

THE S&L CRISIS REVISITED: EXPORTING AN AMERICAN MODEL TO RESOLVE THAILAND'S BANKING PROBLEMS*

I. INTRODUCTION

By all accounts, 1997 was a turbulent and devastating year for Asia.¹ Several countries in the region experienced severe economic dislocation in the midst of weakening currencies, tumbling stock markets, and plummeting sovereign debt ratings.² The languishing economies will inevitably bring scores of bankruptcies in their wake, and the resulting financial hardship can all too easily translate into social and political unrest. The “miracle” economies, for the time being, have suddenly lost their luster.

The problems plaguing Asia stem to a large extent from structural defects that have been festering for years. A major contributing factor is a frail and inefficient banking system. Thailand provides an interesting, and in many ways typical, case study of how serious flaws in the financial sector can undermine the growth and stability of a developing nation. Although each of the Asian countries has its own pathology, one common thread is that their financial institutions have played a prominent role in underwriting an unsustainable bubble economy. The challenge facing Thailand and the other Asian countries involves finding a way to repair the damage from this crisis and to prevent a recurrence by reforming their banking systems.

In contrast to Asia, the United States over the last few years has enjoyed steady growth with low inflation and unemployment, in addition to an unprecedented bull stock market. Despite such impressive achievements, it would be premature to announce the triumph of American-style capitalism. In the not too distant past, America too had a disastrous experience with its financial system when waves of

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1. See, e.g., Keith B. Richburg & Steven Mufson, *In Hindsight, Signs of Asian Crisis Appear Clear: Bank Loan Problems in 1996 Exposed Mountains of Debt, Shook Investor Confidence*, WASH. POST, Jan. 4, 1998, at A1.

2. See *id.*

thrift institutions became insolvent.³ Both the Thai and American banking crises share several parallels in their origins and dynamics.

After some initial waffling, the United States government resolved the savings and loan debacle successfully. Congress first passed legislation to tighten and strengthen supervisory powers of regulators while limiting their discretion to pursue a policy of forbearance. A special government entity, the Resolution Trust Corporation (RTC), was also created to dispose of the assets of troubled savings institutions. Employing the expertise of consultants and investment bankers, the RTC managed both to attract investors and “maximize” returns by exhibiting extraordinary flexibility and efficiency for a government agency. This Note explores the appropriateness of using the American solution as a model for remedying Thailand’s present predicament. First, the origins of the S&L crisis will be examined, followed by a description of the regulatory response to the problem. Next, an analysis of the Thai economic crisis will focus on the shortcomings of the banking system. Lastly, this Note will investigate the advantages and obstacles in pursuing an American solution in Thailand.

II. CONTEXT OF THE S&L CRISIS

Although commentators disagree on where principal culpability should lie,⁴ accounts of the salient events and factors that were involved in the S&L crisis are fairly uniform. The traditional approach divides the financial disaster into two distinct segments: the “interest rate squeeze” from 1979 to 1982, and the “debacle” from 1983 to 1985.⁵ The former period witnessed a rash of thrift insolvencies in the

3. The terms “S&L’s”, “thrifts”, and “saving institutions” are interchangeable for the purpose of this Note.

4. See, e.g., James R. Barth et al., *S&L Closures and Survivors: Are There Systemic Differences in Behavior?*, in *THE CAUSES AND COSTS OF DEPOSITORY INSTITUTION FAILURES* 9, (Allin F. Cottrell et al. eds., 1995) (arguing that incentives derived from S&L ownership structures were the dominant factor in S&L behavior); Gregory A. Lilly, *The Savings and Loan Debacle: Moral Hazard or Market Disaster?*, in *THE CAUSES AND COSTS OF DEPOSITORY INSTITUTION FAILURES* 119 (Allin F. Cottrell et al. eds., 1995) (contending that market forces, including the actual and expected inflation of the 1970s and ‘80s, were the root causes of the S&L failures); Alvin C. Harrell, *Deposit Insurance Reform Issues and the Implications for the Structure of the American Financial System*, in *INTERNATIONAL BANKING REGULATION AND SUPERVISION: CHANGE AND TRANSFORMATION IN THE 1990S* 305, 316-22 (J.J. Norton et al. eds., 1994) (suggesting that regulation rather than deregulation was behind the S&L’s failures).

5. LAWRENCE J. WHITE, *THE S&L DEBACLE: PUBLIC POLICY LESSONS FOR BANK AND THRIFT REGULATION* 67-122 (1991) (using the phrases “interest rate squeeze” and “debacle” to designate the two periods of the crisis).

wake of severe macroeconomic disturbances, while the latter period was characterized by a significant number of S&Ls undertaking excessive, and ultimately fatal, credit risks.

A basic familiarity with the context in which S&Ls operate is helpful in understanding the dynamics of the crisis. The thrift industry was originally conceived as a vehicle to promote home ownership.⁶ In an effort to make affordable housing a reality, Congress and state legislatures chartered thrift institutions that were intended to specialize in home mortgage financing.⁷

A. The Regulatory Quilt

The present form of the thrift industry traces its roots to the Great Depression.⁸ Reacting to the financial turmoil at that time, Congress enacted three pieces of legislation⁹ that brought the flagging thrift industry under federal regulatory control.¹⁰ First, Congress created the Federal Home Loan Bank System (FHLBS) to provide emergency financing to member thrift institutions.¹¹ This system was composed of twelve regional Federal Home Loan Banks (FHLB), which were headed by the Bank Board.¹² Next, in 1933, Congress authorized the Bank Board to charter thrifts.¹³ This development resulted in a system of parallel regulatory regimes. As a result, the thrift industry consisted of both federal-chartered and state-chartered savings institutions that were supervised by federal and state agencies, respectively.¹⁴ Last, Congress granted the Bank Board the power to set up the Federal Savings and Loan Insurance Corporation (FSLIC).¹⁵ This entity insured the time and demand deposits in both state and federal thrift institutions, and resulted in the partial regula-

6. For a brief history of the S&L industry and relevant legislation, see H.R. REP. NO. 101-54(I), at 290, 291-302 (1989), *reprinted in* 1989 U.S.C.C.A.N. 86, 87-98.

7. *See id.* at 294.

8. *See id.* at 292.

9. These three pieces of legislation were the Federal Home Loan Bank Act of 1932, Pub. L. No. 72-304, 47 Stat. 725 (codified as amended at 12 U.S.C. §§ 1421-49 (1994)); the Home Owner's Loan Act of 1933, Pub. L. No. 73-42, 48 Stat. 128 (codified as amended at 12 U.S.C. §§ 1461-70 (1994)); and the National Housing Act of 1934, Pub. L. No. 73-479, 48 Stat. 1246.

10. *See* Paul T. Clark et al., *Regulation of Savings Associations under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, 45 BUS. LAW 1013, 1017 (1990) (providing a historical account of the regulatory framework surrounding thrift institutions).

11. *See id.*

12. *See* Federal Home Loan Bank Act § 1423.

13. *See* Home Owner's Loan Act § 1464(a).

14. *See* Clark et al., *supra* note 10, at 1017-18.

15. *See* National Housing Act § 2.

tion of state-chartered thrifts by the federal government through this scheme of conditional deposit insurance.¹⁶ The FSLIC set the premiums for deposit insurance at a uniform level, without adjustments for risk.¹⁷

Consistent with their assigned mission, S&Ls derived their profits mainly through long-term, fixed-rate home mortgage loans.¹⁸ Their liabilities, on the other hand, consisted of highly liquid demand deposits.¹⁹ This arrangement resulted in a structural vulnerability where an unexpected rise in interest rates confronted a thrift with a no-win situation.²⁰ By raising the interest rates it paid in order to retain its depositors, a thrift would operate at a loss because of its inability to raise the lending rates of previous mortgages to compensate for its increased costs.²¹ Alternatively, the thrift could maintain the relatively low interest rate that it paid and expect many of its customers to withdraw their deposits. To meet its expenses in that event, the thrift would be forced to sell a portion of its fixed-rate mortgages at a depressed price because of the higher prevailing interest rate.²²

B. The Interest Rate Squeeze of 1979-1982

The inflationary environment in the 1960s and early 1970s revealed this structural weakness in the thrift industry, which Congress addressed successfully, albeit temporarily, with the Interest Rate Control Act of 1966.²³ This Act established an interest rate ceiling on deposits, a limitation that previously applied only to commercial banks.²⁴ This so-called "Regulation Q" set the interest rate cap for thrifts at a rate slightly above that allowable for commercial banks.²⁵

16. See Clark et al., *supra* note 10, at 1018.

17. See Harrell, *supra* note 4, at 326 (noting that the major defect with deposit insurance is the taxpayer guarantee to provide a risk-free environment for engaging in high-return, risk-intensive transactions).

18. See H.R. REP. NO. 101-54(I), at 290, 295 (1989), *reprinted in* 1989 U.S.C.C.A.N. 86, 91.

19. See WHITE, *supra* note 5, at 61-62.

20. See *id.* (describing the dilemma faced by S&Ls in an environment of increasing interest rates).

21. At this time, federally chartered thrifts could not at this time offer variable rate mortgages (ARMs). See *id.* at 65.

22. "A long-term, fixed rate mortgage with an option to repay can be viewed as a coupon bond with a known monthly coupon and an unknown maturity date and face value. Whenever interest rates rise, the market value of such assets falls." Lilly, *supra* note 4, at 124.

23. Interest Rate Control Act of 1966, Pub. L. No. 89-597, 80 Stat. 823; see also WHITE, *supra* note 5, at 62-64.

24. See WHITE, *supra* note 5, at 62.

25. See Lilly, *supra* note 4, at 124.

Depositors, who at that time had few comparable investment alternatives, resigned themselves to earning the meager returns paid by depository institutions.²⁶ With Regulation Q in place, the thrift industry was able to halt a self-destructive bidding war for depositors and weather the hostile economic conditions.²⁷

The Federal Reserve Bank's attempt to tame America's high inflation triggered the severe interest rate squeeze of 1979-1982.²⁸ Sharply rising interest rates in the late 1970s and early 1980s accompanied this monetary policy and combined with attractive investment innovations²⁹ in the financial markets to create a fertile environment for large-scale "disintermediation."³⁰ The effect of this disintermediation process was a severe credit shortfall in the construction industry.³¹ The subsequent hardships experienced by home buyers and the housing industry persuaded Congress to phase out Regulation Q by enacting the Depository Institutions Deregulation and Monetary Control Act in 1980 (DIDMCA).³² While the Act erased the thrift industry's competitive advantage with respect to banks, it also raised the federal insurance coverage to \$100,000 for each account.³³ Without Regulation Q, thrifts were free to compete for funds by offering higher yields for their federally insured deposits.

Due to the inherent defect in the thrifts' balance sheets,³⁴ how-

26. See WHITE, *supra* note 5, at 64.

27. See *id.*

28. See H.R. REP. NO. 101-54(I), at 290, 295 (1989), *reprinted in* 1989 U.S.C.C.A.N. 86, 91; WHITE, *supra* note 5, at 67.

29. For example, money market mutual funds allowed investors to pool their money in very safe investments such as Treasury bills, high-quality commercial paper, and high-denomination, short-term CDs offered by commercial banks, thereby obtaining a market rate of return without incurring significant risk. See WHITE, *supra* note 5, at 68-69. These money market mutual funds provided an attractive alternative to low interest bearing deposit accounts in thrift institutions. See *id.*

30. Disintermediation occurs when savings formerly held by financial intermediaries are diverted to financial instruments such as stocks, bonds, and various derivative products—this may occur, for example, when investors seek to avoid a government-imposed ceiling on the rate of return. See Maxwell J. Fry, *Summing-up: Three Issues of Financial Reform and Innovation*, in FINANCIAL INNOVATION AND MONETARY POLICY: ASIA AND THE WEST 319, 320-21 (Yoshio Suzuki & Hiroshi Yomo eds., 1986).

31. See H.R. REP. NO. 101-54(I), at 295.

32. Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified at scattered sections of 12 U.S.C. (1994)). See *id.* § 202(b); see also H.R. REP. NO. 101-54(I), at 294-95 (describing the events leading to the passage of the Depository Institutions Deregulation and Monetary Control Act).

33. See Depository Institutions Deregulation and Monetary Control Act § 308(a)(1).

34. In August 1981, it is estimated that 85% of the thrift industry's assets were locked up in long-term, fixed-rate mortgages while high-yielding short-term CDs constituted 53% of its

ever, attempting to attract depositors with higher interest rates alone was a doomed strategy. For example, in 1981, the thrifts' mortgage portfolios yielded 10% while the interest rate they paid on their deposits had risen to 11% on average.³⁵ The discrepancy in interest rates soon took its toll on the industry. The percentage of unprofitable federally insured thrifts increased from 2.9% in 1978 to 38.4% in 1983,³⁶ while the tangible net worth³⁷ of those thrifts tumbled from 5.6% to 0.4% of assets during the same time period.³⁸ Overall, the industry experienced \$4.6 billion in losses and eighty-one failures in 1981.³⁹ In 1982, the thrifts lost another \$4.3 billion while 252 more thrifts were closed; and in 1983, an additional 102 saving institutions failed.⁴⁰

C. The Debacle of 1983-1985

In response to the thrift industry's plight, Congress took a number of measures to loosen the regulatory constraints on its competitive practices, in the form of the DIDMCA and the Garn-St. Germain Depository Institutions Act of 1982.⁴¹ These two statutes, along with lax regulatory practices, set the stage for a profusion of extremely risky and sometimes abusive behavior by the S&Ls.

The deregulatory inclinations of Congress was strongly evident in DIDMCA. A number of the Act's provisions, in addition to the gradual elimination of Regulation Q and the increase in federal deposit insurance coverage, strengthened the ability of thrifts to attract funds. For example, the Act allowed thrifts to offer more services, including Negotiable Order of Withdrawal (NOW) checking accounts⁴² and credit cards.⁴³

Several of the changes also gave S&Ls greater discretion and

liabilities. *See* H.R. REP. NO. 101-54(I), at 296.

35. *See id.*

36. *See* WHITE, *supra* note 5, at 70.

37. According to Generally Accepted Accounting Principles (GAAP), tangible net worth excludes goodwill as an asset—this exclusion arguably provides a more accurate picture of an institution's financial condition, since goodwill can be used to exaggerate the value of its assets. *See id.* at 95-96 n.11.

38. *See id.* at 19.

39. *See* H.R. REP. NO. 101-54(I), at 296.

40. *See id.*

41. Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (codified at scattered sections of 12 U.S.C. (1994)).

42. *See* Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 303, 94 Stat. 132.

43. *See id.* § 402.

flexibility in managing their assets. The DIDMCA, for instance, allowed thrifts to place up to 20% of their assets in non-traditional investments such as commercial real estate and consumer loans, corporate debt securities, and commercial paper.⁴⁴ Such portfolio diversification helped to create more liquidity and greater potential returns. The Act also preempted state laws against mortgage usury.⁴⁵ This step paved the way for the development of adjustable rate mortgages (ARMs), an asset that did not contribute to the interest rate mismatch in the thrifts' balance sheets.

Perhaps most importantly, the DIDMCA lowered the thrifts' net worth requirements.⁴⁶ Net worth measures the residual value of an institution after liabilities are deducted from assets,⁴⁷ and therefore represents an equity cushion provided by the institution's owners as a buttress to insolvency. Investors would normally allocate their resources based on their assessment of the financial stability of the depository institutions. Institutions would therefore have an incentive to be adequately capitalized so as to reassure cautious investors. In the context of deposit insurance, however, the level of an institution's net worth is dictated generally by regulatory standards instead of market forces.⁴⁸ Before DIDMCA's enactment, thrifts were required to maintain a net worth of at least 5% of their liabilities.⁴⁹ Under the Act, the Bank Board was permitted to set the minimum net worth requirement between 3-6% of liabilities.⁵⁰ Exercising its newly established authority, the Bank Board lowered the net worth floor to 4% in 1980 and then to 3% in 1982. The subsequent reduction in the S&Ls' capitalization exposed the FSLIC's funds to greater potential losses. In other words, the buffer separating the thrifts' liabilities from the government's guaranteed insurance obligations had been degraded.⁵¹

Despite these changes, the thrift industry continued its decline which prompted more deregulatory efforts. In 1982, Congress en-

44. *See id.* § 401(c)(2).

45. *See id.* § 501(a)(1).

46. *See* WHITE, *supra* note 5, at 82-87 (arguing that the lowering of net worth and accounting standards exacerbated the risks posed by the industry).

47. *See id.* at 37.

48. *See id.* at 82.

49. *See id.*

50. *See* Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 409, 94 Stat. 132.

51. *See* WHITE, *supra* note 5, at 82.

acted the Garn-St. Germain Depository Institutions Act.⁵² This Act broadened the investment opportunities of the thrifts even more by, among other things, allowing thrifts to invest a larger percentage of their assets in loans secured by non-residential real estate.⁵³

The Garn-St. Germain Act also diluted the accounting standards applied to S&Ls. The Act authorized the Bank Board to issue promissory notes to thrifts in financial distress in exchange for "certificates of net worth."⁵⁴ Despite being devoid of any real value, the notes were included as assets and, accordingly, overstated the thrifts' actual net worth.⁵⁵ This practice of note exchanges undermined the Bank Board's already weak accounting standards.

The Regulatory Accounting Principles (RAP) that applied to thrifts allowed institutions to continue operating despite a substantial deterioration in their financial condition. For example, RAP allowed thrifts to amortize losses realized on the sale of an asset over its life.⁵⁶ RAP also allowed thrifts to recognize an appreciation of the appraised market value of assets without a corresponding recognition of unrealized asset depreciation.⁵⁷ RAP's illusory standards enabled many thrifts to remain technically solvent, although actually insolvent by Generally Accepted Accounting Principles (GAAP) standards.⁵⁸ Consequently, the ability of regulators to take corrective actions was greatly impaired even as the losses to the FSLIC began to mount.⁵⁹

The Bank Board's laxity regarding accounting standards and net worth requirements was consistent with its general policy of regulatory forbearance. Due to the large number of insolvent S&Ls caused by the soaring interest rates in the late 1970s and early 1980s, the FSLIC itself was effectively insolvent.⁶⁰ In order to avoid cash payments to depositors pursuant to its insurance guarantee, regulators had a strong incentive not to recognize explicitly the insolvencies of

52. See *id.* at 72 (describing the factors motivating further Congressional action).

53. See Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 322, 96 Stat. 1469 (codified at scattered sections of 12 U.S.C. (1994)).

54. See *id.* § 202.

55. See WHITE, *supra* note 5, at 83.

56. See *id.*

57. See *id.* at 84.

58. See *id.* at 86-87.

59. See *id.* at 84-85.

60. See Randall S. Kroszner & Philip E. Strahan, *Regulatory Incentives and the Thrift Crisis: Dividends, Mutual-to-Stock Conversions, and Financial Distress*, 51 J. FIN. 1285, 1285 (1996).

thrift institutions.⁶¹

One strategy for shoring up the thrifts' finances and preserving FSLIC funds was to stimulate an infusion of private capital. "To encourage investors to inject funds into insolvent institutions regulators had to provide special inducements such as lenient enforcement of capital adequacy requirements and relaxed restrictions on dividend payments."⁶² Another option pursued by the Bank Board was to encourage the merger of troubled institutions into stronger ones.⁶³

These deregulatory actions attracted a large amount of investment capital which fueled an increase in supplier-led speculation and a real estate boom.⁶⁴ Consequently, thrifts had both ample funds and opportunities to make risky investments in the hopes of reaping large returns and regaining profitability. With marginal amounts of equity at stake and deposit insurance as a backup, the risk of negative investment incomes had little restraining influence on thrift behavior. In other words, "[o]wners of thinly-capitalized or insolvent thrift institutions, in turn, had a strong incentive to raise the value of the deposit insurance contract through increases in asset risk and capital distributions to shareholders."⁶⁵

During the period 1983-1984, the seemingly revived thrift industry enjoyed tremendous growth.⁶⁶ While this phenomenon was partly the result of the overall economic recovery, the growth was also due to thrift operators taking advantage of expanded opportunities and capabilities.⁶⁷ Further contributing to the industry's expansion was the entry of entrepreneurs attracted by the favorable investment environment.⁶⁸ The growth in the number and size of S&Ls, however,

61. *See id.* at 1286.

62. *Id.* at 1286. Kroszner and Strahan argue that insolvent or thinly-capitalized mutual thrifts had incentives to convert into stock thrifts with the regulators' blessings. The stock form allowed thrifts to pay higher dividends which increased the costs of the S&L clean-up.

63. *See* WHITE, *supra* note 5, at 84.

64. *See* Barney Warf & Joseph C. Cox, *Spatial Dimensions of the Savings and Loan Crisis*, 27 *GROWTH & CHANGE* 135, 138 (1996).

65. Kroszner & Strahan, *supra* note 60, at 1285-86.

66. Annual growth rates for thrifts insured by the Federal Savings and Loan Insurance Corporation (FSLIC) were 18.6% and 19.9% for 1983 and 1984, respectively. *See* WHITE, *supra* note 5, at 100.

67. *See id.* at 101-02.

68. *See id.* at 105. Evidence of increased entrepreneurial activity derives from two sources. First, the number of new thrifts receiving approval for FSLIC deposit insurance jumped from 119 during 1980-1982 to 268 during 1983-1985. *See id.* Second, the number of mutual to stock conversions between 1983-1985 tripled the previous three years. *See id.* at 106. The increase in stock conversions can be attributed in part to new entrepreneurs gaining control of nearly bankrupt institutions and applying for permission to convert to stock form. *See*

masked the steadily deteriorating quality of many thrifts' assets.

A similar pattern was developing in the regulatory scheme at the state level, a significant phenomenon given that 51% of FSLIC-insured thrifts were state-chartered in 1980.⁶⁹ In an attempt to prevent their savings institutions from converting to federal charters, state legislatures went to even greater lengths to deregulate their thrift industries.⁷⁰ The most notable states in this regard were California, Texas, and Florida.⁷¹

The policy of forbearance notwithstanding, the FHLB Board could not provide a meaningful check on the risk-taking S&Ls. Imbued with the philosophy of down-sizing government, the Reagan "[a]dministration would not support an increase in the number of savings and loan examiners even though the thrift industry was going through its most significant restructuring since the Great Depression."⁷² Furthermore, both managers of thrifts and S&L examiners were ill-equipped at that time to assess the risks of unfamiliar and complex transactions.⁷³ As a result, gross mismanagement and outright fraud flourished, adding to the costs of thrift resolutions.

Nevertheless, most thrift insolvencies were not the result of fraud, but were rather the product of risky, poorly planned decisions made against the backdrop of a fizzling real estate market.⁷⁴ Moreover, the enormous costs of the S&L crisis were caused by only a minority of the thrifts that had gambled fabulously.⁷⁵ In the aftermath of the debacle, cleanup of state-chartered thrifts in California and Texas alone consumed roughly 70% of the FSLIC's budget.⁷⁶

Evidence of trouble in the industry began to surface in 1984,⁷⁷ but the full extent of the problem took a few more years to register.⁷⁸ Finally facing up to the situation, the Bank Board promulgated new

id. at 106.

69. See H.R. REP. NO. 101-54(I), at 297 (1989), *reprinted in* 1989 U.S.C.C.A.N. 93.

70. See *id.*

71. See *id.*

72. *Id.* at 301.

73. See WHITE, *supra* note 5, at 76.

74. See *id.* at 117.

75. See *id.* at 81.

76. See H.R. REP. NO. 101-54(I) at 297.

77. Questions concerning the fitness of the thrift industry were raised after the failure of Empire Savings in Mesquite, Texas in early 1984. See WHITE, *supra* note 5, at 125.

78. An overly-lenient accounting system required time to reflect financial difficulties. See *id.* at 112. Furthermore, a real estate downturn after 1984 sounded the death knell for the debt-laden thrifts. See *id.* at 113.

and more stringent regulations for the industry beginning in 1984. It established an annual growth rate ceiling that was adjusted downward for thinly-capitalized thrifts, set the net worth standards at 6% of liabilities (although certain qualifying thrifts could maintain a slightly lower equity cushion), restricted certain categories of investment by some function of tangible net worth; reinstated GAAP standards in lieu of RAP, and beefed up the number and quality of S&L examiners.⁷⁹ As the costs for resolving insolvent thrifts began to swell,⁸⁰ it became painfully apparent that the FSLIC was insufficiently funded to meet its obligations.⁸¹ Congress attempted a recapitalization of the FSLIC when it passed the Competitive Equality Act of 1987 (CEBA).⁸² This Act set up the so-called Financing Corporation (FICO)⁸³ to raise \$10.8 billion for the FSLIC.⁸⁴ Costs, however, continued to escalate and “[b]y the end of 1988, the thrift industry crisis had become a major political issue and a top priority of the incoming Bush administration.”⁸⁵

III. RESOLVING THE S&L CRISIS

Congress enacted two major pieces of legislation to resolve the crisis and stabilize the thrift industry. The stated purpose of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA)⁸⁶ was to resuscitate and reform the federal deposit insurance system and to strengthen the supervisory and enforcement powers of regulators.⁸⁷ The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA)⁸⁸ set up an improved regulatory

79. *See id.* at 128-31.

80. In 1984, the FSLIC's total income from deposit insurance premiums and accrued interest was \$1.325 billion with “net reserves” of another \$5.6 billion. Resolution of the seventy-one thrifts insolvent under the Regulatory Accounting Principles (RAP) at the end of 1984 would have required approximately \$15 billion. *See id.* at 135.

81. “While the exact timing of FSLIC's insolvency and its realization by the regulators is difficult to determine, most observers would not put the date later than 1982.” Kroszner & Strahan, *supra* note 60, at 1286 n.3.

82. Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552 (codified at scattered sections of 12 U.S.C. (1994)).

83. *See id.* § 302(a).

84. *See id.* § 302(e)(1)(B).

85. Clark et al., *supra* note 10, at 1015.

86. Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (codified at scattered sections of 12 U.S.C. (1994)).

87. *See* H.R. REP. NO. 101-54(I), at 307-08 (1989), *reprinted in* 1989 U.S.C.C.A.N. 103-104.

88. Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (codified as amended at scattered sections of 12 U.S.C. (1994)).

framework to supervise depository institutions and effectuate needed corrective measures.

A. The Legislative Response

To address the task of resolving insolvent thrifts, FIRREA first established the Resolution Funding Corporation (REFCORP) to provide the financing for clean-up operations.⁸⁹ Congress initially authorized REFCORP to issue \$30 billion in government debt securities.⁹⁰ FIRREA then established the Resolution Trust Corporation (RTC) to direct the resolution of thrifts, and the Oversight Board to oversee the RTC.⁹¹ The RTC's purpose was to "manage and resolve all cases involving depository institutions" that had been previously insured by the FSLIC.⁹² The RTC's mandate required it to maximize the returns on asset disposition without disrupting local real estate and financial markets.⁹³

In an attempt to prevent a recurrence of this financial calamity, FIRREA included several provisions designed to improve the regulatory structure. Animated by the belief that conflicts of interest within the Bank Board undermined the previous FHLBS,⁹⁴ Congress abolished the Board⁹⁵ and transferred its responsibilities of regulating and chartering thrifts to a new division of the Department of Treasury, the Office of Thrift Supervision (OTS).⁹⁶ The Federal Deposit Insurance Corporation (FDIC) assumed the management of thrifts' deposit insurance.⁹⁷

In enacting FIRREA, Congress realized the importance of stronger capital requirements and the role that excessively lax ac-

89. See Financial Institutions Reform, Recovery and Enforcement Act of 1989 § 511(a).

90. See *id.* sec. 511(a), § 21B(f)(1). The interest of the bonds were to be paid for by earnings on assets owned by the Resolution Funding Corporation (REFCORP), Bank Board contributions, Resolution Trust Corporation (RTC) proceeds generated through the liquidation or sale of insolvent thrifts, and Treasury appropriations. See *id.* sec. 511(a), § 21B(f)(2). Payments on the principal of the debt were to be covered through income produced by non-interest bearing instruments purchased through assessments levied on the regional FHLBS banks, deposit insurance premiums, and receivership proceeds. See *id.* sec. 511(a), § 21B(f)(3).

91. See *id.* sec. 501.

92. *Id.* sec. 501, § 21A(b)(3)(A)(b).

93. See *id.* sec. 501, § 21A(b)(3)(C).

94. See H.R. REP. NO. 101-54(I), at 302 (1989), reprinted in 1989 U.S.C.C.A.N. 98.

95. See Financial Institutions Reform, Recovery and Enforcement Act of 1989 § 401(a).

96. See *id.* § 401(e).

97. See *id.* § 202. FIRREA gave the FDIC control over two separate funds, the Bank Insurance Fund for commercial banks, and the Savings Association Insurance Fund for S&Ls. See *id.* § 206(a)(7).

counting played in the S&L debacle.⁹⁸ To better ensure the adequate capitalization of thrift institutions, FIRREA mandated a capital requirement of only 3% of assets, but added risk-based adjustments similar to the capital standards applied to commercial banks.⁹⁹ In the same vein, FIRREA required the use of certified or licensed appraisers in real estate related transactions and the application of uniform real estate appraisal standards.¹⁰⁰ These modifications were intended to prevent the abusive practice of inflating estimates of real estate values to secure a larger loan.¹⁰¹ Finally, FIRREA also strengthened the enforcement powers of regulators and stiffened the criminal and civil penalties for crimes associated with financial institutions.¹⁰²

The FDICIA represented a further effort to tighten the thrift's regulatory scheme. This Act attempted to constrict the regulatory discretion of S&L examiners and to eliminate the previous "too big to fail" policy.¹⁰³ On-site examinations of all insured institutions were required¹⁰⁴ and accounting methods were tightened.¹⁰⁵ Regulators, armed with up-to-date information, could then act promptly at signs of trouble.¹⁰⁶ Different levels of regulatory scrutiny were applied to different segments of the industry. For example, large institutions are required to have quarterly financial reports prepared by independent public accountants.¹⁰⁷

B. The Mechanics of the RTC

Many observers in the financial community have heralded the RTC as a resounding success.¹⁰⁸ In its six years of existence, the RTC had resolved 747 insolvent thrifts and recovered \$395 billion of the \$456 billion in its charge.¹⁰⁹ The taxpayers' burden for the clean-up

98. See H.R. REP. NO. 101-54(I), at 310.

99. See *id.* at 310-11.

100. See Financial Institutions Reform, Recovery and Enforcement Act of 1989 §§ 1101-22.

101. See H.R. REP. NO. 101-54(I), at 311 (1989), *reprinted in* 1989 U.S.C.C.A.N. 98.

102. See Financial Institutions Reform, Recovery and Enforcement Act of 1989 §§ 961-68.

103. H.R. REP. NO. 102-330, at 96 (1991), *reprinted in* 1991 U.S.C.C.A.N. 1901, 1909.

104. See Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (codified as amended at scattered sections of 12 U.S.C. (1994)) sec. 111, § 10(d)(1).

105. See *id.* sec. 112, § 36(b).

106. See H.R. REP. NO. 102-330, at 99.

107. See Federal Deposit Insurance Corporation Improvement Act of 1991 sec. 112, § 36(g)(2).

108. See, e.g., Dean Foust, *The RTC's Epitaph: It Worked*, BUS. WK., Jan. 15, 1996, at 29; Jeffrey Marshall, *Learning from the RTC*, U.S. BANKER, Sep. 1993, at 28.

109. See Foust, *supra* note 108.

was just under \$145 billion, an amount far less than many experts had predicted.¹¹⁰ After only three years, the agency sold over \$330 billion of assets at an outstanding 92% of book value.¹¹¹ Although many of these assets were difficult to dispose of, the RTC succeeded by employing many innovative strategies,¹¹² and by 1995 the thrift industry was earning a healthy \$7.6 billion in annual profits.¹¹³ The RTC had accomplished its mission so expeditiously that it shut its doors one year ahead of its December 31, 1996 sunset expiration date.¹¹⁴

Nevertheless, given its high profile status in a politically sensitive area, the agency has had its share of critics. Detractors of the RTC have leveled various charges of mismanagement, including the excessive use of expensive consultants as well as outright fraudulent billing by contractors.¹¹⁵ Other critics have contended that the agency had hastily unloaded its assets at bargain prices to the benefit of wealthy investors and detriment of taxpayers.¹¹⁶

The RTC faced a daunting challenge not only because of the enormity and political sensitivity of its task, but also because its fleeting life-span made it difficult to recruit quality personnel.¹¹⁷ Although the agency undoubtedly made mistakes,¹¹⁸ the general consensus is that the RTC was a rare example of a government agency that operated efficiently and effectively.

When a thrift fell below the prescribed minimum net worth requirement or became insolvent, the chartering authority would close down the institution, and the RTC would then take control of the defunct thrift and hold it in conservatorship.¹¹⁹ The resolution of the insolvent S&L would then involve an attempt by the RTC to sell the institution intact, or alternatively, to liquidate its assets.¹²⁰ If the at-

110. *See id.* In 1993, after the agency had sold the bulk of its assets, many economists still expected costs to climb to \$200 billion, or \$500 billion when interest payments were factored into the calculation. *See* Marshall, *supra* note 108.

111. *See* Birge Watkins, *RTC Finds Assets in 1993 Far More Manageable*, NAT'L REAL ESTATE INV., Apr. 1993, at 66, 66.

112. *See* Dean Foust, 'Now They're Really Down to the Dregs,' BUS. WK., Mar. 8, 1993, at 80.

113. *See* 1995 FDIC ANN. REP. 10.

114. *See* Foust, *supra* note 108; Watkins, *supra* note 111.

115. *See* Marshall, *supra* note 108, at 34-35.

116. *See* Foust, *supra* note 108.

117. *See* Marshall, *supra* note 108, at 34.

118. "[Former RTC Senior Vice-President for Asset Sales Lamar] Kelly believes that mistakes were made, but says the staff has been 'superb.'" *Id.*

119. *See* 1995 FDIC ANN. REP. 23-25.

120. *See* Leonard Sahling, *Managing the Cleanup of the Thrift Crisis*, REAL ESTATE REV.,

tempted sale proved to be only partially successful, the RTC would hold residual assets in receivership.¹²¹

The real estate related assets that the agency put up for sale included a wide variety of projects, including raw land, malls, hotels, and office buildings.¹²² The thrifts, however, also invested in a myriad of other kinds of assets, which made the resolution process even more cumbersome.¹²³ To make matters worse, FIRREA imposed various restrictions on how thrifts' assets could be sold.¹²⁴

The disposal of highly liquid assets at fair market value posed no great difficulty. "[G]overnment securities, single-family mortgage-backed bonds, high-yield bonds and non-mortgage loans (especially those to consumers)" could be easily unloaded in well-developed secondary markets.¹²⁵ By contrast, tainted assets such as non-performing mortgages, charge offs, and judgments were harder to sell and required more complicated, innovative procedures.¹²⁶ To surmount these obstacles, the RTC employed three major techniques: bulk sales, auctions, and mortgage securitization.¹²⁷

In response to the unwillingness of many banks to acquire assets of dubious quality, the RTC assembled those assets in large, bulk-sale packages, whose composition attracted institutional investors.¹²⁸ The first bulk sale was closed in March 1991, when a portfolio of non-performing commercial mortgages and Real Estate Owned (REO) properties was sold to a conglomerate.¹²⁹ The proceeds from that transaction amounted to \$122 million for a pool of assets with a book value of \$180 million.¹³⁰ Despite the deep discount, this sale could be considered a success for the RTC considering the nature of the assets being marketed.¹³¹ Subsequently, numerous such deals were put to-

Winter 1993, at 52 n.1.

121. *See id.*

122. *See* Marshall, *supra* note 108, at 29.

123. These assets ranged from interests in highly leveraged transactions to office furniture and supplies. *See id.* at 29-30.

124. *See* Sahling, *supra* note 120, at 54. *See, e.g.*, Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (codified at scattered sections of 12 U.S.C. (1994)) sec. 501(a), § 21A(b)(3)(C)(ii) (prohibiting the RTC from disposing of real estate assets in a manner disruptive to commercial property markets).

125. Sahling, *supra* note 120, at 53.

126. *See* Marshall, *supra* note 108, at 30.

127. *See* Sahling, *supra* note 120, at 54.

128. *See* Marshall, *supra* note 108, at 30.

129. *See* Sahling, *supra* note 120, at 54-56.

130. *See id.*

131. Sale of Real Estate Owned (REO) assets in 1993 typically recouped only 38% of the

gether¹³² with the value of packages offered averaging \$3-4 million.¹³³

In addition to bulk sales, the agency sold assets at auctions. During the auction process, the RTC contracted with a sales agent to manage the disposal of a particular portfolio.¹³⁴ The agent was responsible for implementing all the steps necessary for an auction, which included marketing the asset pool, accepting inquiries, processing the required government forms, operating the auction, and choosing the winning bid.¹³⁵ Auctions offered the RTC the advantage of presenting large amounts of assets to the market, while minimizing overhead costs.¹³⁶

The other major process that the agency used to dispose of assets was securitization.¹³⁷ The structure of each securitization transaction depended on the nature of the underlying asset. For example, single-family home mortgages, which comprised the majority of the RTC's performing loans, were often disposed of in this manner.¹³⁸ Normally, performing mortgages could be sold in the market separately or in pools without resorting to securitization.¹³⁹ However, investors often viewed the creditworthiness of real estate related assets with skepticism.¹⁴⁰ This pessimism caused investors to demand higher premiums, making whole-loan sales economically impractical.¹⁴¹ In search of a more attractive alternative,¹⁴² the RTC turned to securitization.

The RTC developed its own securitization model for mortgage-

properties' book value. See Marshall, *supra* note 108, at 34.

132. See Sahling, *supra* note 120, at 54-56 (chronicling a series of RTC-sponsored bulk sales).

133. See Marshall, *supra* note 108, at 34.

134. See Sahling, *supra* note 120, at 56.

135. See *id.*

136. See Marshall, *supra* note 108, at 34. "'Auctions give us a chance to expose a large volume of assets to the marketplace and dispose of them with a substantial reduction in overhead,' says Ron Cline, director of the RTC National Sales Center in Washington." *Id.*

137. For a description of the securitization process, see generally Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133 (1994).

138. See Sahling, *supra* note 120, at 57.

139. See *id.* at 57 n.5.

140. See *id.*

141. See *id.*

142. Thrifts requiring liquidity often sold mortgages to the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Association (Freddie Mac) if the mortgages conformed to those agencies' standards. See *id.* at 57. By the time a thrift's financial condition forced it into RTC receivership, few conforming mortgages remained. See *id.* Consequently, this avenue of asset disposition was not a viable option for the RTC. See *id.* Furthermore, traditional buyers of whole-loans such as banks and insurance companies, were subject to tighter risk-based capital requirements. See *id.*

backed securities (MBS) known as Ritzzy Maes.¹⁴³ One feature of these securities was that they were issued in a registered offering.¹⁴⁴ The disclosure requirements of registration provided investors with access to substantial information about the risks of the underlying mortgages, thereby increasing the liquidity of the securities. The fact that the collateral backing the securities was typically held in trust¹⁴⁵ further reassured investors that the mortgage pool would be under unitary control. Finally, through use of credit enhancement techniques (usually in the form of reserve funds),¹⁴⁶ the securities were able to achieve a sufficiently high investment rating to entice institutional investors.¹⁴⁷

Compared to the market for single-family MBS, the market for securities backed by multi-family mortgages (i.e., commercial residential mortgages) was relatively undeveloped.¹⁴⁸ The RTC was something of a trailblazer in the development of marketable securities of this kind.¹⁴⁹ The multi-family MBS incorporated the same basic features of the single-family MBS, but required increased credit enhancement mechanisms to achieve comparable credit ratings.¹⁵⁰ While the major risk accompanying single-family mortgages was the possibility that borrowers would retire their loans ahead of schedule, residential commercial mortgages posed relatively insignificant prepayment risk.¹⁵¹ Instead, multi-family mortgages involved a greater risk of default¹⁵² stemming from the precarious position of business enterprises. Securities backed by such mortgages therefore required more extensive insurance that payments will continue despite higher rates of default. Thus, credit enhancement for multi-family MBS of-

143. *See id.*

144. *See id.*

145. *See id.*

146. Cash reserves ensure that the investors' principal and interest will be repaid on time. *See* Marshall, *supra* note 108, at 37.

147. *See* Sahling, *supra* note 120, at 57. "Senior-subordinated structures are sometimes used to provide supplementary credit enhancement, to improve marketability, and to reserve the size of reserve funds." *Id.*

148. *See id.*

149. *See id.* at 58. "They basically created the market, for both secured and unsecured loans. The securitization market had been inefficient and very expensive; the technology for deals was all over the board. They helped develop a market that seemed to be going nowhere." Marshall, *supra* note 108, at 35 (quoting the kudos given by a newsletter editor to the RTC's pioneering securitization program).

150. *See* Sahling, *supra* note 120, at 58.

151. *See id.*

152. *See id.*

ten totaled between 32% to 45% of the amount of the offering.¹⁵³

Securities backed by non-residential commercial mortgages entailed even greater protection requirements for investors. Besides the significant credit enhancement features of multi-family MBS, the non-residential commercial MBS established a “special servicer” to handle any mortgages in the pool that became non-performing.¹⁵⁴ The servicer’s responsibility was to review those cases and take whatever appropriate measures¹⁵⁵ were needed to minimize losses.

From its inception, the agency had a powerful motivation to resolve failed institutions quickly. Not only did the value of “bad assets” shrink over time, but the carrying costs and management fees for real estate property also placed a significant drain on the RTC’s limited funds.¹⁵⁶ This situation fostered a pervasive deal-making ethos in the RTC. As a result, efficiency and flexibility became two important principles in structuring transactions.

The RTC enlisted the aid of big-name consultants and investment bankers to put together large deals.¹⁵⁷ Although many critics decried the heavy involvement of Wall Street firms because of cost¹⁵⁸ and equity concerns,¹⁵⁹ the expertise of such players were needed to expedite the transactions and maximize value. “The big investment banks have the market clout and the expertise to structure and move big asset packages; to minimize their role could have slowed the sales process to a crawl.”¹⁶⁰

In addition, the RTC showed a great deal of flexibility in working with investors. In packaging bulk sales, for example, the RTC allowed interested parties to modify the pool of assets being offered, as long as they didn’t engage in “cherry-picking” where only the best

153. *See id.* The amount of reserve funds for multi-family mortgage-backed securities (MBS) commonly ranged from 25-35% compared with 10-27% for single-family MBS. *See id.* Additionally, multi-family MBS tended to employ senior-subordinated structures more often to boost the credit rating. *See id.*

154. *See id.*

155. *See id.*

156. *See* Marshall, *supra* note 108, at 30.

157. *See id.*

158. *See* Albert R. Karr & John Connor, *Wall Street Cashes in on RTC’s Program*, WALL ST. J., June 15, 1993, at C1 (reporting that eleven firms earned almost \$250 million in underwriting fees in the RTC’s securitization program).

159. Smaller firms complained that they were unfairly excluded from the process by the same firms that sold billions of dollars worth of junk bonds to the faltering S&L industry. *See* Marshall, *supra* note 108, at 30.

160. *Id.*

assets were selected.¹⁶¹ As an inducement to some investors, the RTC had also provided seller financing. “The theory is that if you can sell it and get a substantial enough down payment, you’re just as well off selling it, even if you need to foreclose at a later date.”¹⁶²

In structuring many of the transactions, the RTC insured that it would receive a share of any potential profits from distressed assets. By retaining an equity stake in certain projects, the agency would get a cut of the up-side potential of the assets being sold. For example, the RTC turned down two offers to buy a 21,000-acre residential development outside of Phoenix for a reported \$17 million in cash because it felt that it would benefit more by selling only a 25% stake in the project.¹⁶³

Overall, the RTC’s resolution of the insolvent thrifts was an extremely successful process. In light of the speed and efficiency with which an enormous amount of distressed assets were sold and “maximum” returns realized, the RTC provided a possible template for other countries whose banking systems are being crushed from the weight of bad loans. The recent souring of Asia’s economies can be largely attributed to deficiencies in the banking sector. Thailand, the first country to stumble in the crisis, provides an interesting case study for two reasons. First, in several respects Thailand’s financial problems are symptomatic of the weaknesses hobbling many countries in the region. Second, the origins of Thailand’s financial problems have some significant parallels with the United States crisis. These similarities raise the question of whether any lessons from the American experience can be exported.

IV. THAILAND’S BANKING CRISIS

The wholesale transplantation of one country’s solutions to another warrants a cautionary note. “Each country has [its own] underlying political, economic, sociological, legal, and institutional conditions that are unique to it, all of which will influence its development approach,”¹⁶⁴ including the manner in which it resolves its internal problems. Although the idiosyncrasies of one country should not automatically preclude the application of its strategy to

161. See Sahling, *supra* note 120, at 56.

162. Marshall, *supra* note 108, at 30 (quoting the former RTC Senior Vice-President of Asset Sales).

163. See Foust, *supra* note 112.

164. SEQUENCING?: FINANCIAL STRATEGIES FOR DEVELOPING COUNTRIES 2-3 (Alison Harwood & Bruce L.R. Smith eds., 1997).

other contexts, such an endeavor requires case-by-case tailoring. In this regard, it is necessary to examine the context of Thailand's banking crisis in order to understand the relevance of the S&L experience in the United States.

A. The Context of Thailand's Economic Problems

Throughout most of the last three decades, the economies of Asia recorded enviable rates of economic growth. The amount of economic activity in the Asian-Pacific region grew in real terms from an average annual GDP rate of 5.5% between 1971-81 to 7.1% between 1982-1992.¹⁶⁵ In comparison, the real GDP growth rates fell during the same time periods from 2.9% to 2.8% in industrial countries and from 5.1% to 2.0% in the developing countries of the Western Hemisphere.¹⁶⁶

By the mid-1990s, however, Thailand's economic expansion began to decelerate significantly. In 1996, its GDP growth rate slowed to 7% from the previous year's 8.6% clip.¹⁶⁷ Economists have cited the "weakness of the G-7 industrial countries and an inventory adjustment in the global electronics industry" as main reasons for the slowdown in Thailand's export-driven economy.¹⁶⁸ In January 1997, the Thai government revised its projected GDP growth rate for 1997 downward, due to poor results in the manufacturing sector and a large budget deficit in the last quarter of 1996.¹⁶⁹

At the beginning of 1998, the Thai baht became the target of a speculative attack.¹⁷⁰ Although the Bank of Thailand (BOT), Thailand's central bank,¹⁷¹ had obstinately refused to allow a currency de-

165. See Maxwell J. Fry, *Finance and Growth in Pacific Basin Developing Countries*, in FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH: THEORY AND EXPERIENCES FROM DEVELOPING COUNTRIES 138, 140 (Niels Hermes & Robert Lensink eds., 1996).

166. See *id.*

167. See Michael Vatikiotis, *The Burden of Baht*, FAR E. ECON. REV., Feb. 20, 1997, at 72.

168. Thailand, like many other East Asian countries, depends heavily on exports to power its growth. See *The East Asian Financial Crisis and the World Economy: Hearings Before the House Subcomm. on Domestic and International Monetary Policy of the House Comm. on Banking and Financial Services*, 105th Cong. 59-64 (1997) [hereinafter *Hearings*] (testimony of David Hale, Chief Global Economist for Zurich Kemper Investments). Consequently, sluggishness in the world's major economies translates into a reduced demand for Thailand's goods and services. On the supply-side of the equation, a build-up of inventories must at some point be reduced before new goods can be produced. This, in turn, leads to a reduction in output.

169. See Vatikiotis, *supra* note 167.

170. See *id.*

171. The Bank of Thailand supervises commercial banking. See Cynthia Pornvalai & Colin Perry, *Thailand*, in INTERNATIONAL BANKING: LAW AND REGULATION 1, 1 (Dennis Campbell

valuation, the band around which the baht was allowed to fluctuate was moderately widened in February.¹⁷² The baht subsequently dropped by over 2%, but only after the BOT had expended roughly \$3 billion of its foreign reserves to defend the currency.¹⁷³ Investors, concerned that the baht's weakness reflected broader economic infirmities, dumped their equities and by February 12, sent the Stock Exchange of Thailand down 14% from its mid-January high.¹⁷⁴ Finally on July 2, 1997, the BOT allowed the baht to float, and the Thai currency immediately dropped by about 15%.¹⁷⁵

The problems besetting Thailand stem to a large extent from economic policies that had become inappropriate to many of the country's changing domestic and international realities.¹⁷⁶ Until the recent currency crisis last year, Thailand had more or less maintained a pegged exchange-rate policy. From 1970 until 1984, the Thai baht had been closely tied to the U.S. dollar with only two parity adjustments.¹⁷⁷ In 1984, the BOT modified the exchange rate scheme to set the peg according to a basket of currencies.¹⁷⁸ One possible benefit of the pegged exchange rate policy is the containment of rampant inflation.¹⁷⁹ While this exchange policy could arguably be effective in achieving some domestic economic objectives,¹⁸⁰ its entrenchment in

ed., 1998).

172. See Vatikiotis, *supra* note 167.

173. See *id.* Paul Krugman provides an economic model for understanding the dynamics of a speculative currency attack in the context of a fixed exchange rate. See PAUL KRUGMAN, CURRENCIES AND CRISIS 68-74 (1992) (arguing that a country's balance-of-payment problem leads to dwindling foreign reserves and that speculators, who anticipate the abandonment of a country's fixed exchange rate, will seek to acquire its foreign reserves and capture windfall gains).

174. See Vatikiotis, *supra* note 167.

175. See Michael Vatikiotis, *Free at Last*, FAR E. ECON. REV., July 10, 1997, at 70.

176. See generally *Hearings*, *supra* note 168.

177. See John G. Greenwood, *Financial Liberalization and Innovation in Seven East Asian Economies*, in FINANCIAL INNOVATION AND MONETARY POLICY: ASIA AND THE WEST 79, 94 (Yoshio Suzuki & Hiroshi Yomo eds., 1986).

178. See *id.*

179. For example, Chile used its fixed exchange rate regime to curb its inflation problems during the 1970s. See Hans Visser & Ingmar van Herpt, *Financial Liberalization and Financial Fragility*, in FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH: THEORY AND EXPERIENCES FROM DEVELOPING COUNTRIES 287, 288-89 (Niel Hermes & Robert Lensink, eds., 1996). In a manner similar to that in Thailand, the real exchange rate fell (i.e., foreign goods became cheaper vis-à-vis domestic goods) causing a real appreciation in the Chilean peso. The accompanying capital inflows fueled an economic boom but created a large current account deficit. When foreign funds stopped flowing to Chile in 1982, the combination of bad debts and high exposure to dollar denominated loans forced Chile to float its exchange rate.

180. See WILBERT O. BASCOM, THE ECONOMICS OF FINANCIAL REFORM IN DEVELOPING

the face of changing conditions could produce unintended consequences.¹⁸¹ In the 1990s, keeping pace with the rapid evolution of capital markets has been one of the most formidable challenges for emerging market countries. Thus, “[a]s a result of the virtually fixed exchange rate regime and the absence of controls on capital movement, the combination of domestic monetary arrangements existent in Thailand—which included credit controls and interest rate ceilings—was unsustainable in the face of large and variable international capital flows.”¹⁸²

In maintaining its pegged exchange rate policy, the BOT was forced to set its interest rates at a level dictated by prevailing U.S. monetary policies.¹⁸³ Furthermore, Thailand was subject to changes in its trade competitiveness based on the relative strength of the dollar.¹⁸⁴ This effective abdication of its monetary control rendered Thailand extremely vulnerable to external forces. Thailand’s partially deregulated monetary system came under increased pressure as the global financial system experienced more volatility. “The growing internationalization of business and finance and the vast increase in the speed and volume of information flows have allowed much more rapid reassessment of and response to the real growth possibilities in many developing countries.”¹⁸⁵

During the early 1990s, the U.S. Federal Reserve Bank lowered interest rates to spur economic growth in the domestic economy and help its beleaguered banking system.¹⁸⁶ This policy obliged Thailand to follow suit and pursue a policy of easy credit. The following economic expansion attracted an influx of foreign funds that continued to fuel the rapid growth of Thailand and many other Asian economies. The flow of private foreign investment into emerging markets expanded tremendously in the 1990s because the allure of potential returns there was much higher than that of investments in industrial countries.¹⁸⁷

East Asia, as a result of its strong economic record and hospita-

COUNTRIES 60 (1994).

181. “[A] pegged exchange rate might be attractive where reducing inflation is a policy priority, while a floating exchange rate might be appropriate when foreign exchange reserves are low and balance of payments correction is an important concern.” *Id.* at 66-67.

182. Greenwood, *supra* note 177.

183. *See id.*

184. *See id.*

185. THE WORLD BANK, MANAGING CAPITAL FLOW IN EAST ASIA 6-7 (1996).

186. *See generally Hearings, supra* note 168.

187. *See* THE WORLD BANK, *supra* note 185, at 5.

ble investment environment, became a favorite destination for foreign capital.¹⁸⁸ It is estimated that the region's share of foreign direct and portfolio investment is over half of the total directed towards developing countries.¹⁸⁹ Japan, in particular, was responsible for funding the burgeoning Asian economies. Japanese banks, confronted by an anemic domestic market, invested heavily in Asia and especially in Thailand.¹⁹⁰

Large capital infusions into Thailand produced a large current account deficit.¹⁹¹ By mid-1997, Thailand's deficit was running at about 8% of its GDP.¹⁹² As a consequence of its fixed exchange rate regime and the correlative interest rate differentials, U.S. dollars appeared to be relatively "cheap" to borrowers in Thailand.¹⁹³ Many Thai companies exploited the situation and obtained a large volume of dollar denominated loans.¹⁹⁴ These companies, however, chose not to hedge currency risks because of their steadfast faith in the stability of Thailand's pegged exchange rate.¹⁹⁵

The establishment of Thailand's Bangkok International Banking Facility (BIBF) was an important factor in expediting this process of foreign capital infusion. The BIBF system was designed to be a catalyst for providing financing for infrastructure development and industrial projects in Thailand and in Southeast Asia.¹⁹⁶ The BIBF was established in 1993 as a critical part of Thailand's plan to become a regional financial center.¹⁹⁷ Banks with BIBF licenses were authorized by the government to engage in foreign currency lending.¹⁹⁸ In 1994 and 1995, these banks made loans totaling \$29.2 billion and \$41.1 billion, respectively.¹⁹⁹ The potential danger of the BIBF sys-

188. *See id.* at 7.

189. *See id.* at 9.

190. Thailand owes \$37.5 billion of its \$70 billion foreign private debt to Japanese banks. *See Japan to the Rescue*, THE ECONOMIST, Oct. 11, 1997, at 89, 89.

191. *See* Visser & Van Herpt, *supra* note 179.

192. *See* Brian Mertens & Cris Prystay, *Racing to Stop the Fall*, ASIAN BUS., July 1997, at 14, 15.

193. Foreign banks with branches in Asian countries could offer cheap financing for two reasons: first, "because U.S. interest rates were lower than local interest rates, and [,] second because the foreign bank could borrow in the Euro currency markets at more favorable rates than any Asian bank." Greenwood, *supra* note 177, at 79.

194. *See generally* Hearings, *supra* note 168.

195. *See* Cherie Marriott, *Thailand at a Standstill*, GLOBAL FIN., Oct. 1996, at 34, 38.

196. *See* Cris Prystay, *Rocky Road to Liberalization*, ASIAN BUS., Nov. 1996, at 52, 54.

197. *See id.*

198. *See id.*

199. *See id.*

tem was that it could also funnel overseas capital to Thai customers, thus increasing Thailand's reliance on foreign short-term debt and exacerbating the current account deficit.²⁰⁰ In 1995, BIBF loans amounted to 57.7% of the country's short-term debt.²⁰¹

In summary, the partially deregulated financial system in Thailand distorted the cost of capital and created a huge demand for dollar denominated loans. The influx of capital financed a superabundance of ill-advised property development projects and a speculative bubble in other investments.²⁰² Thailand has since lost favor in the international capital markets due to its fundamental economic weaknesses. One of the most crucial challenges facing Thailand is the reformation of its faltering banking system.

B. The Thai Banking Crisis and the BOT's Response

In September 1997, Thai banks and finance companies²⁰³ carried an estimated \$31 billion in non-performing loans.²⁰⁴ The BOT had announced that non-performing loans comprised 8.15% of the commercial banks' portfolio in June 1997, but many analysts believed that the actual figure had been greatly understated.²⁰⁵ Standard & Poor's, for example, placed the number between 11% to 13% on a ninety-day past due basis.²⁰⁶ These numbers would have appeared even more ominous if the financial statistics for the finance compa-

200. *See id.*

201. *See id.*

202. *See* Michael Dooley, *Globalization, Speculative Bubbles, and Central Banking*, in FINANCIAL SECTOR REFORMS, ECONOMIC GROWTH, AND STABILITY: EXPERIENCES IN SELECTED ASIAN AND LATIN AMERICAN COUNTRIES 103, 105 (Shakil Faruqi ed., 1994) (examining the phenomenon of speculative bubbles which result from short-term capital inflows).

203. The principal law governing commercial banking in Thailand is the Commercial Banking Act B.E. 2505 (1962), which defines a commercial bank as a "business of accepting deposits of money subject to withdrawal on demand or at the end of a specified period and of employing that money in activities, such as granting credits, buying and selling bills of exchange and other negotiable instruments, and buying and selling foreign exchange." Pornvalai & Perry, *supra* note 171. Aside from commercial banks, a number of other institutions, such as finance, insurance and credit companies, also engage in banking activities. *See id.* "A finance company is able to make loans, although usually at higher interest rates and with shorter repayment periods than bank loans. It procures funds by borrowing or accepting deposits from the public, which is then used to finance commercial, development, consumer, and housing projects. A credit company lends on the security of a mortgage of immovable property or a sale of immovable property with a right of redemption." *Id.* at 4.

204. *See* Michael Vatikiotis, *Tainted Technocrats*, FAR E. ECON. REV., Sept. 4, 1997, at 60, 60.

205. *See* Alison Warner, *Asian Meltdown*, THE BANKER, Dec. 1997, at 39, 40.

206. *See id.*

nies had also been included.²⁰⁷ In 1998, non-performing loans of Thai banks are estimated to amount to roughly a third of their total lending.²⁰⁸ This percentage is expected to climb to a staggering 40% in the first half of 1999 as the fallout from the economic contraction continues to be felt.²⁰⁹

The prime cause of the financial industry's present predicament is its heavy exposure to the over-saturated real estate sector. In the period before the current crisis, the country's ninety-one finance companies pursued a high growth strategy involving extensive lending to the property market.²¹⁰ During the period of large foreign capital inflows, the financial institutions had underwritten the rapid profusion of real estate projects using the property itself as collateral.²¹¹ In a speculative bubble, however, the market prices of real estate are grossly out of proportion to their underlying economic value. As the legacy of poor investment decisions began to manifest itself in the form of higher default rates, the financial industry was left with collateral worth a fraction of the amount of loans outstanding.²¹²

In Bangkok, for example, approximately 760,000 housing units were built during the period from 1992 to 1996, but 20% of these are unoccupied.²¹³ Their construction contributed to a pre-existing surplus of housing which brought the number of empty units to 350,000 in Bangkok and 850,000 throughout Thailand.²¹⁴ Experts estimate that this oversupply represents more than six years of demand.²¹⁵ The situation for office space is equally bleak. It is estimated that 50% of the new supply is expected to remain without tenants for the next four years.²¹⁶

The financial industry's troubles are compounded by the distressed situation of its corporate clients. A large segment of Thailand's corporate sector developed in the heyday of easy credit during the late 1980s and early 1990s.²¹⁷ Many of these young companies do

207. *See id.*

208. *See More Banks Seen Swallowing Pride, Seeking Government Help*, BUS. DAY (Thail.), Sept. 10, 1998, at 1, available in 1998 WL 17480444.

209. *See id.*

210. *See* Alison Warner, *Thailand's Tremors*, THE BANKER, May 1997, at 70.

211. *See* Henny Sender, *The Devil to Pay*, FAR E. ECON. REV., June 5, 1997, at 50.

212. *See id.*

213. *See Draw the Blinds*, THE ECONOMIST, Feb. 1, 1997, at 78.

214. *See id.*

215. *See* Warner, *supra* note 205.

216. *See id.*

217. *See* Marriott, *supra* note 195, at 34.

not have the experience or resources to survive difficult economic times. Although the corporate sector had invested aggressively during this period, little attention was paid to the business justifications for this expansion. Since 1990, the level of investment by Thai companies grew at a rate of 16% per annum.²¹⁸ This tremendous growth had been achieved through financing from the banking sector, which itself had been increasing its rate of lending by 20% a year.²¹⁹ The earnings of companies outside of the banking and telecommunications sectors, however, had been growing only at a modest 1% rate per year.²²⁰

In addition to the profligate borrowing practices of Thailand's companies, their assumption of enormous unhedged dollar liabilities left the corporate sector extremely exposed to a devaluation of the baht.²²¹ The government attempted to reduce the inflow of foreign capital in a series of moves. In 1995, the BOT increased the minimum cash reserve requirement for short-term loans from 2% to 7%.²²² The following year, the BOT limited the BIBF banks' foreign denominated loans to 7% of their domestic currency loans and set the ratio of one-to-one for "out-in" and "out-out" lending.²²³ In March 1997, the BOT ordered various distressed finance companies to raise their capital reserves to cover possible defaults.²²⁴ Unfortunately, these measures were much too late to prevent the distribution of billions of dollars to finance poor investments.

The increasing level of defaults, coupled with the declining value of collateral, produced very lopsided balance sheets in the financial sector. Clearly, insufficient checks were in place to prevent the misallocation of funds. Lapses in the industry's regulatory structure became apparent in May 1996 when the scandal involving the Bangkok Bank of Commerce (BBC) erupted.²²⁵ The BBC was a medium size

218. *See id.* at 38.

219. *See id.*

220. *See id.* at 34.

221. At least one estimate of offshore debt of Thai companies totals \$75 billion. *See* Vatikiotis, *supra* note 167.

222. *See* Prystay, *supra* note 196.

223. *See id.* at 55. Out-in lending means that foreign capital is brought into Thailand to finance projects while out-out lending entails foreign capital being deployed in other countries in the region.

224. *See* Warner, *supra* note 210, at 71. It was also stated that the Financial Institutions Development Fund would provide more equity for financial companies unable to raise enough capital by themselves. *See id.* This policy reinforced the belief that financial companies would be bailed out.

225. *See Bank of Thailand under Fire over \$3bn Loans Scandal*, THE BANKER, July 1996, at

commercial bank that had over 50% (\$3 billion) of its loans devoted to questionable stock deals and fraudulent loans.²²⁶ While commentators have acknowledged that the BBC was an anomaly, the failure of the BOT to intervene at an earlier date pointed to a weak supervisory system.²²⁷ Even more troubling, the BOT refused to close down the bank. The Financial Institutions Development Fund (FIDF), which is essentially a rescue fund for cash-starved financial institutions managed by the BOT,²²⁸ instead took a 65% stake in the BBC.²²⁹ The FIDF had even proposed to buy most of the bad debts at a discount of only about 20%.²³⁰

The BOT's actions in the BBC scandal typify the agency's early handling of the banking crisis. In September 1996, Thailand's credit rating was downgraded because of over-reliance by Thai banks on "hot money" to fund their medium- and long-term loans.²³¹ The BOT's response was to request that banks reduce their exposure to short-term foreign debt and to maintain a tight money policy.²³² Interest rates of 13%-14% helped restrain the lending of financial institutions and encouraged depositors not to withdraw their savings, but it also made it difficult for cash-strapped companies to find affordable credit to continue operating.²³³

In February 1997, Somprasong Land became the first of three large property firms to slip into insolvency, thereby earning the dubious distinction of being the first Thai company to default on its Euro-convertible bond.²³⁴ Fearing the precipitation of other corporate failures, the BOT refused to devalue the baht, a measure that would have increased the pressure on companies laden with dollar denominated loans.²³⁵ On the other hand, the BOT's decision to defend the pegged exchange rate necessitated a massive expenditure of its foreign reserves. In February 1997, foreign reserves stood at a reassur-

77.

226. *See id.*

227. *See* Sender, *supra* note 211, at 51.

228. *See* Apisith John Sutham, *The Asian Financial Crisis and the Deregulation and Liberalization of Thailand's Financial Services Sector: Barbarians at the Gate*, 21 *FORDHAM INT'L L. J.* 1890, 1899 (1998).

229. *See* Warner, *supra* note 210.

230. *See id.* In January 1998, the BOT discounted the assets of the BBC by 95%. *See* Henry Sender, *Money Isn't Everything*, *FAR E. ECON. REV.*, Feb. 12, 1998, at 59.

231. *See* Marriott, *supra* note 195, at 34.

232. *See id.*

233. *See id.*

234. *See* Vitikiotis, *supra* note 167.

235. *See* Mertens & Prystay, *supra* note 192.

ing 21% of GDP,²³⁶ but after a futile attempt to fend off speculators, the foreign reserves shrank by almost one-half to an estimated \$16-\$17 billion.²³⁷ By August 1997, foreign reserves dwindled to a mere \$800 million.²³⁸

The strategy of maintaining a pegged exchange rate drove up interest rates and put further strain on the domestic economy as affordable financing disappeared.²³⁹ Recognizing this problem, the Thai government established a two-tiered exchange rate and implemented capital controls to allow a slight lowering of interest rates in Thailand, while still driving up the costs for speculation.²⁴⁰ Eventually, the BOT was forced to abandon this segmented approach because of market pressures.²⁴¹

The BOT had hung its hopes on mergers to stabilize the financial sector. On April 2, 1997, the BOT provided various incentives for financial companies to merge. For instance, a merged group meeting certain net capital and asset requirements would be allowed to engage in a wider range of banking services, including foreign exchange and low rate savings deposits.²⁴² The BOT also dangled before the institutions the possibility of receiving a banking license before any merger group that met an even higher set of requirements.²⁴³ Such an upgrade, however, would require the group to absorb weaker institutions at the discretion of the BOT.²⁴⁴ Experts believed that, in addition to this proviso, an array of complex tax and legal rules would discourage many companies from seeking a merger.²⁴⁵

On March 11, 1997, the government established the Property Loan Management Organization (PLMO) to buy non-performing loans that had partially developed real estate as collateral.²⁴⁶ Critics opined that the fund would be largely ineffective because it was ex-

236. See Vitikiotis, *supra* note 167.

237. See Vitikiotis, *supra* note 204.

238. See Thanong Khanthong & Vatchara Charoonsantikul, *Leading up to Tarrin's Banking Reform Package*, NATION, Aug. 17, 1998, available in 1998 WL 15055821.

239. See Vitikiotis, *supra* note 204.

240. See INTERNATIONAL MONETARY FUND, *Emerging Market Currency Crisis of July 1997*, at 49, 49 (1997).

241. See *id.* (describing the events which led to the abandonment of capital controls).

242. See Warner, *supra* note 210.

243. See *id.*

244. See *id.*

245. See Vitikiotis, *supra* note 175, at 71.

246. See Warner, *supra* note 210, at 71.

tremely undercapitalized.²⁴⁷ The critics also argued that most banks would be unlikely to avail themselves of this outlet because the PLMO was believed to be willing to accept only the best non-performing loans.²⁴⁸

On June 27, 1997, five days before the floating of the baht, the government attempted to inspire more confidence in the financial system by temporarily closing sixteen shaky financial institutions for thirty days.²⁴⁹ The government gave the closed institutions two weeks to submit plans for their re-organization to the Finance Ministry, and encouraged the closed institutions to merge with healthier companies.²⁵⁰ After a prolonged stage of denial filled with numerous futile initiatives, fifty-eight of the ninety-one finance companies were finally shut, but only after the BOT had already supplied them with a cash infusion equivalent to about 10% of Thailand's GDP.²⁵¹

Also on June 27, 1997, the government enacted the so-called "Royal Decrees."²⁵² These laws, among other things, relaxed restrictions on foreign ownership of commercial banks and encouraged mergers of insolvent finance companies.²⁵³ Another set of reform laws, known as the "Emergency Decrees," became effective on October 25, 1997 and served to strengthen the supervisory powers of the BOT.²⁵⁴ Among the more notable decrees, the Emergency Decree on Financial Sector Restructuring B.E. 2540 laid down the legal framework for creating the Financial Sector Restructuring Authority (FRA).²⁵⁵ The FRA was charged with the supervision of the suspended financial institutions. The fifty-eight closed financial companies were required to submit their rehabilitation plans to the FRA, which would then decide if the institution should be liquidated.²⁵⁶ The FRA would auction off those assets that it deemed to be beyond rehabilitation.²⁵⁷

The Emergency Decree on the Asset Management Corporation

247. See Mertens & Prystay, *supra* note 192, at 15.

248. See *id.*

249. See Warner, *supra* note 210.

250. See *id.* at 71.

251. See Vitikiotis, *supra* note 204.

252. For a detailed description of the laws and regulations governing the Thai financial industry, see Sutham, *supra* note 228.

253. See *id.* at 1904-05.

254. See *id.* at 1907-08.

255. See *id.* at 1905.

256. See Warner, *supra* note 205, at 39.

257. See Sutham, *supra* note 228, at 1908.

B.E. 2540 was also a significant development.²⁵⁸ This decree established the Asset Management Corporation (AMC), which was instructed to bid on the assets of the financial companies in liquidation and attempt to sell them.²⁵⁹ The AMC was authorized to establish its own rules regarding the valuation of the assets and collateral that it purchased.²⁶⁰

C. The Application of an American Solution to a Thai Problem

An inquiry into the causation of any social and economic phenomenon obviously is not an exact science. Nevertheless, it would be relatively uncontroversial to posit that the magnitude of both the American and the Thai banking disasters can be attributed to a combination of supervisory lapses, misguided regulations, and severe economic conditions. From a systemic perspective, these factors created conditions where individuals were given the capabilities and the incentives to engage in high-risk investments in a distorted economic environment.

In the United States, the regulatory quilt was entirely inappropriate during periods of high inflation and resulted in a severe interest rate mismatch and heavy losses to the thrift industry. The government's subsequent deregulatory efforts²⁶¹ enhanced the thrifts' ability to attract capital while simultaneously expanding their investment authority. Emboldened by minimum net worth exposure and deposit insurance, savings institutions had both the opportunity and the incentive to gamble with large amounts of other people's money.²⁶² During the 1980s, the S&Ls plunged into unfamiliar and risky investment vehicles, unrestrained by the moderating influence of either economic prudence or adequate government supervision.²⁶³

In Thailand, a situation with similar dynamics developed. A pegged exchange rate policy,²⁶⁴ in the context of modern capital markets and deteriorating trade and economic conditions, made Thailand extremely vulnerable to large shifts in international capital flows and

258. *See id.* at 1905.

259. *See* Warner, *supra* note 205, at 39.

260. *See* Sutham, *supra* note 228, at 1908.

261. *See* WHITE, *supra* note 5, at 88, 90.

262. *See* PAUL ZANE PILZER, *OTHER PEOPLE'S MONEY: THE INSIDE STORY OF THE S&L MESS* 125-26 (1989).

263. *See* WHITE, *supra* note 5, at 99.

264. *See* Paul M. Sherer, *Thailand Shows IMF Intervention Doesn't Necessarily Cure Basic Ills*, WALL ST. J., Dec. 5, 1997, at A14.

speculative currency attacks. During more optimistic times, Thai companies, especially real estate developers, borrowed enormous amounts of unhedged foreign-denominated loans which were subsidized in effect by the BOT's monetary and exchange rate policies.²⁶⁵ Thai financial institutions, which were awash with foreign capital, had imprudently underwritten scores of unsound business ventures.²⁶⁶ All parties involved apparently operated with the unmitigated belief in the Thai government's commitment to maintain a fixed exchange rate and bail out troubled financial institutions.

1. *Basic Principles Drawn from the Resolution of the S&L Crisis.* The legislative effort to resolve the thrift crisis in the United States can be divided into two parts. First, Congress tightened the regulatory regime²⁶⁷ to stop the hemorrhaging of losses suffered by thrift institutions. Second, Congress established a mechanism to dispose of the assets of insolvent thrifts.²⁶⁸

A key element in strengthening the supervisory powers of thrift regulators was, ironically, the curtailment of their discretion. By raising accounting standards and mandating tougher inspections,²⁶⁹ Congress apparently hoped that a breach of the minimum capital requirements would immediately compel regulators to take corrective actions against the offending institution. In order to effectuate these regulations, however, it was necessary that the policy of forbearance be consciously discarded.

For those thrifts failing to meet their net worth requirements, the RTC proved to be an effective government device for the efficient disposal of the insolvent thrifts' assets.²⁷⁰ While the RTC was sufficiently capitalized, an important contributing factor to its success was its pervasive deal-making ethos.²⁷¹ The flexibility and the expedition with which the RTC carried out its mission enabled the government to recoup a significant portion of its claims. Furthermore, its willingness to tap the expertise of Wall Street's talent²⁷² allowed the

265. See John Greenwood, *The Lessons of Asia's Currency Crisis*, WALL ST. J., Oct. 7, 1997, at A22.

266. See *id.*

267. See WHITE, *supra* note 5, at 128-31.

268. See *id.* at 135-40.

269. See *id.* at 129-30.

270. See Martin Mayer, *Turnaround at the RTC*, WALL ST. J., Dec. 22, 1992, at A10.

271. See, e.g., Jim Carlton, *Property Holders Find Sealed-Bid Sale An Effective Method for Moving Assets*, WALL ST. J., Dec. 22, 1992, at A2.

272. See KATHLEEN DAY, S&L HELL 277 (1993).

RTC to put together innovative deals that would attract investors without giving away too much.

2. *Obstacles to Implementing the American Approach in Thailand.* In 1997, the BOT sought to stem the government's losses by closing a number of failed financial institutions. Such actions, however, are only the beginning of the process of financial recovery. Other steps are necessary to bring the financial system back on sounder footing and to prevent the recurrence of widespread institutional failures.

One of the major criticisms of the Thai banking system is not necessarily that banks are too big to fail, but that banks are too political to fail.²⁷³ The BOT and the Ministry of Finance are given extremely wide discretion in the regulation of financial institutions under the Commercial Banking Act (CBA) and the Act on the Undertaking of Finance Business, Securities Business, and Credit Foncier Business B.E. 2522 (1979) (FSCA), i.e., the principal laws governing the banks and finance companies, respectively.²⁷⁴ Regulators may be inclined to forebear not only because of misplaced optimism and self-denial, as was the case in the U.S., but also because of political favoritism. As one economist observed, "[t]oo many people had a vested interest in the system. A lot of people became rich when capital controls were relaxed, and they could access funds with low interest rates. They didn't want to see the system change."²⁷⁵

The problem of regulatory discretion begins at the licensing stage. As a prerequisite, banks must receive a license from the Ministry of Finance, and this license is contingent upon the recommendation of the Bank of Thailand.²⁷⁶ The decision whether to grant a license rests upon vague and subjective criteria, such as the applicant's "reputation, history, contribution to the Thai economy, and intent to develop the international banking system in Thailand."²⁷⁷ Consequently, participation in the banking system is very restricted and competition is limited. The four largest banks in Thailand held roughly 70% of all bank assets.²⁷⁸ Those banks, the Bangkok Bank,

273. See Sender, *supra* note 211, at 53.

274. See Sutham, *supra* note 228, at 1890-91.

275. Sender, *supra* note 211, at 52 (quoting an anonymous economist).

276. See Pornvalai & Perry, *supra* note 171, at 7.

277. *Id.*

278. See Peter Janssen, *Banking and Finance - Banks Underpin Economic Success* (visited October 16, 1998) <<http://web3.asia1.com.sg/timesnet/data/ab/docs/ab1021.html>>.

the Thai Farmers Bank, the Krung Thai Bank, and the Siam Commercial Bank, are controlled respectively by the powerful Sophonpanich and Lamsam families, the government, and the monarchy.²⁷⁹ Further, the Thai Military Bank, which is also one of the larger banks, is run by the armed forces.²⁸⁰

The discretion of the regulatory agencies continues in the supervision of the banks. The CBA authorizes regulators to take corrective measures that may entail the revocation of licenses, closure of branch offices, or placement of institutions under receivership.²⁸¹ It also authorizes the Ministry of Finance and the BOT to establish various rules and regulations regarding, among other operational matters, the interest rate payable on deposits, capitalization standards, and minimum cash reserves.²⁸² For instance, they require domestic commercial banks to hold minimum capital reserves equal to 8% of their assets and contingent liabilities.²⁸³ Also, commercial banks may not lend more than 25% of their capital to any one person.²⁸⁴

In exercising its authority, the BOT has established a number of mandatory ratios and other requirements that constrain the manner in which financial institutions can operate.²⁸⁵ The restrictions relate to such matters as liquidity, capital adequacy, and investment decisions. On the whole, these regulations seem to provide a reasonable framework for supervising financial institutions, and in certain respects, Thailand's regulatory regime is quite progressive. For example, the BOT imposed risk-based capital standards. Thus, assets that are relatively more risky require an institution to hold correspondingly more capital reserves.²⁸⁶ In addition, the BOT has required banks to classify their loans according to their quality and has recently commanded banks to set aside reserves equal to a specified percentage of the loan, depending on its collection grade. These two aspects of the regulatory regime suggest, in principal, that there is a

279. See *id.* Technically, an individual may own a maximum of 5% of a bank's shares with certain exceptions. This limit, however, is subject to modification at the discretion of the BOT which may also attach conditions if it so chooses. See Pornvalai & Perry, *supra* note 171, at 5.

280. See Janssen, *supra* note 278.

281. See Pornvalai & Perry, *supra* note 171, at 7.

282. See *id.*

283. See *id.* at 14.

284. See *id.* at 15.

285. For a discussion of the BOT's regulations concerning finance companies and banks, see Sutham, *supra* note 228, at 1895-1920.

286. See *id.* at 1900, 1915.

correlation between the business decisions of managers and the level of strictures imposed upon the institution. The BOT, nevertheless, still maintains broad discretion over financial institutions and may ultimately choose not to take decisive action.

As part of their compliance efforts, banks must submit yearly audited financial statements and balance sheets as well as monthly reports of assets and liabilities to the Ministry of Finance and the BOT.²⁸⁷ The usefulness of these reports, however, is qualified since there is no specification of auditing standards other than the disallowance of auditors who are not approved by the BOT or who are otherwise employed by the bank.²⁸⁸ Furthermore, the accounting standards are far from rigorous. A collateralized loan was previously not categorized as non-performing until twelve months had passed without payment.²⁸⁹ Although the BOT has shortened the accrual period for payments in arrears by six months, far more drastic regulatory reforms are needed.²⁹⁰

Ideally, regulations should minimize market distortions so that the financial interests of the managers and directors of banks are identified with those of the institution itself. The automatic closure of financial institutions once their capital reserves fall below a prescribed positive level would constrain the discretionary authority of regulators and impose some measure of market discipline. Other less draconian sanctions could be triggered at different levels of sub-par performance. To further the accountability of managers for their investment decisions, criminal and civil sanctions could be stiffened. Also, accounting and reporting guidelines could be designed so that regulating agencies receive accurate, timely information and so that the market can assess the relative health of different financial institutions.²⁹¹

In many respects, the resolution of the Thai banking problems poses a greater challenge than that of the S&L crisis. While many of the thrifts' assets were of dubious quality, they could be packaged with "good" assets to offer an attractive investment opportunity. In

287. See Pornvalai & Perry, *supra* note 171, at 12.

288. *See id.*

289. See Warner, *supra* note 205.

290. *See id.*

291. In the wake of the S&L crisis, Congress enacted the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), which implemented a weakened version of these proposals. See George G. Kaufman, *Bank Failures, Systemic Risk, and Bank Regulation*, 16 CATO J. 1996 at 17, 29-31 (outlining similar proposals in his description of a structured, early intervention and resolution program).

Thailand, most of the assets controlled by financial institutions consist of property that had served as collateral. Because the property market will be saturated for many years to come, even fire sale prices will not entice many investors. Furthermore, due to the absence of a well-developed securities market, financial intermediation plays a much more integral role in the Thai economy than in the United States. Closing the taps on bank lending, therefore, would dry up capital liquidity and bring growth in Thailand to a standstill. Thus, the Thai government must perform a precarious balancing act in the reformation of its financial sector. Political dawdling will likely compound the losses and merely postpone inevitable changes. Cleaning up the banking system will require a decisive, yet innovative approach.

In reality, any drastic reform efforts that might endanger entrenched privileges would likely provoke vehement opposition from vested interest groups. The business elite, the government bureaucracy, and the military are likely to have a major input into important policy changes. On the other hand, Thailand has a multi-party parliamentary democracy which has experienced numerous changes in government.²⁹² The parliament, and consequently the cabinet, are characterized by coalition governments, since no single party can garner a majority of the seats.²⁹³ Powerful, and oftentimes lucrative, ministerial posts have become political bargaining chips instead of vehicles for committed policy implementation.²⁹⁴ These attributes of Thailand's democratic government can act equally as a catalyst or a hindrance to change.

Even assuming that meaningful reform measures can be promulgated, it is uncertain whether the infrastructure necessary for effective enforcement is in place. For example, more regulators would need training to learn how to assess the risks of various investment instruments and to detect fraudulent or inaccurate accounting practices. Auditors should also receive certification or licenses to insure a minimum standard of professionalism. In addition, criminal and civil sanctions may have to be revamped in order to provide a significant deterrent for inappropriate self-dealing behavior.

A related issue is whether these necessary reforms should be undertaken gradually or immediately. Compared to the United States,

292. See COUDERT BROTHERS ET AL., THAILAND LAW YEARBOOK 1995, at 11.

293. See *id.* at 13.

294. See *id.*

Thailand still has an undeveloped and shallow economy, which is largely export-driven. Consequently, Thailand's government must balance the need for regulatory reform with the need for maintaining liquidity to encourage economic growth and development. While these two interests are not mutually exclusive, the pace and ordering of reform is open to debate.²⁹⁵

The introduction of large-scale changes increases the likelihood of instability. This is particularly true in the context of Thailand's banking system, which consists of only fifteen domestic banks²⁹⁶ and has outstanding credit exceeding Thailand's annual GDP.²⁹⁷ Given the dominant role of only a few banks in the Thai economy, an inflexible "closure rule" could create substantial financial and social dislocations.²⁹⁸ In order for market forces to function properly, restrictions on competition in the financial industry will first have to be loosened. The licensing procedure, in other words, should be more open and less dependent on arbitrary bureaucratic decisions. Conversely, more competition might create incentives for banks to underwrite riskier ventures, thus undermining the stability of the system. At any rate, crises provide a window of opportunity to push through needed changes, despite opposition by vested interest groups.

In order to employ techniques similar to those used by the RTC, the infrastructure must be in place. One method that holds out the promise of both the monetization of assets and the matching of asset and liability maturities is securitization. Prior to the currency crash in Asia, the asset-backed securitization market was beginning to take root.²⁹⁹ Both Thailand and Indonesia were expected to be the first ASEAN (Association of Southeast Asian Nations) countries to board

295. Reforming a banking system entails much more than simply the adoption of various policies or statutes. A great deal of infrastructure is necessary to ensure that the system operates effectively as a whole. In general, academics have debated the proper sequence of reforms which would be in the long-term development interests of less-developed countries. See *generally* SEQUENCING?: FINANCIAL STRATEGIES FOR DEVELOPING COUNTRIES, *supra* note 164.

296. See Janssen, *supra* note 278.

297. See Sender, *supra* note 211, at 53. For comparison, one of America's largest banks, Chase Manhattan, controls assets whose value equals about 4% of the United States' GDP, whereas Thailand's largest bank, Bangkok Bank, controls assets equivalent to 25% of Thailand's GDP. See Sender, *supra* note 211 at 58.

298. This potential problem is rendered somewhat less dire by the fact that there are a number of other institutions that provide bank-like services, such as finance and credit foncier companies. See Pornvalai & Perry, *supra* note 171.

299. See Marks Nicholls & Sumit Paul-Choudhury, *Security Conscious*, ASIA RISK, Feb. 1998, at 24.

the securitization bandwagon because of their relatively favorable legal and economic environments.³⁰⁰ A number of large transactions have already been put together in Thailand by a variety of issuers, but mostly by leasing companies.³⁰¹ In 1995, TelecomAsia was the originator for a \$120 million deal involving receivables from AT&T.³⁰² In August 1996, ING Barings structured a deal for TruWay and Tisco Leasing that securitized \$250 million of car hire purchases.³⁰³ On May 14, 1997, Sitca Investment and Securities, a finance company, securitized \$83 million of car hire purchases in a deal which required the BOT's approval.³⁰⁴

One of the June 24, 1997 Emergency Decrees was intended to expedite the securitization process.³⁰⁵ Commercial banks, as well as finance, credit foncier, and securities companies, were the targeted beneficiaries of this speedier approval process.³⁰⁶ Despite this attempt to stimulate the use of securitization by financial institutions, several obstacles must be overcome. Because Thailand lacks the legal concept of the trust,³⁰⁷ securitization transactions instead employ the special purpose vehicle, which, like any other company, must pay taxes.³⁰⁸ While many deals are structured offshore to reduce taxes, the securitization of mortgages would involve a transfer of assets which were previously subject to a 7% value added tax (VAT) and a 1% land transfer tax.³⁰⁹ As a consequence, securitization was economically infeasible in many cases to liquidate the assets or to improve the balance sheets of financial institutions. In response to the deepening crisis, however, securitization transactions have since been exempted from specialized business taxes, VAT, and the stamp duty.³¹⁰

In addition, many investors may demand a hefty yield because of the uncertain economic environment. Although insurance guaran-

300. See Cherie Marriott, *On the Rebound in Asia*, GLOBAL FIN., Oct. 1996, at 45, 46.

301. See Brian Mertens, *Securitisation Emerging in SE Asia*, ASIAN BUS., June 1997, at 12.

302. See Marriott, *supra* note 300, at 45.

303. See Mertens, *supra* note 301, at 13.

304. See *id.* at 12.

305. See Office of the Securities and Commission Exchange, *Press Release No. 59* (visited October 16, 1998) <<http://www.sec.or.th/press/59.html>>.

306. See *id.*

307. See Pornvalai & Perry, *supra* note 171, at 4.

308. See Mertens, *supra* note 301, at 13.

309. See *id.*

310. See *Govt Approves Measures to Promote SPVs*, BUS. DAY (Thail.), July 22, 1998, available in 1998 WL 7907756.

tees can back or “wrap” securities to give the securities a higher rating,³¹¹ such monoline insurance will certainly be expensive. The unpredictability of exchange rates also presents a disincentive for investors. To lessen the risks posed by currency fluctuations, transactions can incorporate currency swaps. The market for such swaps, however, may still be recuperating from the recent currency turmoil.³¹² In summary, these market conditions drive up the costs of raising capital, rendering even fewer securitization transactions cost-effective.

3. *August 1998 Reform Measures.* On August 14, 1998, the Thai government unveiled an ambitious reform plan, which it particularized in three emergency decrees.³¹³ The centerpiece of the plan was a 300 billion baht (about \$7.5 billion) recapitalization of the finance industry, designed to jump-start the economy by increasing liquidity.³¹⁴ The decrees set up two credit support facilities as mechanisms to deploy the recapitalization funds.³¹⁵ Among other things, the decrees also closed down four banks and five finance companies that were unable to raise sufficient new capital.³¹⁶

The Tier 1 credit facility was intended to salvage the good assets of institutions. Banks and financing companies intending to use this facility are required to adopt certain loan classification and provisioning standards that were originally to become effective at the end of 2000.³¹⁷ This requirement reduces the uncertainty of bad loans and forces the original shareholders to absorb any losses resulting from a write-down,³¹⁸ thus facilitating the recapitalization process.³¹⁹ Furthermore, capital raised subsequently from either private or public sources will receive preferred status over the claims of the existing shareholders. Lastly, if the capital adequacy ratio of a participating institution falls below 2.5%, the government agrees to top up the institution's capital reserves with tradable government bonds.³²⁰

311. See Marriott, *supra* note 300, at 45.

312. See Nicholls & Paul-Choudhury, *supra* note 299, at 26.

313. See *Banks to Get Bt300-bn Injection*, NATION, Aug. 15, 1998, at 1.

314. See *id.*

315. See *Banking Sector Reforms*, NATION, Aug. 15, 1998, at 2 (reproducing the emergency decrees).

316. See *Banks to Get Bt300-bn Injection*, *supra* note 313.

317. See *Banking Sector Reforms*, *supra* note 315.

318. A write-down involves a bank either “reducing the par value of its shares, or the number of its shares to reflect a fall in the value of its assets.” *Banks Pose a Thorny Political Puzzle for Government*, BUS. DAY (Thail.), Aug. 10, 1998, available in 1998 WL 17480180.

319. See *id.*

320. See *id.*

The Tier 2 credit facility encourages the financial institutions to work with their corporate customers to restructure debt. Subject to certain restrictions, a financial institution concluding a legally binding debt restructuring agreement would be eligible to receive capital injections equal to the amount of “write-offs, net of amounts provisioned, as well as 20 per cent of the net increase in outstanding loans to the private sector.”³²¹

Before the government announced the plan, there was speculation that Thailand would adopt the Chilean banking reform model.³²² In Chile, the government nationalized the banks’ non-performing loans, which were then replaced with a ten-year government bond.³²³ Although the banks were obligated to buy back their bad assets at a later date, they were able to resume normal lending practices almost immediately.³²⁴ In Thailand’s case, the bad assets would have been transferred to the AMC. The Finance Minister rejected this model on the grounds that it would have introduced too many complicated issues such as the valuation method of bad assets, the source of funding for the AMC, and the proper accounting method for the banks’ books.³²⁵ Consequently, the Thai reform plan left the non-performing loans in the hands of the financial institutions and set up the recapitalization method described above.

The initial response of the public and the private sector to the reform measures has been encouraging.³²⁶ The existing shareholders will have to absorb a huge portion of their equity in order to take part in the plan, which lessens the perception that the rich are being bailed out at the public’s expense. Nonetheless, some allegations are beginning to swirl that the plan is being implemented on a discriminatory basis, since some banks were allowed further time to recapitalize.³²⁷ At any rate, experts predict that Thailand will require an additional \$10 billion in foreign capital to complete the bail-out.³²⁸

321. *Id.*

322. *See, e.g., Govt Looks at Chilean Bail-Outs*, NATION, Aug. 7, 1998, available in 1998 WL 15055574.

323. *See Bank Bail-Out Plan Hostage to Many Factors*, NATION, Aug. 17, 1998, available in 1998 WL 15055824.

324. *See id.*

325. *See id.*

326. *See X File, The Economy as a Jigsaw: Piecing Together the Puzzle*, BANGKOK POST, Aug. 21, 1998, available in 1998 WL 17206458.

327. *See Banking Reform Measures Get Mixed Reactions*, BUS. DAY (Thail.), Aug. 17, 1998, available in 1998 WL 7908006.

328. *See Declining Interest Rates Will Prompt Recovery*, BANGKOK POST, Aug. 18, 1998,

V. CONCLUSION

The financial woes of the S&L and Thai economic crises share a similar matrix of perverse incentives and conditions from which their financial woes had arisen. Despite all the differences between the two countries, America's resolution of its problems provides a number of guiding principles and a useful starting point for discussing possible reforms of Thailand's financial system. Although Thai regulators should certainly have limited discretion to allow hopelessly defunct financial institutions to remain open, an automatic closure rule would have caused enormous disruptions in Thailand's economy. The Thai economy, unlike that of the United States, is in a fragile developmental stage and still relies heavily on disintermediation financing from relatively few institutions. Nevertheless, the importance of timely and accurate accounting remains equally forceful in both cases.

It remains to be seen whether the FRA/AMC will evolve into an entity similar to the RTC, with the authority and the capability to clean up Thailand's financial sector. Given the deteriorated state of the industry's assets, any such entity could greatly benefit from an examination of the American model. The RTC quickly disposed of distressed assets and realized very high returns by employing various innovative techniques such as auctions and securitization. Crucial to the RTC's success was its willingness to tap the expertise of big financial players and its pervasive deal-making attitude, which allowed the flexibility to package deals that would attract investors without giving too much away in the process. In Thailand, however, there are still a number of issues that would have to be addressed, such as where the funding for the AMC would come from and whether adequate infrastructure would be available. Moreover, it is questionable whether the Thai government would welcome a large portion of its economy to fall in the hands of foreign investors.

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