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The Modern Genre of Infrastructural Law Reform: The Legal and Practical Realities - The Case of Banking Reform in Thailand

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THE MODERN *Genre* of Infrastructural Law Reform: The Legal and Practical Realities—The Case of Banking Reform in Thailand

*Joseph J. Norton**

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PRELUDE: TRIBUTE TO PROFESSOR JOSEPH W. McKNIGHT

JOSEPH W. McKnight was my first "connection" with our Law School. This came about through five very independent sources. First, was my Professor of Civil and Roman Law at the University of Edinburgh, Scotland in the late 1960s, who, when he learned my family had just moved to Dallas, strongly suggested I meet with Joe. Second, was a very well-known senior academic from Oxford, who said the same (Joe had been a Rhodes Scholar and had built a reputation as a common law historian as to its reception under American law). Third, was a senior Mexican legal scholar I met at the University of Michigan; apparently, Joe was well-known in Mexican academic legal circles.

Fourth, was when I first came to Dallas in 1972 to work at the Locke Purnell law firm, one of the oldest law firms in Texas. The senior partners at the firm spoke very highly of Joe. What they shared in common with Joe was their love of the law and of legal history. At that time, SMU had the largest private international and comparative collection West of the Mississippi and the Locke firm had the largest such collection of a law firm in the Southwest (including a complete set of all English and Commonwealth law reports). I soon came to realize that Joe was the key "academic operative" in building up the superb English and Commonwealth law and Mexican-Spanish law collections at SMU.

The fifth source was two of the young law associates at the Locke firm, with whom I started practice: both were SMU law alums. One now holds high national office after becoming president of the Locke firm and president of the Dallas and Texas Bars; the other is now a senior partner with a major international and Texas law firm. As we shared time together, it became very clear the deep, warm and humorous affection and respect they had for Joe. As my close colleague, Roy Anderson, so succinctly and aptly concluded at our faculty's 75th birthday celebration for Joe in spring of 2001, Joseph W. McKnight is "unique" and "a one of a kind."

So when I first met Professor McKnight informally in 1972 in the English and Commonwealth section of our library, I really was not sure what exactly to expect. But the person I met then became one of the main reasons I chose SMU as my lifelong "academic home." Not only was Joe both an internationally-respected Common Law and Civil Law scholar, he had helped make our library internationally-known. In addition, he was most highly respected as a Texas lawyer, being the leading expert in Texas family and community property laws. Even more significantly, he was genuinely loved by his students.

As another of my close colleagues (Bill Dorsaneo) noted at Joe's" 75th," Professor McKnight provided the model for young SMU law professors to aspire. In addition, in his own eccentric ways, he took a very nurturing interest in the young SMU Professors, including, now, the not-so-young such as Professor Emeritus Wingo and Professors Anderson, Bridge, Dorsaneo, Lisher, Schuman, Winship and myself, as well as the now young (or younger) faculty members such as Professors Hanna, Mayo and Pryor. For myself, I owe very much to Professor Joseph Webb McKnight—personally and academically. Thank you so very much, Joe!

In greatly wanting to contribute a piece to this Symposium, I had initial difficulty in where to start. As "brought home" to me at the international and comparative law conference hosted by SMU in spring of 2001 to honor Professor McKnight, Joe's legal contributions over the years are indeed most significant and varied. However, in recently chatting with Joe's co-senior faculty member, Professor Alan Bromberg, I came to realize that though Joe is indeed "one-off" (as is Alan), he has been quite *traditional* in terms of the type of legal academic our former Dean Storey sought: an academic with an international/national stature, who was recognized as the best in one's area of expertise as to Texas law and practice and who would make substantial contributions to SMU and its law center and to the advancement of law, judicial and institutional reform, whether through one's writings, influence on the Bar or in actually drafting of laws and rules in one's area (be it state, federal or international).[1] In reflecting on this, and particularly on this later aspect of legal, institutional and judicial reform, I concluded that a piece on my recent experiences with banking law reform in Thailand might be appropriate.

In engaging in this law reform project in Thailand, one of the modern *genre* of law reform efforts largely shaped by international institutions and largely based on so-called "international standards and best practices," I soon came to realize that the "organic approach" to law reform taken by Professor McKnight and some of his contemporaries required considerable sensitivity to the related historical, cultural, and societal

1. In addition to Professors Bromberg and McKnight, names such as Professors Masterson, Ray, Thomas, Galvin, Smith, Kennedy, Carl, Steele and MacLean also come to mind; in the current SMU generation, individuals such as Professors Dorsaneo, Winship, Anderson, Schuman, Hanna and Mayo, as well as our current Dean Attanasio and Senior Associate Dean Steinberg.

strands within the particular jurisdiction.[2] Without incorporating such a perspective (both retrospectively and prospectively), I have become convinced that our modern global economic law reform efforts will fail the same way as many of the foreign law *implants* of the 1950s and 1960s failed.[3]

I. INTRODUCTION

Over the past two decades, the international financial community has been in the process of devising a "consensus" on standards and codes of conduct and a related loose international institutional framework to achieve financial stability and to develop robust financial systems on a global basis. This consensus takes its form from the pronouncement of such bodies as the Basel Committee on Banking Supervision, the International Accounting Standards Committee ("IASC"), the International Organisation of Securities Commissions ("IOSCO"), the International Association of Insurance Supervisors ("IAIS"), the Joint Forum on Financial Conglomerates, and the Financial Stability Forum ("FSF").[4] However, even the diligent application of these standards and codes does not necessarily achieve an optimal outcome for reforming transitional and emerging economies. For example, the former World Bank Chief Economist, Joseph Stiglitz, who is critical of the "Washington consensus,"[5] has emphasized the need to contemplate various political, social and cultural facets as well when embarking on significant economic and financial sector reforms.[6]

This article considers the legal and regulatory implications of adapting "internationally accepted bank supervisory standards" for emerging and transitioning economies and what criteria or preconditions are necessary for the enforcement of these to be *effective*—using the recent reform experiences of Thailand (as to which this author has had significant first-hand experience) as a case study. For financial sector reforms to be *effective*, at a minimum, the legal infrastructure needs to be "enforceable." In order to address the "realities" of this issue in Part IIA of this article, the *sui generis* factors of Thailand in the formulation of its recent banking

2. *See, e.g.*, the comparative law works of Professor's McKnight's close friends (each of whom delivered papers at the Spring 2001 SMU conference honoring Joe), Professors Alan Watson, Bernhard Grossfeld, Roberto MacLean and Hans Baade.

3. *See generally* JOSEPH J. NORTON, FINANCIAL SECTOR REFORM IN EMERGING ECONOMIES (2000).

4. *See, e.g.*, JOSEPH J. NORTON, DEVISING INTERNATIONAL BANK SUPERVISORY STANDARDS (1995); Joseph J. Norton, *A "New International Financial Architecture?"—Reflections on the Possible Law-Based Dimension*, 33 INT'L LAW. 891 (1999); Mario Giovanoli, *A New Architecture for the Global Financial Market: Legal Aspects of International Financial Setting*, *in* INTERNATIONAL MONETARY LAW: ISSUES FOR THE NEW MILLENNIUM (Mario Giovanoli ed., 2000).

5. "Washington consensus" refers to the policy of the IMF and the US Treasury that promotes, among other neo-classical economic thinking, market economies, capital account liberalization and effective external market access.

6. Joseph E. Stiglitz, Whither Reform? Ten Years of the Transition, Keynote address at World Bank Annual Bank Conference on Development Economics (April 30, 1999).

reforms are considered. Many of the problems that led to or exacerbated the recent Thai financial crisis are infrastructural and cultural.[7] Therefore, application of "international best practices," by itself, is not sufficient. As well as substantial improvement of the legal and judicial framework, societal cognisance of and adherence to rules, their enforcement, and normative actions need to be encouraged. This involves a long-term educational process that needs to penetrate the entire society to enhance fairness and greater transparency and to provide greater economic opportunities to a larger proportion of the society.

Part II will touch upon a few relevant *sui generis* factor as they became key elements in the Thai reform processes. Sections IIB-E will more generally discuss and investigate the case of Thailand, taking into account the specific IMF reforms for Thailand, and general prudential reform efforts being undertaken by the Thai authorities. Part III will then analyze some of the highlights of reform currently being considered and debated in the Thai Parliament (still at August 2001) respecting the new proposed financial sector reform legislation. Part IV, more specifically, will consider the critical issue of "effective enforcement." This article winds-up, in Part V, with some modest concluding observations.

II. THE REALITY OF BANKING REFORM: THE CASE OF THAILAND

Logically, "international best practices" are the accumulation of numerous country analyses and experiences. As such, it would seem reasonable that their due application and compliance would nurture a sound "credit culture" and would minimize financial instability. However, the reality of frequent instabilities that sometimes have "contagion effects," threatening the global financial system remains. This is not necessarily the result of regulatory failure to adopt the internationally agreed upon standards. Often, it is the result, in large part, of various *sui generis* factors that inhibit the effective adaptation by each country.[8]

Putting in place the "rules" (i.e., the law and related regulations) is the relatively easy part of reform. Implementing them consistent with their underlying rationale, yet also within the underlying domestic realities, is crucial for successful reform. Unless the standards are adapted to suit the national condition, the intended results often will not be achieved. In such situations, this reform would only be a "paper based" achievement

7. Financial crises erupted in the markets of Asia in 1997 and engendered a broad "contagion" effect. Thailand was the first country to be so affected. Abandoning its pegged exchange rate for the Baht on July 2, 1997, it experienced a dramatic "free fall" of its currency value. After Thailand agreed with the IMF on a "stand-by arrangement" in October 1997, the reform of the Thai financial sector has taken place with the guidance of the international community. *See* ALEXANDRE LAMFALUSSY, FINANCIAL CRISES IN EMERGING MARKETS: AN ESSAY ON FINANCIAL GLOBALISATION AND FRAGILITY (2000).

8. *See, e.g.*, Hon. Roberto G. MacLean, *The Social Efficiency of Laws as an Element of Political and Economic Development*, 4 NAFTA L. & BUS. REV. AM. 6, 6-18 (Spring 1998).

accompanied by red tape regulatory formality.[9]

In the case of Thailand, which has been severely damaged by the recent financial crisis, there have been various political, social and cultural issues influencing the effective implementation of international standards. Without paying adequate heed to these factors, the reform ultimately will not reap the intended results. This would be extremely unfortunate for the Thais and for the international community. The Thais have adhered to and have tolerated the stringent IMF reform program that was initially overly harsh on the national economy. If the current financial sector reforms are not sufficiently carried out with the intended robustness, the Thai and international communities could be faced with further financial instability.

This Part II will give consideration of the various *sui generis* factors apropos to Thailand that would affect the implementation of the needed financial sector reforms. Next in this section is a general discussion of Thai banking, legal and regulatory reforms. Then, a more specific discussion will be provided concerning the new Thai banking legislation, and in the following Part, the specific issue of enforcement will be addressed, a subject that has been problematic in all recent crisis-affected countries.

A. *Sui Generis* Factors of the Thai Financial Sector

Thailand is historically distinct from other Southeast Asian countries in that it was never colonized. It has a monarchy which is highly and reverentially respected and which provides stability to Thai society. The monarch is viewed as a benevolent ruler; and despite being a constitutional monarch since 1932, the monarch will intervene where a significant public interest might be involved.

Despite its numerous revolutions and coup d'états during the 20th century, Thailand has failed to overhaul entirely its feudal social structure. The current system still concentrates power in the hands of a few. As such, the economic growth during the 1980s and early 1990s had not been shared equally by the society. To the contrary, those who held power and money have been the ones who benefited most and who still wield the main political clout.

Although the current financial sector reform program is not directly intended to improve the democratic institutions of Thailand, these sociopolitical factors inevitably will impact the effectiveness of the reform.

1. *The Social and Political Structures*

The society of Thailand still carries, in various indirect ways, the "baggage" of the feudal system, the Sakdi Na system, that burdened the poor and benefited those well-born and well-connected. The Sakdi Na system

9. Tull Traisorat, Thailand: Financial Sector Reform And The East Asian Crisis 45 (Kluwer Law International 2000). *Cf.* IMF Concludes Post-Program Monitoring Discussion on Thailand, IMF PIN No. 00/110 (Dec. 20, 2000).

originated in the mid 14th century until it was formally abolished in 1932, with the transition to the constitutional monarch.

Under the Sakdi Na system, the monarch owned land, labor and other economic resources. The concept of private land ownership was not present under this arrangement, but the monarch could grant aristocrats the right of usufructus (i.e., the temporary right to use and benefit from land). The amount of land would reflect the power, rights, and obligations of the aristocrat. The Sakdi Na system was systematic in underdeveloping the commercial and business framework, and thus creating a mutual dependence between the aristocrats and merchants. The economic surplus was taxed away by the aristocrats and then by the monarch. The commoners saw their lives as predestined according to the prevalent Buddhist and Hindu thinking.

This feudal system further hindered the development of a broad and independent middle class. The middle-class, which is the driving force of modern economic development, was not able to use its creative abilities for its own benefit, being forced to work their mandatory periods for their patron.

Moreover, the Chinese in Thailand were permitted by the monarch and aristocracy to take over the business vacuum, sending their profits back to their home towns in China. The Chinese merchants, in fact, were given special status in Thailand. Since they were foreigners, they were not subject to the Sakdi Na, and taxation was much lower than for Thais—it is said to be as low as by 36 times.[10] Being traditionally entrepreneurial, the Chinese had excellent trading skills. Because trade was monopolized by the monarch, they needed to conduct business under the auspices of an aristocrat. A patron-client relationship between the aristocrats and Chinese businessmen was formed in which the Chinese received protection from the aristocrats, and the aristocrats received pecuniary benefits. Once the Chinese secured a position in the Thai economy, they were able to tap other avenues of Thai society.

This is a basis for the use of "connections," a practice prevalent in Asian societies. Once the Chinese obtained an aristocrat-patron, they were embraced in the monopolistic Thai governmental business world, and could win bids for governmental work, such as collecting taxes. They also were given social titles, which was believed to solidify their allegiance to the monarch. This social system of "inter-dependence" and "connections" remains a main conduit for doing business in Thailand resulting in concentration of economic power in the hands of a privileged few.

The power of commercial banks which has been controlled (directly or indirectly) by government factions or an elite group of private business families, is especially pronounced. Companies in Thailand typically acquire funding through the banking system. Thus, banks have a creditor

10. *See* TRAISORAT, *supra* note 9, at 53.

interest in these businesses. Further, Thai companies form conglomerates through cross-holding of shares or cross-directorates. Banks have a crucial role in assisting the financing of these groups. This interconnection is strengthened by the intra-marriage among the business elites. All this has created a concentration of economic power in Thailand that is enhanced with every business deal.

The extraordinary power of the Thai business sector has made it extremely influential over the government as well. Businesses invite members of the government and bureaucracy as directors to protect their business interests. This gives the company increased "negotiation leverage." The patron receives economic benefit in return for the services rendered.

Political instability has plagued Thailand since its revolution in 1932. After the 1932 revolution that turned the monarchy from an absolute to a constitutional one, the period from 1938 witnessed the rise of Thai nationalism under the rule of the dictator, Luang Pibulsongkram. Foreign merchants such as the Chinese needed to buy protection from the government. Then the military regime took hold in 1957 after a coup d'état. The military split into two fractions, causing continuous coup d'états between the two sides. Then the civilian protest in 1973 caused a military massacre of civilians, which eventually led to a democratically elected civilian government.

The Thai monarch has had a special role in this unstable political environment, creating a national impression of political stability and continuity in spite of its political instability. As with all modern monarchs, the Thai monarch cannot boast of past deeds to maintain the throne. However, the monarch, *in persona*, has been viewed as a benevolent ruler throughout the feudal system.[11] Particularly, since 1932, the monarch has been a most constructive force in political, educational and cultural development. The respect that people express towards the incumbent King Bhumibol is immense. Since he came to reign in 1946, there have been seventeen coups and twenty-two prime ministers, but only one King. He has acted with consistency and selflessness, being a psychological and moral anchor to the Thai people.[12]

On a more positive side, the King also has been a moderating power on scheming politicians, bureaucrats and generals. The stability and the pride that the Thai people have in their King have also led to pride in the social and cultural heritage of the Thais. They did not have the colonial powers interfering in their affairs as did many developing countries.[13] As such, they retained pride and dignity in their own system, applying certain modifications to adapt to the changing time.

11. *Id.* at 47.

12. William Barnes, *Thai Change Likely to Bypass Revered King* (1999) FINANCIAL TIMES, Dec. 4, 1999, at 6.

13. This is not strictly correct, because Thailand was forced to open in ports to foreigners after the Bowring Treaty was signed with the English in 1855. It was an unfair treaty that necessitated Thailand to require certain modern structures to be renegotiated.

However, if the argument of "preservation of the traditional system" were used to retain the undemocratic system in Thailand, this would be most unfortunate. The negative effects that the old system imposes are socially and economically detrimental.

2. The Legislative Process

Today, Thailand boasts a democratic system and institutions. However, the vibrancy of these have been adversely affected, at times, by a variety of historical remnants.

The Thai legislature comprises the Lower House and Senate. While the Lower House is an elected body, the Prime Minister, until most recently, constituted the Senate with appointees. As a result, the Senate has been dominated by ex-bureaucrats and businessmen. Both houses traditionally have been subject to vote-buying and influence-peddling, producing corrupt and unstable governments, though recent legislative and governmental enforcement efforts are now being made to address these abuses.

Because the legislature largely consists of the "connected" people of Thai society, who have been the principle power-holders over the centuries, the legislative processes were and are often subject to delays or opposition to any legislation contrary to a particular business' vested interest. Businessmen are able to influence governmental policy-making or legislation through these "connections" as well. The result has been a legislature that does not always act for the public interest, but often for vested interests.[14]

There are numerous examples of such unwarranted and detrimental delays. The most significant for this analysis is the failures, on two recent occasions, to establish a deposit insurance institution. It is generally accepted in Thailand that some form of deposit insurance scheme would be in the Thai public interest, especially for those with little savings. Also an appropriate deposit insurance scheme could help prevent bank runs that may cause failure of the depository institution. Nevertheless, its establishment would cost the financial institutions the insurance premiums and moreover would prevent the government from formulating generous bailout schemes.[15] Thus, the efforts to develop a deposit insurance institution have not yet been successful; though a draft Deposit Insurance Act ("DIA") has been prepared by the Bank of Thailand ("BoT") and the Thai Ministry of Finance ("MoF"). This draft deposit insurance law may at last be fruitful on its third attempt, but probably not for another two years.

As mentioned above, the concentration of economic power is considerable in Thailand, with large conglomerates running or involved in most major businesses. The government has been attempting to dilute this

14. *See* TRAISORAT, *supra* note 9, at 68.
15. *Id.*

concentration since 1979 by preventing the inclusion of a depository institution into these conglomerates; however, these efforts have often been thwarted by indirect and disguised "nominee" ownerships. In addition, while cross-holdings between commercial banks, finance companies and securities companies, and between those and other companies is restricted to prohibit further concentration of power in the finance and banking sector,[16] as a result of legal compromise, this restriction of other companies controlling financial institutions was not applied to those banks already in operation at the time of enactment.[17]

Even, on some occasions, certain politicians have expressed their outright opposition to orders issued by the MoF or BoT. For example, when the MoF and the BoT ordered the Nakorn Luang Thai Bank to increase its capital within forty-five days in 1987, the Select Committee on Economic Affairs announced that the forty-five days deadline was unjustified, and requested relevant authorities to provide an extension of another six months.[18] The media was also utilized on this occasion, by criticizing the government for its "harsh" decision.

In a more recent event, when the bankruptcy law was being amended in March 1998, the legislation was unduly held-up in the Senate for several months. These legislative amendments would make it more difficult for a few creditors to hold up the insolvency process and simpler for secured creditors to realize upon debtor's assets. However, as explained above, the Senate consists of a number of prominent businessmen and they are sometimes instrumental in "foot dragging."[19]

The prospect of such delays is slowly changing, due in large measure to the new Thai Constitution that was introduced in 1997. The 200 members of Senate are now subject to direct election, the first of which was conducted on March 4, 2000. In order to root out the "vote-buying," influence-peddling, corruption, fraud, and nepotism, the Constitution empowers the Election Commission to suspend any candidate suspected of breaching the election rules. Due to the confusion and unclear rules, the Election Commission, to date, has not been as effective as intended.[20] For instance the recent re-election of the Senate seats that were considered fraudulently secured was conducted in late April 2000, but there is still the possibility of illegal transactions involved in that vote. Yet, in the course of this recent Senate election, the power granted to the Election Commission is encouraging, *symbolizing* a determination to enforce the rules.[21]

16. Banks, finance companies, and credit foncier companies are not permitted to hold more than 10 percent of shares among themselves. A commercial bank is not permitted to hold shares of other commercial banks. Commercial Banking Act, 1962, § 12(6) (Thail.), amended by the Emergency Decree 1985, (Thail.).

17. Commercial Banking Act, 1962, § 22 (Thail.).

18. *See* TRAISORAT, *supra* note 9, at 67.

19. *Broken Thais*, THE ECONOMIST, Mar. 18, 2000.

20. *Mired in Money Politics*, THE ECONOMIST, Mar. 4, 2000.

21. Ted Bardacke, *Election to First Thai Senate Declared a Draw*, FINANCIAL TIMES, Mar. 6, 2000, at 6.

These mixed, but changing political dynamics, undoubtedly will continue to influence the final shape and effect of the currently pending Thai banking reform legislation.

3. *The Administrative Process*

The BoT sits in a rather precarious position. On the one hand, it has been relatively unfavorably treated by the Thai system, being hierarchically placed under the MoF. When there is disagreement between the Court of Directors, the decision-making body of the BoT, and the Governor of the BoT, the Minister of Finance had the power to make the final decision.[22] Further, and crucially, while the MoF is ultimately responsible for the conduct of prudential supervision of commercial bank, finance companies and credit foncier companies,[23] the MoF authorizes the BoT by delegation to carry out the supervision by administrative assignment.[24] This administrative assignment makes the BoT fully responsible for mistakes arising from supervision.

Yet, on the other hand, the BoT consists of highly qualified economists, many educated in the US.[25] A job at the BoT is prestigious, and well paid. But, the Governor is not necessarily so, since he/she is appointed by the Prime Minister. During the recent financial crisis, the Governor of the BoT was dismissed, taking formal responsibility for unsuccessfully using the country's international reserves to defend the currency.[26] This being said, the current Governor, Mr. Mongol Sonakul, has been able to personally exert considerable political independence.

A bureaucracy's power ultimately rests upon the extent of its influence over its constituency (for the BoT, over the financial institution community). But, because, historically, Thai financial institutions (and those behind these institutions) have had enormous political power and "connections," it has been difficult for the BoT to bring about an effective supervisory regime, despite the powers it has been granted.

Further, as will be discussed below, what Thai administrative process has existed has rested largely on bureaucratic discretion and not on a developed rule-based administrative process.

4. *The Enforcement Process*

Historically, enforcement of economic laws and regulations traditionally has not been strong in Thailand. Because the owners or controllers

22. Bank of Thailand Act, 1942, § 17 (Thail.).
23. Commercial Banking Act, 1962, § 4 (Thail.).
24. Finance Minister letter to the Governor of BoT, RE: Assignment to the BoT to Supervise Commercial Banks According to the Commercial Banking Law of April 27, 1962.
25. Economists who join the BOT are given the opportunity to obtain a Ph.D. in economics overseas, but are contractually bound to employment with BOT depending on the length of studies.
26. Nukul Commission Report Analysis and Evaluation on Facts Behind Thailand's Economic Crisis (March 31, 1998), *in* TRAISORAT, *supra* note 9, at 373.

of banks and corporates have substantial political power, the regulatory possibility of revocation of license or cessation of operations arising from non-compliance does not intimidate or restrain business. Further, in the Thai business community, formation of private cartels is widespread, deterring the competitive advantage of running a sound business.[27]

The recent financial crisis was an instance where the lack of "safe and sound" business practices and regulatory non-compliance by banks resulted in a vast amount of nonperforming loans as well, contributing significantly to the overall vulnerability of the financial sector. The BoT's regulation and supervision had been frequently ignored or influenced by politicians, or were countermanded or modified by the MoF to accommodate the commercial interests, and not necessarily to pursue financial safety and the public interests.

On various occasions, the BoT, itself, decided not to act or has seen its modest efforts to act rebuffed by the courts.[28] For example, in 1989, the BoT made an attempt to control credit allocation to the property market by "moral suasion," but was ignored by the commercial banks.[29] The Military Bank was regarded as one of the most unsound banks in Thailand, with low quality and connected assets, but was shielded from the remedial supervisory and prudential policies of the BoT due to the military influence.[30]

After a series of bank crises in the mid 1980s, some attempts were made to boost the enforcement power of the BoT to rectify the unsound practices of banks. In 1985, the BoT was given prosecution power, permitting the BoT to bring charges against bank mismanagement as if the BoT were the damaged party.[31] However, it is doubtful whether this power has ever been used effectively. On numerous occasions, the BoT has politically compromised the exercise of prosecution against bank management or opted not to proceed for the sake of "preserving investor confidence."[32]

Another factor that would have influenced the actions of the BoT is the rarity of bringing financial cases to court in Thailand.[33] The judicial process in the commercial, business and financial areas is extremely weak,[34] and those who have prosecuted powerful people in Thailand generally have fared badly.[35] So far, as of January 2000, not one Thai finan-

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27. *Id.* at 64.
28. *Id.* at 67.
29. *Id.* at 129.
30. *Id.* at 127.
31. Commercial Banking Act, 1962, § 18 (Thail.), as amended by the Emergency Decree, 1985, (Thail.).
32. *See* TRAISORAT, *supra* note 9, at 44, 84-90.
33. *Id.* at 44.
34. *Broken Thais*, THE ECONOMIST, Mar. 18, 2000.
35. The governor of BoT, Chatu Mongol Sonakul, commenting on the progress of his prosecution team against past fraudulent practices. Ted Bardacke, *Thai Unease Over Cronyism to be Aired*, FINANCIAL TIMES, Dec. 15, 1999, at 12.

cier has been imprisoned.[36]

Some hopeful measures, however, have been taken. Thailand enacted a formal reorganization process in 1998, and amended its bankruptcy law in March 1998, establishing a new bankruptcy court.[37] This might encourage creditors to request the courts to intervene in dealing with stubborn debtors. Further, the BoT is actively prosecuting bank management conducting illegal practices. This has recently resulted in the extradition of one high-profile business elite from the UK.[38]

B. Implementing Financial and Banking Sector Reform: IMF Concerted Reform Program

As mentioned above, following the financial crisis that hit Thailand in 1997, the authorities of Thailand agreed on a "standby agreement" with the International Monetary Fund ("IMF") in October 1997. As the crisis hit other Asian countries, the IMF program came to include not only macroeconomic policy measures, but structural measure as well. Thailand had been pursuing a relatively sound macroeconomic policy, and the main causes of its crisis were seen as the structural rigidities and deficiencies of the system.

The Thai financial and banking sector was especially targeted for reform by the IMF. Technically, the IMF reform influence comes in two main ways: (i) through Letters of Intent ("LOIs") agreed to by the applicant country seeking an IMF "facility," with such facilities subject to IMF "conditionality" reflected in the LOI (as it may be amended or revised, from time to time), and (ii) through the technical assistance programs furnished by the IMFs Monetary and Economic Department ("MAE") and often also by the World Bank. These two "prongs" of the IMF structural reform efforts run parallel to each other and in theory (at least) in a coordinated manner.

The main points agreed upon by the Thai government and the IMF on financial sector reform are the following:

- To restore investor confidence in the Thai banking and financial system;
- To restore the solvency, profitability, and liquidity of the broader financial system;
- To enhance foreign ownership in domestic financial institutions;
- To effect medium-term practices in order to strengthen the structure of the financial system and enhance incentives for increased market discipline; and
- To require shareholders and creditors of subordinated debts to bear the burden of their losses.[39]

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36. *Id.*

37. *Broken Thais*, THE ECONOMIST, Mar. 18, 2000.

38. Ted Bardacke, *Thai Unease Over Cronyism to be Aired*, FINANCIAL TIMES, Dec. 15, 1999, at 12.

39. H.E. Dr. Thanong Bidaya, Statement at the IBRD/IMF Joint Annual Meeting (Sept. 23-25, 1997).

In this context, the Thais committed themselves to amending their Commercial Banking Act ("CBA"), The Act Regulating the Finance and Securities Business, Bankruptcy Act and the Civil and Commercial Code. The Bank of Thailand Act ("BTA") is also being amended to strengthen the BoT's function. The draft BTA, draft CBA and prudential regulations are discussed in detail below. A draft Deposit Insurance Act ("DIA") is considered an integral part of this reform package, but both the IMF and BoT/MoF have come to practically realize that the passage of a DIA is still a year or two off.

The IMF financial sector reform program has consisted of six specific measures. The first is the separation of viable and unviable financial institutions to regain investor confidence in the financial system. A total of fifty-eight financial institutions were suspended and closed by December 1997. Also, a blanket guarantee of all deposits was issued by the MOF and BOT in August 1997. Funds from safer institutions were recycled into those institutions losing deposits; but, this effort was unsuccessful in the end because of the high risk in lending to unsound banks and the "moral hazard" that might occur.

Second, existing banks and other depository institutions were required to recapitalize and to enhance loan loss provisioning. Foreign ownership was encouraged by the relaxation of restrictions on shareholding by foreign investors (though, in reality, foreign banks are not provided true "national treatment" or "effective market access").

Third, the Financial Restructuring Authority ("FRA") was established in October 1997 to restructure and to monitor the fifty-eight financial institutions suspended. Two of the institutions were able to reopen given the approval of their rehabilitation plan, but the others were closed and liquidated.

Fourth, the Asset Management Corporation ("AMC") and the Radhanasin Bank ("RAB") were established in October 1997 to participate in the auction of the assets with other private bidders. The AMC purchases the lowest quality assets, acting as "the buyer of last resort."[40] The RAB will on the other hand bid for the highest quality assets and operate on strict commercial principles, assisting the restructuring process.[41]

Fifth, the BOT was empowered to address financially distressed financial institutions more readily through the amendment of the banking law.[42]

Sixth, in order to reduce moral hazard, authorities prompted that they will not provide unjustified guarantees or bail outs of insolvent banks.

40. Third Letter of Intent to the IMF from MoF Minister and BoT Governor, Attachment, Memorandum of Economic Policies of The Royal Thai Government, Feb. 24, 1998, para. 4.

41. *Id.*

42. *See* TRAISORAT, *supra* note 9, chs. 4, 5.

To ensure that these measures are adequately carried out, the Thai authorities have drafted three pieces of major legislations (referred to above) to make permanent the various reforms and also to ensure that sanctions are applied when non-compliance is determined. As opposed to the other crises-affected countries, Thailand has taken the position that it would "own" the reforms by taking the lead in any legislative movements. Thus, it has taken a longer period of time for the Thais to draft and to process the necessary legislation. The three pieces of legislation are currently (as of August 2000) under review by the Council of State (the former Judicial Committee), having been approved by the BoT and MoF. Formal submission to Parliament will await the election of a new Parliament and Government in late 2000.

The changes that are envisaged by this legislation are explored below. However, for present purposes, some of the main areas that would be improved through the legislation (if enacted in substantially the same form as submitted to Parliament) are the following:

- Deterrence of unsound insider/affiliate/nominee transactions;
- Strengthening of enforcement;
- Enhancement of supervision;
- Stricter application of prudential requirements;
- Application of prompt corrective actions;
- Improvement of financial institutions "governance;" and
- Better treatment of accountants and accounting standards.

One under appreciated beneficial effect of the IMF-Thai financial sector reform program has been its influence on enhanced governmental and IFI transparency. In the past, IMF reform programs were conducted largely in secrecy (confidentiality) and the reforms were largely imposed top-down. In addition, in general, the policy-making and decision-making process of central banks, bank supervisors and IFIs were largely non-transparent, "less markets or governments be unduly disrupted."

With the recent reform efforts, both the IFIs and governments (starting with Thailand) have come to a consensus that disclosure is more beneficial than detrimental. This had had a substantial effect upon the LOI and reform processes and is significantly transforming the culture of central banks (worldwide) and IFIs to being more open, transparent, responsive, cooperative and accountable institutions.

C. The Proposed New BTA[43]

A significant improvement achieved through the proposed amendments to the BTA is that the BoT would become the primary and independent bank supervisor. Currently, the BoT is not statutorily defined as

43. References in this article to the proposed BTA and CBA are to Draft No. 7 of July 1999 as prepared by the BoT and submitted to the MoF. Additional amendments have been made and are being considered as the bill goes through the Thai parliamentary processes; but, for personal purposes, this author will assume the *substance* of Draft No. 7 remains largely intact.

the "supervisor", but merely acts as such through an appointment by the MoF. This is not sufficient to legally justify the role of the BoT and to grant it effective powers to enforce its regulation against financial institutions.

As explained above, the management of Thai financial institutions have traditionally wielded strong political power. To enable action against non-compliant financial institutions, immunity for BoT executives is also most desirable, if not necessary.

A major concern that arises from any increased independence for the BoT is how *accountability* will be achieved. The proposed legislation does not set out clear guidelines as to who and how the BoT will report on and account for its activities. In practice, it is envisaged that the BoT will report to a committee comprised of persons who are knowledgeable of monetary policy (no mention of supervisory policy). This committee in fact will be comprised mostly of MoF officials. Although there may be a lack of appropriate people to fill this role, assigning the majority to MoF officials would defeat the purpose of the law. Either a committee more independent of political influence and administrative hierarchy and more broader based, or reporting to a parliamentary committee would be more democratically justified.

The relationship between the BoT and the MoF continues to be an uneasy one. While the reforms since the recent financial crisis has clarified the role of the central bank, the MoF is still heavily involved in the business of the BoT. As explained above, the committee through which the BoT is to be accountable will comprise a number of MoF officials. Moreover, draft legislation would have to be scrutinized and approved by the MoF in order for it to proceed to the Parliamentary Judiciary Committee. In a recent incident, a public dispute erupted between the Governor of the BoT and the Minister of Finance over how to resolve the losses incurred by the Financial Institutions Development Fund.[44]

Further, the decision of monetary policy lies in the sole hand of the Governor of BoT. This is in the process of being transferred to a Monetary Policy Board. This is an attempt by the BoT towards adopting an "inflation target" approach. It intends to create a system where inflation is stabilized by an independent board determining the level of interest rates.

In a recent speech by the former BoT Governor, attempts to truly

44. The Financial Institutions Development Fund ("FIDF") comprises contributions made from Thai financial institutions and BOT. Since Thailand did not have a deposit insurance scheme, FIDF was used to provide financial support for banks and finance companies in distress. The dispute is over how to resolve the staggering losses of 280 billion baht. MOF wants the foreign exchange reserve merged with two other accounts so the excess profits could be used to offset the debt. Since the exact losses from the FIDF is not clear there is a possibility of exhausting the central bank's reserves, and further, it would result in the central bank monetizing the fiscal debt. How to finance the losses was discussed in a meeting convened in May 2000. *See Time to Let Cool Heads Prevail*, BANGKOK POST, Apr. 27, 2000.

strengthen the Thai financial system were emphasized.[45] A strong determination to improve the operation of its monetary policy and subsequent robustness of the economy is essential. Unless the issues that are addressed by the relevant legislation are administered and enforced with a true understanding of their respective (but interrelated) purposes, it might be difficult to achieve the intended results.

D. The Proposed New CBA

Notwithstanding the reform efforts to make the BoT "independent" (a matter proving to be raising considerable debate in Parliament) both as to monetary policy and as to bank supervision, the MoF maintain responsibility for enforcing the provisions of the Commercial Banking Act.[46] Despite this legal provision under the proposed new CBA, the actual enforcement would be conducted by the BoT. This creates a gap between where the statutory power lies and who actually enforces these powers. The incentive for the enforcer to effectively enforce could be compromised, as could be a financial institution's regulatorees' incentive to comply. For true reform, it seems imperative that the statutory power and practical enforcement are consolidated so that the incentive to enforce and to comply are not impaired.

One way to resolve this separation of power is by exchanging a Memorandum of Understanding ("MoU") between the BoT and the MoF to ensure that enforcement is "contractually" delegated to the BoT. The MoF and the BoT currently exchange a MoU to ascertain the scope of the BoT's bank supervision.[47] Although enforcement is, in practice, conducted by the BoT, a MoU could formalize and clarify the enforcement process of the BoT.

Such an MoU could define the legal power of the instruments available to BoT against non-compliant financial institutions. The MoF being the statutory administrator of the financial sector, a procedure could be established where the BoT's regulation-setting power is "semi-automatically" approved by a board comprising the MoF officials and independent advisers. The Money Market Committee that is being established might be able to take up this role to ensure the soundness of the BoT regulations.

Of note for this article, the BoT established a Litigation Department in 1998 in order to address the increasing need for legally effective enforcement clauses, and has been able to tackle some of the illegal activities through liaison with the Public Investigator's Office.[48] Through its recent

45. Chatu Mongol Sonakul, Maintaining Monetary Discipline in the Face of Rising Public Debt, Address at Merrill Lynch's Asia Pacific Investor Conference (Apr. 18, 2000).

46. Draft Commercial Banking Act, 1999 (Thail.) [hereinafter CBA].

47. CBA, § 121 (Thail.).

48. In a recent case, the BoT caught Pin Chakkapak who owned Finance One and had fled to the UK. He was caught through extradition procedures carried out in London. Ted Bardocke, Thai Unease Over Cronyism to be Aired, Financial Times, Dec. 15, 1999, at 12. As of Sept. 2001, this case is still working its way through the UK judicial system.

action, the BoT and its Litigation Department have set an example that non-compliance will no longer be tolerated.

This will include application of a modified "prompt corrective actions" ("PCA") scheme as proposed to be engrafted into the Banking Act. Specifically, the proposed CBA (as submitted to the MoF) states that financial institutions will be subject to PCA if a certain capital level is not maintained. However, the "tripwires" of capital levels that trigger PCA are not clear and the gradation of PCA is also not submitted. With a "scaling" of PCA, the incentive to correct unsound operations should be stronger since the negative impact will rise with each decrease of capital level. CAMEL, which is the international best practice for bank supervision, defines three levels of capital after the adequate capital level is not satisfied. Financial institutions are thus aware at what level, what action will be taken and can take preventive actions when they enter a lower CAMEL rating.

E. Related Prudential Regulations: Some Summary Comments

The BoT is in the process of vigorously improving its supervisory methods. The most recent Governor (who maintained a high-level of independence and public respect, being a member of the Royal Family) had been especially active, encouraging various measures to ensure this. First and foremost, a training school for supervisors has been established. Supervisors will have to attend five prescribed courses and pass a final examination in order to become a fully-fledged examiner.[49] Although there is no deadline as to by when one has to pass these final exams, this requirement will certainly apply pressure on those who do not succeed in passing. Since this Governor was recently "sacked" by the Government, a "vacuum" appears to be setting into BoT proactively.

The BoT is phasing in the application of "CAMEL ratings" for financial institutions in a much more comprehensive manner. CAMEL (derived from long-standing U.S. supervisory/examination practices) has been Thailand's benchmark for supervision, but had not been actually achieved. Risk analysis mainly focused on credit risk until recently. In order to address risks such as market risk and hedging risk, detailed scrutiny is being made from various areas of the finance industry (domestic and foreign) to derive a greater and more relevant sophistication in its risk evaluation methods.

Along with this development, the BoTs Supervisory Department has revised its *Supervisory Manual*. The old *Manual* had only looked into credit risk and the quality of securities. The new *Manual* considers procedures of transactions and back-office operations that were formerly ne-

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The Thai government lost its extradition attempts before the English High Court, but, is now reformulating a different judicial strategy.

49. Depending on how long one has been an examiner, one is given concession to some of the courses.

glected. The new *Manual* will be disseminated widely so as ensure financial institutions understand the methodology of BoT examination.

However, the publication of this new *Manual* has been delayed due to an internal dispute on its final contents. This reflects some of the continuing weaknesses in the internal structure of the BoT, itself, which should be addressed. Whereas staff members who have long worked at the BoT believe in their ability to conduct supervision and to carry out monetary policy, they are not sufficiently aware of the politics involved in their decisions. This can be of concern since the central bank needs to be able to account for its policies not only to those who are knowledgeable of monetary policy, but also to the general public which is affected by this policy and to the legislature.

Another area which the BoT has especially addressed is asset classification and loan loss provisioning. Thailand has had the problem of not being able to ascertain the amount of non-performing loans (NPL). This has inhibited the government from gaining a true understanding of the economic situation. Asset classification is being addressed through various avenues. Relevant re-stating regulations have been issued.[50] The new supervisory *Manual* will also address this problem.

A further critical area of prudential concern under the proposed new CBA will be extensive treatment of "nominee" situations and of insider and affiliated transactions.

III. SELECTIVE GENERAL COMMENTS ON THAILAND'S PROPOSED NEW BANKING LEGISLATION AND RELATED SUBJECT-MATTER

A. Perspective on Thailand Reform Efforts

From the mid-1980s through 1996, Thailand was viewed by most international experts (including leading international and regional financial organizations) as a "model" for emerging market/developing country reform, and these views were generally accurate. The significant cracks in the Thai economic infrastructure, particularly in the financial sector area, which manifested in 1997 and facilitated the East Asian Financial Crises, were largely unforeseen by the domestic and international experts.

Following the events of 1997, the Thai Government, especially through its MoF and BoT, has very responsibly worked, internally and in cooperation with the IFIs, to undertake significant economic infrastructural reforms. These reform efforts are based on the realization that reform needs not simply to embrace the "macroeconomic," but also relevant "microeconomic" aspects. These latter reforms have concentrated on the Thai financial sector and included major legal infrastructural reforms.

50. Bank of Thailand, Regulations on Loan Classification, Provisioning, Suspension of Interest and Other Related Requirements (1998) Regulation No. 15/1998 (July 1), and Amendment in Asset Classification and Provision as a Result of Debt Restructuring (1999) Regulation 17/1999 (April 1).

These current financial sector legal reforms, as mentioned in Part II above, include the CBA, BTA (both now before Parliament, even after its submission two years ago) and a pending draft DIA.

Once again, perspective is needed. On a relative and regionally comparative basis, the Thai banking and other financial law reforms of the 1980s and early 1990s were relatively "progressive" and "modern." In fact, it is clear that at least as of the early 1990s, the MoF and BoT were increasingly moving towards consistency with international best practices of the time.

Two other additional perspectives are germane. First, since the 1980s and even now, Thailand has been under significant external pressures to "liberalize" and "internationalize" its economy and financial sector. Efforts in these regards, without concurrent counter-balancing measures to "manage" such external pressures, proved to be a major contributing factor in the crises beginning in 1997. Hindsight indicates that meaningful and effective legal and prudential reforms in the financial sector should have been more diligently emphasized by the experts and the Thai Government.

Second, effective financial sector legal infrastructural reform cannot be achieved simply by statutory revisions, but necessarily entail much broader and deeper dimensions, including a fundamental appreciation of the following:

- The societal rationale for adopting a "rule-based" approach;
- A full appreciation that a rule-based approach is not a "rule-by-law approach," but a "rule-of law approach;"
- A "rule-of-law approach" requires a high degree of transparency and accountability for all involved levels of government (executive, administrative, legislative and judicial);
- Inherent in the "rule of law" approach are the notions of "procedural due process" and independent "judicial review;" and
- A meaningful and effective "rule-based" approach should balance a number of internal tensions such as: rule-orientation versus governmental discretion; transparency versus confidentiality needs; globalization pressures versus internal domestic needs; and international standardization/convergence versus domestic political realities.

In reviewing the Thai reform program in this manner, the enactment of the proposed new CBA is a most desirable and necessary *first* step of a much longer and deeper legal reform process—a process that will need to transform traditional political, administrative, judicial and societal "ways of doing business."

B. The Proposed CBA as a "Crisis-Oriented" Statute

The reforms embraced by the proposed CBA are naturally reactive to many of the perceived vulnerabilities generated by, and causes associated with, the 1997 financial crises. In this sense, the CBA most commendably and aggressively addresses such matters as: (i) insider/affiliated/nominee

transactions; (ii) enhanced supervision, prudential requirements, and enforcement; (iii) emphasis on improving financial institution "governance;" and (iv) treatment of the role of external auditors and accounting standards in financial institution supervision. In fact, the CBA endeavors substantially to conform to current "international best practices."

In being "reactive," the draft CBA is (in a sense) understandably "backward-looking;" that is, directed to shoring up the legal infrastructure from a crisis management perspective. This is not, however, to say that there are no "forward-looking" aspects to the draft CBA, such as the embrace of the "universal banking model" and consumer protection. The modern realities of financial markets, instruments, and institutions, however, point to a rapidly changing financial environment requiring a "forward-looking" approach which captures the ongoing rise of e-finance, multifunctional banking, financial conglomerates, converging financial markets and instruments, changing bank services/products, and rising pressures from globalization and internationalization. While it may not be realistic to attempt to address such matters in the CBA, these are matters of importance that will probably require legislative and/or regulatory attention within the foreseeable future.

C. The Proposed CBA as a "Framework" Statute

Draft No. 7 of the CBA (July 1999), as reviewed by this author, appears to be largely a "framework" statute, that is, a statute that sets out the broad areas of legislative coverage, but leaves most of the substantive "details" to administrative rulemaking and discretion. This legislative approach is one legitimate way to approach statutory drafting because it often results in a statute that is easier to pass in a divided political environment, and provides considerable flexibility for the Thai government and regulatory authorities to implement. In fact, this may well be the best approach for the Thai government at this time, given current economic and political circumstances in Thailand.

However, such an approach is problematic in several respects. First, it can militate against a true "rule-based approach" as the rules are really only "skeletal" and are dependent upon administrative/executive discretion without judicial review. In addition, it cuts against international trends towards increased transparency as there are no regular, visible and predictable administrative procedures, no regular and prescribed administrative disclosure and publication, and no meaningful judicial review. Much will depend on how effectively Thailand's new proposed administrative procedures and administrative court and legislation, and revised practices and regulations of the BoT address these fundamental "procedural due process" issues. In all events, the need for regular, transparent, fair, and reviewable procedures should be a paramount concern for the BoT.

D. The BoT as Bank Supervisor

In various visits to and lectures in Thailand over the past four years, this author has consistently answered the question regarding the proper structure of a bank supervisor with the response that there really is no uniform, international model. There are a series of "pros and cons" that need to be evaluated in the light of all of a country's particular circumstances and on the premise that emerging economies are fundamentally different from industrialized nations.

With respect to Thailand, retaining the BoT as bank supervisor does make sense given the economic and political circumstances in Thailand. The BoT appears to be best suited at this stage of Thailand's economic development to provide effective financial institution supervision and regulation, although, other recent institutional structural models (*e.g.*, UK "single regulator" approach and Japanese "FSA" approach) could also be viable.[51]

However, as alluded to above, the enhancement of supervisory and regulatory authority of the BoT should be accompanied by a high degree of independence from undue political influence, resource sufficiency, and accountability. As to independence, the DBTA and DBA appear to adequately ensure insulation of the BoT from undue political influences. The resources of the BoT are being enhanced both within and without the current legislative initiatives. For the BoT to succeed in its laudable supervision, examination and enforcement objectives, however, significant additional resource support may well be in order. A separate, sufficiently staffed, well-trained, and independent Financial Institution Examination Section within the BoT, similar to the FSA Examination Section developed in Japan, might be appropriate, as would an expanded Enforcement Section. Further, the BoT could establish and develop meaningful and coordinated linkages between various BoT departments/ sections and among interacting counterparts in other Thai government agencies and foreign regulatory agencies, and with external industry and academic groups.

In addition, a broad-based, active and informed BoT Court of Directors and Financial Institutions Policy Board are most desirable for ensuring both transparency and accountability in the BoT.

In developing countries and transitional economies—countries which are most in need of good banking supervision given their financial fragility in times of crises—the case for having both monetary and bank supervisory responsibilities within the central bank is supported by other arguments (in addition to the ones mentioned above). In particular, there are advantages of synergy in placing banking supervision under the umbrella of the central bank, due to the scarcity of qualified economists

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51. *See, e.g.*, Joseph J. Norton, *Structuring the Banking Regulators and Supervisors: Developed Country Experiences and their Possible Implications for Latin America and Other Developing Countries*, 4 NAFTA L. & Bus. Rev. 5, 5-29 (1998).

and financial experts, the shortage of financial instruments to hedge financial risks, the lack of sophisticated accounting standards and practices, and the difficulties in establishing appropriate co-ordination between various agencies (in this case between the central bank and a separate supervisory agency).

In the case of Thailand, it is advisable for the BoT to be in charge of both monetary policy and banking supervision. However, the delegation of responsibility in the supervisory arena neither implies nor requires that the central bank should be independent from government in the exercise of these supervisory responsibilities. It is perfectly possible to restrict independence exclusively to the monetary policy functions of a central bank, leaving other central bank functions—e.g., banking supervision—under political control.

What does it mean to be independent in supervision? An analogy with the independence of the central bank in monetary policy is helpful to understand this issue. In order to carry out these responsibilities, a central bank must have control over monetary policy. Control in this context has two senses. First, it must have the technical capacity and the resources (human and otherwise) to meaningfully control or influence monetary conditions. Secondly, there is control in the sense of being able to exercise the bank's own best judgment, which in turn is linked to the rules regarding appointment and dismissal procedures, terms of office, budgetary autonomy and liaisons with the MoF. A central bank is truly a central bank, and not just the monetary agent of government, when it is free to make and implement decisions.[52]

However, in a democratic community independence is only one side of the coin, for accountability is also necessary. To begin, it is important to point out that authority is not given away, but "delegated." A clearly specified mandate is given by parliament, and the agency to whom the mandate is given, be it the central bank or another agency, is then left to get on with carrying it out. In addition, it should be stressed that accountability requires, at the very least, that the central bank explain and justify its decisions and actions and account for the decisions made in the execution of its responsibilities. Lawyers and economists tend to emphasize different issues in attempting to measure accountability. Lawyers emphasize the institutional dimension, i.e., the placing of the institution (the independent central bank) within the existing system of checks and balances, in relation to the three branches of the State: legislative, executive and judiciary.

The concept of accountability—from a legal perspective—should be "diversified" to include parliamentary accountability as well as judicial review of the central bank's acts and decisions, and a degree of co-operation with the executive branch to ensure consistent overall economic policymaking.

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52. *See generally* ROSA M. LASTRA, CENTRAL BANKING AND BANKING REGULATION (1996).

In a national context, Parliament remains sovereign in its legislative decisions, and one statute proclaiming central bank independence can always be removed by another one revoking it. Parliamentary accountability should be exercised through a variety of procedures and mechanisms, including annual reports and appearances of the Governor and other officials on a regular basis, and also in the case of an emergency situation.

Judicial review of the BoT's decisions and actions (conducted by an independent and depoliticized judiciary or special and independent administrative judicial committee) is essential to prevent and control the arbitrary and unreasonable exercise of discretionary powers. This is a fundamental element of the rule of law. The discretion of central bankers—or any other officials—should never remain unfettered but instead should be subject to legal controls.

In concluding that it is desirable for the central bank to conduct banking supervision in Thailand, it is important to consider a related issue. What should be the relationship between the central bank (or the banking regulator) and other financial regulators, in particular securities and insurance regulators? The answer is not straightforward. In the U.S., regulatory competition among various financial regulators is considered to be a good institutional solution to the increasing complexity and sophistication of financial transactions and financial actors. The U.K., on the other hand, has opted for a mega-regulator for all financial services and markets, and considers that this single regulator is the best option to deal with financial conglomerates and the increasing blurring of frontiers between different types of financial businesses. Some smaller countries, such as Norway, have also adopted the single regulator model. Whenever this model has been adopted, the central bank has relinquished its supervisory powers, *i.e.*, the single regulator has been typically placed outside the central bank. In a 1999 survey of 123 countries conducted by Professor David Llewellyn, only the Netherlands Antilles, Singapore and Uruguay had supervision of banking, insurance and securities within the central bank. There are economic reasons for having the single financial supervisor—if that is the preferred institutional arrangement—outside the central bank. On the economic front, the central bank would need to develop business and consumer protection rules that go beyond its core competence of monetary policy and systemic oversight. On the political front, the granting of excessive power to the central bank is undesirable and potentially dangerous (if not matched by appropriate mechanisms of accountability).

In summary, the proposed solution of entrusting the BoT with both monetary and banking supervisory powers is sensible. However, other financial supervisory powers (over securities and insurance firms) should be entrusted to a different agency or agencies. In addition, the granting of independence to the BoT—which should be further clarified to cast some light on whether independence in monetary policy is accompanied

by independence in banking supervision—must be matched by appropriate mechanisms of accountability.

E. BoT Administrative and Regulatory Implementation Processes

Two of the major "environmental" changes being brought about by the current Thai banking law reform program are the enhanced independence of and primary supervisory responsibilities for the BoT. These changes are being effected, in large measure, under "framework" statutes granting the BoT a broad range of regulatory and supervisory discretion.

"International best practices" would indicate that the BoT should carefully review and revise its current administrative practices through formal regulations. The aim of such regulations should be, to ensure the development of an administrative process that is regular, transparent, fair and reviewable.

Thailand is currently considering major reforms to its general administrative procedures, including the possible establishment of an Administrative Court. These efforts are to be commended and encouraged as necessary counterparts to the CBA.

The BoT should view the current circumstances as an opportunity to take a forward-looking approach to upgrading substantially its current administrative processes and procedures. For example, the BoT might wish to consider issuing formal regulations setting forth the parameters of its administrative processes. These regulations might touch upon the following:

- Prior notice of all proposed Regulation and solicitation of external comments,
- An interim period (except in emergency situations) between a Regulation's enactment and its legal effect, so as to permit the industry/society time to adjust,
- In the case of individual orders, meaningful opportunity (not simply at the examination level) for affected parties to respond,
- Regular and meaningful process for an administrative appeal of a BoT order,
- General *Gazette* publication requirement for all regulations, notices, and orders (note here that a general provision could be added to the DBA), and
- Expanded and timely use of the BoT's internet website to create greater transparency as to BoT decisions and actions (here the author makes a favorable note that the BoT has already made great steps in this area).

As to the extensive BoT Regulatory Implementation Process that will be required under the CBA, it is critically important to get this process "right." The BoT, with the assistance of the World Bank, will be seeking outside technical assistance in this matter. While this is certainly a positive approach, the presence of external assistance should not relieve the BoT from taking primary responsibility for its regulatory program. Re-

gardless of the approach taken, the legal effect of a new CBA (as distinguished from its passage) should be aligned with the substantial completion of the related regulatory program.

F. Information Gateways/Sharing as to Other Domestic and International Supervisors

No provisions currently exist in the proposed CBA regarding information-sharing, cooperation, and coordination by and between BoT and (1) other domestic agencies; and (2) international counterpart agencies in countries or regions where Thai financial institutions have a presence or where foreign financial institutions have a presence in Thailand. The existence of "information gateways" regarding transfer of information in appropriate circumstances is an important aspect of financial institution regulation and supervision. In Thailand, domestic information gateways should be established in the draft CBA between the BoT and the Thai MoF, SEC, and insurance regulators, and criminal prosecution officials with respect to money laundering and financial fraud activities. These gateways should attempt to establish precisely when information regarding financial institution affairs is to be disclosed outside of the BoT, and the instances in which economic or financial information Thailand or other entities not regulated by the BoT should be disclosed to the BoT. This is especially pertinent given that the draft CBA establishes "financial business groups" that could well include non-financial institutions subject to the functional regulation of another regulatory agency, and that troubled financial institutions close to being placed in receivership may be addressed in a manner using public funds under the draft DIA, which may necessarily involve the MoF and Thai Government. With regards to international arrangements, international information gateways should be established in the CBA which expressly authorizes the BoT to disclose certain information and otherwise coordinate with regulatory counterparts in other nations with interests relevant to Thai financial institutions or markets. The Basle Committee and IOSCO have provided ample guidance in this area, which should be reviewed prior to drafting any CBA provisions in this area. The provisions in Hong Kong's Banking Ordinance could be instructive in this regard.

G. Judicial Linkage

As mentioned throughout this working volume, effective law reform goes well beyond the drafting and implementation of statutes and regulations. A responsive, well-trained judiciary in the banking law/regulation area is also required. In this respect, Thailand is considering the possibility of a new Administrative Court. This is most commendable, but the problem of maintaining well-trained judges in financial law matters is still a matter to be addressed, as it would be ideal to have set administrative judges trained in handling these matters. More generally, the BoT should take a proactive approach in interacting with the relevant judicial training

authorities to help promote a better understanding of the bank regulatory processes.[53]

H. Broader Societal Educational Needs

Recognizing that the BoT does not have unlimited resources, the author still believes the BoT can (and should) have a meaningful role to play in meeting the broader educational needs of the Thai society in understanding the nature and importance of a sound bank regulatory environment. The expanded use of the BoT website is one starting point. Also, active collaboration with leading domestic, regional and international academies/academics and "think-tanks", with domestic and foreign industry associations, and with responsible NGOs representing other legitimate, affected societal interests might be fostered by the BoT.

IV. ADDRESSING THE ENFORCEMENT ISSUE

A. In General

The BoT has addressed the issue of enforcement in various institutional ways. First and foremost, as mentioned above, the Litigation Department was established in 1998 to deal with matters of enforcement. Second, is the reform of various supervisory method and procedures discussed in Part III above. Third, is the revision of the internal structure of the BoT. Fourth, is the establishment of external committees to monitor the operations of the BoT.

The Litigation Department was established to draw a clear line of responsibility in litigation, additional to the normal quasi-judicial sanctions conducted by the BoT. The Department deals with the law enforcement process, especially bringing criminal actions to court against executives and management staff of financial institutions who have incurred damages and losses fraudulently to the assets of financial institutions. Presently, there are about sixty to seventy on-going cases either under the process of consideration by public prosecutors or under police investigation. Other aspects of change include the employment of some high-ranking prosecutors to head the Department, providing equipment support (such as photocopying machines, etc.) and general financial support to facilitate the working process for police and prosecutor, and arranging inter-agency seminars and sending out legal officers to participate in external seminars about litigation techniques and process particularly on financial fraud. Furthermore, there have been internal working groups within the BoT for legal officers and examiners to develop a common understanding for detecting and starting up litigation process.

The process of litigation begins by the discovery of non-compliance or violation of regulations by the Examination Department. To ensure that it is genuinely non-compliant, the Examination Department refers the

53. *See* MacLean, *supra* note 8.

case to the Legal Department. The case is then taken to the Litigation Department to determine the next course of action. Usually, a fine is assessed according to an internal scale of fines. The fine is communicated between the BoT, the Public Investigator, and the MoF which is then passed on to a committee set up by the Litigation Department to decide on the final fine. Serious cases are first referred to the Public Investigator. The Public Investigator, Police and the Litigation Department cooperate to conduct any prosecutions. Some extraditions of fraudulent management have been conducted, which will pose a further warning against potential criminals.

The Examination Department has undergone some of the most significant reforms since the financial crisis. They have revised various aspects of the supervisory processes in order to achieve "international best practices" for bank supervision.

Since the lack of a clear asset classification has intensified the problems of enforcement, it is being addressed by not only publication of the classification, but also by comparative research in the various methods of other central banks and bank supervisors. The frequency of on-site examination is now also ensured to be annual. While the Examination Department has sought to achieve annual on-site examination, it was not always possible due to workload restraints. Since the financial crisis, the number of financial institutions has been halved, now allowing annual inspection to be carried out.

Supervision will also include aspects such as the financial institution procedures which were not previously inspected. Lending practices, back-office operations, and internal guidelines and rules of financial institutions will be scrutinized so as to ensure that the rules that are laid out are not only international standards, but are also followed.

The Examination Department is also reforming its own supervisory methods. Research on the best supervisory method and training of examiners are some examples. The contents of the training course emphasizes the aspects which are being strongly advocated by the Examination Department. This includes teamwork and cooperation in supervision, which is the final training course examiners must take in order to become an approved examiner.[54]

The BoT has restructured all departments to shorten the decision-making process. As a result, there is less hierarchy in the institution ensuring more speedy decisions. The BoT is a public institution that is plagued by the bureaucratic processes required in such an institution. A central bank is unique from other public institutions because of its dealings with the financial market. This will not just require it to ensure that its decisions

54. The five courses of the examiners' training school are the following: 1) general accounting of financial institutions (CAMEL), 2) overall financial institution analysis, 3) lending analysis, 4) advanced level CAMEL analysis (lending policy), and 5) teamwork and cooperation.

are sound and accountable, but necessitates the process to eradicate as much red tape as possible (i.e., bureaucratic "streamlining").

Three committees are being established to monitor the operations of the BoT. The BoT will be accountable to these committees that will be in charge of monetary policy, money market operations, and general affairs. The Monetary Policy Board will decide on the official discount rate of the central bank periodically. The Money Market Committee will meet on a day-to-day basis to preserve financial stability of the market. The General Affairs Committee will look into various operational issues of the BoT. Monetary policy decisions were formerly in the sole hand of the Governor. But, there was no statute to ensure that his decision was sound or accountable. The BoT is in the process of adopting more formal inflation targeting, and the establishment of the Monetary Committee is a step in this direction.

Despite the recent commendable efforts of the BoT, there is still scope for further improvement that would encourage better operations and would provide incentives for the subjects of the regulation/supervision to abide by the new "rules." One such improvement would be the development of a process of communication between the MoF and the BoT. There is currently a vacuum of legal justification in certain activities of the BoT, leaving uncertainty to some of its operations. By formalizing the responsibilities and decision-making process between the two institutions, issue conflicts could be more easily and readily resolved.

The BoT must also expand its accountability by way of reporting to a democratically elected body. It currently reports to an external committee that comprises mainly of the MoF officials. Although there is a strong view in Thailand that a parliamentary committee would not sufficiently understand monetary policy to be able to determine its soundness, it is the central bank's responsibility to improve its reporting techniques so as to gain the understanding of any party. In most cases, while the understanding of monetary policy will not be initially advanced with experience, parties will gain knowledge and understand the intricacies of monetary policy.

As for the enforcement process *per se*, a review of the internal fine scale is necessary. The particular fine imposed on a financial institution in case of non-compliance should have the effect of correcting wrongdoing and inhibiting the possibility of repetition. Thus, the fine should be high enough to create an incentive to permanently correct its activities, but not too high that it erodes the capital base of the financial institution. The BoT's scale for fines has not been revised for many years and the BoT concedes that the old (but current) scale does not pose an effective sanction against financial institutions. Frequent revision of the scale is not necessary unless the inflation rate is high, but periodic revision to ensure that it provides sufficient incentives for rehabilitation is necessary.

Also, as to the supervisory process, meaningful examination should be made into the management of financial institutions. Currently, manage-

ment of a financial institution is not interviewed during supervision to hear their strategy and to assess the soundness of their views. The only occasion in which examiners meet with the management of a financial institution is after a summary of the examination has been compiled, and a meeting is convened to convey the contents of it. The attitude and morale of financial institution management is a key element for the examiners to better understand the working of the institution, and to determine the mood and performance of the employees as well. Although it is difficult to ascertain the character of an institution's director and how this will affect the institution, a meeting with directors may direct an examiner to where some of the inadequacies of operations might arise.

B. Educational Dimensions

Enforcement cannot be fully implemented unless there is awareness not only among the responsible institutions, but also by the general public. This requires an educational process that facilitates an increase in the knowledge of the operations of a financial institution, how it affects the conduct of others, and the consequences of improper or deficient operation. In relation to the overall Thai financial sector reform program, three parties are the main subject of this educational process: members of the BoT staff, of the financial institutions, and of the general public.

The education of members of BoT staff is being addressed through two conduits: the training school for examiners and new public relations efforts of the BoT. As explained above, the training school not only focuses on technical issues, but also coordination issues. All this is aimed to improve the communication between examiners and other BoT staff members. In terms of PR, there is a new BoT mission statement, which addresses three issues: the structure, engineering and culture of BoT. The "culture" dimension is to be an educational process to improve the current poor coordination and communication in the BoT. This emphasis of "teamwork and cooperation" is to be contrasted with its deficiency in the past, which has obstructed a better understanding of the true state of the financial sector. Inter-department communication was limited and understanding of other department's operation has been minimal.

Further, members of the BoT staff need to grasp the direction toward which the Thai and the global financial systems are moving. Without a clear idea of what kind of financial sector they want, it is difficult to conduct effective research or to consider policies that will have an effect into the future. Circulating the Governor's speeches, internal policy memos on prospects of the financial sector, and memos/papers of international experts, is important in this respect.

Financial institutions need also to be aware of the consequences of their actions. The disclosure of supervisory results is an effective and low cost way to achieve this. Currently, only serious violations are being published, and only in an informal way. Publication of all non-compliances should be considered since the adverse impact on an institution's public

image will be a powerful incentive for financial institutions to operate soundly. Disclosure of the minutes of the Monetary Policy Board should also be considered so as to enhance the accountability of the monetary policy role. Disclosure to a parliamentary committee might also be considered.

As for the general public, there is an overall lack of public understanding of the nature and significance of monetary policy, and of the operations of the central bank and bank supervision. Many central banks are characterized by their mystified nature, and the BoT is no exception. Members of BoT staff acknowledge that those who understand monetary policy outside BoT are extremely limited. This should not be left in this state since the central bank has a responsibility to promote its policies and to enhance the understanding of its *raison d'être*. Unless the central bank's existence is supported by the general public, it will be difficult to conduct effective monetary and supervisory policies.[55]

The BoT should support the education of the general public by disclosing information on its operations and policies, and by holding seminars for the public. Publication of user-friendly, but meaningful brochures are another method of promoting the public understanding.

As long as the central bank exists in a democratic society, its public nature should require it to be accountable to the general public. Although this significance may seem diminished in terms of policy-formulation, the long-term consequences of neglect to public understanding could result in loss of regulatory power and broader governmental credibility.

C. Enforcement and Good Governance

The draft new CBA provisions, taken collectively, generally represent a meaningful approach to enforcement and good governance, but could be further revised to ensure that the proper incentives exist for the BoT to develop an "Enforcement Section" (not simply a Litigation Department) and to implement/utilize these provisions accordingly. The premise behind enforcement provisions and mechanisms for formal or informal enforcement actions is to establish an environment of "good governance" within the financial institution system.

As such, the enforcement provisions and mechanisms for enforcement action should be balanced so as not to preclude individuals with requisite expertise from avoiding positions as directors or managers because of fears of potential liability under nebulous statutes. For instance, the U.S. banking agencies were plagued with various instances of directors and managers engaging in fraudulent or abusive activities that were "unsafe and unsound" with respect to depository institutions during the 1980s, particularly with respect to the S&L industry crisis. Although many rea-

55. Some have advocated that the reputation of the central bank is essential for an effective monetary policy. *See e.g.*, Robert J. Barro & David B. Gordon, *Rules, Discretion and Reputation in a Model of Monetary Policy*, 12 J. OF MONETARY ECON. 101 (1983).

sons other than "insider" fraud and abuse contributed heavily to the demise of the thrift industry, the U.S. congressional response (conveniently) focused on such fraud and abuse in enacting legislation under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") and the Bank Fraud Act of 1990. The U.S. legislation granted the banking agencies acting in various capacities, including conservator or receiver, numerous new and enhanced enforcement powers over financial institutions and individuals associated with them.[56]

Thus, the U.S. banking agencies have a range of enforcement powers, including cease and desist orders, removal, prohibition and civil money penalty assessment authority, now over certain financial institutions and "institution-affiliated" parties, including controlling shareholders. The term "institution-affiliated party" has been expanded to include independent attorneys, appraisers, and accountants, as well as other "independent contractors" who knowingly or recklessly participate in any law or regulatory violation, any breach of fiduciary duty, or any unsafe and unsound practice that causes or is likely to cause more than a minimal financial loss to or a significant adverse effect on a financial institution. The U.S. banking agencies are authorized to issue regulations further defining which individuals should be considered as institution-affiliated parties due to their participation in the conduct of the affairs of an institution. The receiver institutions (primarily the FDIC as receiver or another entity so established by Congress to recover assets of failed banks, such as the Resolution Trust Corporation) were further authorized under FIRREA to pursue certain "insiders" in civil litigation for damages caused to their institutions under the "gross negligence" standard.[57]

The BoT needs to develop an adequate "enforcement framework" beyond simply articulating fines and penalties for violations of various sections for any violations of particular statutes and BoT regulations. In particular, the BoT could establish this "Enforcement Section" to enforce the DBA provisions. This Enforcement Section would need to be provided with a range of statutory enforcement tools available to address such violations, and to receive appropriate training and policy guidance so as to be able to exercise appropriate discretion in using them, given the facts and circumstances of particular cases. Most importantly, in order for an Enforcement Section to be effective, the BoT would have to provide adequate legal and financial resources and training. The Enforcement Section would necessarily need to be in close coordination with the BoT Supervision and Examination Sections, and in liaison with government prosecutors, to enforce violations and deficiencies uncovered through the supervisory process.

56. *See generally* Daniel B. Gail & Joseph J. Norton, *A Decade's Journey from 'Deregulation' to 'Supervisory Reregulation': The Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, 45 Bus. Law. 1103 (1990).

57. *Id.*

An Enforcement Section should generally be capable of uncovering violations of law, regulation, or other unsafe and unsound practices of various financial institution employees or affiliated parties, and is required to aggressively undertake some type of enforcement action to correct any deficiencies or address violations as appropriate, before such violations or practices seriously jeopardize the financial institution or affect the Thai financial system. The penal provisions should be triggered by the Enforcement Section for violations or practices that merit more serious consequences, subject to an expedited administrative review process which gives parties the opportunity to present their case to the BoT and MoF. As suggested above, the BoT and MoF should draft a binding agreement (MOU) which establishes how the enforcement process will proceed.

D. Prompt Corrective Action (PCA)

The PCA terminology is derived from the U.S. regulatory and legislative responses to the most severe series of banking and thrift crises experienced in the U.S. since the 1930s. In enacting the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), the U.S. Congress established the PCA scheme which imposed severe restrictions on the operation of under-capitalized, federally insured financial institutions. The PCA scheme also provided banking and thrift agencies with broadened powers to impose additional limitations and sanctions on such institutions. The PCA scheme also imposed restrictions on regulatory discretion by limiting the extent the regulators could assist troubled institutions on a non-transparent basis. The overall policy of the U.S. PCA scheme is to protect the government-insured deposit funds and the taxpayers. The draft CBA proposes a modified PCA scheme.[58]

E. Exit Policies

The draft CBA establishes basic policies and procedures for ordering a financial institution to be placed "under control" of a "Control Committee", and procedures for the Control Committee to submit a "project for rectification" to the BoT to recommend whether or not the financial institution should continue its business operations. The BoT authority to revoke licenses of financial institutions introduces the assumption that such revocations will result in the liquidation of the respective financial institutions. The draft CBA provides that the withdrawal of licenses results in such institutions being liquidated in accordance with "the law on deposit insurance institution." However, the draft CBA generally fails to establish any meaningful "exit" criteria, policies, and processes. The DIA will likely not be enacted for several years. Thus, the CBA will have to interface, as to exit policies, with the existing Thai interim, emergency decrees. For a new modern statute, such a situation would prove problematic, at

58. *See, e.g.*, G. N. Olson, Banks in Distress: Lessons From The American Experience Of The 1980s, ch. 11 (2000).

least until the inactment of a modern DIA.[59]

F. Consolidated and Conglomerate Supervision

Once an institution has been authorized to carry on any particular financial activity, it is necessary to ensure that it conducts its activities in a prudent and safe manner on a continuing basis thereafter. This is necessary to protect the interests of current and potential depositors and other creditors, as well as the stability of the banking and financial system as a whole, against the risk of contagion and systemic collapse. The objective of supervision is to allow the authorities to confirm that particular institutions are either conducting themselves in accordance with accepted standards of market practice or more specific statutory or administrative provisions designed to limit the financial exposures generated by their activities. Supervision is accordingly a monitoring or review process which ensures that financial institutions comply with recognized market standards or more specific regulatory provisions.

Supervision may be effected through a number of parallel processes which generally operate on an informal basis although they are backed by statutory powers in number of specific regards. To ensure that such supervision is complete and effective in modern markets, however, financial institutions must be examined on an individual (or "*solo*") as well as group (or *consolidated*) basis. This is necessary to ensure that full account is taken of all group or other connected relationships or exposures which may exist within increasingly complex financial group structures.

Since the mid-1970s, consolidated supervision has become an essential part of bank supervisory practice in many countries. Consolidation is also used in the other areas, such as securities business, in some countries. Although bank supervisors and securities regulators within the EU increasingly rely on consolidated supervision (with sometimes no solo supervision being undertaken at all), most insurance regulators and certain securities regulators, for example, in the US, prefer "*solo-plus*" supervision. "*Solo plus*" supervision involves the supervision of an institution on a solo basis initially only but with some adjustment subsequently being undertaken to reflect the other group relationships which exist. This may be preferred due to the perceived disadvantages involved with consolidation which include additional costs, the possibility of supervisory involvement in non-financial activities and the combination of distinct balance sheets to which different prudential requirements are applied.[60]

The main difficulty which arises with regard to consolidated and solo plus supervision, however, is that they are both based on legal structures and relationships. In modern financial markets, business structures within

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59. *Cf.* Gilliam Garcia, Deposit Insurance and Crises Management (IMF Working Paper WP/00/57, Mar. 2000); Gillian Garcia, Deposit Insurance—A Survey of Actual and Best Practices (IMF Working Paper WP 99/54, Apr. 1999).

60. For a general background on financial conglomerates, *see, e.g.*, George A. Walker, *The Law of Financial Conglomerates: The Next Generation*, 30 Int'l Law. 57 (1996).

groups are increasingly set up on product, regional grouping or some other management unit rather than a purely legal entity basis. The organizational structure of the group in economic or management terms will then have little relationship with its legal or corporate structure. For this reason, the authorities in such countries as the United Kingdom are developing new forms of supervision based on an examination of significant business units within a single company or group of companies and not just with legal entities.

This new management unit centered form of bank supervision is not designed to replace but to supplement the more traditional consolidated (legal entity) type of supervisory practice. While this has now been fully incorporated into standard United Kingdom supervisory processes it is still not used extensively elsewhere. It is, however, to be expected that it will be become IBP throughout the world within the next two to five years.

The other most significant recent development which has occurred has been the need to extend the existing forms of solo or partial consolidated supervision which exist to deal with the even more complex financial and mixed financial and commercial or industrial conglomerate group structures which have emerged. This has proved to be very difficult in light of the distinct nature of the underlying systems of supervision which exist in each of the three principal financial sectors of banking, securities and insurance. While some progress has been possible within Europe, for example, in bringing investment firms within the scope of bank consolidation, little further progress has been possible in this area. The issue has been considered at the international level by the Joint Forum on Financial Conglomerates and a number of papers have been produced. Most of these are, however, superficial in their terms and none have as yet been implemented at the national level.[61]

The final CBA should reflect best supervisory practice currently in operation elsewhere as well as include adequate provision to allow for future developments in this area to be given effect in Thailand in as quick and flexible a manner as possible.

The proposed provisions concerning consolidated supervision as set out in the draft CBA empower the Bank of Thailand to conduct examinations and supervision on a consolidated basis. The companies within the group are required to comply with the rules, procedures and conditions laid down by the Bank which may also impose additional capital requirements on group companies. Here, again, the drafting of comprehensive regulations will be essential.

V. CONCLUDING OBSERVATIONS

Clearly, the realities of effective banking law reform demand a meaningful and relevant "factoring-in" of the sundry *sui generis* dimensions

61. *Supervision of Financial Conglomerates*, BASEL COMM. PUB. NO. 47 (1999).

presented by a specific economy and society. Even, more clearly the focal point for insuring effective financial sector reform consistent with international best practices rests with the domestic reform process. As to an emerging economy such as Thailand, it is in the process of creating a financial sector legal infrastructure that adheres to international standards. With the passage of key legislation whether the Thai Parliament will confirm the institutional setting for an independent central bank, as determiner of monetary policy and as bank supervisor, will be a most telling sign to the financial markets and international community. In all events, the final reforms should lead to a practical supervisory regime based on international best practices. For example, stakeholders' interests will be controlled by more stringent lending limits, insider/affiliate transaction restraints and related penalties.

The Thai judicial system has also been improving with a new Constitution and bankruptcy court. Yet, the absence of a modern administrative procedure (without appropriate judicial review) for the BoT rulemaking remains a serious deficiency, if a more rule-based, rule of law approach to reform is to be achieved.

It would be premature to say that the legal infrastructure of the financial system in Thailand is *reformed* and that foreign investors can now expect the same "safety and soundness" of the advanced economies. Thailand is still in the process of fostering a credit culture, which is a key for enforcement to be effectively and efficiently carried out. A sound credit culture is also a foundation for a better and more widespread understanding of the reform process, and helps educate those involved in evaluating financial institutions through performance on the basis of political connections.

Independence of the central bank (if accepted by Parliament in the final legislation) must also be democratically supported by disclosure of its operations and reporting to an independent body. The current framework does not envisage reporting to an elected body, which could be problematic for the BoT. If the BoT is to adopt inflation targeting, reporting to an independent body should be seriously contemplated.

In any event, there is a clear need for wider disclosure of information. Statistics of non-compliant cases or statements on individual violations could be issued.[62]

The core bases for a viable financial infrastructure is readily at hand for Thailand, if the Thai Parliament acts in the national and not vested interests. Then, it will depend on the relevant sections of the economy, the politicians, the bureaucrats, the judiciary and the public as a whole to

62. In terms of broadening the understanding of the reform process by Thai society, the BoT should take advantage of its website to disclose more detailed reports and information of its operations and research conducted. It could hold seminars for the business community, academic community and the general public on the formulation of its policies. The problem of assessing the performance of a central bank and financial system lies with the lack of information. More effort should be taken to gain a wider audience for its publications in order to foster a better understanding of the rationale of its operations.

alter their behavior vis-à-vis the reforms. The ultimate reforms need to be "owned" by all sectors of the Thai economy and society, and not only by the officials of the BoT and MoF. This may be a slow and tedious process; but, if done rightly, an *effective* reform process should create a *"sound and safe"* financial system with the *robustness* that is envisaged by the international standards and best practices to which Thailand has committed to adhere.

In effect, the "organic" comparative methodology employed by Professor M^c^Knight remains most relevant today as to the modern *genre* of global infrastructural law reform—both in a retrospective and prospective context.