide an adequate base to support its level of operations. Therefore, a substantial minimum capital requirement should be required for commercial banks and finance companies.

2. *Quality of shareholders*: The "qualifying shareholders" (i.e., founders who intend to acquire at least 10 percent to exert voting control in the institution to be licensed) must have the capacity to oversee the affairs of the institution. They need not necessarily have prior banking experience, but they should demonstrate good business sense and be able to serve as the source of direction and deliberation for the management of the bank. However, for the rehabilitation of specific entities, it may be requested that shareholders be able to provide the financial institution with professional expertise in finance or banking businesses.

The "qualifying shareholders" must be in a position to provide a real capital base for the financial institution. It is therefore necessary to assess their financial condition and their business affiliation. They must have a strong financial standing so as to be able to provide additional capital to the institution. The exact source of capital must be scrutinized. For example, the shares purchased in the financial institution should not be funded with borrowed money.

The shareholders must be of great integrity. Their motivation for establishing a financial institution should be assessed very carefully. Particular attention must be paid to the links between prospective shareholders and their interests in related nonfinancial companies. It will be important to prevent the shareholders from establishing a financial institution so that it can be a source of loans for related companies or affiliates.

When controlling shareholders are foreign financial institutions, it is of great importance to request information from the home supervisors and to ensure the scope of their supervision (consolidated supervision or not).

3. *Quality of managers and directors*: Senior managers (particularly the chief executive officer, the chief financial officer, and the head of the credit department) must be skilled professionals with at least 10 years of experience in the finance or banking businesses. Their professional record must show their administrative, organizational, and decisionmaking skills, as well as demonstrate reliability and sound character. In particular, they must be of great integrity.

The designation of the board of directors should ensure that nonexecutive directors represent at least two thirds of all directors. In addition, at least three nonexecutive directors should be individuals without any relationships to the main shareholders. These directors might be chosen from among representatives of foreign companies, external auditors, accountants, lawyers, and finance professors. All directors must be of great integrity.

4. Quality of the business plan: This will be developed through further consultations with the government.

Licensing of an institution that will be part of a financial group or conglomerate. The position of an institution to be licensed must be known in relation to other companies owned by its shareholders. Particularly, it will be of great importance to know whether the new entity will be part of a financial group (i.e., including other financial institutions, such as finance companies or commercial banks) or a financial conglomerate (i.e., including security or insurance businesses).

In addition to the above-mentioned requirements for a single entity, specific diligence should be performed when the institution is part of a group. First, in complex structures, particularly those where a commercial bank and other nonfinancial companies are linked and are not licensed or regulated themselves, the identification of the real shareholders and the review of their soundness should be performed with great care and via special procedures. As a general requirement, the overall structure of the group should be disclosed to the supervisors who should make sure that they have an adequate knowledge of the group with a particular emphasis on nonregulated entities.

Second, a consolidated assessment of the capital adequacy of a financial group should be performed. Ideally, consolidated financial statements, including statements from all financial institutions within the group, that are based on international accounting standards should be provided. Based on this information, the capital adequacy of the whole group should be assessed; the consolidated capital ratio should be in compliance with regulatory requirements. In cases where consolidated financial statements cannot be provided in time, as well as for financial conglomerates (which include entities such as banks or insurance that are subject to very different capital requirements), a strict review should ensure that no double gearing takes place when complying with prudential capital requirements.[1]

2. Approving Substantial Changes within the Lifetime of the Licensed Institution

The role and responsibilities of licensing authorities (MOF and BOT) should not end after a new license has been granted. **They must be empowered to ensure that conditions required before granting the new license are maintained overtime.**

Therefore, licensed institutions should be required to obtain prior approval from the licensing authorities before specific changes such as (a) acquisition by an existing shareholder or a new investor of 10 percent or more of the institution capital; (b) appointment of new directors and senior managers; (c) changes in the name of the licensed institution; (d) very substantial changes in the activities performed by the institution; and (e) opening of new branches by the licensed institution (the approval may cover all branches or only branches located overseas).

Similar procedures to those used during the licensing process should be used by MOF and BOT before approving the above-mentioned modifications.

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[1] Double gearing means that same prudential capital is used twice for complying with different prudential requirements.

3. Authorizing Mergers of Existing Institutions

When a financial institution is willing to merge with one or several financial institutions, the supervisory authorities have to approve the merger. Basically, the same prudential assessment, using the criteria noted above, should be conducted by BOT. Given the fact that the institutions involved in the merger have already been licensed, however, this assessment should be facilitated. Normally, shareholders and managers should already be known and satisfactory to the supervisory authority. Nevertheless, given the fact that the licensing of financial institutions may have been pretty lax in Thailand in the past, it might be wise to adopt the same standards that are applied to new institutions (Attachment 2 provides a detailed list of information to be provided by merging institutions.)

Particular attention should be paid to mergers involving several finance companies. Such a merger is likely to be aimed at getting a bank license for the new entity. It should be made clear that the asset size will not be a decisive criterion to grant a bank license. On the contrary, quality of management, efficiency of internal control procedures, and reliability of the business plan should be stressed as the main criteria for a finance company to apply for a bank license.

Attachment 3 provides information on the licensing process and timing.

ATTACHMENT 1: APPLICATION FOR A FINANCIAL INSTITUTION LICENSE

3. The application for a license must contain the following information:

(a) name of the bank or the finance company for which a license is being requested;

(b) legal status of the bank;

(c) address of the institution's headquarters;

(d) date of the application;

(e) capital (amount of capital subscribed and paid in by the founders, number of shares, value of each share);

(f) general information on the "founders" (persons who intend to acquire at least 1 percent of the voting control in the financial institution to be licensed), including full name, age, occupation, nationality and legal status (individual or legal entity);

(g) number and value of shares held by each "founder";

(h) legal status of each "founder" that is a legal entity, its nominal and paid-in capital, establishment license number, commercial registry number, names of the members and chairman of the board of directors and name of the chief executive officer; and

(i) name(s) of person(s) authorized by the "founders" to pursue the license application.

4. The following should be attached to the license application:

(a) a certificate stating that a "founder," if a legal entity, has been duly licensed and registered in accordance with the law (with an authorized translation in Thai for foreign corporations);

(b) a draft of the financial institution's by-laws;

(c) names of envisaged directors (including the chairman) and senior managers (chief executive officer, chief financial officer, head of credit department);

(d) a draft of the organizational structure, and the management and decisionmaking procedures of the financial institution with a description of administrative procedures and proposed methods of establishing an internal control system;

(e) a clear definition of the type and scope of activities anticipated for the financial institution to be licensed;

(f) a document including the exact definition of the planned area of operation;

(g) a medium-term plan, for the first three years, and the plans to provide the personnel and material conditions required for the operation;

(h) a certificate evidencing payment into an account with BOT for the full amount of the required registered capital of the institution to be established; and

(i) in the case of applicants located abroad, submission to the jurisdiction of the courts of Thailand and the designation for an agent for service of process.

5. If there is a person among the "founders" who intends to acquire at least 10 percent of the voting control in the financial institution to be established ("qualifying holder"), the following should be provided in addition to the information noted above:

(a) information regarding control of the "qualifying holder," professional experience, areas of specialization, and the banks with which they do business;

(b) a certificate or declaration that the amount required for the payment of registered capital results from a legal income of the "qualifying holder";

(c) the balance sheets and income statements of any "qualifying holder" for the previous three calendars years, certified by a reputable auditor;

(d) a declaration about the liabilities of any "qualifying holder" as contingent or future liabilities according to international accounting standards;

(e) in the case of persons who as a group will constitute a "qualifying holder," a detailed description of the capital structure of such a group, as well as the consolidated balance sheet and income statement of the group for the previous year, provided that the group was required to prepare consolidated statements; and

(f) a declaration of the persons participating in the application, stating that each of such persons agrees to give the BOT access to all data necessary for the issue of the license.

6. Specific information to be provided when a "qualifying holder" is a foreign bank:

(a) location of its headquarters and subsidiaries in home country and abroad;

(b) nominal and paid-in capital;

(c) date of issue of license to operate in home country and starting date of operations;

(d) activities of the bank;

(e) documents and contract establishing the bank (in original language and in Thai);

(f) chairman and members of the board of directors of the bank, and persons authorized to represent the bank; and

(g) certificate issued by the competent bank supervisory authority in the home country of the bank stating the type of activities in which the bank is engaged, that its level of performance is not below A+ (or an equivalent supervisory rating) and that its capital adequacy ratio is not less than 10 percent of risk-adjusted assets as defined by the Basle Committee for Bank Supervision.

ATTACHMENT 2: APPLICATION FOR AUTHORIZING A MERGER

1. The application for a merger must contain the following information:

(a) name(s) of the suspended financial institution(s) that is proposed for merger into a running financial institution;

(b) name of the running financial institution into which the merger is proposed;

(c) reasons and justification for the merger;

(d) period of the proposed merger;

(e) general information on the "founders" (persons who intend to acquire at least 1 percent of the voting control in the financial institution to be licensed), including full name, age, occupation, nationality, and legal status (individual or legal entity);

(f) number and value of shares held by each "founder";

(g) legal status of each "founder" that is a legal entity, its nominal and paid-in capital, establishment license number, commercial registry number, names of the members and chairman of the board of directors, and name of the chief executive officer; and

(h) name(s) of person(s) authorized by the "founders" to pursue the license application.

2. The following documents must be attached to an application for a merger:

(a) results of the due diligence process performed in the suspended financial institution(s);

(b) financial position showing the rights and obligations of the financial institution into which the merger is proposed;

(c) the latest financial position of both entities corresponding to the period during which the merger is proposed;

(d) results of the consolidated financial position (pro forma balance sheet of the combined entities);

(e) the merger plan;

(f) proposal by the extraordinary general assembly of the financial institution to be merged;

(g) decision of the extraordinary general assembly on the financial institution to be merged;

(h) a certificate stating that a "founder," if a legal entity, has been duly licensed and registered in accordance with the law (with an authorized translation in Thai for foreign corporations);

(i) a draft of the merged financial institution's by-laws;

(j) names of envisaged directors (including the chairman) and senior managers (chief executive officer, chief financial officer, head of the credit department);

(k) a draft of the organizational structure, and management and decisionmaking procedures of the financial institution with a description of administrative procedures and proposed methods of establishing an internal control system;

(l) a clear definition of the type and scope of activities anticipated for the financial institution to be licensed;

(m) a document including the exact definition of the planned area of operation;

(n) a medium-term plan, for the first three years, and the plans to provide the personnel and material conditions required for the operation; and

(o) a certificate evidencing payment into an account with BOT for the full amount of the required registered capital of the institution to be established.

3. If there is a person among the "founders" who intends to acquire at least 10 percent of the voting control in the merged financial institution ("qualifying holder"), the same information as that requested in case of a new license (see Attachment 1) should be provided in addition to the information noted above.

ATTACHMENT 3: LICENSING PROCESS

1. Granting of license:

a. Decision criteria:

During the licensing process, BOT shall thoroughly assess the available documents and information related to the application. BOT may request additional information, and shall grant or decide not to grant the requested license based on its judgments of:

(a) the institution's management;

(b) the financial institution's future earning prospects;

(c) the adequacy of its capital structure;

(d) the best interest of the Thai economy;

(e) the likelihood that the institution will be operated in a safe and sound manner;

(f) the compliance with legal and regulatory provisions; and

(g) the future viability of the financial institution to be established (assessment of the business plan).

With respect to the chief executive officer, BOT will ensure that the proposed chief executive officer:

(a) possesses skills that complement the directors' skills and that fit the needs of the new financial institution;

(b) is thoroughly familiar with the proposed new financial institution's plan;

(c) has managed a financial institution successfully or has successful experience as an officer in an area relevant to the proposed financial institution strategic business plan; and

(d) has executive experience in operations or administration.

b. Background investigations:

BOT will ensure that the qualifying holders, directors, and the senior managers have the experience, competence, and willingness to operate the financial institution in a safe, sound, and legal manner. Qualifying holders, directors, and senior managers whose previous financial experience is tied to failed or problem financial institutions will be carefully scrutinized by BOT to determine their ability to safely and adequately carry out their duties.

BOT will conduct background checks on candidates for the position of directors (including chairman) and senior managers, as well as qualifying holders. BOT will scrutinize the competence, experience, integrity, and financial ability of these persons. BOT will make an independent determination of the accuracy and completeness of any information submitted in conjunction with those persons. Background checks are to be specified.

If a license application is incomplete, BOT shall instruct the applicant, in writing, and shall indicate the applicable deadline by which to provide the missing information.

BOT may set such fees as it may determine appropriate for each element of the licensing process.

2. Rejecting a license:

BOT may recommend rejecting any application if:

(a) the applicant fails to provide the required information;

(b) the applicant provides deceptive or false data in the licensing procedure;

(c) the financial institution to be established does not meet the legal and regulatory requirements;

(d) on the basis of the available data, information and documents, in the judgment of the BOT, the applicant does not have sufficient capital, management or other required resources to safely perform the proposed function; and

(e) as otherwise permitted by the Banking Act or the Finance Company Act.

3. Timing:

BOT shall submit to MOF its recommendation regarding the license application within a period of 60–90 days from the date of submission of the application. This recommendation shall be justified.

Within one week, MOF shall endorse the recommendation of BOT or may instruct BOT to reexamine the application or to submit additional information. In the latter case, BOT shall submit another recommendation within two weeks; MOF shall approve or reject the application within one week.

The applicants shall be notified in writing of the approval or rejection of their application within a period of one week after the MOF decision. If the application is rejected, justification must be provided to the applicants.

ANNEX 5: MAIN PRUDENTIAL REGULATIONS FOR COMMERCIAL BANKS AND FINANCE COMPANIES

Fields	Commercial Banks	Finance companies
1. Loan quality		
Loan classification	• Loans that have not been serviced by borrowers are classified. • Loans are classified in three categories (substandard, doubtful, and loss) according three criteria : past due period (6 or 12 months), value of collateral, and repayment capacity of the borrower.	Same classification.
Loan provisioning	• Minimum provisioning requirement of 15% for substandard loans since June 1997. • Requirement of 100% provisioning of unsecured loan value for doubtful (since 1995). • Loss loans (principal and interest) must be written off.	• Minimum provisioning requirement of 20% for substandard loans since June 1997. • Same rules for doubtful and loss loans.
Income recognition	• Since July 1995, no interest accrued for unsecured loans past due for more than 6 months; limit extended to 12 months for secured loans (principal and interest). • From January 1998, the limit will be 6 months irrespective of the collateral.	Same rules as for banks.
2. Prudential rules		
Capital ratio	• 8.5% for domestic banks since 1996 (with at least 6% for Tier 1). • 6.75% (or 7.5% ?) for foreign banks. • Bangkok International Banking Facilities (BIBFs) are not required to maintain the capital adequacy ratio. • Drawbacks in calculation methodology [nondeduction of shortfall in provisions and accrued interests for nonperforming loans (NPLs)].	• 7.5% since January 1997 (with at least 5% for Tier 1) against 7% before. • 8% from January 1998 (with at least 5.5% for Tier 1). • Same calculation methodology.

Fields	Commercial Banks	Finance companies
Single lending limit	• Risk exposure (including credit, contingent liabilities, investment, debt underwriting, financial derivatives) on a single counterpart must not exceed 25% of banks' Tier 1 capital (the definition was broadened in July 1996). • Single counterpart includes an individual or a company and its affiliates (defined as shareholding exceeding 30%).	• Credits and security investments on a single counterpart must not exceed 25% of finance companies' Tier 1 capital funds. • Contingent liabilities on a single counterpart must not exceed 25% of finance companies' Tier 1 capital funds. • Total risk exposure on a single counterpart (credits, security investment and contingent liabilities) must not exceed 35% of finance companies' Tier 1 capital funds. • Same definition of a counterpart.
Investment limit	• Commercial banks cannot hold more than 10% of the shares of a company (including financial institutions). • Commercial banks cannot hold more than 20% of their capital funds in company shares (debt instruments are excluded).	• Finance companies cannot hold more than 10% of the shares of a company (including financial institutions). • Finance companies cannot hold more than 60% of their capital funds in company shares.
Insider lending	• Commercial banks are not allowed to grant any credit or contingent liability to their directors and affiliates (spouse, minor children, and professional partners). • Lending to a company with common director or senior managers must be strictly collateralized (such as government bond). • No specific limit for shareholders.	• Same rules for the directors. • Same rule for the lending to a company with common director or senior managers. • No specific rules for the shareholders.
Liquid assets requirement	• Domestic banks must hold 6% (7% until September 1997) of their deposits in liquid assets; at least 2% of these 6% must be in the form of deposits with the BOT. • Domestic banks and BIBFs must hold 6% (7% in between July 1996 and September 1997) of their short-term foreign borrowings (with less than 1 year maturity) in the form of deposits with the BOT. • Foreign branches are subject to the same requirements.	• Finance companies must hold 6% (7% until September 1997) of their domestic borrowings (deposits) and long-term foreign borrowings in liquid assets; at least 0.5% of these 6% must be in the form of deposits with the BOT. • Finance companies must hold 6% (7% in between July 1996 and September 1997) of their short-term foreign borrowings in the forms of deposits with the BOT.

Fields	Commercial Banks	Finance companies
Net foreign exchange position limit	• Net long foreign exchange position must not exceed 20% of Tier 1 capital. • Net short foreign exchange position must not exceed 15% of Tier 1 capital. • The net open position includes all types of exposures, including spot and forward positions, as well as currency derivatives. • In October 1995, the calculation method was revised: foreign currency-denominated loans granted to high-risk activities and past-due loans are totally or partially excluded from foreign assets (unless fully hedged against losses).	• Finance companies are not authorized to perform any foreign exchange business (this does not include borrowing and lending in foreign currency). • Since May 1996, large and sound finance companies (total assets over B 20 billion and Tier 1 capital of B 2 billion) are permitted to apply to the BOT for foreign exchange business operations (trade financing, deposits and lending in foreign currencies for foreign exchange trading). • Net long foreign exchange position must not exceed 25% of Tier 1 capital. • Net short foreign exchange position must not exceed 20% of Tier 1 capital.
3. Activity limit		
Limit on hire-purchase loans	Banks are not authorized to grant hire-purchase loans.	
Minimum loan disbursement for certain BIBF operations	Since April 1995, the minimum loan disbursement made for out-in lending operations was increased from $500,000 to $2 million equivalent (the objective was to ensure that loans are granted to large size business, able to manage the foreign exchange risk.	
Loan-to-deposit ratio	• Since July 1995, domestic banks whose loan-to-deposit ratios are above industry average are required to cap their growth; they are also required to specify their targets to lower the ratio over time. • Later ? same approach for foreign branches; but higher loan-to-deposit ratios than local banks are accepted.	• The finance companies do not collect deposits from the public. • However, in the same time as foreign branches, same capping was adopted for finance companies; but higher loan-to-deposit ratios than local banks are accepted.
Credit plan	• Since 1990, domestic banks are required to submit to the BOT their credit expansion and targets with respect to both total credit growth and sector allocation of credit. • Since 1995, credit plans are required to off shore banks for domestic lending.	Since 1995, credit plan are required from large finance companies (total assets exceeding B 20 billion).

ANNEX 6: STATUS OF BANK GROUP OPERATIONS IN THAILAND

IBRD Loans and IDA Credits in the Operations Portfolio

Project ID	Loan or Credit No.	Fiscal year	Borrower	Purpose	Original amount in $ million: IBRD	IDA	Canceled	Undisb.	Difference between expected and actual disbursements /a: Orig.	Frm Rev'd	Last ARPP supervision rating /b: Dev Obj	Imp Prog
Number of Closed Loans/Credits: *106*												
Acting Loans												
TH-PE-4787	IBRD 34460	1992	Kingdom of Thailand	H'way IV	177.50	0.00	0.00	23.94	21.90	0.00	HS	S
TH-PE-4772	IBRD 34040	1992	Prov. Electricity Authority	Distrib. Syst. Upgrading	40.00	0.00	0.00	10.58	10.58	7.01	S	S
TH-PE-4796	IBRD 35980	1993	Metro Elec Authority	Distrib. Sys & Egy E	109.00	0.00	0.00	22.09	26.19	-9.23	S	S
TH-PE-4802	IBRD 38890	1995	Bangchak Petroleum PCL	Clean Fuels & EA Qua	90.00	0.00	0.00	90.00	49.67	0.00	S	S
TH-PE-4799	IBRD 3884A	1995	EGAT	Lam Takhong Pump Sto	70.47	0.00	0.00	66.66	15.81	0.00	S	S
TH-PE-4797	IBRD 37990	1995	Petroleum Authority	Second Gas Transmiss	155.00	0.00	42.58	2.00	44.58	0.00	S	S
TH-PE-4801	IBRD 37980	1995	Prov Elec Authority	Distribut.System Rei	50.00	0.00	0.00	9.29	5.59	0.00	S	S
TH-PE-4803	IBRD 37970	1995	RTG	Land Titling III	118.10	0.00	0.00	75.13	21.16	0.00	S	S
TH-PE-4793	IBRD 40530	1996	Govt of Thailand	Technical Education	31.60	0.00	0.00	31.60	6.00	0.00	S	S
TH-PE-4791	IBRD 40520	1996	Govt of Thailand	Sec.Educ. Quality Im	81.90	0.00	0.00	81.90	12.67	0.00	S	S
TH-PE-4800	IBRD 39680	1996	Gov. of Thailand	Highways V	150.00	0.00	0.00	149.65	87.65	0.00	S	S
TH-PE-37086	IBRD 41990	1997	Metropolitan Electricity	Metropol'n Dist Rein	145.00	0.00	0.00	145.00	0.00	0.00	S	S
TH-PE-4805	IBRD 41600	1997	Govt of Thailand	Univer Sci & Eng.Edu	143.40	0.00	0.00	143.40	8.34	0.00	S	S
TH-PE-42268	IBRD 40670	1997	PEA	Distr Autom & Relia	100.00	0.00	0.00	99.89	22.64	0.00	S	S
TH-PE-53616	IBRD 42330	1998		Economic/Fin. TA	15.00	0.00	0.00	15.00	0.00	0.00		
Total					**1,476.97**	**0.00**	**42.58**	**966.13**	**332.78**	**-2.22**		

	Active Loans	Closed Loans	Total
Total Disbursed (IBRD and IDA):	468.25	4,049.71	4,517.96
of which has been repaid:	5.86	3,045.43	3,051.29
Total now held by IBRD and IDA:	1,428.53	1,004.56	2,433.09
Amount sold	0.00	196.73	196.73
Of which repaid:	0.00	196.73	196.73
Total Undisbursed:	966.13	0.00	966.13

/a Intended disbursements to date minus actual disbursements to date as projected at appraisal..

/b Following the FY94 Annual Review of Portfolio performance (ARPP), a letter based system was introduced (HS = highly Satisfactory, S = satisfactory, U = unsatisfactory, HU = highly unsatisfactory): see proposed Improvements in Project and Portfolio Performance Rating Methodology (SecM94-901), August 23, 1994.

Statement of IFC's Committed and Disbursed Portfolio, as of November 30, 1997

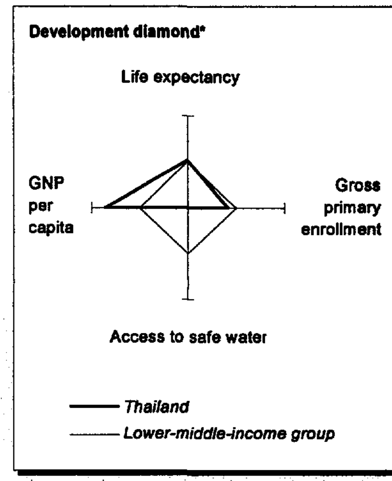
(In $ million)

		Committed				Disbursed			
FY Approval	Company	Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1979/81/84/87/91	Siam City	20.00	0.00	0.00	55.00	20.00	0.00	0.00	55.00
1984/91	SEAVI Thailand	0.00	1.50	0.00	0.00	0.00	1.50	0.00	0.00
1987/96	HMC Polymers	0.00	3.92	1.07	0.00	0.00	3.92	1.07	0.00
1988	Peroxythai	5.52	0.00	0.00	0.00	5.52	0.00	0.00	0.00
1989	SCB-CKAP	0.00	.41	0.00	0.00	0.00	.41	0.00	0.00
1989	SCB-Thai Baroda	0.00	.78	0.00	0.00	0.00	.78	0.00	0.00
1989	TFB-Ladprao	0.00	.33	0.00	0.00	0.00	.33	0.00	0.00
1989	TFB-Top Easy	0.00	.15	0.00	0.00	0.00	.15	0.00	0.00
1990	Siam Asahi	0.00	7.59	0.00	0.00	0.00	6.37	0.00	0.00
1990/95	Shin Ho Paper	13.75	7.54	0.00	21.13	13.75	7.54	0.00	21.13
1991	Bank of Asia-AL	17.50	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1991	BOA-Wing Fat	2.50	0.00	0.00	0.00	2.50	0.00	0.00	0.00
1991	VIM Thailand	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1991/93/96	Ayudhya Leasing	0.00	1.50	0.00	0.00	0.00	1.50	0.00	0.00
1992	Krung Thai IBJ	0.00	.35	0.00	0.00	0.00	.35	0.00	0.00
1993	Advance Agro	10.00	0.00	0.00	0.00	10.00	0.00	0.00	0.00
1993	Bumrungrad	25.00	2.24	0.00	32.00	25.00	2.24	0.00	32.00
1993	Central Hotel	0.00	13.95	0.00	0.00	0.00	13.95	0.00	0.00
1993	Samui Beach	2.79	0.00	0.00	4.64	2.79	0.00	0.00	4.64
1993	Star Petroleum	100.00	0.00	0.00	332.50	100.00	0.00	0.00	332.50
1993	Sukhontha	1.86	0.00	0.00	4.64	1.86	0.00	0.00	4.64
1993	TUNTEX	12.00	4.92	0.00	123.50	12.00	4.92	0.00	123.50
1994	Dhana Siam	26.00	0.00	0.00	4.00	26.00	0.00	0.00	4.00
1994	Vinythai	38.21	0.00	0.00	51.13	38.21	0.00	0.00	51.13
1995	Finance One	30.00	0.00	0.00	150.00	30.00	0.00	0.00	132.40
1995	Saha Farms	25.00	9.90	10.00	25.00	25.00	9.90	10.00	25.00
1995	UPOIC	0.00	1.08	0.00	0.00	0.00	1.08	0.00	0.00
1995/96	BTSC	50.00	9.83	9.83	0.00	0.00	9.83	9.83	0.00
1996	NFS	30.00	0.00	0.00	250.00	30.00	0.00	0.00	190.00
1996	Thai Petrochem	80.00	0.00	20.00	400.00	76.67	0.00	20.00	383.33
1997	Phatra Thanakit	23.53	0.00	0.00	0.00	11.76	0.00	0.00	0.00
	Total Portfolio	**513.66**	**65.99**	**40.90**	**1,453.54**	**431.06**	**64.77**	**40.90**	**1,359.27**

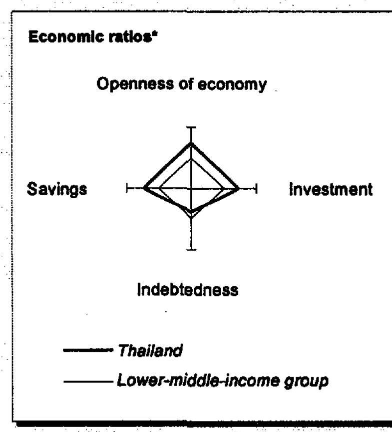
		Approvals Pending Commitment			
		Loan	Equity	Quasi	Partic
1996	ADLC II	10.00	0.00	0.00	15.00
1998	HMC RI II	0.00	1.84	0.00	0.00
1996	NFS	10.00	0.00	0.00	0.00
1997	PHATRA	0.00	0.00	0.00	13.04
1996	TUNTEX II	45.00	0.00	0.00	200.00
	Total Pending Commitment	**65.00**	**1.84**	**0.00**	**228.04**

ANNEX 7: THAILAND AT A GLANCE

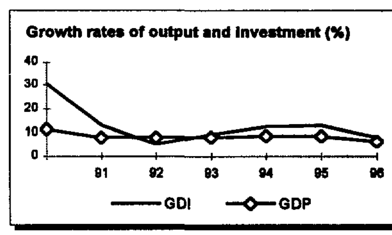
POVERTY and SOCIAL	Thailand	East Asia	Lower-middle-income
Population mid-1996 *(millions)*	58.7	1,726	1,125
GNP per capita 1996 *(US$)*	3,020	890	1,750
GNP 1996 *(billions US$)*	177.3	1,542	1,967
Average annual growth, 1990-96			
Population *(%)*	0.9	1.3	1.4
Labor force *(%)*	1.3	1.3	1.8
Most recent estimate *(latest year available since 1989)*			
Poverty: headcount index *(% of population)*	13	..	..
Urban population *(% of total population)*	20	31	56
Life expectancy at birth *(years)*	69	68	67
Infant mortality *(per 1,000 live births)*	35	40	41
Child malnutrition *(% of children under 5)*	13	..	..
Access to safe water *(% of population)*	81	49	..
Illiteracy *(% of population age 15+)*	6	17	..
Gross primary enrollment *(% of school-age population)*	87	117	104
Male	..	120	105
Female	..	116	101



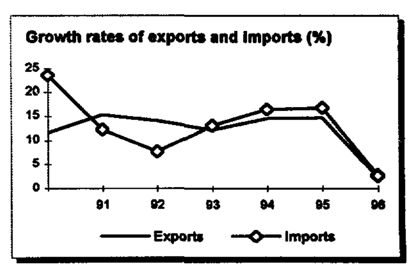
KEY ECONOMIC RATIOS and LONG-TERM TRENDS		1975	1985	1995	1996
GDP *(billions US$)*		14.9	38.9	168.4	185.0
Gross domestic investment/GDP		26.7	28.2	42.3	41.0
Exports of goods and services/GDP		18.4	23.2	41.7	38.6
Gross domestic savings/GDP		22.1	25.5	36.7	36.3
Gross national savings/GDP		22.7	24.2	34.3	33.1
Current account balance/GDP		-4.1	-4.0	-8.0	-7.9
Interest payments/GDP		0.7	2.3	2.5	2.4
Total debt/GDP		12.5	45.1	49.4	49.1
Total debt service/exports		12.0	31.9	11.6	11.5
Present value of debt/GDP		..	..	..	..
Present value of debt/exports		..	..	..	..
	1975-85	1986-96	1995	1996	1997-05
(average annual growth)					
GDP	6.5	9.6	8.7	6.4	..
GNP per capita	4.1	8.3	7.8	4.1	..
Exports of goods and services	9.5	15.9	14.8	2.4	..



STRUCTURE of the ECONOMY	1975	1985	1995	1996
(% of GDP)				
Agriculture	26.9	15.8	10.8	10.7
Industry	25.8	31.8	39.4	39.8
Manufacturing	18.7	21.9	28.5	28.6
Services	47.3	52.3	49.7	49.5
Private consumption	67.6	61.0	53.8	54.1
General government consumption	10.3	13.5	9.5	9.6
Imports of goods and services	23.0	25.9	47.3	43.2



	1975-85	1986-96	1995	1996
(average annual growth)				
Agriculture	4.1	*3.7*	3.2	3.0
Industry	7.9	*13.2*	11.3	7.7
Manufacturing	7.0	*13.6*	12.4	7.3
Services	6.7	*9.1*	7.7	6.0
Private consumption	5.2	8.2	8.3	6.2
General government consumption	9.1	5.1	0.8	4.5
Gross domestic investment	6.1	15.1	13.3	8.2
Imports of goods and services	6.2	17.8	16.9	2.8
Gross national product	6.3	9.4	8.4	5.4



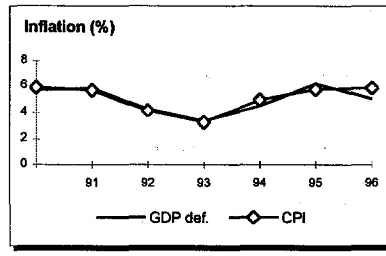
Note: 1996 data are preliminary estimates. Figures in italics are for years other than those specified.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

Thailand

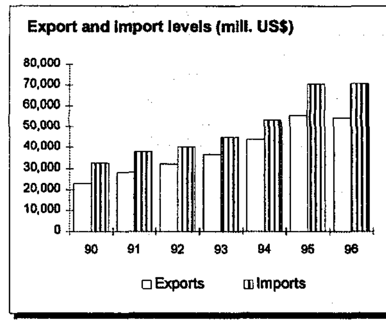
PRICES and GOVERNMENT FINANCE

	1975	1985	1995	1996
Domestic prices				
(% change)				
Consumer prices	5.3	2.5	5.8	5.9
Implicit GDP deflator	3.5	2.2	6.2	5.1
Government finance				
(% of GDP)				
Current revenue	..	15.2	18.8	19.1
Current budget balance	..	-0.6	8.0	8.5
Overall surplus/deficit	..	..	2.6	2.3



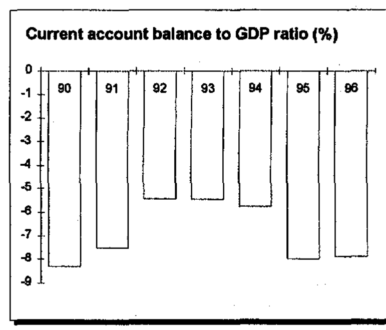
TRADE

	1975	1985	1995	1996
(millions US$)				
Total exports (fob)	..	7,120	55,735	54,675
Rice	..	829	1,928	2,012
Other food	..	..	4,312	4,239
Manufactures	..	2,920	46,445	45,653
Total imports (cif)	..	9,248	70,387	70,814
Food	..	348	2,025	2,234
Fuel and energy	..	2,696	4,620	6,203
Capital goods	..	2,598	31,950	33,494
Export price index *(1987=100)*	..	73	139	138
Import price index *(1987=100)*	..	72	154	153
Terms of trade *(1987=100)*	..	101	90	90



BALANCE of PAYMENTS

	1975	1985	1995	1996
(millions US$)				
Exports of goods and services	2,780	9,100	70,590	71,725
Imports of goods and services	3,478	10,160	82,169	83,617
Resource balance	-698	-1,060	-11,579	-11,892
Net income	11	-643	-2,114	-3,257
Net current transfers	80	165	487	780
Current account balance, before official capital transfers	-607	-1,537	-13,206	-14,369
Financing items (net)	555	1,620	19,954	16,066
Changes in net reserves	52	-82	-6,748	-1,697
Memo:				
Reserves including gold *(mill. US$)*	2,008	3,003	37,027	38,725
Conversion rate *(local/US$)*	20.4	27.2	24.9	25.3



EXTERNAL DEBT and RESOURCE FLOWS

	1975	1985	1995	1996
(millions US$)				
Total debt outstanding and disbursed	1,865	17,552	83,166	90,813
IBRD	270	2,202	1,805	1,607
IDA	4	105	102	100
Total debt service	357	3,263	8,608	8,666
IBRD	32	232	336	318
IDA	0	1	3	3
Composition of net resource flows				
Official grants	11	120	99	110
Official creditors	93	556	511	634
Private creditors	107	956	5,788	9,618
Foreign direct investment	22	163	2,068	2,900
Portfolio equity	0	44	2,154	1,551
World Bank program				
Commitments	95	113	190	250
Disbursements	44	285	146	138
Principal repayments	13	75	203	198
Net flows	31	210	-57	-60
Interest payments	20	158	136	122
Net transfers	12	51	-193	-183