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Issue 124/2541: RE: Criteria, Conditions and Procedures for Financial Institutions Participating in the Tier 1 and Tier 2 Capital Support Schemes of the Ministry of Finance (English)

Thai Ministry of Finance

RE: Criteria, conditions and procedures for financial institutions participating in the tier 1 and tier 2 capital support schemes of the Ministry of Finance

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On August 14, 1998, the Ministry of Finance and the Bank of Thailand announced a comprehensive financial sector reform package. This package is aimed at addressing the remaining weaknesses in the system, as well as at achieving further consolidation in the sector. In particular, recognizing that the continuing macroeconomic uncertainties impede injections of new private capital into the banking system, the government is making available public resources to facilitate recapitalization, corporate debt restructuring, and new lending. The objective of this initiative is to reduce uncertainty, restore the solvency and credibility of the Thai financial system and, most importantly, to enable financial institutions to perform their role in supporting economic growth effectively.

The August 14 announcement contained the key elements of two public support schemes. One scheme is aimed at catalyzing the entry of private capital, while the other scheme provides resources and incentives to financial institutions to accelerate corporate debt restructuring and extend new lending. However, recognizing that the terms and conditions of any public support facility should be transparent and subject to the strongest possible safeguards, a high-level Financial Restructuring Advisory Committee (FRAC) was set up to prepare detailed guidelines for the use and monitoring of public resources under the two schemes. The detailed guidelines developed with the assistance of FRAC are attached to this announcement, and the key features are summarized in Tables 1 and 2.

In a well-functioning financial system, financial institutions can meet their obligations, serve their customers, and thereby promote economic growth. It is the Thai authorities firm view that the two public support schemes will facilitate the process of returning the Thai financial system to soundness and enable the financial institutions to meet the credit demands of their customers in a prudent fashion. However, the speed with which that can be done depends on the willingness of financial institutions to make use of the public support made available by the government.

Because the process of raising capital is one which normally takes some months, financial institutions need to have developed plans for raising capital well before their capital adequacy ratios fall below stipulated minima. Moreover, it would be advisable for financial institutions to have a margin in their compliance with the stipulated minimum capital adequacy ratio as a safeguard against unexpected losses.

Thus, the Bank of Thailand will closely monitor the trend in each financial institutions capital adequacy ratio and, when the trend is negative and well before it reaches the regulatory minima, financial institutions will be encouraged to enter the public support schemes. Failing this, the financial institutions will be required to present a plan of actions which they intend to take to reverse the trend and to avoid violating the stipulated minimum. There will be no forbearance for the financial institutions that wait until they violate the prudential regulations. We stand ready to intervene in any institutions which fails to meet the necessary standards.

	Tier 1 Capital Support Scheme
Objective	* Recapitalize financial institutions by catalyzing the injection of private capital * Assist in resumption of normal lending practices
Conditions & Safeguards	* Adopt up-front the end-2000 LCP rules * Losses on the old portfolio to be borne by original shareholders * New public and private capital to have preferred status * Government/new investor to have the right to change management

	* Institutions to provide their restructuring plans to FRAC/BOT
Form of public injection	* Tradeable government bonds with a maturity of 10 years
Amount of public injection	* The government will inject capital up to the amount provided by the private investor. However, if after full provisioning, the Tier 1 CAR falls below 2 $^{1}/_{2}$ percent, the government would be prepared to recapitalize the institution by itself up to this level before matching private funds. * New investors to have the option to buy back government shares * No pre-determined limit per institution. We will encourage institutions to recapitalize above regulatory minima.
Availability & application period	* Banks and finance companies can apply during October 1, 1998 to November 1, 2000, provided there will be private contributions.

	Tier 2 Capital Support Scheme
Objective	* Recapitalize financial institutions * Facilitate corporate debt restructuring * Encourage new lending
Conditions & Safeguards	* Legally binding debt restructuring agreement between the financial institution and the debtor * Debtor has to service the loan according to BOT regulations on troubled debt restructuring before Tier 2 capital is provided * Measurable increase in new lending
Form of public injection	* Nontradeable government bonds with a maturity of 10 years in exchange for subordinated debt instruments with matching maturity
Amount of public injection	* Up to 2 percent of each institution's risk weighted assets. The amount of Tier 2 support provided for new lending cannot exceed 1 percent of risk weighted assets
Availability & application period	* Banks and finance companies can apply during October 1, 1998 to November 1, 2000 * The generosity of the scheme will decline over time to encourage early debt restructuring